Intermediate
Course: Paper 1

ADVANCED ACCOUNTING

(New Scheme of Education and Training)

Part 3

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

CHAPTER 1

Introduction to Accounting Standards

Question 1

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

(*Source: Question 6, Study Material*)

Answer

Accounting Standards are the written policy documents issued by Government relating to various aspects of measurement, treatment, presentation and disclosure of accounting transactions and events.

Following are the objectives of Accounting Standards:

(a) Accounting Standards harmonize the diverse accounting policies and practices followed by different companies in India.

(b) Accounting Standards facilitates the preparation of financialstatements and make them comparable.

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

The main advantage of setting accounting standards are as follows:

(a) Accounting Standards makes the financial statements of different companies comparable which helps investors in decision making.

(b) Accounting Standards prevent any misleading accounting treatment.

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

Question 2

Briefly explain the process of issuance of Indian Accounting Standards.

(*Source: Question 7, Study Material*)

Answer

Due to the recent stream of overseas acquisitions by Indian companies, there is need for adoption of high-quality standards to convince foreign enterprises about the financial standing as also the disclosure and governance standards of Indian acquirers.

The Government of India in consultation with the ICAI decided to convergeand not to adopt IFRSs issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRSs requirements and extensive discussion with various stakeholders.

The ICAI has worked towards convergence of global accounting standards by considering the application of IFRS in Indian corporate environment. Recognising the growing need of full convergence of Ind AS with IFRS, ICAI constituted a Task Force to examine various issues involved.

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

Question 3

Explain the significance of emergence of IFRS as Global Standards.

(*Source: Question 8, Study Material*)

Answer

Global Standards facilitate cross border flow of money, global listing in different bourses and comparability of financial statements. Global Standards improve the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates some costly requirements say reinstatement of financial statements.

Question 4

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

(*Source: Question 9, Study Material*)

Answer

Certain changes have been made in Ind AS considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'. Additional guidance given in Ind AS over and *above what is given in IFRS, is termed as 'Carve in'.*

QUESTION BANK

Question 5

"Accounting Standards standardize diverse accounting policies with a view to eliminate the non-comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting Standards.

(*November 2018*) (*4 Marks*)

Answer:

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

The following are the benefits of Accounting Standards:

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

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

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

Question 6

"Accounting Standards standardize diverse accounting policies with a view to eliminate the non- comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting Standards.

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

Answer

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

The following are the benefits of Accounting Standards:

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

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

Question 7

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain in brief.

(*RTP, November 2021*)

Answer

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

Historical cost	This is the Acquisition price. According to this, assets are recorded at an amount of cash and cash equivalent paid or the fair value of the assets at time of acquisition.
Current Cost	Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
Realisable (Settlement) Value	For assets, amount currently realizable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount expected to be paid on settlement of liability in the normal course of business.
Present Value	Assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

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

CHAPTER

2

Framework for Preparation and Presentation of Financial Statements

Question 1

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

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

Additional information:

(a) The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.X2 was ₹ 60,000.

(b) The trader's purchases and sales in 20X1-X2 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.

(c) The cost and net realisable value of stock on 31.03.X2 were ₹ 32,000 and ₹ 40,000 respectively.

(d) Expenses (including interest on 10% Loan of ₹ 3,500 for the year) amounted to ₹ 14,900.

(e) Deferred expenditure is amortised equally over 4 years.

(f) Trade receivables on 31.03.X2 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another ₹ 4,000 depends on successful re-installation of certain product supplied to the customer.

(g) Closing trade payable is ₹ 12,000, which is likely to be settled at 5% discount.

(h) Cash balance on 31.03.X2 is ₹ 37,100.

(i) There is an early repayment penalty for the loan ₹ 2,500.

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

(*Source: Illustration 1, Study Material*)

Answer:

Profit and Loss Account for the year ended 31st March, 20X2

	Case (i)	***Case (ii)***		***Case (i)***	***Case (ii)***
	₹	***₹***		***₹***	***₹***
To Opening Stock	30,000	30,000	By Sales	4,50,000	4,50,000
To Purchases	4,00,000	4,00,000	By Closing Stock	32,000	40,000
To Expenses	14,900	14,900	By Trade payables	-	600
To Depreciation	13,000	5,000			
To Provision for doubtful debts	2,000	6,000			

	Case (i)	Case (ii)		Case (i)	Case (ii)
	₹	₹		₹	₹
To Deferred expenditure	2,500	10,000			
To Loan penalty	-	2,500			
To Net Profit (b.f.)	19,600	22,200			
	4,82,000	4,90,600		4,82,000	4,90,600

Balance Sheet as at 31st March, 20X2

Liabilities	*Case (i)* ₹	*Case (ii)* ₹	*Assets*	*Case (i)* ₹	*Case (ii)* ₹
Capital	60,000	60,000	Property, Plant and Equipment	52,000	60,000
Profit & Loss A/c	44,600	47,200	Stock	32,000	40,000
10% Loan	35,000	37,500	Trade		
			receivables (less provision)	23,000	19,000
Trade payables	12,000	11,400	Deferred expenditure	7,500	Nil
			Bank	37,100	37,100
	1,51,600	1,56,100		1,51,600	1,56,100

Question 2

A trader commenced business on 01/01/20X1 with ₹ 12,000 represented by 6,000 units of a certain product at₹ 2 per unit. During the year 20X1 he sold these units at ₹ 3 per unit and had withdrawn ₹ 6,000. Let us assume that the price of the product at the end of year is ₹ 2.50 per unit. In other words, the specific price index applicable to the product is 125.

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

Opening equity at closing current costs = ₹ 15,000

Closing equity at closing current costs = ₹ 12,000

Retained Profit = ₹ 12,000 – ₹ 15,000 = (-) ₹ 3,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of ₹12,000 is not sufficient to buy 6,000 units again at increased price of ₹ 2.50 per unit. The drawings should have been restricted to ₹ 3,000 (₹ 6,000 – ₹ 3,000). Had the trader withdrawn ₹ 3,000 instead of ₹ 6,000, he would have left with ₹15,000, the fund required to buy 6,000 units at ₹ 2.50 per unit.

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

(*Source: Illustration 2, Study Material*)

Answer:

Financial Capital Maintenance at historical costs

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

Financial Capital Maintenance at current purchasing power

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

Physical Capital Maintenance

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

Question 3

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

(*Source: Question 6, Study Material*)

Answer

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Understandability; Relevance; Reliability; Comparability are the qualitative characteristics of financial statements.

Question 4

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

(*Source: Question 7, Study Material*)

Answer

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results.

Question 5

Mohan started a business on 1st April 20X1 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 20X2, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 20X1-X2 if Financial Capital is maintained at historical cost.

(*Source: Question 8, Study Material*)

Answer

Particulars	Financial Capital Maintenance at Historical Cost (₹)
Closing equity (₹ 30 x 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units x ₹ 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 – 12,00,000)

Question 6

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

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

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

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

(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction.

(*Source: Question 9, Study Material*)

Answer

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

Transactions	Assets ₹ lakh	–	Liabilities ₹ lakh	=	Equity ₹ lakh
Opening	8.00	–	3.00	=	5.00
(1) Dividend earned	8.20	–	3.00	=	5.20
(2) Settlement of Creditors	7.70	-	2.30	=	5.40
(3) Rent Outstanding	7.70	–	2.40	=	5.30
(4) Drawings	7.61	–	2.40	=	5.21

Question 7

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

Liabilities	*Amount (₹)*	*Assets*	*Amount (₹)*
Capital	*50,000*	*Property, Plant and Equipment*	*69,000*
Profit and Loss A/c	*22,000*	*Stock in Trade*	*36,000*
10% Loan	*43,000*	*Trade Receivables*	*10,000*
Trade Payables	*18,000*	*Deferred Expenditure*	*15,000*
		Bank	*3,000*
	1,33,000		*1,33,000*

Additional Information:

(i) Remaining life of Property, Plant and Equipment is 5 years with even use. The net realisable value of Property, Plant and Equipment as on 31st March, 20X2 was ₹ 64,000.

(ii) Firm's sales and purchases for the year 20X1-X2 amounted to ₹ 5 lacs and ₹ 4.50 lacs respectively.

(iii) The cost and net realisable value of the stock were ₹ 34,000 and ₹ 38,000 respectively.

(iv) General Expenses for the year 20X1-X2 were ₹ 16,500.

(v) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 20X0-X1 i.e. ₹ 5,000 per year.

(vi) Out of trade receivables worth ₹10,000, collection of ₹4,000 depends on successful re-design of certain product already supplied to the customer.

(vii) Closing trade payable is ₹10,000, which is likely to be settled at 95%.

(viii) There is pre-payment penalty of ₹2,000 for Bank loan outstanding.

Prepare Profit & loss Account for the year ended 31st March, 20X2 by assuming it is not a Going Concern.

(*Source: Question 10, Study Material*)

Answer

Profit and Loss Account of Anurag Trading Co. for the year ended 31st March, 20X2
(Assuming business is not a going concern)

	₹		₹
To Opening Stock	36,000	By Sales	5,00,000
To Purchases	4,50,000	By Trade payables	500
To General expenses	16,500	By Closing Stock	38,000
To Depreciation (69,000-64,000)	5,000		
To Provision for doubtful debts	4,000		
To Deferred expenditure	15,000		
To Loan penalty	2,000		
To Net Profit (b.f.)	10,000		
	5,38,500		5,38,500

QUESTION BANK

Question 8

Summarised Balance Sheet of Cloth Trader as on 31.03.2017 is given below:

Liabilities	Amount (₹)	Assets	Amount (₹)
Proprietor's Capital	3,00,000	Fixed Assets	3,60,000
Profit & Loss Account	1,25,000	Closing Stock	1,50,000
10% Loan Account	2,10,000	Sundry Debtors	1,00,000
Sundry Creditors	50,000	Deferred Expenses	50,000
		Cash & Bank	25,000
	6,85,000		**6,85,000**

Additional Information is as follows:

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realizable value of fixed assets on 31.03.2018 was ₹ 3,215,000.

(2) Purchases and Sales in 2017-18 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.

(3) The cost and net realizable value of stock on 31.03.2018 were ₹ 2,00,000 and 2,50,000 respectively.

(4) Expenses for the year amounted to ₹ 78,000.

(5) Deferred Expenses are amortized equally over 5 years.

(6) Sundry Debtors on 31.03.2018 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successfully re-installation of certain product supplied to the customer.

(7) Closing Sundry Creditors are ₹ 75,000, likely to be settled at 10% discount.

(8) Cash balance as on 31.03.2018 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000.

You are required to prepare:

(Not assuming going concern)

(1) Profit & Loss Account for the year 201718.

(2) Balance Sheet as on 31st March, 2018.

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

Answer

Profit and Loss Account for the year ended 2017-18(not assuming going concern)

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

Balance Sheet as at 31st March, 2018 (not assuming going concern)

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

*Assumed that ₹ 78,000 includes interest on 10% loan amount for the year.

Question 9

Summarised Balance Sheet of Cloth Trader as on 31.03.2020 is given below:

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

Additional Information is as follows:

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realizable value of fixed assets on 31.03.2021 was ₹ 3,25,000.

(2) Purchases and Sales in 2020-21 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.

(3) The cost and net realizable value of stock on 31.03.2021 were ₹ 2,00,000 and ₹ 2,50,000 respectively.

(4) Expenses for the year amounted to ₹ 78,000 which includes interest on 10% loan amount for the year.

(5) Deferred Expenses are amortized equally over 5 years.

(6) Trade receivables on 31.03.2021 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successful re-installation of certain product supplied to the customer;

(7) Closing trade payables are ₹ 75,000, likely to be settled at 10% discount.

(8) Cash balance as on 31.03.2021 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000.

You are required to prepare: (Not assuming going concern)

(1) Profit & Loss Account for the year 2020-21.

(2) Balance Sheet as on 31st March, 2021.

(RTP May, 2022)

Answer

Books of Cloth Trader

Profit and Loss Account for the year ended 2020-21 (not assuming going concern)

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

Balance Sheet as at 31st March, 2021 (not assuming going concern)

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

Question 10

"One of the characteristic of the financial statement is neutrality." Do you agree with this statement? Explain in brief.

(*November 2018*) (*4 Marks*)

Answer:

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias.

Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion based on the business results.

Information contained in the financial statements must be free from bias. It should reflect a balanced view of the financial position of the company without attempting to present them in biased manner. Financial statements cannot be prepared with the purpose to influence certain division, i.e. they must be neutral.

Question 11

Briefly explain the elements of financial statements,

(*May 2018*) (*4 Marks*)

Answer:

Elements of Financial Statements

Asset	Resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise
Liability	Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.
Equity	Residual interest in the assets of an enterprise after deducting all its liabilities
Income/gain	Increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants
Expense/loss	Decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants

Question 12

With regard to financial statements name any four.

(1) Users

(2) Qualitative characteristics

(3) Elements

(*RTP May 2019*)

Answer:

(1) Users of financial statements:

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

(2) Qualitative Characteristics of Financial Statements:

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(3) Elements of Financial Statements:

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

Question 13

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*RTP November 2018*)

Answer:

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

A brief explanation of each measurement basis is as follows:

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

Question 14

Mohan started a business on 1st April 2017 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 2018, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 2017-18 if Financial Capital is maintained at historical cost.

(*RTP November 2018*)

Answer:

Particulars	Financial Capital Maintenance at Historical Cost (₹)
Closing equity (₹ 30 × 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units × ₹ 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 -12,00,000)

Thus, in order to maintain the capital intact Mohan can withdraw ₹ 6,00,000 as the maximum amount

Question 15

Explain main elements of Financial Statements.

(*RTP May 2018*)

Answer:

Elements of Financial Statements

The Framework for preparation and Presentation of financial statements classifies items of financial statements can be classified in five broad groups depending on their economic characteristics: Asset, Liability, Equity, Income/Gain and Expense/Loss.

Asset	Resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise
Liability	Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.
Equity	Residual interest in the assets of an enterprise after deducting all its liabilities.
Income/gain	Increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants
Expense/loss	Decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants.

Question 16

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*MTP March 2019*) (*5 Marks*)

Answer:

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

A brief explanation of each measurement basis is as follows:

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

Question 17

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*MTP April 2019*) (*5 Marks*)

Answer:

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

A brief explanation of each measurement basis is as follows:

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

Question 18

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

(*MTP March 2018*) (*5 Marks*)

Answer

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias.

Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results.

For example, if the assets of a company primarily consist of trade receivables and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key trade receivables have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.

Question 19

Aman started a business on 1st April 20X1 with ₹24,00,000 represented by 1,20,000 units of ₹20 each. During the financial year ending on 31st March, 20X2, he sold the entire stock for ₹30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 20X1-X2 if Financial Capital is maintained at historical cost.

(*RTP November 2019*)

Answer

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

Question 20

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the financial statements.

(*MTP April, 2018*) (*5 Marks*)

Answer:

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

A brief explanation of each measurement basis is as follows:

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

Question 21

With regard to financial statements name any four.

(i) Users
(ii) Qualitative characteristics
(iii) Elements

(*RTP, November 2020*)

Answer

(i) Users of financial statements:
Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public

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

(iii) Elements of Financial Statements:
Asset, Liability, Equity, Income/Gain and Expense/Loss

Question 22

What are the issues, with which Accounting Standards deal?

(*RTP, November 2020*)

Answer

Accounting Standards deal with the issues of (i) Recognition of events and transactions in the financial statements, (ii) Measurement of these transactions and events, (iii) Presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and (iv) Disclosure requirements.

Question 23

Explain how financial capital is maintained at historical cost?

Kishore started a business on 1st April, 2019 with ₹ 15,00,000 represented by 75,000 units of ₹20 each. During the financial year ending on 31st March, 2020, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Kishore in the year 2019-20 if Financial Capital is maintained at historical cost. (*Suggested January 2021, 5 marks*)

Answer

Financial capital maintenance at historical cost: Under this convention, opening and closing assets are stated at respective historical costs to ascertain opening and closing equity. If retained profit is greater than or equals to zero, the capital is said to be maintained at historical costs. This means the business will have enough funds to replace its assets at historical costs. This is quite right as long as prices do not rise.

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

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

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

Question 24

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*MTP March, 2021*) (*4 Marks*)

Answer

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

A brief explanation of each measurement basis is as follows:

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

Question 25

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

(1) Earned 10% dividend on 2,000 equity shares held of ₹ 100 each
(2) Paid ₹ 50,000 to creditors for settlement of ₹ 70,000
(3) Rent of the premises is outstanding ₹ 10,000
(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction.

(*MTP April, 2021*) (*5 Marks*)

Answer

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

Transactions		***Assets ₹ lakh***	**–**	***Liabilities ₹ lakh***	**=**	***Equity ₹ lakh***
Opening		8.00	–	3.00	=	5.00
(1)	Dividend earned	8.20	–	3.00	=	5.20
(2)	Settlement of Creditors	7.70	-	2.30	=	5.40
(3)	Rent Outstanding	7.70	–	2.40	=	5.30
(4)	Drawings	7.61	–	2.40	=	5.21

Question 26

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

(*Question Paper, July 2021*) (*4 Marks*)

Answer

Physical Capital Maintenance at Current Cost

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

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

Closing equity at closing current costs = ₹ 1, 20,000 Retained Profit = ₹ 1, 20,000 – ₹ 1, 50,000 = (-) ₹ 30,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of ₹ 1, 20,000 is not sufficient to buy 6,000 units again at increased price of ₹ 25 per unit. The drawings should have been restricted to ₹30,000 (₹ 60,000 – ₹ 30,000).

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

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

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

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

Question 27

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

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

Answer

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

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(ii) Elements of Financial Statements:

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

(b)

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

Question 28

What are the qualitative characteristics of the Financial Statements which improve the usefulness of the information furnished therein?

(*4 Marks*) (*November 2020*)

Answer

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

1. **Understandability**: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities and accounting.
2. **Relevance:** The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user.
3. **Reliability:** To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless transactions and events reported are faithfully represented. The reporting of transactions and events should be neutral, i.e. free from bias and be reported on the principle of 'substance over form'. The information in financial statements must be complete. Prudence should be exercised in reporting uncertain outcome of transactions or events.
4. **Comparability:** Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

Question 29

Following is the Balance Sheet of M/s. S Traders as on 31st March, 2019:

Liabilities	**(₹)**	**Assets**	**(₹)**
Capital	1,50,000	Fixed Assets	1,05,000
11% Bank Loan	80,000	Closing stock	76,000
Trade payables	52,000	Debtors	68,000
Profit & Loss A/c	56,000	Deferred Expenditure	24,000
		Cash & Bank	65,000
	3,38,000		3,38,000

Additional Information:

(i) Remaining life of Fixed Assets is 6 years with even use. The net realizable value of Fixed Assets as on 31st March, 2020 is ₹ 90,000.

(ii) Firm's Sales & Purchases for the year ending 31st March, 2020 amounted to ₹7,80,000 and ₹6,25,000 respectively.

(iii) The cost & net realizable value of the stock as on 31st March, 2020 was, ₹ 60,000 and ₹ 66,000 respectively.

(iv) General expenses (including interest on Loan) for the year 2019-20 were ₹ 53,800.

(v) Deferred expenditure is normally amortised equally over 5 years starting from the Financial year 2018-19 i.e. ₹6,000 per year.

(vi) Debtors on 31st March, 2020 is ₹ 65,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 10,000 debtors depends on successful re-installation of certain products supplied to the customer.

(vii) Closing Trade payable ₹ 48,000, which is likely to be settled at 5% discount.

(viii) There is a prepayment penalty of ₹ 4,000 for Bank loan outstanding.

(ix) Cash & Bank balances as on 31st March, 2020 is ₹ 1,65,200.

Prepare Profit & Loss Account for the year ended 31st March, 2020 and Balance Sheet as on 31st March, 2020 assuming the firm is not a going concern.

(*4 Marks*) (*November 2020*)

Answer

Profit and Loss Account of M/s S Traders for the year ended 31st March, 2020
(business is not a going concern)

	₹		₹
To Opening Stock	76,000	By Sales	7,80,000
To Purchases	6,25,000	By Trade payables	2,400
To General expenses	53,800	By Closing Stock	66,000
To Depreciation (1,05,000 less 90,000)	15,000		
To Provision for doubtful debts	15,000		
To Deferred expenditure	24,000		
To Loan penalty	4,000		
To Net Profit (b.f.)	35,600		
	8,48,400		8,48,400

Balance Sheet M/s S Traders as on 31st March, 2020

Liabilities and Capital		₹	Assets	₹
Capital		1,50,000	Fixed assets	90,000
Profit & Loss A/c			Debtors	
Opening balance	56,000		(65,000 less provision for doubtful debts ₹ 15,000)	50,000
Profit earned during the year	35,600	91,600	Closing stock	66,000
11% Loan		84,000	Cash & Bank balance	1,65,200
Trade payables		45,600		
		3,71,200		3,71,200

Question 30

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

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

You are required to prepare the statement of the effect of aforesaid each transactions on closing balance sheet in the form of Assets - Liabilities = Equity after each transaction.

(*Suggested December 2021*) (*4 Marks*)

Answer

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

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

Question 31

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

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

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

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

(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets- Liabilities = Equity after each transaction.

(MTP April, 2022) (5 Marks)

Answer

Effects of each transaction on Balance sheet of Mr. A is shown below:

Transactions	**Assets ₹ lakh**	**–**	**Liabilities ₹ lakh**	**=**	**Equity ₹ lakh**
Opening	8.00	–	3.00	=	5.00
(1) Dividend earned	8.20	–	3.00	=	5.20
(2) Settlement of Creditors	7.70	-	2.30	=	5.40
(3) Rent Outstanding	7.70	–	2.40	=	5.30
(4) Drawings	7.61	–	2.40	=	5.21

Question 32

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain in brief. (*Suggested December 2021*) (*4 Marks*)

Answer

Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit and loss. The Framework for Preparation and Presentation of Financial statements recognizes four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss.

These bases are: (i) Historical Cost; (ii) Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

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

Question 33

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

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

(1) A liability of ₹ 50,000 was finally settled at a discount of 2%.

(2) Dividend earned @ 15% on 1,000 (F.V 100 each) Equity shares held @ ₹ 12,000.

(3) Rent of the premises paid ₹ 20,000.

(4) Mr. Mohanty withdrew ₹ 10,000 for personal purposes and also withdrew Goods worth ₹ 5,000 for personal purposes.

(5) ₹ 15,000 were received against Bill Receivables.

You are required to show the effect of the above transactions on Balance Sheet in the form of Assets - Liabilities = Equity equation after each transaction.

(*Suggested November, 2022*)(*4 Marks*)

Answer

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

Transactions	***Assets***	**–**	***Liabilities***	**=**	***Equity***
	₹ lakh		***₹ lakh***		***₹ lakh***
Opening	12	–	3	=	9
(1) Settlement of Creditors	12 – 0.49		3 – 0.50		9.0 + 0.01
	11.51	–	2.5	=	9.01
(2) Dividend earned	11.51 + 0.15				9.01+ 0.15
	11.66	–	2.5	=	9.16
(3) Rent paid	11.66 -0.20				9.16 -0.20
	11.46	–	2.5	=	8.96
(4) Drawings	11.46 -0.15				8.96 -0.15
	11.31	–	2.5	=	8.81
(5) *Money received against Bills receivables	11.31+0.15 -0.15	–	2.5	=	8.81
	11.31				

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

Question 34

A Ltd. has entered into a binding agreement with Gamma Ltd. to buy a custom-made machine ₹ 1,00,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.

You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2.

RTP May, 2023)

Answer

A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, A Ltd. should recognise a liability of ₹ 1,00,000 to Gamma Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense.

Journal entry

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

Question 35

Mille started a business on 01.04.2022 with a capital of ₹15,00,000.

She purchased ₹1,5,00 units of stock at ₹1,000 each. She sold the entire stock for ₹1,500 each unit till 31.03.2023.

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

(i) Historical Cost

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

(iii) Physical Capital Maintenance
(Price per unit at the end of year is (₹1,350)

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

CHAPTER 3

Applicability of Accounting Standards

Question 1

M/s Omega & Co. (a partnership firm), had a turnover of ₹ 1.25 crores (excluding other income) and borrowings of ₹ 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.20X1. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI.

(*Source: Example 1, Study Material*)

Answer

The question deals with the issue of Applicability of Accounting Standards to a non- corporate entity. For availment of the exemptions, first of all, it has to be seen that M/s Omega & Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under 4 levels viz Level I, Level II, Level III and Level IV entities.

Non-corporate entities which meet following criteria are classified as Level IV entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) does not exceed rupees ten crores in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) does not exceed rupees two crores at any time during the immediately preceding accounting year.

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

As the turnover of M/s Omega & Co. is less than ₹ 10 crores and borrowings less than ₹ 2 crores, it falls under Level IV non-corporate entities. In this case, AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27 and AS 28 will not be applicable to M/s Omega & Co. Relaxations from certain requirements in respect of AS 10, AS 11, AS 13, AS 15, AS 19, AS 22, AS 26 and AS 29 are also available to M/s Omega & Co.

Question 2

What are the issues, with which Accounting Standards deal?

(*Source: Question 6, Study Material*)

Answer

Accounting Standards deal with the issues of (i) Recognition of events and transactions in the financial statements, (ii) Measurement of these transactions and events, (iii) Presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and (iv) Disclosure requirements.

Question 3

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

(*Source: Question 7, Study Material*)

Answer

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

Question 4

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

(*Source: Question 8, Study Material*)

Answer

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

Question 5

XYZ Ltd., with a turnover of ₹ 50 crores during previous year and borrowings of ₹ 1 crore during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.20X1. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.

(*Source: Question 9, Study Material*)

Answer

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

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

As per the Companies (Accounting Standards) Rules, 2021, criteria for above classification as SMCs, are:

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

- whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- which is not a bank, financial institution or an insurance company;
- whose turnover (excluding other income) does not exceed rupees two- fifty crores in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and
- which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Since, XYZ Ltd.'s turnover was ₹ 50 crores which does not exceed ₹ 250 crores and borrowings of ₹ 1 crore are less than ₹ 50 crores, it is a small and medium sized company (SMC).

Question 6

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

(*Source: Question 10, Study Material*)

Answer

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

CHAPTER 4

AS 1: Disclosure of Accounting Policies

Question 1

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

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to ₹1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to ₹1,95,000.

Discuss disclosure requirement of change in accounting policy as per AS-1.

(*Source: Illustration 1, Study Material*)

Answer

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

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

Question 2

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

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

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

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

(*Source: Illustration 2, Study Material*)

Answer

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

Notes on Accounts:

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

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

Question 3

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

(*Source: Illustration 3, Study Material*)

Answer

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

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

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

Question 4

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

(*Source: Question 4, Study Material*)

Answer

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

Question 5

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

(*Source: Question 5, Study Material*)

Answer

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

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

Question 6

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

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

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

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

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

(*Source: Question 6, Study Material*)

Answer

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

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

(iii) True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

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

Question 7

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

(*Source: Question 7, Study Material*)

Answer

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

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

QUESTION BANK

Question 8

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

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

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

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

(*November 2018*)/*(MTP April, 2022) (5 Marks)*

Answer

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

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

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

Question 9

What are fundamental accounting assumptions?

(*RTP May 2019*)

Answer:

Fundamental Accounting Assumptions:

Accrual, Going Concern and Consistency

Question 10

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

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017.

(*MTP April 2019*) (*5 Marks*)

Answer:

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

Notes on Accounts:

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

Question 11

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

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016 -2017.

(*MTP August, 2018*) (*5 Marks*)

Answer:

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

Notes on Accounts:

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

Question 12

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to ₹ 1,63,000 (on the basis of FIFO method).

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to ₹ 1,95,000.

Discuss disclosure requirement of change in accounting policy as per AS-1.

(*MTP October, 2018*) (*5 Marks*)

Answer:

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

'The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014 -15, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

Question 13

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

As chief accountant of the company, you are asked by the managing director to prepare the notes on accounts for inclusion in the annual report for 2016-2017.

(*MTP April, 2018*) (*5 Marks*)

Answer

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

Notes on Accounts:

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

Question 14

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

[*RTP, November 2020*]

Answer

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

(i) Going Concern: The financial statements are normally prepared on the assumption that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.

(ii) Consistency: The principle of consistency refers to the practice of using same accounting policies for similar transactions in all accounting periods unless the change is required (i) by a statute, (ii) by an accounting standard or (iii) for more appropriate presentation of financial statements.

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

Question 15

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

Answer

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

Notes on Accounts:

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

Question 16

(a) ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2019.

The company wants to provide during the year ending 31.3.2020 based on technical evaluation:

Total value of inventory	₹ 100 lakhs
Provision required based on 12 months issue	₹ 3.5 lakhs
Provision required based on technical evaluation	₹ 2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

(*RTP May 2020*)

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

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

(*RTP May 2020*) (*MTP March, 2022*) (*5 Marks*)/(*Question Paper, May 2022*) (*4 Marks*)

Answer

(a) (i) The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made. In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2019-20:

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

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

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

3. True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

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

Question 17

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

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

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

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

(*5 Marks*)

Answer

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

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

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

Question 18

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

(*Old Study Material*)

Answer

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

Question 19

When can a company change its accounting policy? Explain.

(*Old Study Material*)

Answer

A change in accounting policy should be made in the following conditions:

(i) If the change is required by some statute or

(ii) for compliance with an Accounting Standard or

(iii) change would result in more appropriate presentation of the financial statement.

Question 20

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

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

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

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

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

(*Old Study Material*)

Answer

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

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

(iii) True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

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

Question 21

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

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

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

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

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

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

(*5 Marks*)

Answer

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

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

(iii) True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed at one place.

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

(v) True; As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

Question 22

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

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

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

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

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

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

[*MTP October, 2019, 5 marks*]

Answer

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

Question 23

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

- (i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed.
- (ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
- (iii) All significant accounting policies adopted in the preparation and presentation of financial statements should not form part of the financial statements.
- (iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need to be indicated.
- (v) There is a single list of accounting policies which are applicable to all circumstances.

(5 Marks) (MTP, May 2020)

Answer:

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

Question 24

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

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

Answer

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

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

Question 25

(i) ABC Ltd. was previously making provision for non-moving stocks based on not issued for the last 12 months up to 31.03.2020. Now, the company wants to make provision based on technical evaluation during the year ending 31.03.2021.

Total value of stock ₹ 133.75 lakhs

Provision required based on technical evaluation ₹4.00 lakhs Provision required based on 12 months not issued ₹5.00 lakhs

(ii) In the Books of M/s Kay Ltd, Closing stock as on 31st March, 2021 amounts to ₹1,24,000 (on the basis of FIFO method)

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2020-2021. On the basis of weighted average method, closing stock as on 31st March, 2021 amounts to 1 1,15,000. Realisable value of the inventory as on 31st March, 2021 amounts to ₹ 1,54,000.

Discuss Disclosure Requirements of change in accounting policy in above cases as per AS 1

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

Answer

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

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

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

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

"The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2020-21, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 9,000."

CHAPTER 5

AS 2 (Revised): Valuation of Inventory

Question 1

The company deals in three products, A, B and C, which are neither similar nor inter-changeable. At the time of closing of its account for the year 20 X1-X2, the Historical Cost and Net Realisable Value of the items of closing stock are determined as follows:

Items	*Historical Cost (₹ in lakhs)*	*Net Realisable Value (₹ in lakhs)*
A	*40*	*28*
B	*32*	*32*
C	*16*	*24*

What will be the value of closing stock?

(*Source: Illustration 1, Study Material*)

Answer

As per AS 2 (Revised) on 'Valuation of Inventories', inventories should be valued at the lower of cost and net realisable value. Inventories should be written down to net realisable value on an item-by-item basis in the given case.

Items	Historical Cost (₹ in lakhs)	Net Realisable Value (₹ in lakhs)	Valuation of closing stock (₹ in lakhs)
A	40	28	28
B	32	32	32
C	16	24	16
	88	84	76

Hence, closing stock will be valued at ₹76 lakhs.

Question 2

X Co. Limited purchased goods at the cost of ₹40 lakhs in October, 20X1. Till March, 20X2, 75% of the stocks were sold. The company wants to disclose closing stock at 10 lakhs. The expected sale value is ₹11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.20X2.

(*Source: Illustration 2, Study Material*)

Answer

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost or net realisable value.

In this case, the cost of inventory is ₹10 lakhs. The net realisable value is 11,00,000 × 90% = ₹9,90,000. So, the stock should be valued at ₹9,90,000.

Question 3

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

(*Source: Illustration 3, Study Material*)

Answer

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

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

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000/4,750 = ₹1,052.6315 Total value of inventory = 4,700 MT x ₹1,052.6315 = ₹49,47,368.

Question 4

You are required to value the inventory per kg of finished goods consisting of:

	₹ per kg.
Material cost	*200*
Direct labour	*40*
Direct variable overhead	*20*

Fixed production charges for the year on normal working capacity of 2 lakh kgs is ₹20 lakhs. 4,000 kgs of finished goods are in stock at the year end.

(*Source: Illustration 4, Study Material*)

Answer

In accordance with AS 2 (Revised), the cost of conversion include a systematic allocation of fixed and variable overheads that are incurred in converting materials into finished goods. The allocation of fixed overheads for the purpose of their inclusion in the cost of conversion is based on normal capacity of the production facilities.

Cost per kg. of finished goods:

		₹
Material Cost		200
Direct Labour	40	
Direct Variable Production Overhead	20	
Fixed Production Overhead $\left(\frac{20,00,000}{2,00,000}\right)$	10	70
		270

Hence the value of 4,000 kgs. of finished goods = 4,000 kgs x ₹270 = ₹10,80,000

Question 5

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

(*Source: Question 5, Study Material*)

Answer

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

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

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

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

(d) selling and distribution costs.

Question 6

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-20X2 the Company used 12,000 MT of raw material costing ₹150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the *context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss, if any.*

(*Source: Question 6, Study Material*)

Answer

As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Abnormal Loss:

Material used	12,000 MT @ ₹150 = ₹18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520 MT
Abnormal Loss in quantity	150
MT Abnormal Loss	₹23,437.50

[150 units @ ₹156.25 (₹18,00,000/11,520)]

Amount ₹23,437.50 will be charged to the Statement of Profit and Loss.

Question 7

gives the following information relating to items forming part of inventory as on 31-3-20X1. His factory produces Product X using Raw material A.

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

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

(iii) 1500 units of finished Product X and total cost incurred ₹320 per unit. Expected selling price of Product X is ₹300 per unit.

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

(*Source: Question 7, Study Material*)

Answer

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In the given case, selling price of product X is ₹300 and total cost per unit for production is ₹320.

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.20X1:

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

Question 8

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

(*Source: Question 8, Study Material*)

Answer

Valuation of unfinished unit

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

QUESTION BANK

Question 9

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

As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price.

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

Answer

False: Inventories should be valued at the lower of cost and net realizable value (not selling price) as per AS 2.

Question 10

Wooden Plywood Limited has a normal wastage of 5% in the production process. During the year 2017-18, the Company used 16,000 MT of Raw material costing ₹ 190 per MT. At the end of the year, 950 MT of wastage was in stock. The accounting wants to know haw this wastage is to be treated in the books.

You are required to:

(1) Calculate the amount of abnormal loss.

(2) Explain the treatment of normal loss and abnormal loss.
[In the context of AS-2- (Revised)]

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

Answer

(i) As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Abnormal Loss:

(ii)	Material used	16,000 MT @ ₹ 190 = ₹ 30,40,000
	Normal Loss (5% of 16,000 MT)	800 MT (included in calculation of cost of inventories)
	Net quantity of material	15,200 MT
(ii)	Abnormal Loss in quantity	(950 - 800) 150 MT
	Abnormal Loss	₹ 30,000

[150 units @ ₹ 200 (₹ 30,40,000/15,200)]

Amount of ₹ 30,000 (Abnormal loss) will be charged to the Profit and Loss statement.

Question 11

On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2017-18 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage
on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2017 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi finished form and its NRV is zero without processing it further.

(*RTP May 2019*)

Answer:

Valuation of unfinished unit

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

Question 12

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2017.

	₹ Per unit
Raw Material X	
Cost price	380
Unloading Charges	20
Freight Inward	40
Replacement cost	300

Chemical Y	
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 20,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was ₹ 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when

(i) Net realizable value of Chemical Y is ₹ 800 per unit

(ii) Net realizable value of Chemical Y is ₹ 600 per unit

(*RTP November 2018*)

Answer:

(i) When Net Realizable Value of the Chemical Y is ₹ 800 per unit

NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 (Refer W.N.)

Hence, Raw Material and Finished Goods are to be valued at cost.

Value of Closing Stock

	Qty.	Rate (₹)	Amount (₹)
Raw Material X	1,000	440	4,40,000
Finished Goods Y	2.400	660	15,84,000
Total Value of Closing Stock			20,24,000

(ii) When Net Realizable Value of the Chemical Y is ₹ 600 per unit

NRV is less than the cost of Finished Goods Y i.e. ₹ 660. Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.

Value of Closing Stock

	Qty.	Rate (₹)	Amount (₹)
Raw Material X	1,000	300	3,00,000
Finished Goods Y	2,400	600	14,40,000
Total Value of Closing Stock			17,40,000

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	**₹**
Cost Price	380
Add: Freight Inward	40
Unloading charges	20
Cost	440
Chemical Y	**₹**
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (₹4,00,000/20,000 units)	20
Cost	660

Question 13

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export but the ownership in these goods had not been transferred to the foreign buyers.

You are required to advise the company on the valuation of the inventories in line with the provisions of AS 2.

(*RTP May 2018*)

Answer:

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. The standard states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods are often valued at net realizable value at certain stages of production".

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realizable value and not at net realizable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

Question 14

Rohan Pvt. Ltd., a wholesaler in agriculture products, has valued the inventory on Net Realizable Value on the ground that AS 2 does not apply to inventory of agriculture products.

(RTP May, 2022)

Answer

AS 2 does not apply to producers of agricultural products but applies to traders in agricultural products. Hence AS 2 will apply to Rohan Pvt. Ltd. and it will have to value inventory at lower of cost or market value.

Question 15

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2017 on weighted Average Basis.

Details of Purchases:

Date of purchase	Unit (Nos.)	Purchase cost per unit (₹)
01-03-2017	20	108
08-03-2017	15	107
17-03-2017	30	109
25-03-2017	15	107

Details of issue of Inventory:

Date of Issue	Unit (Nos.)
03-03-2017	10
12-03-2017	20
18-03-2017	10
24-03-2017	20

Net realizable value of inventory as on 31st March, 2017 is ₹ 107.75 per unit.

You are required to compute the value of Inventory as per AS 2.

(*MTP March 2019*) (*5 Marks*)/(*RTP May 2022*)

Answer:

Net Realisable Value of Inventory as on 31st March, 2017

= ₹ 107.75 x 20 units = ₹ 2,155

Value of inventory as per Weighted Average basis

Total units purchased and total cost:

01.03.2017	₹ 108 x 20 units = ₹ 2160
08.3.2017	₹ 107 x 15 units = ₹ 1605
17.03.2017	₹ 109 x 30 units = ₹ 3270
25.03.2017	₹ 107 x 15 units = ₹ 1605
Total	80 units = ₹ 8640

Weighted Average Cost = ₹ 8640/80 units = ₹108

Total cost = ₹ 108 x 20 units = ₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2017 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

Question 16

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016-17, the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories". (*MTP April 2019*) (*5 Marks*)

Answer:

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

Material used	12,000 MT @ ₹ 150 = ₹ 18,00,000	
Normal Loss (4% of 12,000 MT)	480 MT	
Net quantity of material	11,520 MT	
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)	
Abnormal Loss	₹ 23,437.50 [150 units @ ₹ 156.25	(₹18,00,000/11,520)]

Amount ₹ 23,437.50 will be charged to the Profit and Loss statement.

Question 17

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2017.

	₹ Per unit
Raw Material X	
Cost price	380
Unloading Charges	20
Freight Inward	40
Replacement cost	300
Chemical Y	
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 20,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was ₹ 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is ₹ 800 per unit.

(*MTP August, 2018*) (*5 Marks*)

Answer:

When Net Realizable Value of the Chemical Y is ₹ 800 per unit

NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 (Refer W.N.)

Hence, Raw Material and Finished Goods are to be valued at cost.

Value of Closing Stock:

	Qty.	***Rate (₹)***	***Amount (₹)***
Raw Material X	1,000	440	4,40,000
Finished Goods Y	2,400	660	15,84,000
Total Value of Closing Stock			20,24,000

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	**₹**
Cost Price	380
Add: Freight Inward	40
Unloading charges	20
Cost	440

Chemical Y	**₹**
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (₹4,00,000/20,000 units)	20
Cost	660

Question 18

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016 -17, the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories".

(*MTP October, 2018*) (*5 Marks*)

Answer:

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred . The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

Material used	12,000 MT @ ₹ 150 = ₹ 18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520 MT
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)
Abnormal Loss	₹ 23,437.50 [150 units @ ₹ 156.25 (₹18,00,000/11,520)]

Amount of ₹ 23,437.50 will be charged to the Profit and Loss statement.

Question 19

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2017 on weighted Average Basis.

Details of Purchases:

Date of purchase	**Unit (Nos.)**	**Purchase cost per unit (₹)**
01-03-2017	20	108
08-03-2017	15	107
17-03-2017	30	109
25-03-2017	15	107

Details of issue of Inventory:

Date of Issue	**Unit (Nos.)**
03-03-2017	10
12-03-2017	20
18-03-2017	10
24-03-2017	20

Net realizable value of inventory as on 31st March, 2017 is ₹ 107.75 per unit.

You are required to compute the value of Inventory as per AS 2?

(*MTP March 2018*) (*5 Marks*)

Answer:

Net Realisable Value of Inventory as on 31st March, 2017

= ₹ 107.75 x 20 units = ₹ 2,155

Value of inventory as per Weighted Average basis

Total units purchased and total cost:

01.03.2017	₹ 108 x 20 units = ₹ 2160
08.3.2017	₹ 107 x 15 units = ₹ 1605
17.03.2017	₹ 109 x 30 units = ₹ 3270
25.03.2017	₹ 107 x 15 units = ₹ 1605

Total 80 units = ₹ 8640

Weighted Average Cost = ₹ 8640/80 units = ₹108

Total cost = ₹ 108 x 20 units = ₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2017 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

Question 20

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016-17, the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and give the treatment thereof in line with AS 2 "Valuation of inventories".

(*MTP April, 2018*) (*5 Marks*)

Answer:

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

Material used	12,000 MT @ ₹ 150 = ₹ 18,00,000	
Normal Loss (4% of 12,000 MT)	480 MT	
Net quantity of material	11,520 MT	
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)	
Abnormal Loss	₹ 23,437.50 [150 units @ ₹ 156.25	(₹16,00,000/11,520)]

Amount ₹ 23,437.50 will be charged to the Profit and Loss statement.

Question 21

Hello Ltd. purchased goods at the cost of ₹ 20 lakhs in October. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at ₹ 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. You are required to ascertain the value of closing stock?

(*RTP November 2019*)

Answer

As per para 5 of AS 2 “Valuation of Inventories”, the inventories are to be valued at lower of cost or net realizable value.

In this case, the cost of inventory is ₹5 lakhs. The net realizable value is ₹4.95 lakhs (₹5.5 lakhs less cost to make the sale @ 10% of ₹5.5 lakhs). So, the closing stock should be valued at ₹4.95 lakhs.

Question 22

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2020.

	₹ Per unit
Raw Material X	
Cost price	400
Freight Inward	40
Replacement cost	320
Chemical Y	
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 25,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is ₹ 600 per unit.

[*RTP, November 2020*]

Answer

Net Realizable Value of the Chemical Y (Finished Goods) is ₹ 600 per unit which is less than its cost ₹ 656 per unit. Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.

Value of Closing Stock:

	Qty.	Rate (₹)	Amount (₹)
Raw Material X	1,000	320	3,20,000
Finished Goods Y	2,400	600	14,40,000
Total Value of Closing Stock			17,60,000

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	**₹**
Cost Price	400
Add: Freight Inward	40
Cost	440
Chemical Y	**₹**
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (₹4,00,000/25,000 units)	16
Cost	656

Question 23

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2019-20, the Company used 12,000 MT of raw material costing ₹150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories".

(5 Marks) (MTP, May 2020)

Answer:

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

Material used	12,000 MT @ ₹ 150 = ₹ 18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520MT
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)
Abnormal Loss	₹ 23,437.50 [150 units @ ₹ 156.25 (₹18,00,000/11,520)]

Amount of ₹ 23,437.50 will be charged to the Profit and Loss statement.

Question 24

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

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

(ii) 400 units of partly finished goods in the process of producing P. Cost incurred till date is ₹ 245 per unit. These units can be finished next year by incurring additional cost of ₹ 50 per unit.

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

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

Determine how each item of inventory will be valued as on 31.03.2019. Also calculate the value of total Inventory as on 31.03.2019.

(*5 marks*)

Answer

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product P is ₹ 266 and total cost per unit for production is ₹ 295.

Hence the valuation will be done as under:

(i) 900 units of raw material X will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 80 per unit.

(ii) 400 units of partly finished goods will be valued at 216 per unit i.e., lower of cost (₹ 245) or Net realizable value ₹ 216 (Estimated selling price ₹ 266 per unit less additional cost of ₹ 50).

(iii) 800 units of finished product P will be valued at NRV of ₹ 266 per unit since it is lower than cost ₹ 295.

Valuation of Total Inventory as on 31.03.2019:

	Units	***Cost (₹)***	***NRV/Replacement cost***	***Value = units x cost or NRV whichever is less (₹)***
Raw material X	900	100	80	72,000
Partly finished goods	400	245	216	86,400
Finished goods P	800	295	266	2,12,800
Value of Inventory				3,71,200

Question 25

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

(*RTP May 2022*)

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

(*5 Marks*)

Answer

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

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

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

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

(d) selling and distribution costs.

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

Question 26

Joy Ltd. purchased 20,000 kilograms of Raw Material @ ₹20 per kilogram during the year 2020-21. They have furnished you with the following further information for the year ended 31st March, 2021:

Particulars	**Units**	**Amount (₹)**
Opening Inventory:		
Finished Goods	2,000	1,00,000

Particulars	Units	Amount (₹)
Raw Materials	2,200	44,000
Direct Labour		3,06,000
Fixed Overheads		3,00,000
Sales	20,000	11,20,000
Closing Inventory:		
Finished Goods	2,400	
Raw Materials	1,800	

The plant has a capacity to produce 30,000 Units of finished product per annum. However, the actual production of finished products during the year 2020-21 was 20,400 Units. Due to a fall in the market demand, the price of the finished goods in which the raw material has been utilized is expected to be sold @ ₹40 per unit. The replacement cost of the raw material was ₹19 per kilogram.

You are required to ascertain the value of closing inventory as at 31st March, 2021 as per AS 2.

(*5 Marks*)

Question 27

SM Enterprises is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. For the end month of June 2021 following information is available:

(i) Sales for the month of June 2021 was ₹ 30,40,000.
(ii) General overheads cost ₹ 4,00,000.
(iii) Inventory at beginning 10,000 litres @ ₹ 92 per litre.
(iv) Purchases - June 1 2021, 20,000 litres @ ₹ 90 per litre, June 30 2021, 10,000 litres @ ₹ 95 per litre.
(v) Closing inventory 13,000 litres.

You are required to compute the following by FIFO method as per AS 2:

(i) Value of Inventory on 30th June, 2021.
(ii) Amount of cost of goods sold for June, 2021.
(iii) Profit/Loss for the month of June, 2021. (*Question Paper, May 2022*) (*5 Marks*)

Question 28

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

Details of cost for these products are:

Product – A: Material cost, wages cost and overhead cost of each unit are ₹ 40, ₹ 30 and ₹ 20 respectively, Each unit is sold at ₹ 110, selling expenses amounts to 10% of selling costs.

Product – B: Material cost and wages cost of each unit are ₹ 45 and ₹ 35 respectively and normal selling rate is ₹ 150 each, however due to defect in the manufacturing process 800 units of Product-B were expected to be sold at ₹ 70.

You are requested to value closing inventory according to AS 2 after considering the above.

Answer

According to AS 2 'Valuation of Inventories', inventories should be valued at the lower of cost and net realizable value.

Product – A

Material cost	₹ 40 x 200 = 8,000	
Wages cost	₹ 30 x 200 = 6,000	
Overhead	₹ 20 x 200 = 4,000	
Total cost		₹ 18,000
Realizable value [200 x (110-11)]		₹ 19,800
Hence inventory value of Product -A		₹ 18,000

Product – B

Material cost	₹ 45 x 800 = 36,000	
Wages cost	₹ 35 x 800 = 28,000	
Total cost		₹ 64,000
Realizable value (800 x 70)		₹ 56,000
Hence inventory value of Product-B		₹ 56,000
Total Value of closing inventory i.e. Product A + Product B (18,000+ 56,000)		₹ 74,000

Question 29

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000

Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

[*RTP May 2020*]

Answer

Calculation of cost for closing inventory

Particulars	**₹**
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead $\frac{75,000 \times 10,200}{15,000}$	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

Therefore, value of closing inventory: Finished Goods (1,200 x 20) ₹	24,000
Raw Materials (900 x 9.50)	₹ 8,550
	₹ 32,550

Question 30

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

(*Old Study Material*)

Answer

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

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

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

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and selling and distribution costs.

Question 31

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-20X2 the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss, if any.

(*Old Study Material*)

Answer

As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Abnormal Loss:

Material used	12,000 MT @ ₹150 = ₹18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520 MT
Abnormal Loss in quantity	150 MT
Abnormal Loss	₹ 23,437.50 [150 units @ ₹ 156.25 (₹ 18,00,000/11,520)]

Amount ₹ 23,437.50 will be charged to the Statement of Profit and Loss.

Question 32

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-20X1. His factory produces Product X using Raw material A.

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

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

(iii) 1500 units of finished Product X and total cost incurred ₹ 320 per unit. Expected selling price of Product X is ₹ 300 per unit.

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

(*Old Study Material*)

Answer

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.20X1:

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

Question 33

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2019. His factory produces Product X using Raw material A.

(i) 600 units of Raw material A (purchased @ ₹120). Replacement cost of raw material A as on 31-3-2019 is ₹90 per unit.

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

(iii) 1500 units of finished Product X and total cost incurred ₹320 per unit. Expected selling price of Product X is ₹300 per unit.

Determine how each item of inventory will be valued as on 31-3-2019. Also calculate the value of total inventory as on 31-3-2019.

[*MTP October, 2019, 5 marks*]

Answer

As per AS 2 "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

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

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost ₹320 (₹ 260 + additional cost ₹ 60) or Net estimated selling price or NRV i.e. ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

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

Valuation of Total Inventory as on 31.03.2019:

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

Question 34

Mr. Rakshit gives the following information relating to items forming part of inventory as on **31st** March, 2019. His factory produces product X using raw material A.

(i) 800 units of raw material A (purchased @ ₹140 per unit). Replacement cost of raw material A as on 31st March, 2019 is ₹190 per unit.

(ii) 650 units of partly finished goods in the process of producing X and cost incurred till date ₹310 per unit. These units can be finished next year by incurring additional cost of ₹50 per unit.

(iii) 1,800 units of finished product X and total cost incurred ₹360 per unit.
Expected selling price of product X is ₹350 per unit.

In the context of AS-2, determine how each item of inventory will be valued as on 31st March, 2019. Also, calculate the value of total inventory as on 31st March, 2019.

(*November 2019*) (*5 Marks*)

Answer

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product X is ₹ 350 and total cost per unit for production is ₹ 360.

Hence the valuation will be done as under:

(i) 800 units of raw material will be valued at cost 140.

(ii) 650 units of partly finished goods will be valued at 300 per unit* i.e. lower of cost (₹ 310) or Net realizable value ₹ 300 (Estimated selling price ₹ 350 per unit less additional cost of ₹ 50).

(iii) 1,800 units of finished product X will be valued at NRV of ₹ 350 per unit since it is lower than cost ₹ 360 of product X.

Valuation of Total Inventory as on 31.03.2019:

	Units	**Cost (₹)**	**NRV/ Replacement cost ₹**	**Value = units x cost or NRV whichever is less (₹)**	**₹**
Raw material A	800	140	190	1,12,000	(800 x 140)
Partly finished goods	650	310	300	1,95,000	(650 x 300) (1,800
Finished goods X	1,800	60	350	6,30,000	x 350)
Value of Inventory				9,37,000	

*It has been assumed that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further.

Question 35

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste and finished output is in stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case? What will be treatment for normal and abnormal waste?

(MTP April, 2022) (5 Marks)

Answer

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

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

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315 Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

Question 36

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

Raw Material P

Closing balance	600 units
	₹per unit
Cost price including GST	250
Input tax credit available	20
Freight inward	30
Handling charges	15
Replacement cost	180

Finished goods Q

Closing balance	1500 units
	₹per unit
Material consumed	250
Direct labour	70
Direct overhead	30

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

Calculate the value of closing stock, when

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

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit.

(MTP, October 2021) (5 Marks)

Answer

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

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

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

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

Value of Closing Stock:

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

Working Note:

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

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

Question 37

On 31st March 2020, a business firm finds that cost of a partly finished unit on that date is ₹ 430. The unit can be finished in 2020-21 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 2% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2020 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further.

(*RTP, November 2021*)

Answer

Valuation of unfinished unit

	₹
Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (2 % of 750)	(15)
Net Realisable Value	425
Cost of inventory	430
Value of inventory (Lower of cost and net realisable value)	425

Question 38

Following information of Sarah Limited is given:

Sarah Limited uses Raw Material 'A' for production of production of Finished Goods 'B'

Closing balance of Raw Material 'A' in units on 31st March,2022	*750*
	Price Per Unit in ₹
Cost Price	*150*
Freight inward	*10*
Replacement Cost	*152*
Closing balance of Finished Good 'B' in units on 31st March,2022	*1,600*
	Price Per Unit in ₹
Material Consumed	*225*
Direct Labour	*75*
Direct variable overhead	*60*

Total Fixed Overheads amounts to ₹ 1,00,000 on normal capacity of 20,000 units.

You are required to calculate the value of Closing Stock of Raw materials and Closing Stock of Finished Goods, as on 31st March, 2022, as per AS 2, when selling price of Finished Goods 'B' is ₹ 360 per unit.

(*Suggested November, 2022*) (*5 Marks*)

Answer

Raw Material A	₹
Cost Price	150
Add: Freight Inward	10
Cost per unit	160
Replacement cost per unit of raw material	152

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value. Materials and other supplies held for use in the production of inventories are written down below cost if the selling price of finished product containing the material does not exceed the cost of the finished product. In the given case, netrealizable value of the Product 'B' (Finished Goods) is ₹ 360 per unit which is less than its cost ₹ 365 per unit. Raw Material is to be valued at replacement cost.

Value of the closing stock of raw material on 31/03/2022 would be₹ 1,14,000(750 units X ₹152 per unit).

Finished Goods B	**₹**
Materials consumed	225
Direct Labour	75
Direct Variable overheads	60
Fixed overheads (₹ 1,00,000/20,000 units)	5
Cost per unit	365
Net realizable value per unit	360

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value. Hence, Finished Goods are to be valued at NRV since NRV is less than the cost.

Value of the closing stock of Finished goods as on 31/03/2022 would be ₹ 5,76,000(1,600 units X ₹ 360 per unit).

Question 39

The closing stock of finished goods (at cost) of a company amounted to ₹ 4,50,000. The following items were included at cost in the total:

(a) 100 coats, which had cost ₹ 2,200 each and normally sold for ₹ 4,000 each. Owing to a defect in manufacture their NRV was determined at 50% of their normal selling price.

(b) Shirts which had cost ₹ 50,000, their net realizable value at Balance sheet date was ₹ 55,000. Commission @ 10% on sales is payable to agents.

What should the inventory value be according to AS 2 after considering the above items?

(*RTP November, 2022*)

Answer

Valuation of closing stock

	₹
Closing stock at cost	4,50,000
Less: Adjustment for 100 coats (Working Note 1)	(20,000)
Value of inventory	4,30,000

Working Notes:

1. Adjustment for Coats	₹
Cost included in Closing Stock	2,20,000
NRV of Coats	2,00,000
Adjustment to be made as NRV is less than Cost	20,000

2. No adjustment required for shirts as their NRV is more than their cost which was included in value of inventory.

Question 40

An enterprise ordered 20,000 KG of certain material at ₹ 110 per unit. The purchase price includes GST ₹ 12 per KG, in respect of which full input tax credit (ITC) is admissible. Freight incurred amounted to ₹ 1,17,600. Normal transit loss is 2%. The enterprise actually received 19,500 KG and consumed 18,000 KG of the material.

(i) You are required to calculate cost of material per KG;

(ii) Allocation of material cost.

(*RTP May, 2023*)

Answer

Calculation of Normal cost per Kg.

	₹
Purchase price (20,000 Kg. x ₹ 110)	22,00,000
Less: Input Tax Credit (20,000 Kg. x ₹ 12)	(2,40,000)
	19,60,000
Add: Freight	1,17,600
A. Total material cost	20,77,600
B. Number of units normally received = 98% of 20,000 Kg.	Kg. 19,600
C. Normal cost per Kg. (A/B)	106

Allocation of material cost

	Kg.	**₹ /Kg.**	**₹**
Materials consumed	18,000	106	19,08,000
Cost of inventory	1,500	106	1,59,000
Abnormal loss	100	106	10,600
Total material cost	19,600	106	20,77,600

Note: Abnormal losses are recognized as separate expense.

CHAPTER

6

AS 3: Cash Flow Statement

Question 1

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

(a) Purchase of Machinery.

(b) Proceeds from issuance of equity share capital

(c) Cash Sales.

(d) Proceeds from long-term borrowings.

(e) Cheques collected from Trade receivables.

(f) Cash receipts from Trade receivables.

(g) Trading Commission received.

(h) Purchase of investment.

(i) Redemption of Preference Shares.

(j) Cash Purchases.

(k) Proceeds from sale of investment

(l) Purchase of goodwill.

(m) Cash paid to suppliers.

(n) Interim Dividend paid on equity shares.

(o) Wages and salaries paid.

(p) Proceed from sale of patents.

(q) Interest received on debentures held as investment.

(r) Interest paid on Long-term borrowings.

(s) Office and Administration Expenses paid

(t) Manufacturing Overheads paid.

(u) Dividend received on shares held as investments.

(v) Rent Received on property held as investment.

(w) Selling and distribution expense paid.

(x) Income tax paid

(y) Dividend paid on Preference shares.

(z) Underwritings Commission paid.

(aa) Rent paid.

(bb) Brokerage paid on purchase of investments.

(cc) Bank Overdraft

(dd) Cash Credit

(ee) Short-term Deposits

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

(gg) Refund of Income Tax received.

(*Source: Illustration 1, Study Material*)

Answer

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

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

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

(d) Cash Equivalent: ff.

Question 2

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

(*Source: Illustration 2, Study Material*)

Answer

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

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

Question 3

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

(i) Interest paid by financial enterprise

(ii) Tax deducted at source on interest received from subsidiary company

(iii) Deposit with Bank for a term of two years

(iv) Insurance claim received towards loss of machinery by fire

(v) Bad debts written off

(*Source: Illustration 3, Study Material*)

Answer

(i) Interest paid by financial enterprise
Cash flows from operating activities

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

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

(iv) Insurance claim received against loss of fixed asset by fire

Extraordinary item to be shown as a separate heading under 'Cash flow from investing activities'

(v) Bad debts written off

It is a non-cash item which is adjusted from net profit/loss under indirect method, to arrive at net cash flow from operating activity.

Question 4

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

Cash Flow (Abstract)

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

Inflows	₹	*Outflows*	₹
Sale of Property, plant and equipment	*70,000*	*Bank loan repaid*	*2,50,000*
		Taxation	*55,000*
		Dividends	*1,00,000*
		Closing balance:	
		Cash	*5,000*
		bank	*10,000*
	10,00,000		*10,00,000*

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

(*Source: Illustration 4, Study Material*)

Answer

Cash Flow Statement for the year ended 31.3.20X1

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

Question 5

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

Particulars	₹
Plant acquired by the issue of 8% Debentures	*1,56,000*
Claim received for loss of plant in fire	*49,600*
Unsecured loans given to subsidiaries	*4,85,000*
Interest on loan received from subsidiary companies	*82,500*
Pre-acquisition dividend received on investment made	*62,400*
Debenture interest paid	*1,16,000*

Particulars	***₹***
Term loan repaid	*4,25,000*
Interest received on investment	*68,000*
(TDS of ₹8,200 was deducted on the above interest)	
Book value of plant sold (loss incurred ₹9,600)	*84,000*

(*Source: Illustration 4, Study Material*)

Answer

Cash Flow Statement from Investing Activities of M/s Creative Furnishings Limited for the year ended 31-03-20X1

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

Note:

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

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

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

Question 6

What are the main features of the Cash Flow Statement?

(*Source: Question 6, Study Material*)

Answer

According to AS 3 on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either (a) the direct method, or (b) the indirect method. A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.

Question 7

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

(*Source: Question 7, Study Material*)

Answer

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

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

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

Question 8

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

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

(*Source: Question 8, Study Material*)

Answer

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

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

Question 9

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

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

(1) to suppliers

(2) to employees

(3) to its subsidiaries companies

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

(iii) Dividend paid for the year

Discuss in the context of AS 3 Cash Flow Statement.

(*Source: Question 9, Study Material*)

Answer

Treatment as per AS 3 'Cash Flow Statement'

(i) Loans and advances given and interest earned

(1) to suppliers - Cash flows from operating activities

(2) to employees - Cash flows from operating activities

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

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

(iii) Dividend paid for the year

Cash flows from financing activities

Question 10

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

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

(*Source: Question 10, Study Material*)

Answer

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

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

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

Question 11

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

(*Source: Question 11, Study Material*)

Answer

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

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

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

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

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

QUESTION BANK

Question 12

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

(a) Proceeds from long-term borrowings.
(b) Proceeds from Trade receivables.
(c) Trading Commission received.
(d) Redemption of Preference Shares.
(e) Proceeds from sale of investment
(f) Interim Dividend paid on equity shares.
(g) Interest received on debentures held as investment.
(h) Dividend received on shares held as investments.
(i) Rent received on property held as investment.
(j) Dividend paid on Preference shares.
(k) Marketable Securities

[*RTP May 2020*]

Answer

Operating Activities: b, c.
Investing Activities: e, g, h, i.
Financing Activities: a, d, f, j.
Cash Equivalent: k.

Question 13

What are the main features of the Cash Flow Statement?

(*Old Study Material*)

Answer

According to AS 3 on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either (a) the direct method, or (b) the indirect method. A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.

Question 14

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

(i) Loans and Advances given to the following and interest earned on them:
  (1) to suppliers
  (2) to employees
  (3) to its subsidiaries companies
(ii) Investment made in subsidiary Smart Ltd. and dividend received
(iii) Dividend paid for the year
(iv) TDS on interest income earned on investments made
(v) TDS on interest earned on advance given to suppliers Discuss in the context of AS 3 Cash Flow Statement.

(*Old Study Material*)

Answer

Treatment as per AS 3 'Cash Flow Statement'

(i) Loans and advances given and interest earned
  (1) to suppliers Cash flows from operating activities
  (2) to employees Cash flows from operating activities
  (3) to its subsidiary companies Cash flows from investing activities
(ii) Investment made in subsidiary company and dividend received
  Cash flows from investing activities
(iii) Dividend paid for the year
  Cash flows from financing activities

(iv) TDS on interest income earned on investments made
No cash inflow/cash outflow

(v) TDS on interest earned on advance given to suppliers
No cash inflow/cash outflow

Question 15

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

Particulars	Amount (₹)
Balance as per the Bank Statement	25,000
Cheque issued but not presented in the Bank	15,000
Short Term Investment in liquid equity shares of ABC Limited	50,000
Fixed Deposit created on 01-11-20X1 and maturing on15-04-20X2	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund on 01-03-20X2 (having maturity period of less than 3 months)	1,00,000
Bank Balance in a Foreign Currency Account in India	$ 1,000
(Conversion Rate: On the day of deposit ₹ 69/USD as on 31-03-20X2 ₹ 70/USD)	

(*Old Study Material*)

Answer

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

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

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

Question 16

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

Particulars	Note No.	31st March,2021 (₹)	31st March,2020 (₹)
(I) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share capital	1	5,60,000	3,00,000
(b) Reserve and Surplus	2	35,000	25,000
2. Current Liabilities			
(a) Trade payables		1,50,000	60,000
(b) Short-term provisions (Provision for taxation)		8,000	5,000
Total		7,53,000	3,90,000
(II) Assets			
1. Non-current assets			
(a) Property, Plant and Equipment		3,50,000	1,80,000
2. Current assets			
(a) Inventories		1,20,000	50,000
(b) Trade receivables		1,00,000	25,000
(c) Cash and cash equivalents		1,05,000	90,000
(d) Other current assets		78,000	45,000
Total		7,53,000	3,90,000

Notes to Accounts

Particulars	31st March, 2021 (₹)	31st March, 2020 (₹)
1. Share capital		
(a) Equity share capital	4,10,000	2,00,000
(b) Preference share capital	1,50,000	1,00,000
	5,60,000	3,00,000

Particulars	31st March, 2021 (₹)	31st March, 2020 (₹)
2. Reserve and surplus		
Surplus in statement of profit and loss at the beginning of the year	25,000	
Add: Profit of the year	20,000	
Less: Dividend	(10,000)	
Surplus in statement of profit and loss at the end of the year	35,000	25,000

Additional Information:

1. Dividend paid during the year ₹ 10,000
2. Depreciation charges during the year ₹ 40,000.

(*RTP May, 2023*)

Answer

Fox Ltd.

Cash Flow Statement for the year ended 31st March, 2021

	₹	₹
Cash flows from operating activities		
Net Profit (35,000 less 25,000)	10,000	
Add: Dividend	10,000	
Provision for tax	8,000	
Net profit before taxation and extraordinary items	28,000	
Adjustments for:		
Depreciation	40,000	
Operating profit before working capital changes		68,000
Increase in trade receivables	(75,000)	
Increase in inventories	(70,000)	
Increase in other current assets	(33,000)	
Increase in trade payables	90,000	(88,000)
Cash used in operating activities		(20,000)
Less: Tax paid*		(5,000)
Net cash used in operating activities		(25,000)
Cash flows from investing activities		
Purchase of PPE	(2,10,000)	
Net cash used in investing activities		(2,10,000)
Cash flows from financing activities		
Issue of equity shares for cash	2,10,000	
Issue of preference shares	50,000	
Dividends paid	(10,000)	
Net cash generated from financing activities		2,50,000
Net increase in cash and cash equivalents		15,000
Cash and cash equivalents at beginning of period		90,000
Cash and cash equivalents at end of period		1,05,000

Provision for tax of last year considered to be paid in the current year.

Working Note:

	₹
Property, plant and equipment acquisitions	
W.D.V. at 31.3.2021	3,50,000
Add back:	
Depreciation for the year	40,000
	3,90,000
Less: W.D.V. at 31.12.2020	1,80,000
Acquisitions during 2020-2021	2,10,000

Question 17

The Balance Sheet of Max Ltd. for the year ending 31st March, 2022 and 31st March, 2021 were summarised as:

Particulars	Note No	2022 ₹	2021 ₹
Equity and Liabilities			
Shareholders' funds			
Equity share capital		1,20,000	1,00,000
Reserves	1	9,000	8,000
Current Liabilities			
(i) Trade Payables		8,000	5,000
(ii) Short term provision	2	7,000	4,000
		1,44,000	1,17,000
Non-current assets			
(i) PPE (at W.D.V)	3	78,000	58,000
(ii) Long Term Investments		32,000	28,000
Current Assets			
(i) Inventory		14,000	8,000
(ii) Trade Receivables		8,000	6,000
(iii) Cash & Bank		12,000	17,000
		1,44,000	1,17,000

Notes to accounts

		2022	2021
1	**Reserves and Surplus**		
	Profit & Loss A/c	9,000	8,000
2	**Short term provision**		
	provision for Income tax	7,000	4,000
3	**PPE**		
	Building	19,000	20,000
	Furniture & Fixture	34,000	22,000
	Cars	25,000	16,000
		78,000	58,000

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

	₹
Profit before tax	8,000
Income Tax	(7,000)
Profit after tax	1,000

Further Information is available:

1. Depreciation on Building for the year ₹ 1,000
2. Depreciation on Furniture & Fixtures for the year ₹ 2,000
3. Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.
4. Purchase investments for ₹ 6,000.
5. Sold investments for ₹ 10,000, these investments cost ₹ 2,000.

Prepare Cash Flow Statements for the year ended 31st March, 2022 as per AS-3 (revised) using indirect method.

(*RTP November, 2022*)

Answer

Max Ltd.

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

	(₹)	(₹)
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation ₹ (1,000 + 2,000 +5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	

	(₹)	(₹)
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(4,000)	
Net cash generated from operating activities (A)		(2,400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	
Net cash from financing activities(C)		20,000
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		12,000

Working Notes:

1. Calculation of Income taxes paid

	₹
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	4,000
	11,000
Less: Income tax liability at the end of the year	(7,000)
	4,000

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (₹)	**Car (₹)**
W.D.V. at 31.3.2022	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	-	2,000
	36,000	32,000
Less: W.D.V. at 31.3.2021	(22,000)	(16,000)
Acquisitions during 2021-2022	14,000	16,000

Question 18

The summarised Balance Sheet of Flora Limited for the year ended 31st March, 2022 and 31sl March, 2023 are as below:

Assets	**31/3/2023 (₹)**	**31/3/2022 (₹)**
Goodwill	15,000	28,000
Land	5,75,000	6,00,000
Furniture and Fixtures	48,000	44,000
Vehicles	22,000	28,000
Office Equipment	21,000	-
Long-term Investments	60,000	1,10,000
Stock-in-hand	96,000	88,000
Bills Receivables	18,150	14,500
Trade Receivables	46,000	52,000
Cash and Bank Balances	1,29,850	34,500
Total	**10,31,000**	**9,99,000**

Liabilities	**31/03/2023 (₹)**	**31/03/2022 (₹)**
Equity Share Capital	6,80,000	5,00,000
General Reserves	90,000	60,000
Profit and Loss Account	93,000	52,000
Capital Reserve	75,000	
8% Debentures of 7 100 each		3,00,000
Loan from Mr. Andrew	—	15,000
Bills Payables	11,000	13,000
Trade Payables	49,000	45,000
Creditors for Equipment	10,500	
Outstanding Expenses	4,500	3,000
Provision for Taxation	18,000	11,000
Total	**10,31,000**	**9,99,000**

Additional Information:

(i) On 1st April, 2022, one of the vehicles was sold for ₹3,000. No new purchases were made during the year.

(ii) A part of the total land was sold for ₹1,25,000 (Cost ₹1,00,000) and the balance land was revalued. Capital reserve consists of profit on revaluation of balance land. No new purchases were made during the year.

(iii) Depreciation provided during the year –

- Furniture and Fixtures ₹5,000
- Vehicles ₹2,200

(iv) Interim dividend of ₹5,000 was paid during the year.

(v) Provision for taxation for the year 2022-2023 was ₹16,000.

(vi) 8% Debentures were redeemed at par after half year interest payment on 30th September, 2022.

(vii) Part of the long-term investments were sold at a profit of~ 8,000.

(viii) Interest income received during the year on long-term investment was ₹ 6,500.

You are required to prepare Cash Flow Statement from Operating Activities for the year ended 31st March, 2023 using indirect method. (All workings should form part of the answer)

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

CHAPTER 7

Cash Flow Statements

Question 1

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

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

(1) to suppliers

(2) to employees

(3) to its subsidiaries companies

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

(iii) Dividend paid for the year

(iv) TDS on interest income earned on investments made

(v) TDS on interest earned on advance given to suppliers

(vi) Insurance claim received against loss of fixed asset by fire Discuss in the context of AS 3 Cash Flow Statement.

(*Source: Illustration 1, Study Material*)

Solution

(i) Loans and advances given and interest earned

(1)	to suppliers	Operating Cash flow
(2)	to employees	Operating Cash flow
(3)	to its subsidiary companies	Investing Cash flow

(ii) Investment made in subsidiary company and dividend received

Investing Cash flow

(iii) Dividend paid for the year

Financing Cash Outflow

(iv) TDS on interest income earned on investments made

Investing Cash Outflow

(v) TDS on interest earned on advance given to suppliers

Operating Cash Outflow

(vi) Insurance claim received of amount loss of fixed asset by fire

Extraordinary item to be shown under a separate heading as ‘Cash inflow from investing activities’.

Question 2

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

		Particulars	Notes	31.3.20X1 ₹	31.3.20X2 ₹
		Equity and Liabilities			
		Shareholder's funds			
	(a)	*Share capital*	*1*	*5,00,000*	*5,00,000*
	(b)	*Reserve & surplus*	*2*	*50,000*	*90,000*
		Non-current liabilities			
	(a)	*Long-term borrowings*	*3*	*5,00,000*	*7,50,000*
		Current liabilities			
	(a)	*Other current liabilities*	*4*	---	*5,000*
		Assets			
		Non-current assets			
	(a)	*Intangible assets*	*5*	*2,05,000*	*1,80,000*

Notes to accounts

		31.3.20X1 ₹	31.3.20X2 ₹
1	***Share Capital***		
	50,000 Equity Shares of ₹10 each	*5,00,000*	*5,00,000*
2	***Reserve & surplus***		
	Profit & Loss A/c	*50,000*	*90,000*
3	***Long-term borrowings***		
	10% Debentures	*5,00,000*	*7,50,000*
4	***Other current liabilities***		
	Unpaid interest	---	*5,000*
5	***Intangible assets***		
	Goodwill	*2,05,000*	*1,80,000*

You are required to show the related items in Cash Flow Statement.

(*Source: Illustration 2, Study Material*)

Solution

An Extract of Cash Flow Statement for the year ending 31.3.20X2

	₹
Cash flows from operating activities:	
Closing balance as per Profit & Loss A/c	90,000
Less: Opening balance as per Profit & Loss Alc	(50,000)
Add: Goodwill amortisation	25,000
Add: Interest on Debentures (Refer Note 1)	75,000
Net Cash from Operating Activities	1,40,000

Note 1: Interest has been computed on the closing balance of debentures as on 31.3.20X2 assuming that all the additions/ deletions were made, if any, at the beginning of the year.

Cash flows from financing activities:

Proceeds from debentures (Refer Working Note)	2,50,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,80,000

Working Note:

10% Debentures Account

Particulars	**₹**	***Particular***	**₹**
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,50,000
	7,50,000		7,50,000

Question 3

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

Summary of Cash Account
for the year ended March 31, 20X1

Particulars	**₹**	***Particulars***	**₹**
To Balance b/d	*1,00,000*	*By Cash Purchases*	*1,20,000*
To Cash sales	*1,40,000*	*By Trade payables*	*1,57,000*
To Trade receivables	*1,75,000*	*By Office & Selling Expenses*	*75,000*
To Trade Commission	*50,000*	*By Income Tax*	*30,000*
To Sale of Investment	*30,000*	*By Investment*	*25,000*
To Loan from Bank	*1,00,000*	*By Repayment of Loan*	*75,000*
To Interest & Dividend	*1,000*	*By Interest on loan*	*10,000*
		By Balance c/d	*1,04,000*
	5,96,000		*5,96,000*

(*Source: Illustration 3, Study Material*)

Solution

Cash Flow Statement of ……
***for the year ended March 31, 20X1*(*Direct Method*)**

Particulars	**₹**	**₹**
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

Question 4

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

Summary Cash Account

		(*₹ '000*)
Balance at 1.3.20X1		*35*
Receipts from customers		*2,783*
Issue of shares		*300*
Sale of fixed assets		*128*
Payments to suppliers	*2,047*	*3,246*

		(₹ '000)
Payments for property, plant & equipment	*230*	
Payments for overheads	*115*	
Wages and salaries	*69*	
Taxation	*243*	
Dividends	*80*	*(3,034)*
Repayments of bank loan	*250*	
Balance at 31.3.20X2		*212*

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 20X2 in accordance with AS-3 (*Revised*).

The company does not have any cash equivalents.

(*Source: Illustration 4, Study Material*)

Solution

Hills Ltd.

Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)

		(₹'000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Question 5

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 20X1 with the help of the following information:

(1) *Company sold goods for cash only.*

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

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

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

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

(6) *Dividend paid during the year ₹ 30,000.*

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

(8) *Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by ₹ 25,000.*

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

(10) *Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.20X1 ₹ 45,000).*

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

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

(13) *Plant and machinery purchased on 15th November, 20X0 for ₹ 2,50,000.*

(14) *Cash and Cash Equivalents on 31st March, 20X0 ₹ 2,00,000.*

(15) *Cash and Cash Equivalents on 31st March, 20X1 ₹ 6,07,500.*

(*Source: Illustration 5, Study Material*)

Solution

M/s MNT Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	**₹**	**₹**
Cash flows from Operating Activities		
Cash sales (₹ 3,82,500/.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from investing activities		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash used in investing activities (B)		4,70,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,07,500
Cash and cash equivalents at beginning of the period		2,00,000
Cash and cash equivalents at end of the period		6,07,500

Question 6

Ryan Ltd provides you the following information at the year-end, March 31, 20X1:

	₹	₹
Sales		*6,98,000*
Cost of Goods Sold		*(5,20,000)*
Operating Expenses		*1,78,000*
(including Depreciation Expense of ₹ 37,000)		*(1,47,000)*
		31,000

	₹	₹
Other Income / (Expenses):		
Interest Expense paid	*(23,000)*	
Interest Income received	*6,000*	
Gain on Sale of Investments	*12,000*	
Loss on Sale of Plant	*(3,000)*	
		(8,000)
		23,000
Income tax		*(7,000)*
		16,000

Information available:

	31st March 20X1	***31st March 20X0***
	₹	₹
Plant	*7,15,000*	*5,05,000*
Less: Accumulated Depreciation	*(1,03,000)*	*(68,000)*
	6,12,000	*4,37,000*
Investments (Long term)	*1,15,000*	*1,27,000*
Inventory	*1,44,000*	*1,10,000*
Trade receivables	*47,000*	*55,000*
Cash	*46,000*	*15,000*
Prepaid expenses	*1,000*	*5,000*
Share Capital	*4,65,000*	*3,15,000*
Reserves and surplus	*1,40,000*	*1,32,000*
Bonds	*2,95,000*	*2,45,000*
Trade payables	*50,000*	*43,000*
Outstanding liabilities	*12,000*	*9,000*
Income taxes payable	*3,000*	*5,000*

Analysis of selected accounts and transactions during 20X0 -X1

1. *Purchased investments for ₹ 78,000.*
2. *Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000.*
3. *Purchased plant assets for ₹ 1,20,000.*
4. *Sold plant assets that cost ₹10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.*
5. *Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 20X1.*
6. *Repaid ₹ 50,000 of bonds at face value at maturity.*
7. *Issued 15,000 shares of ₹ 10 each.*
8. *Paid cash dividends ₹ 8,000.*

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

(*Source: Illustration 6, Study Material*)

Solution

Ryan Ltd.
Cash Flow Statement
for the year ending 31st March, 20X1

	₹	₹
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in trade receivables	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in trade payables	7,000	
Increase in outstanding liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash generated from operating activities		47,000
Cash flows from investing activities		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

Note: Significant non-cash adjustments: Issued ₹ 1,00,000 of bonds at face value for acquisition of plant on 31st March, 20X1.

***Working Note:**

Income taxes paid:	₹
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000
	12,000
Less: Income tax liability at the end of the year	(3,000)
	9,000

Question 7

The balance sheets of Sun Ltd. as at 31st March 20X1 and 20X0 were as:

		Particulars	Notes	*20X1* ₹	*20X0* ₹
		Equity and Liabilities			
1		***Shareholder's funds***			
	(*a*)	*Share capital*	*1*	*60,000*	*50,000*
	(*b*)	*Reserve & surplus*	*2*	*5,000*	*4,000*
2		***Current liabilities***			
	(*a*)	*Trade Payables*		*4,000*	*2,500*
	(*b*)	*Other current liabilities*	*3*	*-*	*1,000*
	(*c*)	*Short term provision* (*provision for tax*)		*1,500*	*1,000*
		Total		***70,500***	***58,500***
		Assets			
1		***Non-current assets***			
	(*a*)	*Property, Plant & Equipment*	*4*	*39,500*	*29,000*
2		***Current assets***			
	(*a*)	*Current investments*		*2,000*	*1,000*
	(*b*)	*Inventories*		*17,000*	*14,000*
	(*c*)	*Trade receivables*		*8,000*	*6,000*
	(*d*)	*Cash & cash equivalents*	*5*	*4,000*	*8,500*
				70,500	***58,500***

Notes to accounts

		20X1 ₹	*20X0* ₹
1	***Share Capital***		
	Equity Shares of ₹10 each	*60,000*	*50,000*
2	***Reserve & surplus***		
	Profit and Loss Account	*5,000*	*4,000*
3	***Other current liabilities***		
	Dividend Payable	*-*	*1,000*
4	***Property, plant and equipment (at WDV)***		
	Building	*10,000*	*10,000*
	Fixtures	*17,000*	*11,000*

		20X1 ₹	20X0 ₹
	Vehicles	*12,500*	*8,000*
	Total	*39,500*	*29,000*
5	***Cash and cash equivalents***		
	Cash and Bank	*4,000*	*8,500*

The profit and loss statement for the year ended 31st March, 20X1 disclosed:

Particulars	₹
Profit before tax	*4,500*
Tax expense: Current tax	*(1,500)*
Profit for the year	*3,000*
Declared dividend	*(2,000)*
Retained Profit	*1,000*

Further information is available:

	Fixtures ₹	Vehicles ₹
Depreciation for the year	*1,000*	*2,500*
Disposals:		
Proceeds on disposal of vehicles	—	*1,700*
Written down value	—	*(1,000)*
Profit on disposal		*700*

Prepare a Cash Flow Statement for the year ended 31st March, 20X1.

(*Source: Illustration 7, Study Material*)

Solution

Sun Ltd.
Cash Flow Statement
for the year ended 31st March, 20X1

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid (**W.N.1**)	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of current investments	(1,000)	

	₹	₹
Purchase of vehicles (**W.N.3**)	(8,000)	
Purchase of fixtures (**W.N.3**)	(7,000)	
Net cash used in investing activities		(14,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid **(W.N.2)**	(3,000)	
Net cash generated from financing activities		7,000
Net decrease in cash and cash equivalents		(4,500)
Cash and cash equivalents at beginning of period (See Note)		8,500
Cash and cash equivalents at end of period (See Note)		4,000
Note to the Cash Flow Statement		
Cash and Cash Equivalents	*31.3.20X1*	*31.3.20X0*
Bank and Cash	4,000	8,500
Cash and cash equivalents	4,000	8,500

Working Notes:

			₹
1.	**Income taxes paid**		
	Income tax expense for the year		1,500
	Add: Income tax liability at the beginning of the year		1,000
			2,500
	Less: Income tax liability at the end of the year		(1,500)
			1,000
2.	**Dividend paid**		
	Declared dividend for the year		2,000
	Add: Amount payable at the beginning of the year		1,000
			3,000
	Less: Amount payable at the end of the year		-
			3,000
3.	**Property, plant and equipment acquisitions**		
		Fixtures	*Vehicles*
		₹	₹
	W.D.V. at 31.3.20X1	17,000	12,500
	Add back:		
	Depreciation for the year	1,000	2,500
	Disposals	—	1,000
		18,000	16,000
	Less: W.D.V. at 31.12.20X0	(11,000)	(8,000)
	Acquisitions during 20X0-20X1	7,000	8,000

Note: Current investments may not be readily convertible to a known amount of cash and may not be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

Question 8

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 20X1:

	(₹ in lakhs)
Net Profit	*25,000*
Dividend paid	*8,535*
Provision for Income tax	*5,000*
Income tax paid during the year	*4,248*
Loss on sale of assets (net)	*40*
Book value of the assets sold	*185*
Depreciation charged to the Statement of Profit and Loss	*20,000*
Profit on sale of Investments	*100*
Carrying amount of Investment sold	*27,765*
Interest income received on investments	*2,506*
Interest expenses of the year	*10,000*
Interest paid during the year	*10,520*
Increase in Working Capital (excluding Cash & Bank Balance)	*56,081*
Purchase of Fixed assets	*14,560*
Investment in joint venture	*3,850*
Expenditure on construction work in progress	*34,740*
Proceeds from calls in arrear	*2*
Receipt of grant for capital projects	*12*
Proceeds from long-term borrowings	*25,980*
Proceeds from short-term borrowings	*20,575*
Opening cash and bank balance	*5,003*
Closing cash and bank balance	*6,988*

Prepare the Cash Flow Statement for the year ended 31 March 20X1 in accordance with AS 3. (Make necessary assumptions)

(*Source: Illustration 8, Study Material*)

Solution

Star Oils Limited Cash Flow Statement
for the year ended 31st March, 20X1

		(₹ in lakhs)
Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bank balance)	(56,081)	
Cash generated from operations	1,353	

		(₹ in lakhs)
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flows from investing activities		
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Receipt of grant for capital projects Interest income on investments	12 2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,622)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	27,502
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note:

1. Book value of the assets sold	185
Less : Loss on sale of assets	(40)
Proceeds on sale	145

Question 9

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31 3.20X1

	₹'000		***₹'000***
Balance on 1.4.20X0	*50*	*Payment to Suppliers*	*2,000*
Issue of Equity Shares	*300*	*Purchase of Fixed Asset*	*200*
Receipts from Customers	*2,800*	*Overhead expense*	*200*
Sale of Fixed Assets	*100*	*Wages and Salaries*	*100*
		Taxation	*250*
		Dividend	*50*
		Repayment of Bank Loan	*300*
		Balance on 31.3.20X1	*150*
	3,250		*3,250*

(*Source: Illustration 9, Study Material*)

Solution

X Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

	₹ '000	**₹ '000**
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash generated from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at the beginning of the year		50
Cash at the end of the year		150

Question 10

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

Extract of Balance sheet

		Particulars	Notes	31.3.20X1 (₹ in lakhs)	31.3.20X0 (₹ in lakhs)
		Equity and Liabilities			
1		***Current liabilities***			
	(a)	*Trade Payables*		*250*	*230*
	(b)	*Short term Provisions*	*1*	*200*	*180*
	(c)	*Other current liabilities*	*2*	*70*	*50*
		Assets			
1		***Current assets***			
	(a)	*Inventories*		*200*	*180*
	(b)	*Trade Receivables*		*400*	*250*
	(c)	*Other current assets*	*3*	*195*	*180*

Statement of Profit and Loss of ABC Ltd. for the year ended 31st March, 20X1

	Particulars	**Notes**	**₹ in lakhs**
I	*Revenue from operations*		*4,150*
II	*Other income*	*4*	*100*
III	*Total Revenue (I + II)*		***4,250***
	***Expenses**:*		
	Purchases of Stock-in-Trade		*2,400*
	Change in inventories of finished goods		*(20)*
	Employee benefits expense		*800*
	Depreciation expense		*100*
IV	*Finance cost*	*5*	*60*
	Other expenses		*200*
	Total expenses		***3,540***
V	*Profit before tax (**III – IV**)*		*710*
VI	*Tax expense:*		
	Current tax		*200*
VII	*Profit for the year from continuing operations*		*510*

Appropriations

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

Notes to accounts:

		20X1 (₹ in lakhs)	***20X0 (₹ in lakhs)***
1	*Short term Provisions:*		
	Provision for Tax	*200*	*180*
2	*Other current liabilities:*		
	Outstanding wages	*50*	*40*
	Outstanding expenses	*20*	*10*
	Total	*70*	*50*
3	*Other current assets:*		
	Advance tax	*195*	*180*
4	*Other income:*		
	Interest and dividend	*100*	
5	*Finance cost:*		
	Interest	*60*	

Compute cash flow from operating activities using both direct and indirect method.

(*Source: Illustration 10, Study Material*)

Solution

Cash Flows from Operating Activities

	₹ in lakhs	***₹ in lakhs***
Using Direct Method Cash Receipts:		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 - 400	4,000

	₹ in lakhs	**₹ in lakhs**
Cash payments:		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables – Closing Trade payables	2,400 + 230 - 250	2,380
Wages and salaries paid	800 + 40 - 50	790
Cash expenses	200 + 10 - 20	190
Taxes paid – Advance tax		195
(B)		3,555
Cash flow from operating activities (A – B)		445
Using Indirect Method		
Profit before tax		710
Add: Non-cash items : Depreciation		100
Add: Interest : Financing cash inflow		60
Less: Interest and Dividend : Investment cash outflow		(100)
Less: Tax paid		(195)
Working capital adjustments		
Trade receivables	250 - 400 (150)	
Inventories	180 - 200 (20)	
Trade payables	250 - 230 20	
Outstanding wages	50 - 40 10	
Outstanding expenses	20- 10 10	(130)
Cash flow from operating activities		445

Question 11

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:

(1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.

(2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.

(3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.

(4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.

(5) Dividend paid during the year amounted to ₹ 11.7 crores.

(6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.

(7) ₹ 8 crores was paid towards income tax during the year.

(8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.

(9) The following balances are also provided:

	₹ in crores 1.4.20X0	***₹ in crores 31.3.20X1***
Debtors	*45*	*50*
Creditors	*21*	*23*
Bank	*6*	*18.2*

(*Source: Illustration 11, Study Material*)

Solution

Gamma Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	*₹ in crores*	*₹ in crores*
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors	49	
[45+ (135x40%) - 50]		
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers	(42)	
[21+ (55x80%) – 23]		
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	
Payments for purchase of fixed assets (21 – 10)	(11)	
Net cash generated from investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Significant non-cash items:

(a) Debenture-holders received equity shares of ₹ 15 crores on redemption of the debentures.

(b) Plant having book value of ₹ 12 crores was given in exchange of an asset costing ₹ 21 crores. The said plant was transferred at a value of ₹ 10 crores only, and ₹ 11 crores was paid for the balance dues towards the plant.

Question 12

From the following information of Mr. Zen, prepare a Cash flow statement as per AS- 3 for the year ended 31.3.20X1:

Ledger balances of Mr. Zen as of 20X0 and 20X1

	As on 1.4.20X0	*As on 1.4.20X1*
	₹	*₹*
Zen's Capital A/c	*10,00,000*	*12,24,000*
Trade payables	*3,20,000*	*3,52,000*
Mrs. Zen's loan	*2,00,000*	--
Loan from Bank	*3,20,000*	*4,00,000*
Land	*6,00,000*	*8,80,000*

	As on 1.4.20X0 ₹	As on 1.4.20X1 ₹
Plant and Machinery	*6,40,000*	*4,40,000*
Inventories	*2,80,000*	*2,00,000*
Trade receivables	*2,40,000*	*4,00,000*
Cash	*80,000*	*56,000*

Additional information:

A machine costing ₹ 80,000 (accumulated depreciation there on ₹24,000) was sold for ₹ 40,000. The provision for depreciation on 1.4.20X0 was ₹ 2,00,000 and 31.3.20X1 was ₹ 3,20,000. The net profit for the year ended on 31.3.20X1 was ₹ 3,60,000.

(*Source: Illustration 12, Study Material*)

Solution

Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.20X1

		₹
(i) Cash flow from operating activities		
Net Profit (given)		3,60,000
Adjustments for		
Depreciation on Plant & Machinery (W.N.2)	1,44,000	
Loss on Sale of Machinery (W.N.1)	16,000	1,60,000
Operating Profit before working capital changes		5,20,000
Decrease in inventories	80,000	
Increase in trade receivables	(1,60,000)	
Increase in trade payables	32,000	(48,000)
Net cash generated from operating activities		4,72,000
(ii) Cash *flow from* investing activities		
Sale of Machinery (W.N.1)	40,000	
Purchase of Land (8,80,000 – 6,00,000)	(2,80,000)	
Net cash used in investing activities		(2,40,000)
(iii) Cash *flow from* financing activities		
Repayment of Mrs. Zen's Loan	(2,00,000)	
Drawings (W.N.3)	(1,36,000)	
Loan from Bank	80,000	
Net cash used in financing activities		(2,56,000)
Net decrease in cash		(24,000)
Opening balance as on 1.4.20X0		80,000
Cash balance as on 31.3.20X1		56,000

Working Notes:

1. Plant & Machinery A/c

	₹		₹
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision for Depreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 64,000)	16,000
		By Balance c/d (4,40,000+3,20,000)	7,60,000
	8,40,000		8,40,000

2. Provision for depreciation on Plant and Machinery A/c

	₹		₹
To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c (Bal. fig.)	1,44,000
	3,44,000		3,44,000

3. To find out Mr. Zen's drawings:

	₹
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,000)
Drawings	1,36,000

Note: Students may note that in case there is an increase in the amount of debentures/ loans during the year and the interest is required to be computed, then in such a case, students may choose either to compute interest on the closing balance of the debentures or may compute interest on opening balance for full year (in case of no repayment) and proportionate interest on additions. Suitable note for assumption may be given in the solution for this.

Question 13

What is the significance of cash flow statement? Explain in brief.

(*Source: Question 6, Study Material*)

Answer

Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.

Question 14

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

(*Source: Question 7, Study Material*)

Answer

As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Question 15

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

(a) Brokerage paid on purchase of investments

(b) Underwriting commission paid

(c) Trading commission received

(d) Proceeds from sale of investment

(e) Purchase of goodwill

(f) Redemption of preference shares

(g) Rent received from property held as investment

(h) Interest paid on long-term borrowings

(i) Marketable securities (having risk of change in value)

(j) Refund of income tax received

(*Source: Question 8, Study Material*)

Answer

Classification of activities with reference to AS 3

(a)	Brokerage paid on purchased of investments	Investing Activities
(b)	Underwriting Commission paid	Financing Activities
(c)	Trading Commission received	Operating Activities
(d)	Proceeds from sale of investment	Investing Activities
(e)	Purchase of goodwill	Investing Activities
(f)	Redemption of Preference shares	Financing Activities
(g)	Rent received from property held as investment	Investing Activities
(h)	Interest paid on long term borrowings	Financing Activities
(i)	Marketable securities	Not a Cash equivalent
(j)	Refund of Income tax received	Operating activities

Question 16

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?

(i) 10% Debentures issued: As on 01-04-20X1 ₹ 1,10,000
As on 31-03-20X2 ₹ 77,000

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

(iii) Unpaid Interest on Debentures: As on 01-04-20X1 ₹ 275
As on 31-03-20X2 ₹ 1,175

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

(v) 10% Bonds (Investments): As on 01-04-20X1 ₹ 3,50,000
As on 31-03-20X2 ₹ 3,50,000

(vi) Accrued Interest on Investments: As on 31-03-20X2 ₹ 10,500

(*Source: Question 9, Study Material*)

Answer

Cash Flow Statement of M/s Gagan Ltd. for the year ended March 31, 20X2

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

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

Question 17

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1:

		Particulars	*Notes*	31st March, *20X1*	31st March, *20X0*
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		10,00,000	8,00,000
	B	Reserves and Surplus	1	3,00,000	2,10,000
2		**Non-current liabilities**			
		Long term borrowings	2	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		7,00,000	8,20,000
	B	Other current liabilities	3	-	1,00,000
	C	Short term provision (provision for tax)		1,00,000	70,000
		Total		**23,00,000**	**20,00,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	4	13,00,000	9,00,000
	B	Non-Current Investments		1,00,000	-
2		**Current assets**			
	A	Inventories		4,00,000	2,00,000
	B	Trade receivables		5,00,000	7,00,000
	C	Cash and Cash equivalents		-	2,00,000
		Total		**23,00,000**	**20,00,000**

Notes to accounts

No.	Particulars	31st March, *20X1*	31st March, *20X0*
1	**Reserves and Surplus**		
	Revenue reserve	2,00,000	1,50,000
	Profit and Loss account	1,00,000	60,000
	Total	**3,00,000**	**2,10,000**
2	**Long term borrowings**		
	Debentures	2,00,000	--
3.	**Other current liabilities**		
	Dividend payable	-	1,00,000
4	**Property, plant and equipment**		
	Plant and machinery	7,00,000	5,00,000
	Land and building	6,00,000	4,00,000
	Net carrying value	**13,00,000**	**9,00,000**

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

(ii) At the year end, one old machine costing ₹ 50,000 (WDV ₹ 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.

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

(iv) Construction of the building got completed on 31.03.20X1 and hence no depreciation may be charged on the same.

Prepare Cash flow Statement.

(*Source: Question 10, Study Material*)

Answer

Cash Flow Statement of Grow More Ltd for the year ended 31st March, 20X1

Cash Flow from Operating Activities

		₹
Increase in balance of Profit and Loss Account (1,00,000 – 60,000)	40,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	2,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	(1,20,000)	
Cash generated from operations	1,60,000	
Income tax paid	(50,000)	
Net Cash generated from operating activities		1,10,000

Cash Flow from Investing Activities

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

Cash Flow from Financing activities

Proceeds from issue of shares (10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	(1,00,000)	
Net cash generated from financing activities		3,00,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,00,000
Cash and Cash equivalents at the end of the year		Nil

Working Notes:

1. Provision for taxation account

		₹			₹
To	Cash (Paid)	50,000	By	Balance b/d	70,000
To	Balance c/d	1,00,000	By	Profit and Loss A/c (Balancing figure)	80,000
		1,50,000			1,50,000

2. Plant and Machinery account

		₹			₹
To	Balance b/d	5,00,000	By	Depreciation	1,25,000
To	Profit and Loss A/c (profit on sale of machine)	15000			
To	Cash (Balancing figure)	3,45,000	By	Cash (sale of machine)	35,000
			By	Balance c/d	7,00,000
		8,60,000			8,60,000

Question 18

From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

		Particulars	***Notes***	***31st March 20X1 ₹***	***31st March 20X0 ₹***
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	6,00,000	7,00,000
	B	Reserves and Surplus	2	4,20,000	3,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		1,15,000	1,10,000
	B	Other current liabilities	4	30,000	80,000
	C	Short term provision (provision for tax)		95,000	60,000
		Total		**14,60,000**	**12,50,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	9,15,000	7,00,000
	B	Non-Current Investments		50,000	80,000
2		**Current assets**			
	A	Inventories		95,000	90,000
	B	Trade receivables		2,50,000	2,25,000
	C	Cash and Cash equivalents		50,000	90,000
	D	Other Current assets		1,00,000	65,000
		Total		**14,60,000**	**12,50,000**

Notes to accounts

No.			**31st March, *20X1***	**31st March, *20X0***
1.	**Share capital**			
	Equity share capital		6,00,000	5,00,000
	10% Redeemable Preference share capital		--	2,00,000
	Total		**6,00,000**	**7,00,000**

No.			31st March, *20X1*	31st March, *20X0*
2	**Reserves and Surplus**			
	Capital redemption reserve		1,00,000	-
	Capital reserve		70,000	-
	General reserve		1,50,000	2,50,000
	Profit and Loss account		1,00,000	50,000
	Total		**4,20,000**	**3,00,000**
3	**Long term borrowings**			
	9% Debentures		2,00,000	--
4.	**Other current liabilities**			
	Dividend payable		-	60,000
	Liabilities for expenses		30,000	20,000
	Total		**30,000**	**80,000**
5	**Property, plant and equipment**			
	Plant and machinery		7,65,000	5,00,000
	Land and building		1,50,000	2,00,000
	Net carrying value		**9,15,000**	**7,00,000**

Additional Information:

(i) A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.

(ii) On 1st April, 20X0 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹1 lakh were issued at par as part consideration for plant of ₹4.5 lakhs acquired.

(iii) Part of the investments (Cost – ₹50,000) was sold for ₹70,000.

(iv) Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.

(v) Interim dividend was declared and paid @ 15% during the current year.

(vi) Income-tax liability for the current year was estimated at ₹1,35,000.

(vii) Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.

(*Source: Question 11, Study Material*)

Answer

Cash Flow Statement of Ryan Limited For the year ended 31st March, 20X1

	₹	₹
Cash flow from operating activities Net Profit before taxation (W.N.1)	2,75,000	
Adjustment for		
Depreciation (W.N.3)	1,35,000	
Profit on sale of land	(30,000)	
Profit on sale of plant (W.N.3)	(40,000)	
Profit on sale of investments (W.N.4)	(20,000)	
Interest on debentures (2,00,000 X 9%)	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	
Increase in trade receivables	(25,000)	
Increase in Other current assets (W.N.9) Increase in Trade payables	(35,000) 5,000	

	₹	₹
Increase in liabilities for expenses	10,000	
Cash generated from operations	2,88,000	
Income taxes paid (W.N.8)	(1,00,000)	
Net cash generated from operating activities		1,88,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.2)	1,50,000	
Proceeds from sale of plant (W.N.3)	90,000	
Proceeds from sale of investments (W.N.4)	70,000	
Purchase of plant (W.N.3)	(3,50,000)	
Purchase of investments (W.N.4)	(25,000)	
Pre-acquisition dividend received (W.N.4)	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares (6,00,000 – 5,00,000)	1,00,000	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(1,50,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(1,68,000)
Net decrease in cash and cash equivalents		(40,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		50,000

Working Notes:

1.

	₹
Net profit before taxation	
Retained profit	1,00,000
Less: Balance as on 31.3.20X0	(50,000)
	50,000
Provision for taxation	1,35,000
Dividend	90,000
	2,75,000

2. **Land and Building Account**

		₹			₹
To	Balance b/d	2,00,000	By	Cash (Sale)	1,50,000
To	Profit and Loss A/c (Profit on sale)	30,000	By	Balance c/d	1,50,000
To	Capital reserve (Revaluation profit)	70,000			
		3,00,000			3,00,000

3. Plant and Machinery Account

		₹			₹
To	Balance b/d	5,00,000	By	Cash (Sale)	90,000
To	Profit and loss account	40,000	By	Depreciation	1,35,000
To	Debentures	1,00,000	By	Balance c/d	7,65,000
To	Bank	3,50,000			
		9,90,000			9,90,000

4. Investments Account

		₹			₹
To	Balance b/d	80,000	By	Cash (Sale)	70,000
To	Profit and loss account	20,000	By	Dividend	
To	Bank (Balancing figure)	25,000		(Pre-acquisition)	5,000
			By	Balance c/d	50,000
		1,25,000			1,25,000

5. Capital Reserve Account

		₹			₹
To	Balance c/d	70,000	By	Profit on revaluation of land	70,000
		70,000			70,000

6. General Reserve Account

		₹			₹
To	Capital redemption reserve	1,00,000	By	Balance b/d	2,50,000
To	Balance c/d	1,50,000			
		2,50,000			2,50,000

7. Dividend payable Account

		₹			₹
To	Bank (Balancing figure)	1,50,000	By	Balance b/d	60,000
To	Balance c/d	-	By	Profit and loss account	90,000
		1,50,000			1,50,000

8. Provision for Taxation Account

		₹			₹
To	Bank (Balancing figure)	1,00,000	By	Balance b/d	60,000
To	Balance c/d	95,000	By	Profit and loss account	1,35,000
		1,95,000			1,95,000

9. Other Current Assets Account

		₹			₹
To	Balance b/d	65,000			
To	Bank (Balancing figure)	35,000	By	Balance c/d	1,00,000
		1,00,000			1,00,000

Question 19

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

			Notes	₹ 31st March 20X0	₹ 31st March 20X1
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	16,00,000	18,80,000
	B	Reserves and Surplus	2	8,40,000	11,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	4,00,000	2,80,000
3		**Current liabilities**			
	A	Other current liabilities	4	6,00,000	5,20,000
	B	Short term provision (provision for tax)		3,60,000	3,40,000
		Total		**38,00,000**	**41,20,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	22,80,000	26,40,000
	B	Non-Current Investments		4,00,000	3,20,000
2		**Current assets**			
	A	Cash and Cash equivalents		10,000	10,000
	B	Other Current assets		11,10,000	11,50,000
		Total		**38,00,000**	**41,20,000**

Notes to accounts

No.	Particulars		31st March, 20X0	31st March, 20X1
1.	**Share capital**			
	Equity share capital		12,00,000	16,00,000
	10% Preference share capital		4,00,000	2,80,000
	Total		**16,00,000**	**18,80,000**
2	**Reserves and Surplus**			
	General reserve		6,00,000	7,60,000
	Profit and Loss account		2,40,000	3,40,000
	Total		**8,40,000**	**11,00,000**
3	**Long term borrowings**			
	9% Debentures		4,00,000	2,80,000
	Total		**4,00,000**	**2,80,000**
4.	**Other current liabilities**			
	Dividend payable		1,20,000	-
	Current Liabilities		4,80,000	5,20,000
	Total		**6,00,000**	**5,20,000**

No.	Particulars		31st March, *20X0*	31st March, *20X1*
5	**Property, plant and equipment**			
	Property, plant and equipment		32,00,000	38,00,000
	Less: Depreciation		(9,20,000)	(11,60,000)
	Net carrying value		**22,80,000**	**26,40,000**

Additional information:

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

(ii) The company also decided to write off another item of property, plant and equipment costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

(iii) Depreciation on property, plant and equipment provided ₹ 3,60,000.

(iv) Company sold some investment at a profit of ₹ 40,000.

(v) Debentures and preference share capital redeemed at 5% premium.

(vi) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was ₹ 2,16,000. The inventory on 31.3.20X1 was correctly valued at ₹ 3,00,000.

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

(*Source: Question 12, Study Material*)

Answer

New Light Ltd.

Cash Flow Statement for the year ended 31st March, 20X1

A.	Cash Flow from operating activities	₹	₹
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [₹3,40,000 – (₹2,40,000 + ₹24,000)]	76,000	
	Transfer to general reserve	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	5,76,000	
	Adjustments for:		
	Depreciation	3,60,000	
	Loss on sale of property, plant and equipment	20,000	
	Decrease in value of property, plant and equipment	16,000	
	Profit on sale of investment	(40,000)	
	Premium on redemption of preference share capital	6,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	9,44,000	
	Increase in current liabilities (₹5,20,000 – ₹4,80,000)	40,000	
	Increase in other current assets [₹11,50,000 – (₹ 11,10,000 + ₹24,000)]	(16,000)	
	Cash generated from operations	9,68,000	
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		6,08,000

B.	**Cash Flow from investing activities**		
	Purchase of property, plant and equipment (W.N.3)	(8,56,000)	
	Proceeds from sale of property, plant and equipment (W.N.3)	1,00,000	
	Proceeds from sale of investments (W.N.2)	1,20,000	
	Net Cash used in investing activities		(6,36,000)
C.	**Cash Flow from financing activities**		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital (₹1,20,000 + ₹6,000)	(1,26,000)	
	Redemption of debentures (₹ 1,20,000 + ₹ 6,000)	(1,26,000)	
	Dividend paid	(1,20,000)	
	Net Cash generated from financing activities		28,000
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

Working Notes:

1. Revaluation of inventory will increase opening inventory by ₹ 24,000. 2,16,000/90 x 10 = ₹ 24,000

Therefore, opening balance of other current assets would be as follows:

₹ 11,10,000 + ₹ 24,000 = ₹ 11,34,000

Due to under valuation of inventory, the opening balance of profit and loss account be increased by ₹ 24,000.

The opening balance of profit and loss account after revaluation of inventory will be ₹ 2,40,000 + ₹ 24,000 = ₹ 2,64,000

2. Investment Account

		₹			₹
To	Balance b/d Profit and Loss A/c	4,00,000	By	Bank A/c (balancing figure being investment sold)	1,20,000
To	(Profit on sale of investment)	40,000	By	Balance c/d	3,20,000
		4,40,000			4,40,000

3. Property, Plant and Equipment Account

		₹			₹	₹
To	Balance b/d	32,00,000	By	Bank A/c (sale of assets)	1,00,000	
To	Bank A/c (balancing figure being assets purchased)	8,56,000	By	Accumulated depreciation A/c	80,000	
			By	Profit and loss A/c(loss on sale of assets)	20,000	2,00,000
			By	Accumulated depreciation A/c	40,000	
			By	Profit and loss A/c (assets written off)	16,000	56,000
			By	Balance c/d		38,00,000
		40,56,000				40,56,000

4. **Accumulated Depreciation Account**

		₹			₹
To	Property, plant and equipment A/c	80,000	By	Balance b/d	9,20,000
To	Property, plant and equipment A/c	40,000	By	Profit and loss A/c (depreciation for the year)	3,60,000
To	Balance c/d	11,60,000			
		12,80,000			12,80,000

Question 20

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

		Particulars	*Notes*	*₹ 31st March 20X0*	*₹ 31st March 20X1*
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		50,00,000	50,00,000
	B	Reserves and Surplus		26,50,000	36,90,000
2		**Non-current liabilities**			
		Long term borrowings	1	-	9,00,000
3		**Current liabilities**			
	A	Short-term borrowings (Bank loan)		1,50,000	3,00,000
	B	Trade payables		8,80,000	8,20,000
	C	Other current liabilities	2	4,80,000	2,70,000
		Total		**91,60,000**	**1,09,80,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	3	21,20,000	32,80,000
2		**Current assets**			
	A	Current Investments		11,80,000	15,00,000
	B	Inventory		20,10,000	19,20,000
	C	Trade receivables	4	22,40,000	26,40,000
	D	Cash and Cash equivalents		15,20,000	15,20,000
	E	Other Current assets (Prepaid expenses)		90,000	1,20,000
		Total		**91,60,000**	**1,09,80,000**

Notes to accounts

No.	Particulars		*₹20X0*	*20X1*
1	**Long term borrowings**			
	9% Debentures		-	9,00,000
	Total		**-**	**9,00,000**
2.	**Other current liabilities**			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		**4,80,000**	**2,70,000**

No.	Particulars		₹20X0	20X1
3	**Property, plant and equipment**			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		**21,20,000**	**32,80,000**
4	**Trade receivables**			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000)	(1,90,000)
	Total		**22,40,000**	**26,40,000**

Additional Information:

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

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

(*Source: Question 13, Study Material*)

Answer

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities		₹	₹
Net Profit		10,40,000	
Add: Adjustment For Depreciation (₹7,90,000 – ₹6,10,000)		1,80,000	
Add: Adjustment for Provision for Doubtful Debts (₹ 4,20,000 – ₹1,50,000)		2,70,000	
Operating Profit Before Working Capital Changes		14,90,000	
Add: Decrease in Inventories (₹ 20,10,000 – ₹ 19,20,000)		90,000	
Less: Increase in Current Assets		15,80,000	
Trade Receivables (₹ 30,60,000 – ₹23,90,000)	6,70,000		
Prepaid Expenses (₹ 1,20,000 – ₹90,000)	30,000		
Decrease in Current Liabilities:			
Trade Payables (₹ 8,80,000 – ₹ 8,20,000)	60,000		
Expenses Outstanding (₹ 3,30,000 – ₹ 2,70,000)	60,000	(8,20,000)	
Net Cash generated from Operating Activities			7,60,000
Cash Flows from Investing Activities			
Investment in Current Investments Purchase of Plant & Machinery (₹ 40,70,000 – ₹ 27,30,000)		(3,20,000) (13,40,000)	
Net Cash Used in Investing Activities			(16,60,000)
Cash Flows from Financing Activities			
Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000)		1,50,000	
Issue of Debentures		9,00,000	
Payment of Dividend		(1,50,000)	
Net Cash Used in Financing Activities			9,00,000
Net Increase in Cash During the Year			-
Add: Cash and Cash Equivalents as on 1.4.20X0			15,20,000
Cash and Cash Equivalents as on 31.3.20X1			15,20,000

Note:

1. Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

QUESTION BANK

Question 21

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

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

(*May 2019*) (*10 Marks*)

Answer

(i) **PQR Ltd.**

Cash Flow Statement for the year ended 31st March, 2019 (Using direct method)

Particulars	₹	₹
Cash flows from Operating Activities		
Cash sales (₹ 3,75,000/25%)		15,00,000
Less: Cash payments for trade payables	(6,10,000)	
Wages Paid	(5,55,000)	
Office and selling expenses ₹ (35,000 + 15,000)	(50,000)	(12,15,000)
Cash generated from operations before taxes		2,85,000
Income tax paid		(55,000)
Net cash generated from operating activities (A)		2,30,000
Cash flows from Investing activities		
Sale of investments ₹ (8,20,000 + 20,000)	8,40,000	
Payments for purchase of Plant & machinery	(3,50,000)	
Net cash used in investing activities (B)		4,90,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,05,000)	
Dividend paid (including dividend distribution tax)	(40,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,75,000
Cash and cash equivalents at beginning of the period		2,25,000
Cash and cash equivalents at end of the period		7,00,000

(ii) 'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year before tax and extraordinary items		2,80,000
Add: Non-Cash and Non-Operating Expenses:		
Depreciation		60,000
Interest Paid		5,000
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Investments		(20,000)
Net Profit after Adjustment for Non-Cash Items	15,000	3,25,000
Less: Decrease in trade payables	25,000	
Increase in inventory		(40,000)
Cash generated from operations before taxes		2,85,000

Working Note:

Calculation of net profit earned during the year

	₹	₹
Gross profit		3,75,000
Less: Office expenses, selling expenses	50,000	
Depreciation	60,000	
Interest paid	5,000	(1,15,000)
		2,60,000
Add: Profit on sale of investments		20,000
Net profit before tax		2,80,000

Question 22

Preet Ltd. presents you the following information for the year ended 31st March, 2019:

		(₹ in lacs)
(i)	Net profit before tax provision	72,000
(ii)	Dividend paid	20,404
(iii)	Income-tax paid	10,200
(iv)	Book value of assets sold	444
	Loss on sale of asset	96
(v)	Depreciation debited to P & L account	48,000
(vi)	Capital grant received-amortized to P & L A/c	20
(vii)	Book value of investment sold	66,636
	Profit on sale of investment	240
(viii)	Interest income from investment credited to P & L A/c	6,000
(ix)	Interest expenditure debited to P & L A/c	24,000
(x)	Interest actually paid (Financing activity)	26,084
(xi)	Increase in working capital [Excluding c ash and bank balance]	1,34,580
(xii)	Purchase of fixed assets	44,184
(xiii)	Expenditure on construction work	83,376
xiv)	Grant received for capital projects	36
(xv)	Long term borrowings from banks	1,11,732
(xvi)	Provision for Income-tax debited to P & L A/c	12,000
	Cash and bank balance on 1.4.2018	12,000
	Cash and bank balance on 31.3.2019	16,000

You are required to prepare a cash flow statement as per AS-3 (Revised).

(*RTP May 2019*)

Answer:

Cash Flow Statement as per AS 3

Cash flows from operating activities:		***₹ in lacs***
Net profit before tax provision		72,000
Add: Non c ash expenditures:		
Depreciation	48,000	
Loss on sale of assets	96	
Interest expenditure (non-operating activity)	24,000	72,096
		1,44,096
Less: Non cash income		
Amortisation of capital grant received	(20)	
Profit on sale of investments (non-operating income)	(240)	
Interest income from investments (non-operating income)	(6,000)	6,260
Operating profit		1,37,836
Less: Increase in working capital		(1,34,580)
Cash from operations		3,256
Less: Income tax paid		(10,200)
Net cash generated from operating activities		(6,944)
Cash flows from investing activities:		
Sale of assets (444 – 96)	348	
Sale of investments (66,636+240)	66,876	
Interest income from investments	6,000	
Purchase of fixed assets	(44,184)	
Expenditure on construction work	(83,376)	
Net cash used in investing activities		(54,336)
Cash flows from financing activities:		
Grants for capital projects	36	
Long term borrowings	1,11,732	
Interest paid	(26,084)	
Dividend paid	(20,404)	
Net c ash from financing activities		65,280
Net increase in c ash		4,000
Add: Cash and bank balance as on 1.4.2018		12,000
Cash and bank balance as on 31.3.2019		16,000

Question 23

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 were summarised as follows:

	2018 (₹)	**2017 (₹)**
Equity share capital	1,20,000	1,00,000
Reserves:		
Profit and Loss Account	9,000	8,000
Current Liabilities:		
Trade Payables	8,000	5,000
Income tax payable	3,000	2,000
Declared Dividends	4,000	2,000
	1,44,000	1,17,000
Fixed Assets (at W.D.V):		
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	25,000	16,000
Long Term Investments	32,000	28,000

	2018 (₹)	2017 (₹)
Current Assets:		
Inventory	14,000	8,000
Trade Receivables	8,000	6,000
Cash & Bank	12,000	17,000
	1,44,000	1,17,000

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

	₹
Profit before tax	8,000
Income Tax	(3,000)
Profit after tax	5,000
Declared Dividends	(4,000)
Retained Profit	1,000

Further Information is available:

1. Depreciation on Building ₹ 1,000.
2. Depreciation on Furniture & Fixtures for the year ₹ 2,000.
3. Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.
4. Purchase investments for ₹ 6,000.
5. Sold investments for ₹ 10,000, these investments cost ₹ 2,000.
   You are required to prepare Cash Flow Statement as per AS-3 (revised) using indirect method.

(*RTP November 2018*)

Answer:

Harry Ltd.
Cash Flow Statement
for the year ended 31st March, 2018

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation (1,000 + 2,000 + 5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(2,000)	
Net cash generated from operating activities (A)		(400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	
Dividends paid*	(2,000)	
Net cash from financing activities(C)		18,000
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		12,000

*Dividend declared for the year ended 31st March, 2017 amounting ₹ 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

Working Notes:

1. Calculation of Income taxes paid

	₹
Income tax expense for the year	3,000
Add: Income tax liability at the beginning of the year	2,000
	5,000
Less: Income tax liability at the end of the year	(3,000)
	2,000

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (₹)	Car (₹)
W.D.V. at 31.3.2018	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	—	2,000
	36,000	32,000
Less: W.D.V. at 31.3. 2017	(22,000)	(16,000)
Acquisitions during 2016-2018	14,000	16,000

Question 24

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement for the year ended 31st March, 2021:

	31.03.2021 (₹)	31.03.2020 (₹)
Share Capital	14,00,000	11,20,000
General Reserve	5,60,000	3,50,000
Profit and Loss Account	1,40,000	84,000
Debentures	2,80,000	-
Provision for taxation	1,40,000	98,000
Trade payables	9,80,000	11,48,000
Plant and Machinery	9,80,000	7,00,000
Land and Building	8,40,000	5,60,000
Investments	1,40,000	-
Trade receivables	7,00,000	9,80,000
Inventories	5,60,000	2,80,000
Cash in hand and at Bank	2,80,000	2,80,000

(i) Depreciation @ 20% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing 70,000 (WDV 28,000) was sold for ₹ 49,000. Purchase of machinery was also made at the year end.

(iii) ₹ 70,000 was paid towards Income tax during the year.

(iv) Land & Building is not subject to any depreciation. Expenses on renovation of building amount ₹2,80,000 were incurred during the year.

Prepare Cash Flow Statement.

(RTP May, 2022)

Answer

Omega Ltd.

Cash Flow Statement for the year ended 31st March, 2021

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account	56,000	
Provision for taxation	1,12,000	
Transfer to General Reserve	2,10,000	
Depreciation	1,40,000	
Profit on sale of Plant and Machinery	(21,000)	
Operating Profit before Working Capital changes	4,97,000	
Increase in Inventories	(2,80,000)	
Decrease in Trade receivables	2,80,000	

Decrease in Trade payables	(1,68,000)	
Cash generated from operations	3,29,000	
Income tax paid	(70,000)	
Net Cash from operating activities		2,59,000
Cash Flow from Investing Activities		
Purchase of plant & machinery	(4,48,000)	
Expenses on building	(2,80,000)	
Increase in investments	(1,40,000)	
Sale of old machine	49,000	
Net Cash used in investing activities		(8,19,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	2,80,000	
Proceeds from issue of debentures	2,80,000	
Net cash from financing activities		5,60,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,80,000
Cash and Cash equivalents at the end of the year		2,80,000

Working Notes:

Provision for taxation account

		₹			₹
To	Cash (Tax Paid)	70,000	By	Balance b/d	98,000
To	Balance c/d	1,40,000	By	Profit and Loss A/c (Balancing figure)	1,12,000
		2,10,000			2,10,000

Plant and Machinery account

		₹			₹
To	Balance b/d	7,00,000	By	Depreciation	1,40,000
To	Profit and Loss A/c (profit on sale of machine)	21,000			
To	Cash (Balancing figure)	4,48,000	By	Cash (sale of machine)	49,000
			By	Balance c/d	9,80,000
		11,69,000			11,69,000

Question 25

Classify the following activities as

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

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

(*May 2018*) (*4 Marks*)

Answer:

(a) Operating Activities: Items 1 and 5.
(b) Investing Activities: Items 3, 7 and 9
(c) Financing Activities: Items 4, 6, 8 and 10
(d) Cash Equivalent: 2

Question 26

A company provides you the following information:

(i) Total sales for the year were ₹ 398 crores out of which cash sales amounted to ₹ 262 crores.

(ii) Receipts from credit customers during the year, aggregated ₹ 134 crores.

(iii) Purchases for the year amounted to ₹ 220 crores out of which credit purchase was 80%.
Balance in creditors as on
1.4.2016 ₹ 84 crores
31.3.2017 ₹ 92 crores

(iv) Suppliers of other consumables and services were paid ₹ 19 crores in cash.

(v) Employees of the enterprises were paid 20 crores in cash.

(vi) Fully paid preference shares of the face value of ₹ 32 crores were redeemed. Equity shares of the face value of ₹ 20 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of ₹ 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) ₹ 26 crores were paid by way of income tax.

(ix) A new machinery costing ₹ 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹ 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 15 crores. The balance was paid in cash to the vendor.

(x) Investment costing ₹ 18 cores were sold at a loss of ₹ 2 crores.

(xi) Dividends amounting ₹ 15 crores (including dividend distribution tax of ₹ 2.7 crores) was also paid.

(xii) Debenture interest amounting ₹ 2 crore was paid.

(xiii) On 31st March 2016, Balance with Bank and Cash on hand was ₹ 2 crores.

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method).

(*RTP May 2018*)

Answer:

Cash flow statement (using direct method) for the year ended 31st March, 2017

	(₹ in crores)	(₹ in crores)
Cash flow from operating activities		
Cash sales	262	
Cash collected from credit customers	134	
Less: Cash paid to suppliers for goods & services		
and to employees (Refer Working Note)	(251)	
Cash from operations	145	
Less: Income tax paid	(261	
Net cash generated from operating activities		119
Cash flow from investing activities		
Net Payment for purchase of Machine (25 - 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities		
Redemption of Preference shares	(32)	
Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net cash used in financing activities		(25)
Net increase in cash and cash equivalents		100
Add: Cash and cash equivalents as on 1.04.2016		2
Cash and cash equivalents as on 31.3.2017		102

Working Note:

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

	(₹ in crores)
Opening Balance in creditors Account	84
Add: Purchases (220 x .8)	176
Total	260
Less: Closing balance in Creditors Account	92
Cash paid to suppliers of goods	168
Add: Cash purchases (220 x .2)	44
Total cash paid for purchases to suppliers (a)	212
Add: Cash paid to suppliers of other consumables and services (b)	19
Add: Payment to employees (c)	20
Total cash paid to suppliers of goods & services and to employees [(a) + (b) + (c)]	251

Question 27

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

(a) Purchase of Machinery.
(b) Proceeds from issuance of equity share capital
(c) Cash Sales.
(d) Proceeds from long-term borrowings.
(e) Proceeds from Trade receivables.
(f) Cash receipts from Trade receivables.
(g) Trading Commission received.
(h) Purchase of investment.
(i) Redemption of Preference Shares.
(j) Cash Purchases.

(*MTP October, 2018*) (*5 Marks*)

Answer:

(i) Operating Activities: c, e, f, g, j.
(ii) Investing Activities: a, h.
(iii) Financing Activities: b, d, i.

Question 28

Prepare Cash Flow from Investing Activities of Creative Furnishings Limited for the year ended 31-3-2017.

Particulars	**₹**
Plant acquired by the issue of 8% Debentures	1,56,000
Claim received for loss of plant in fire	49,600
Unsecured loans given to subsidiaries	4,85,000
Interest on loan received from subsidiary companies	82,500
Pre-acquisition dividend received on investment made	62,400
Debenture interest paid	1,16,000
Term loan repaid	4,25,000
Interest received on investment	68,000
(TDS of ₹ 8.200 was deducted on the above interest)	
Book value of plant sold (loss incurred ₹ 9,600)	84,000

(*MTP April, 2018*) (*5 Marks*)

Answer:

Cash Flow Statement from Investing Activities of
Creative Furnishings Limited for the year ended 31-03-2017

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

Note:

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

Question 29

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

Balance Sheets

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

Note 1: Share Capital

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

Note 2: Reserves and Surplus

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000
Capital Reserve	25,000	
Total	82,000	38,000

Note 3: Current Liabilities

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

Note 4: Tangible Assets

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

Additional Information:

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

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

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

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

(v) An interim dividend of ₹ 10,000 including Dividend Distribution Tax has been paid.

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

(vii) Amount of provision for tax existing on 31 3.2018 was paid during the year 2018 -19.

(*RTP November 2019*)

Answer

Cash flow Statement for the year ending 31st March, 2019

		Particulars	₹	₹
1		**Cash Flow from Operating Activities**		
	A.	Closing balance as per Profit and Loss Account		27,000
		Less: Opening balance as per Profit and Loss Account		(18,000)
		Add: Dividend declared during the year		37,000
		Add: Interim dividend paid during the year		10,000
		Add: Transfer to reserve		10,000
		Add: Provision for Tax		32,000
	B.	Net profit before taxation, and extra-ordinary item		98,000
	C.	*Add:* Items to be added		
		Depreciation	18,000	
		Loss on sale of Plant	3,000	
		Goodwill written off	13,000	34,000
	D.	*Less:* Dividend Income		(1,500)
	E.	Operating profit before working capital changes [B + C - D]		1,30,500
	F.	*Add:* Decrease in Current Assets and Increase in Current Liabilities		
		Decrease in Inventories	7,000	
		Increase in Trade Payables	21,000	28,000
	G.	*Less:* Increase in Trade Receivables		(33,000)
	H	Cash generated from operations (E+F-G)		1,25,500
	I	Less: Income taxes paid		(28,000)
	J	Net Cash from (used in) operating activities		97,500
II.		**Cash Flows from investing activities:**		
		Purchase of Plant		(1,34,000)
		Sale of Land		50,000
		Sale of plant		12,000
		Purchase of investments		(25,600)
		Dividend Received		2,100
		Net cash used in investing activities		(95,500)
III.		**Cash Flows from Financing Activities:**		
		Proceeds from issue of equity share capital		1,00,000
		Redemption of preference shares		(50,000)
		Interim Dividend (inclusive of DDT) paid		(10,000)
		Final dividend (inclusive of DDT) paid		(27,000)
		Net cash from financing activities		13,000
IV.		**Net increase in cash and cash equivalents (I+II+III)**		15,000
V.		**Cash and cash equivalents at beginning of period**		17,000
VI.		**Cash and cash equivalents at end of period (IV+V)**		32,000

1. Land and Building Account

Particulars	**₹**	***Particulars***	**₹**
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

2. Plant and Machinery Account

Particulars	**₹**	***Particulars***	**₹**
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss on sale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

3. Investments Account

Particulars	**₹**	***Particulars***	**₹**
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To bank A/c (Purchase	25,600	By Balance c/d	35,000
	35,600		35,600

Question 30

J Ltd. presents you the following information for the year ended 31st March, 2019:

		(₹ in lacs)
(i)	Net profit before tax provision	36,000
(ii)	Dividend paid	10,202
(iii)	Income-tax paid	5,100
(iv)	Book value of assets sold	222
	Loss on sale of asset	48
(v)	Depreciation debited to P & L account	24,000
(vi)	Capital grant received - amortized to P & L A/c	10
(vii)	Book value of investment sold	33,318
	Profit on sale of investment	120
(viii)	Interest income from investment credited to P & L A/c	3,000
(ix)	Interest expenditure debited to P & L A/c	12,000
(x)	Interest actually paid (Financing activity)	13,042
(xi)	Increase in working capital	67,290
	[Excluding cash and bank balance]	
(xii)	Purchase of fixed assets	22,092
(xiii)	Expenditure on construction work	41,688
(xiv)	Grant received for capital projects	18
(XV)	Long term borrowings from banks	55,866
(xvi)	Provision for Income-tax debited to P & L A/c	6,000
	Cash and bank balance on 1.4.2018	6,000
	Cash and bank balance on 31.3.2019	8,000

You are required to prepare a cash flow statement as per AS-3 (Revised). [*MTP October, 2019, 12 marks*]

Answer

Cash Flow Statement as per AS 3

		₹ in lacs
Cash flows from operating activities:		36,000
Net profit before tax provision		
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048
		72,048

		₹ in lacs
Less: Non cash income		
Amortisation of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Sale of assets (222-48)	174	
Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of fixed assets	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,168)
Cash flows from financing activities:		
Grants for capital projects	18	
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,640
Net increase in cash		2,000
Add: Cash and bank balance as on 1.4.2018		6,000
Cash and bank balance as on 31.3.2019		8,000

Question 31

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

Particulars	Amount (₹)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received form associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of ₹8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable within 3 mouths	3,00,000
Book value of plant & machinery sold (loss incurred ₹9,600)	90,000

(*November 2019*) (*5 Marks*)

Answer

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

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

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.
3. The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

Question 32

Prepare Cash Flow Statement of Light Ltd. for the year ended 31st March, 2020, in accordance with AS 3 (Revised) from the following Summary Cash Account:

Summary Cash Account

	₹ in '000	₹ in '000
Balance as on 01.04.2019		315
Receipts from Customers		24,894
Sale of Investments (Cost ₹ 1,35,000)		153
Issue of Shares		2,700
Sale of Fixed Assets		1,152
Payment to Suppliers	18,306	29,214
Purchase of Investments	117	
Purchase of Fixed Assets	2,070	,
Wages & Salaries	621	
Selling & Administration Expenses	1,035	
Payment of Income Tax	2,187	
Payment of Dividends	720	
Repayment of Bank Loan	2,250	
Interest paid on Bank Loan	450	(27,756)
Balance as on 31.03.2020		1,458

(*RTP, November 2020*)

Answer

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

Cash flows from operating activities	(₹ '000)	(₹ '000)
Cash receipts from customers	24,894	
Cash payments to suppliers	(18,306)	
Cash paid to employees	(621)	
Other cash payments (for Selling & Administrative expenses)	(1,035)	
Cash generated from operations	4,932	
Income taxes paid	(2,187)	
Net cash from operating activities		2,745
Cash flows from investing activities		
Payments for purchase of fixed asset	(2,070)	
Proceeds from sale of fixed assets	1,152	
Purchase of investments	(117)	
Sale of investments	153	
Net cash used in investing activities		(882)
Cash flows from financing activities		
Proceeds from issuance of share capital	2,700	
Bank loan repaid	(2,250)	
Interest paid on bank loan	(450)	
Dividend paid	(720)	
Net cash used in financing activities		(720)
Net increase in cash and cash equivalents		1,143
Cash and cash equivalents at beginning of period		315
Cash and cash equivalents at end of period		1,458

Question 33

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

Summary Cash Account

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

(8 Marks) (MTP, May 2020)

Answer:

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

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	16,596	
Cash payments to suppliers	(12,204)	
Cash paid to employees	(414)	
Other cash payments (for Selling & Administrative expenses)	(690)	
Cash generated from operations	3,288	
Income taxes paid	(1,458)	
Net cash from operating activities		1,830
Cash flows from investing activities		
Payments for purchase of fixed asset	(1,380)	
Proceeds from sale of fixed assets	768	
Purchase of investments	(78)	
Sale of investments	102	
Net cash used in investing activities		(588)
Cash flows from financing activities		
Proceeds from issue of share capital	1,800	
Bank loan repaid	(1,500)	
Interest paid on bank loan	(300)	
Dividend paid	(480)	
Net cash used in financing activities		(480)
Net increase in cash and cash equivalents		762
Cash and cash equivalents at beginning of period		210
Cash and cash equivalents at end of period		972

Question 34

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

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

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

Answer

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

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

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

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

Question 35

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

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

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

(3) Company issued 60,000 Equity Shares of ₹10 each at a premium of 20% on 10th April, 2019.

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

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

(6) A new Plant costing ₹7 Lakhs was purchased in part exchange of an old plant on 1st January, 2020. The book value of the old plant was ₹8 Lakhs but the vendor took over the old plant at a value of ₹6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March, 2020.

(7) Company decided to value inventory at cost less 10%, whereas previously the practice was to value inventory at cost. The inventory according to books on 31.03.2020 was ₹ 14,76,000.
The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

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

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

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method. (*Suggested January 2021*) (*12 marks*)

Answer

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

	₹	₹
Cash flows from operating activities		
Net profit before taxation*		30,00,000
Adjustments for:		
Depreciation on PPE	7,00,000	
Discount on debentures	45,000	
Profit on sale of investments	(25,000)	
Interest income on investments	(70,000)	
Interest on debentures	4,35,000	
Stock adjustment	1,64,000	
{14,76,000 less 16,40,000(14,76,000/90X100)}		
Operating profit before working capital changes		12,49,000
Changes in working capital		42,49,000
(Excluding cash and bank balance):		
Less: Increase in inventory	(2,90,000)	
{16,40,000(14,76,000/90X100) less 13,50,000}		
Add: Decrease in Trade receivables	13,800	
Increase in trade payables	2,600	
Increase in o/s expenses	4,400	(2,69,200)
Cash generated from operations		39,79,800
Less: Income taxes paid		(12,80,000)
Net cash generated from operating activities		26,99,800
Cash flows from investing activities		
Sale of investments	3,75,000	
Interest received	70,000	
Payments for purchase of fixed assets	(1,00,000)	
(7,00,000 – 6,00,000)		
Net cash used in investing activities		3,45,000
Cash flows from financing activities		
Redemption of Preference shares	(21,00,000)	
Issue of shares	7,20,000	
Interest paid	(4,35,000)	
Dividend paid	(11,00,000)	
Net cash used in financing activities		(29,15,000)
Net increase in cash		1,29,800
Cash at beginning of the period		2,40,700
Cash at end of the period		3,70,500

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

Question 36

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

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

(ii) Depreciation on Fixed Assets ₹ 10 lakhs.

(iii) Discount on issue of Debentures written off ₹ 60,000.

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

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

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

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

(viii) Income tax paid ₹ 21,00,000

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

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

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

(*Question Paper, May 2022*) (*4 Marks*)

Question 37

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

Particulars	Amount (₹)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received from associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest)	73,800
Book value of plant & machinery sold (loss incurred ₹ 9,600)	90,000

(*MTP March, 2021*) (*MTP April, 2022*) (*4 Marks*)

Answer

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

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

Note:

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

Question 38

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

Cash Flow (Abstract)

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

Prepare Cash Flow Statement for the year ended 31st March, 2021 in accordance with AS 3.

(*MTP April, 2021*) (*MTP March 2022*) (*5 Marks*)

Answer

Cash Flow Statement for the year ended 31.3.2021

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

Question 39

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

Cash Summary Account

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

(*Question Paper July 2021*) (*5 Marks*)

Answer

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

Particulars	Amount (₹'000)	Amount (₹'000)
Cash flow from Operating Activities:		
Cash receipts from customers	74,682	
Cash payments to suppliers	(54,918)	
Cash payments for wages & salaries	(1,863)	

Particulars	Amount (₹'000)	Amount (₹'000)
Cash payments of overheads	(3,105)	
Cash Generated from Operations	14,796	
Payment of Taxation	(6,561)	
Net Cash from Operating Activities		8,235
Cash Flow from Investing Activities:		
Proceeds from sale of investments	459	
Proceeds from sale of Property, Plant and Equipment	3,456	
Purchase of Investments	(351)	
Purchase of Property, Plant and Equipment	(6,210)	
Net Cash Used in Investing Activities		(2,646)
Cash Flow from Financing Activities:		
Proceeds from issue of shares	8,100	
Payment of Dividend	(2,160)	
Repayment of Bank Overdraft	(6,750)	
Interest paid on Bank Overdraft	(1,350)	
Net Cash Used in Financing Activities		(2,160)
Net Increase in Cash & Cash Equivalent		3,429
Cash and Cash Equivalent in the Beginning of the year		945
Cash and Cash Equivalent in the end of the year		4374

Question 40

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

Extract of Balance Sheet

		Particulars	*Notes*	*2021 (₹000)*	*2020 (₹000)*
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	Share capital	1	500	200
2		**Non- current liabilities**			
	(a)	Long term loan from bank		---	250
3		**Current liabilities**			
	(a)	Trade Payables		1,000	3,047
		Assets			
1		**Non-current assets**			
	(a)	Property, Plant and Equipment		230	128
2		**Current assets**			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	*Notes*	*2021 (₹000)*	*2020 (₹000)*
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			
	Current tax (paid during year)		243	140

Notes to accounts

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

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

Answer

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

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of Property, Plant and Equipment	(102)	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Question 41

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

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs:

- (a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.
- (b) Discount on issue of Debentures written off ₹ 45,000.
- (c) Interest on Debentures paid ₹ 5,25,000.
- (d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).
- (e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹1,35,000 by the company in a suit filed.

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

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.

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

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

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

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

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

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

(10 Marks) (November 2020)

Answer

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

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

Question 42

The following figures have been extracted from the books of X Limited for the year ended on 31.3.2019. You are required to prepare a cash flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 20 lakhs:

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

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

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

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

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

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

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

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

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

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

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

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

(*RTP May 2020*)

Answer

X Ltd.

Cash Flow Statement
for the year ended 31st March, 2019

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		20,00,000
Adjustments for:		
Depreciation on PPE	5,00,000	
Discount on issue of debentures	30,000	
Interest on debentures paid	3,50,000	
Interest on investments received	(60,000)	
Profit on sale of investments	(20,000)	8,00,000
Operating profit before working capital changes		28,00,000
Adjustments for:		
Increase in inventory	(1,18,000)	
Decrease in trade receivable	4,900	
Increase in trade payables	300	
Increase in outstanding expenses	6,800	(1,06,000)
Cash generated from operations		26,94,000
Income tax paid		(10,50,000)
Cash flow from extraordinary items:		16,44,000
Compensation received in a suit filed		90,000
Net cash flow from operating activities		17,34,000
Cash flow from Investing Activities		
Sale proceeds of investments	3,20,000	
Interest received on investments	60,000	
Net cash flow from investing activities		3,80,000
Cash flow from Financing Activities		
Proceeds by issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(15,75,000)	
Preference dividend paid	(1,50,000)	
Interest on debentures paid	(3,50,000)	
Dividend paid (5,00,000 + 3,00,000)	(8,00,000)	
Net cash used in financing activities		(22,75,000)
Net decrease in cash and cash equivalents during the year		(1,61,000)
Add: Cash and cash equivalents as on 31.3.2018		1,96,300
Cash and cash equivalents as on 31.3.2019		35,300

Note: Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

Question 43

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

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

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

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

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

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

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

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

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

(ix) Interest of ₹ 1,44,000 paid on long-term borrowing.

(MTP, October 2021) (5 Marks)

Answer

Statement showing Cash Flow from Financing Activities

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

Question 44

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

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs :

(a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.

(b) Discount on issue of Debentures written off ₹ 45,000.

(c) Interest on Debentures paid ₹ 5,25,000.

(d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).

(e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹1,35,000 by the company in a suit filed.

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

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.

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

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

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

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

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

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

(*MTP, November, 2021*) (*10 Marks*)

Answer

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

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

Question 45

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2021 (Using direct method):

(i) Total sales for the year were ₹ 597 crores out of which cash sales amounted to ₹ 393 crores.

(ii) Receipts from credit customers during the year, totalled ₹ 201 crores.

(iii) Purchases for the year amounted to ₹ 330 crores out of which credit purchases were 80%.
Balance in creditors as on
1.4.2020 ₹ 126 crores
31.3.2021 ₹ 138 crores

(iv) Suppliers of other consumables and services were paid ₹ 28.5 crores in cash.

(v) Employees of the enterprises were paid 30 crores in cash.

(vi) Fully paid preference shares of the face value of ₹ 48 crores were redeemed. Equity shares of the face value of ₹ 30 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of ₹ 30 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) ₹ 39 crores were paid by way of income tax.

(ix) A new machinery costing ₹ 15 was purchased.

(x) Investment costing ₹ 27 cores were sold at a loss of ₹ 3 crores.

(xi) Dividends totalling ₹ 22.5 crores was also paid.

(xii) Debenture interest amounting ₹ 3 crore was paid.

(xiii) On 31st March 2020, Balance with Bank and Cash on hand totalled ₹ 3 crores.

(*RTP, November 2021*)

Answer

Cash flow statement (using direct method) for the year ended 31st March, 2021

	(*₹ in crores*)	(*₹ in crores*)
Cash flow from operating activities		
Cash sales	393	
Cash collected from credit customers	201	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(376.5)	
Cash from operations	217.5	
Less: Income tax paid	(39)	
Net cash generated from operating activities		178.5
Cash flow from investing activities		
Payment for purchase of Machine	(15)	
Proceeds from sale of investments	24	
Net cash used in investing activities		9
Cash flow from financing activities		
Redemption of Preference shares	(48)	
Proceeds from issue of Equity shares	36	
Debenture interest paid	(3)	
Dividend Paid	(22.5)	
Net cash used in financing activities		(37.5)
Net increase in cash and cash equivalents		150
Add: Cash and cash equivalents as on 1.04.2020		3
Cash and cash equivalents as on 31.3.2021		153

Working Note:

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

	(*₹ in crores*)
Opening Balance in creditors Account	126
Add: Purchases (330x .8)	264
Total	390
Less: Closing balance in Creditors Account	138
Cash paid to suppliers of goods	252
Add: Cash purchases (330x .2)	66
Total cash paid for purchases to suppliers (a)	318
Add: Cash paid to suppliers of other consumables and services (b)	28.5
Add: Payment to employees (c)	30
Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)]	376.5

Question 46

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

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

Equity Share Capital for the year ended 31st March, 2021 'includes ₹ 60,000 of equity shares issued to Grey Ltd at par for supply of Machinery of ₹ 60,000.

Profit & Loss account on 31st March, 2021 includes ₹50,000 of dividend received on Equity shares invested in X Ltd Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised)

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

Answer

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

	₹	₹
Cash flows from operating activities		
Closing Balance as per Profit and Loss Account	28,00,000	
Less: Opening Balance as per Profit and Loss Account	(20,00,000)	
	8,00,000	
Less: Dividend received	50,000	
		7,50,000
Cash flows from investing activities		
Dividend received		50,000
Cash flows from financing activities		
Proceeds from issuance of share capital Equity shares issued for cash ₹ 10,00,000 Proceeds from securities premium (₹ 5,50,000 – 5,00,000) ₹ 50,000	10,50,000	
Less: Redemption of Preference shares (₹ 7,00,000 – ₹ 6,00,000)	(1,00,000)	9,50,000

Note:

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

CHAPTER 8

Accounting Standard 7 Construction Contracts

Question 1

XYZ construction Ltd, a construction company undertakes the construction of an industrial complex. It has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should XYZ Ltd, treat construction of each unit as a separate construction contract according to AS 7?

(*Source: Illustration 1, Study Material*)

Answer

As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, XYZ Ltd. is required to treat construction of each unit as a separate construction contract.

Question 2

AB contactors enters into a contract on 1st January 20X1 with XY to construct a 5- storied building. Under the contract, AB is required to complete the construction in 3 years (i.e., by 31st December 20X3). The following information is relevant:

Fixed price (agreed) ₹5 crore

Material cost escalation (to the extent of 20% of increase in material cost) Labour cost escalation (up to 30% of increase in minimum wages)

In case AB is able to complete the construction in less than 2 years and 10 months, it will be entitled for an additional incentive of ₹50 lakh. However, in case the construction is delayed beyond 3 years and 2 months, XY will charge a penalty of ₹20 lakh. At the start of the contract, AB has a reason to believe that construction will be completed in 2 years and 8 months. Assume that the construction was actually completed in 2 years 9 months.

Labour cost was originally estimated to be ₹1.20 crore (based on initial minimum wages). However, the costs have increased by 25% during the construction period.

Material costs have increased by 40% due to short-supply. The total increase in material cost due to the 40% escalation is ₹80 lakh.

You are required to suggest what should be the contract revenue in above case?

Assume that in year 20X2, XY has requested AB to increase the scope of the contract. An additional floor is required to be constructed and there is an increase in contract fee by ₹1 crore.

AB has incurred a cost of ₹20 lakh for getting the local authority approvals which it will be entitled to claim from XY in addition to the increase in the fixed fee.

Also measure the total contract revenue in this case.

(*Source: Illustration 2, Study Material*)

Answer

Total Revenue after considering the escalation costs, claims and incentives:

	₹
Fixed Price:	5.00 crore
Incentive for early completion	0.50 crore
Material costs recovery (to the extent of 20%)	0.40 crore
Labour costs recovery (Actual increase is less than 30%) [1.20 crore x 25%]	0.30 crore
Total Contract Revenue	6.20 crore
Add: Variation to the contract	1.00 crore
Add: Claims recoverable from XY	0.20 crore
Total Contract Revenue	7.40 crore

Question 3

X Ltd. commenced a construction contract on 01-04-20X1. The fixed contract price agreed was ₹2,00,000. The company incurred ₹81,000 in 20X1-X2 for 45% work and received ₹79,000 as progress payment from the customer. The cost incurred in 20X2-X3 was ₹89,000 to complete the rest of work. Show the extract of the Profit and Loss Account and Customer's Account for the related years.

(*Source: Illustration 3, Study Material*)

Answer

Profit & Loss Account

Year		₹ 000	Year		₹ 000
20X1-X2	To Construction Costs (for 45% work)	81	20X1-X2	By Contract Price (45% of Contract Price)	90
	To Net profit (for 45% work)	9			
		90			90
20X2-X3	To Construction costs (for 55% work)	89	20X2-X3	By Contract Price (55% of Contract Price)	110
	To Net Profit (for 55% work)	21			
		110			110

Customer's Account

Year		*₹ 000*	*Year*		*₹ 000*
20X1-X2	To Contract Price	90	20X1-X2	By Bank	79
				By Balance c/d	11
		90			90
20X2-X3	To Balance b/d	11	20X2-X3		
	To Contract Price	110		By Bank	121
		121			121

AS 7 provides that the percentage completion method should not be applied if the outcome of a construction contract cannot be estimated reliably. In such cases:

(a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and

(b) contract costs should be recognised as an expense in the period in which they are incurred.

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

Question 4

PQ & Associates undertakes a construction contract the details of which are provided below:

Total Contract Value	*₹40 lakh*
Costs incurred to date	*₹3 lakh*
Estimated future costs of completion	*₹30 lakh*
Work completed	*10%*

The work has started some time ago and there is an uncertainty with respect to the outcome of the contract due to expected changes in regulations. PQ is certain that it would be able to recover the costs incurred to date.

(*Source: Illustration 4, Study Material*)

Answer

In the given case, revenue and costs can only be recognised to the extent of the costs incurred and those which are expected to be recovered. Therefore, the profit & loss statement would appear as under:

Contract Revenue	₹3 lakh
Contract Costs	₹3 lakh
Contract Profit	Nil

When the uncertainties that prevented the outcome of the contract being estimated reliably cease to exist, revenue and expenses associated with the construction contract should be recognised by the percentage completion method.

Question 5

X Ltd. commenced a construction contract on 01/04/X1. The contract price agreed was reimbursable cost plus 10%. The company incurred ₹1,00,000 in 20X1-X2, of which cost of ₹90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹5,000. The other costs to complete the contract could not be estimated reliably. The Profit & Loss A/c extract of X Ltd. for 20X1-X2 is shown below:

(*Source: Example 4, Study Material*)

Answer

Profit & Loss Account

	₹ 000		*₹ 000*
To Construction Costs	*100*	*By Contract Price (90+9)*	*99*
To Provision for loss	*5*	*Net loss*	*6*
	105		*105*

Question 6

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data for Year 1.

Information for Year 1	*₹ 000*
Contract price (Fixed)	*600*
Cost incurred to date	*390*
Estimated cost to complete	*260*

Assume that the contract period is 2 years. The contract is 100% completed by Year 2. Actual costs incurred is the same as total estimated costs to complete (Cost incurred to date plus estimated cost to complete).

(*Source: Illustration 5, Study Material*)

Answer

		Amount INR ₹ 000	
	Year (1)	***Total up to Year2 (2)***	***Year 2 (2) – (1)***
A. Cost incurred to date	*(390)*	*(650)*	*(260)*
B. Estimate of cost to completion	*(260)*	*-*	*-*

		Amount INR ₹ 000	
	Year (1)	***Total up to Year2 (2)***	***Year 2 (2) – (1)***
C. Estimated total cost	*(650)*	*650*	*650*
D. Degree of completion (A/C)	*60%*	*100%*	*40%*
E. Revenue Recognised			
(60% of 600)	*360*		
(100% of 600)		*600*	*240*
Total foreseeable loss (650 – 600)	*50*		
Less: Loss for current year (E – A)	*(30)*		
Expected loss to be recognised immediately	*(20)*		
Reversal of Loss provision in Year 2			*20*

Profit & Loss A/c (Year 1)

	₹		₹
To Construction costs To Provision for loss	*390* *20*	*By Contract Price By Net Loss*	*360* *50*
	410		*410*

Profit & Loss A/c (Year 2)

	₹		₹
To Construction costs	*260*	*By Contract Price* *By Reversal of Provision for loss*	*240* *20*
	260		*260*

Question 7

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

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

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

(*Source: Illustration 6, Study Material*)

Answer

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

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

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

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

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

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

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

= [505 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

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

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

	₹ in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35
Method of revenue recognition (use of percentage completion method) Method of determining state of completion (based on proportionate cost	

Question 8

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

(*Source: Illustration 7, Study Material*)

Answer

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

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

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

Proportion of total contract value recognised as turnover:

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

The amount of expected loss will be split as under:

Particulars	Workings	Amount
Expected Loss	97,00,000– 85,00,000	12,00,000
Contract revenue	67% of 85,00,000	56,95,000
Contract cost	Given	64,99,000
Actual loss	56,95,000– 64,99,000	8,04,000
Amount of provision required [As per Para 35]	12,00,000– 8,04,000	3,96,000

Question 9

It is argued that profit on construction contracts should not be recognised until the contract is completed. Please explain whether you believe that this suggestion would improve the quality of financial reporting for long-term construction contracts.

(*Source: Theory Question 7, Study Material*)

Answer

Usually, construction contracts are long term nature i.e., the contracts are entered in one accounting period, however, the work performed will flow into more than one accounting year. If the profit on construction contracts is not recognised over the construction period, then the costs incurred during the earlier years of the contract would be recognised without any corresponding revenue. This will result in losses for initial years followed high profits in future years.

The current treatment under AS 7 results in matching of revenue and associated costs as they are recognised during the same period. Also, the current accounting incorporates the prudence concept as any foreseeable losses are accounted for immediately.

Therefore, AS 7 results in a fair representation of the underlying financial substance of the transaction.

Question 10

A contractor has entered into a contract with a municipal body for construction of a flyover. As per the contract terms, the contractor will receive an additional ₹ 2 Crore as incentive if the construction of the flyover were to be finished within a period of two years from the start of the contract. The contractor wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Explain whether the contractor's view-point is correct?

(*Source: Theory Question 8, Study Material*)

Answer

The contractor's view is not entirely correct in considering the variation as a part of contract revenue. There is an argument that he has been able to complete similar contracts within stipulated time. However, each contract needs to be assessed in isolation with respect to the specific challenges associated with the timing and uncertainty in completion.

Accordingly, the contractor needs to validate the assumptions with respect to the specific contract. Only after that assessment is done, the incentive of ₹ 2 crore may be included within the contract revenue.

Question 11

A construction contractor has a fixed price contract for ₹ 9,000 lakhs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lakhs)		
	Year 1	**Year 2**	**Year 3**
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	-	200	200
Contracts costs incurred up to the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lakhs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lakhs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(*Source: Practical Question 9, Study Material*)

Answer

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in ₹ lakhs)

	Up to the reporting date	***Recognized in previous years***	***Recognized in current year***
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	***Year 2***	***Year 3***
Revenue after considering variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

Question 12

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7.

(*Source: Practical Question 10, Study Material*)

Answer

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

	Cost of Construction	₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	38,00,000
Add:	Outstanding on 31.03.20X2	2,00,000	10,00,000
	Hire Charges of Plant		15,00,000
	Other Contract cost incurred		1,34,00,000
	Cost incurred upto 31.03.20X2		
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

Question 13

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.

During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1: ₹ 52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)

Year 3: ₹ 205 crore.

You are required to calculate:

(a) Stage of completion for each year.

(b) Profit to be recognised for each year.

(*Source: Practical Question 11, Study Material*)

Answer

(a) Stage of completion = Costs incurred to date / Total estimated costs

Year 1: 52.52 crore / 202 crore = 26%

Year 2: (154.20 crore – 2.50 crore) / 205 crore = 74%

Year 3: 205 crore / 205 crore = 100%

(b) Profit for the year

	Year 1	**Year 2**	**Year 3**
Contract Revenue (1)	57.20 crore	109.30 crore	58.50 crore
	(220 crore x 26%)	(225 crore x 74% - 57.20 crore)	(225 crore x 100% - 109.30 crore – 57.20 crore)
Contract Cost (2)	52.52 crore	99.18 crore	53.30 crore
	(202 crore x 26%)	(205 crore x 74% - 52.52 crore)	(205 crore x 100% - 99.18 crore – 52.52 crore)
Contract Profit (1) – (2)	4.68 crore	10.12 crore	5.20 crore

QUESTION BANK

Question 14

Sarita Construction Co. obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2018:

	₹ in lakhs
Total Contract Price	12,000
Work Certified	6,250
Work not certified	1,250
Estimated further cost to completion	8,750
Progress payment received	5,500
Progress payment to be received	1,500

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2018.

(ii) Contract work in progress as at end of financial year 2017-18.

(iii) Revenue to be recognized out of the total contract value.

(iv) Amount due from/to customers as at the year end.

(May 2018) (5 Marks)

Answer:

(i)	**Loss for the year ended, 31st March, 2018**	**(₹ in lakhs)**
	Amount of foreseeable loss	
	Total cost of construction (6,250 + 1,250 + 8,750)	16,250
	Less: Total contract price	(12,000)
	Total foreseeable loss to be recognised as expense	4,250

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

Loss for the year ended, 31st March, 2018 amounting ₹4,250 will be recognized.

(ii)	**Contract work-in-progress as on 31.3.18**	**(₹ in lakhs)**
	Contract work-in-progress i.e. cost incurred to date are ₹7,500 lakhs:	
	Work certified	6,250
	Work not certified	1,250
		7,500

(iii) Proportion of total contract value recognised as revenue

Cost incurred till 31.3.18 is 46.15% (7,500/16,250 x 100) of total costs of construction.

Proportion of total contract value recognised as revenue:

46.15% of ₹12,000 lakhs = ₹5,538 lakhs

(iv) Amount due from/to customers at year end

(Contract costs + Recognised profits - Recognised Losses) - (Progress payments received + Progress payments to be received)

= (7,500 + Nil - 4,250) - (5,500 + 1,500) ₹ in lakhs

= [3,250-7,000] 7 in lakhs

Amount due to customers = ₹3,750 lakhs

Question 15

Uday Constructions undertake to construct abridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹12 crores with an escalation clause. The costs to complete the whole contract are estimated at ₹9.50 crores of rupees. You are-given the following information for the year ended 31.03.2016:

Cost incurred upto 31.03.2016 ₹4 crores

Cost estimated to complete the contract ₹6 crores

Escalation in cost by 5% and accordingly the contract price is increased by 5%.

You are required to identify the state of completion and calculate the revenue and profit to be recognized for the year as per AS 7.

(*RTP May 2018*)

Answer:

	₹ in crore
Cost of construction of bridge incurred 31.3.16	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= (4/10) x 100 = 40%

Revenue and Profit to be recognized for the year ended 31st March, 2016 as per AS 7

Proportion of total contract value recognized as revenue = Contract price x percentage of completion

= ₹12.60 crore x 40% = ₹5.04 crore

Profit for the year ended 31st March, 2016 = ₹5.04 crore less ₹4 crore = 1.04 crore

Question 16

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹50 Lakh, ₹60 Lakh and ₹75 Lakh respectively. Agreement also lays down the completion time for each unit.

Comment, with reference to AS-7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹45 lakhs. On 31st March, 2018, the company found that it had already spent ₹32.50 lakhs on the construction. Additional cost of completion is estimated at ₹15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provision of AS-7?

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

Answer:

(i) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

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

(ii)

	₹ *in lakhs*
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) × 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st Marc h, 2018 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹45 lakh x 68.28% = ₹30.73 lakhs.

	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

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

Question 17

On 1st December, 2018, "Sampath" Construction Company Limited undertook a contract to construct a building for ₹108 lakhs. On 31st March, 2019 the company found that it had already spent ₹83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹36.01 lakhs.

You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2019 based on AS 7 "Accounting for Construction Contracts."

(*RTP November 2019*)

Answer:

Calculation of foreseeable loss for the year ended 31st March, 2019

(as per AS 7 "Construction Contracts")

	(₹ in lakhs)
Cost incurred till 31st March, 2019	83.99
Prudent estimate of additional cost for completion	36.01
Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31st March, 2019.

Question 18

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹3 Crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent ₹1 Crore 80 Lakhs on the construction. Prudent estimate of additional cost for completion was ₹1 Crore 40 Lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

(*May 2012, 5 Marks*)

Question 19

M/s. Highway Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹150 crores. Up to 31.03.2014 the company incurred ₹ 120 crores and the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Project & Loss A/c in the books of M/s. Highway Constructions.

(*May 2014, 5 Marks*)

Answer:

Statement showing the amount to be charged to Revenue as per AS 7

		₹ in crores
	Cost of construction incurred upto 31.03.2014	120
Add:	Estimated future cost	45
	Total estimated cost of construction	165
	Degree of completion (120/165 x 100)	72.73%
	Revenue recognized (72.73% of 150)	109 (approx)
	Total foreseeable loss (165 – 150)	15
Less:	Loss for the current year (120 – 109)	11
	Loss to be provided for	4

Profit and Loss Account (Extract)

	₹ in crores		₹ in crores
To Construction Costs	120	By Contract Price	109
To Provision for loss	4	By Net loss	15
	124		124

Question 20

A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lacs)		
	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	—	200	200
Contracts costs incurred up to the reporting date	2093	6168*	8100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(*May 2015, 5 Marks*)

Answer

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are shown below:

(Amount in ₹ lakhs)

	Upto the reporting date	Recognized in prior years	Recognized in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	Year 2	Year 3
Revenue after consider variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068	8,200
		(6,168-100)	(8,100+100)
Degree of completion (B/A)	26%	74%	100%

Question 21

GTI Ltd. Negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹ 102 lacs. ₹ 150 lacs, ₹ 130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region.

Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

(*Group I, November 2016, 5 Marks*)

Answer

As per AS 7 'Construction Contracts', when a contract covers number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Offices, which can be separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one single agreement for contracts.

Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.

Question 22

Akar Ltd. signed on 01/04/19, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/20.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.20.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and additional provision for foreseeable loss to be recognized as per AS 7.

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

Answer

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

Cost of Construction		**₹**	**₹**
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.2020	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2020		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
Loss to be provided for			3,50,000

Question 23

(a) Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract. As per the terms of the contract, Sky Limited will receive an additional ₹ 50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The Accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

(b) ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units i .e. ₹ 50 lakh, ₹ 60 lakh and ₹ 75 lakh respectively. Agreement also lays down the completion time for each unit. Comment, with reference to AS 7, whether ABC Ltd., should treat it as a single contract or three separate contracts.

(*RTP, May, 2021*)

Answer

(a) According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when both the conditions are met:

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

(ii) the amount of the incentive payment can be measured reliably.

In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing ₹ 50 lakhs as revenue is not correct.

(b) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

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

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

Question 24

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed.
Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

(Suggested, November, 2020) (5 marks)

Answer

Year 1

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

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

Revenue to be recognized = 20,00,000 x 46.24%
= ₹ 9,24,800

Year 2

Actual expenditure	4,75,000
Future Expenditure	4,00,000
Expenditure incurred in Year 1	8,60,000

% of work completed

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

Revenue to be recognized (cumulative) = 20,00,000 x 76.95%
= 15,39,000
Less: revenue recognized in Year 1 = (9,24,800)
Revenue to be recognized in Year 2 ₹ 6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000.

Note: Calendar year has been considered as accounting year.

Question 25

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price - ₹ 85 lakhs
(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused at the end of the period.
(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)
(iv) Specific Contract Costs - ₹ 5 Lakhs
(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to sub-contractors - ₹ 4 Lakhs
(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

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

Answer

Computation of contract cost

	₹ Lakh	**₹ Lakh**
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost
= ₹ 45,00,000/₹ 80,00,000
= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000 x 56.25%) = ₹ 47,81,250 Contract costs = ₹ 45,00,000

Question 26

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

	(₹ crore)
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress payments in pipe line	300

Using the given data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2021.

(ii) Arrive at the contract work in progress as at the end of financial year 2020-21.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

(i)	**Calculation of profit/ loss for the year ended 31st March, 2021**	**(₹ *in crores*)**
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	**Contract work-in-progress i.e. cost incurred to date**	**(₹ *in crores*)**
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250) □ 100 = 46.15%

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

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

= ₹ [1,500 + Nil – 850 – (1100 + 300)] crores

= ₹ [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = ₹ 750 crores.

Question 27

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.

(b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional ₹ 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss.

(*RTP November 2021*)

Answer

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;

(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

(b) According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

Question 28

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹ 53 crores.

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

(*RTP May, 2022*)

Answer

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

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

(ii) Stage of completion of contract activity; or

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

Question 29

On 1st December, 2021, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2022, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2022 as per provisions of AS-7?

(*RTP May, 2023*)

Answer

	₹ in lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) x 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 2022 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs.

	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

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

Question 30

Fisher Construction Co. obtained a contract for construction of a 5 commercial complex. The following details are available in records of a company for the year ended 31st March, 2023:

Particulars	Amount in lakhs
Total contract price	24000
Work certified	12500
Work not certified	2500
Estimated further cost to completion of work	17500
Progress payment received	11000
Progress payment to be received	3000

Applying the provisions of AS 7, you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2023

(ii) Contract work in progress at the end of financial year 2022-2023

(iii) Revenue to be recognised out of the total contract value-

(iv) Amount due from/to customers as at the year end

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

CHAPTER

9

Accounting Standard 9 Revenue Recognition

Question 1

Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item	-	*₹ 200 lakhs*
Delivery charges	-	*₹ 60 lakhs*
GST -	-	*₹ 40 lakhs*
Total -	-	*₹ 300 lakhs*

Zigato has received ₹ 300 lakhs for the above orders from customers and the orders were delivered to the customer in stipulated time.

How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?

(*Source: Illustration 1, Study Material*)

Answer

The risks and rewards associated with the food item are not with Zigato. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare the food and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, Zigato is acting as an agent. Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹ 200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

Question 2

AB sells goods to CD on 1st March 20X1. CD is having significant cash flows issues since last few months. However, it is trying to raise funding through bank loan to be able to run its operations in future. On 5th of May 20X1, CD is able to seek the funding and is expected to be able to pay for the goods in future.

At the time of sale, it is difficult for AB to ascertain whether it will be able to collect the amount from CD due to poor financial conditions.

Explain how the recognition of revenue be done by AB?

(*Source: Illustration 2, Study Material*)

Answer

In the above case, AB should not recognise any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognised by AB on 5th of May 20X1. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Question 3

AB sells goods to CD on 1st January 20X1 for ₹ 2 lakhs. After the sale was made, CD is having significant cash flows issues. It is trying to raise funding through bank loan to be able to run its operations in future. However, it is unable to do so and has gone under liquidation on 15th of March 20 X1.

At the time of sale, there was no reason for AB to believe that it will not be able to collect the amount from CD in future.

Explain how the recognition of revenue be done by AB for the year ended 31st March 20X1?

(*Source: Illustration 3, Study Material*)

Answer

In the above case, at the time of sale, it was not unreasonable for AB to expect ultimate collection from CD. Therefore, AB should recognise the revenue of ₹ 2 lakhs on 1st of January 20X1 and recognise a receivable for the same amount.

Later, since CD went into liquidation, AB should write off the receivables and book a loss in his books.

Accounting in the books of AB 1st January 20X1

CD A/c (Receivables) To Revenue A/c (Being goods sold to CD Ltd)	Dr.	₹ 2 lakhs	₹ 2 lakhs

15th March 20X1

Bad Debts A/c To CD A/c (Receivables)A/c (Being receivables from CD written off due to its liquidation)	Dr.	₹ 2 lakhs	₹ 2 lakhs

Question 4

During the year ended 31st March 20X1, ZX Enterprises has recognized ₹ 100 lakhs on accrual basis income from dividend on units of mutual funds held by it. The dividends on mutual funds were declared on 15th June, 20X1. The dividend was proposed on 10th April, 20X1.

Whether the above treatment is as per the relevant Accounting Standard?

(*Source: Illustration 4, Study Material*)

Answer

Dividends from investments in shares are not recognized in the statement of profit and loss until a right to receive payment is established. In the given situation, the dividend is proposed on 10th April, 20X1, while it is declared on 15th June, 20X1. Thus, the right to receive the payment of dividend gets established on 15th June, 20X1.

The recognition of ₹ 100 lakhs on accrual basis in the financial year 20X0-20X1 is not correct as per AS 9 'Revenue Recognition'.

Question 5

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20 X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd.

(*Source: Illustration 5, Study Material*)

Answer

As per AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable. Therefore X Ltd. should recognize interest revenue of ₹ 10 Lakhs

(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.

Question 6

On 1st January 20X1, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of ₹ 6 Lac.

You are required to do the accounting for above transactions in the books of M/s KJ.

(*Source: Example 7, Study Material*)

Answer

1st Jan 20X1:

Bank A/c To Loan from M/s TH A/c (Being borrowing made under the Sale & Repurchase arrangement)	Dr.	₹5 lakhs	 ₹5 lakhs

31st March 20X1

Interest expense A/c To Loan from M/s TH A/c (Being interest cost recognised on the borrowing)	Dr.	₹1 lakhs	 ₹1 lakhs

31st March 20X1:

Loan from M/s TH A/c To Bank A/c (Being repayment of loan taken from TH)	Dr.	₹6 lakhs	 ₹6 lakhs

Question 7

In the year 20X1-X2, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹ 10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods.

During the year 20X1-X2, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 20X1-X2.

Answer

As per AS 9, consignment risk and rewards are not transferred to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party. Therefore, XYZ can recognize revenue of ₹ 5,50,000 only.

Question 8

The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2.

Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 20X1-20X2.Advise.

(*Source: Illustration 6, Study Material*)

Answer

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

If the company is not reasonably certain on ultimate collection ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2, it shall postpone recognition of revenue and disclose it in financial statements for year 20X1-20X2 as per AS 1

Question 9

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

(*Source: Illustration 7, Study Material*)

Answer

AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is certain to be collected. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,50,000 were collected against a claim of ₹ 2,00,000. So this transaction can not be taken as a Prior Period Item.

Hence receipt of ₹ 1,50,000 shall be recognized as revenue in year ended 31st March, 20X3

In the light of AS 5, it will not be treated as extraordinary item. However, AS 5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

Question 10

GH manufactures and sells televisions. The televisions are shipped to the customer by sea. In order to transfer risk related to the shipment of the televisions, GH also gets an insurance coverage for the goods while they are in transit from the factory to customer's location.

The insurance policy will reimburse GH for the value of the goods in the event of loss or damage arising anytime up to these goods reaching customer's location. The legal title passes when the goods arrive at the customer's premises one month later.

When should Entity GH recognize revenue in its books?

(*Source: Practical Question 6, Study Material*)

Answer

GH should recognize revenue for the sale when the goods arrive at the customer's premises. GH has not transferred the televisions' significant risks and rewards of ownership to the customer when the goods depart from the factory. This is evidenced by the fact that any insurance proceeds received from the goods' damage or destruction will be repaid to GH. Further, the legal title does not pass until the goods arrive at the customer's premises.

Question 11

The following information of Meghna Ltd. is provided:

(i) Goods of ₹ 60,000 were sold on 20-3-20X2 but at the request of the buyer these were delivered on 10-4-20X2.

(ii) On 15-1-20X2 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-20X2.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1 -12-20X1. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X2 and no approval or disapproval received for the remaining goods till 31 -3- 20X2.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS 9.

(*Source: Practical Question 7, Study Material*)

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 20X2.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the ₹ 90,000 upon receipt of approval on 31-02-20X1 and for the balance ₹ 30,000 on 01-03- 20X1 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue.

Thus, revenue should be ₹ 7,41,000.

Question 12

For the year ended 31st March 20X1, KY Enterprises has entered into the following transactions.

On 31 March 20X1, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 20X1. Machine 1 was a machine that was routinely supplied by KY to many customers and the installation process was very simple.

Machine 1 was installed on 2 April 20X1 by ST's employees.

Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 20X1. Details of costs and sales prices are as follows:

	Machine 1	*Machine 2*
Sale Price	*3,20,000*	*3,00,000*
Cost of production	*1,60,000*	*1,50,000*
Installation fee	*nil*	*10,000*

How should above transactions be recognized by KY Enterprises for the year ended 31st March 20X1?

(*Source: Practical Question 8, Study Material*)

Answer

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

Revenue (Machine 1)	₹ 3,20,000
Cost of Goods Sold	₹ 1,60,000
Profit during the period	₹ 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 20X1. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to ST.

Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 20X1.

Revenue (Machine 2)	₹ 3,00,000
Cost of Goods Sold	₹ 1,50,000
Profit during the period	₹ 1,50,000

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges ₹10,000 needs to be recognized on 5 April 20X1 once the installation process gets completed.

QUESTION BANK

Question 13

Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014?

(*November 2014, 5 Marks*)

Answer

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2014, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2014. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2014 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2014 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2015 after the magazine is published on 02.04.2014**.** The amount received from sale of advertising space on 10.03.2014 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2014.

Question 14

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

(*May 2015, 4 Marks*)

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

<u>In case (i):</u>

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2015.

<u>In case (ii):</u>

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

<u>In case (iii):</u>

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, in case (iii) revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

<u>In case (iv):</u>

Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2015 in the books of M/s Paper Products Ltd.

Question 15

M/s Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard-9.

(*November 2015, 5 Marks*)

Answer

As per para 9.2 of AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made".

In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹ 1,72,000 should not be recognized in the books for the year ended 31st March, 2015. Thus the contention of accountant is incorrect.

However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹ 1,72,000 as interest amount.

Question 16

A manufacturing company has the following stages of production and sale in manufacturing Fine paper rolls:

Date	Activity	Costs to Date (₹)	Net Realizable Value (₹)
15.1.16	Raw material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state how much would be net profit for year ending 31-3-16 on this product according to AS-9.

(*Group I, November 2016, 5 Marks*)

Answer

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit ₹ 150,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2016.

Question 17

Ruby Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to ₹5 lakhs. The accountant of Ruby Ltd. booked ₹5 lakhs as interest income in the year ended 31st March, 2017.

Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition".

(*MTP April/October 2018 & April 2019*) (*5 Marks*)

Answer:

As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹5 lakhs as interest amount.

Question 18

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2017:

(i) On 15th January, 2017 garments worth ₹4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2017.

(ii) Garments worth ₹1,95,000 were sold to Shine boutique on 25th March, 2017 but at the request of Shine Boutique, these were delivered on 15th April, 2017.

(iii) On 1st November, 2016 garments worth ₹2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2016 and no approval or disapproval received for the remaining goods till 31st March, 2017.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9

(*RTP November 2018*)

Answer:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i): 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹3,00,000 (75% of ₹4,00,000) for the year ended on 31.3.17. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (ii): The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2017.

Case (iii): In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹2,50,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2017 in the books of Fashion Ltd.

Question 19

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth ₹15,00,000 ready for dispatch. Raj Ltd. accounted ₹15,00,000 as sales and transferred the balance to Advance received against Sales account.

Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9.

(*RTP May, 2019*)

Answer*:*

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognize the entire sale of ₹30,00,000 (₹5,00,000 $\times$ 6) and no part of the same is to be treated as Advance Received against Sales.

Question 20

Given below are the following informations of M/s B.S. Ltd.

(i) Goods of ₹50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.

(ii) On 13-01-2018 goods of ₹1,25,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.

(iii) ₹1,00,000 worth of goods were sold on approval basis 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of M/s B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9.

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

Answer:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should recognize the entire sale of ₹50,000 for the year ended 31st March, 2018.

Case (ii)

In case of consignment sale revenue should not be recognized until the goods are sold to a third party. 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹1,00,000 (80% of ₹1,25,000).

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹1,00,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.

Question 21

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include ₹15 lakhs in the sales for 2018-2019. Advise.

(*RTP November 2019*)

Answer:

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognised in 2018-2019 vide para 10 of AS 9.

Question 22

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributor or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(5) On 11-03-2019 cloths worth ₹50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019.

(*November 2019, New Course, 5 Marks*)

Answer

(1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

Question 23

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2019:

(i) On 15th January, 2019 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2019.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2019 but at the request of Shine Boutique, these were delivered on 15th April, 2019.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9 .

(*RTP, November, 2020*)

Answer

As per AS 9 “Revenue Recognition”, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i): 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 3,00,000 (75% of ₹ 4,00,000) for the year ended on 31.3.19. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (ii): The sale is complete but delivery has been postponed at buyer’s request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2019.

Question 24

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

(i) On 31st December, 2019 shoes worth ₹ 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March, 2020.

(ii) On 10th January, 2020, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.

(iii) On 21st March, 2020 shoes worth ₹ 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April, 2020.

You are required to advise the accountant of Tonk Tanners, when amount is to be recognised as revenue in 2019 -20 in above cases in the context of AS 9.

(*RTP, May, 2021*)

Answer

(i) Shoes sent to Mohan Shoes (consignee) for consignment sale

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2019- 2020, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for ₹ 3,20,000 x 75% = ₹ 2,40,000.

(ii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2019-2020. Hence, sale of ₹ 4,50,000 to Shani Shoes should not be recognized as revenue.

(iii) Delivery is delayed at buyer’s request

On 21st March, 2020, if Shoe Shine takes title and accepts billing for the goods then it is implied that the sale is complete and all the risk and rewards of ownership has been transferred to the buyer. In case no significant uncertainty exists regarding the amount of consideration for sale, revenue shall be recognized in the year 2019-2020 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

Question 25

Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2020 issue of the magazine was sold in the month of February, 2020. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2020 and ₹ 30,000 was received on 10th April, 2020 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2020.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

Definition: As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,70,000 will be treated as payment received against the sale.

Question 26

(a) An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

(b) Indicate in each case whether revenue can be recognized and when it will be recognized as per AS 9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributors or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(*RTP May, 2022*)

Answer

(a) AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

(b) (1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Question 27

(a) How will you recognize revenue in the following cases:

1. Installation Fees;
2. Advertising and insurance agency commissions;
3. Subscriptions for publications.

(b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9.

(*RTP November 2021*)

Answer

(a) **Installation Fees**: In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Subscription for publications: Revenue received or billed should be deferred and recognized either on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

(b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

Question 28

Given the following information of Rainbow Ltd.

(i) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

(ii) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

(iii) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchase the same goods on 14th April.

(iv) Dew Ltd. used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 lakhs as interest and royalties respectively from Dew Ltd. during the year·2020-21.

(v) On 25th December goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.

(*Question Paper of December 2021*) *(5 Marks)*

Answer:

(i) As per AS 9 "Revenue Recognition", in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period for rejecting the goods had expired.

(ii) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 2,40,000 for the year ended 31st March.

(iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

(iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The royalty should be recognized on accrual basis in accordance with the terms of relevant agreement.

(v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Question 29

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(i) Delivery is delayed at buyer's request but buyer takes title and accepts billing.

(ii) Instalment Sales.

(iii) Trade discounts and volume rebates.

(iv) Insurance agency commission for rendering services.

(v) Advertising commission.

Answer

(i) Delivery is delayed at buyer's request and buyer takes title and accepts billing: Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

(ii) Instalment sales: When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the date of sale. The interest element should be recognized as revenue, proportionately to the unpaid balance due to the seller.

(iii) Trade discounts and volume rebates: Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(iv) Insurance agency commissions for rendering services: Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(v) Advertising commission: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

Question 30

When revenue will be recognized in the following situation:

(i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

(ii) Where seller concurrently agrees to repurchase the same goods at a later date.

(iii) Where goods are sold to distributors, dealers or others for resale.

(iv) Commissions on service rendered as agent on insurance business.

(*RTP November, 2022*)

Answer

(i) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

(ii) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

(iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

Question 31

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree?

(*RTP May, 2023*)

Answer

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, PQR Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

Question 32

Toy Ltd. is engaged in manufacturing toys. They provide you the following information as on 31st March, 2023 :

(i) On 15th January, 2023, Toys worth ₹ 5,00,90 were sent to A Ltd. on consignment basis of which 25% Toys unsold were lying with A Ltd. as on 31st March, 2023:

(ii) Toys worth ₹ 2,25,000 were sold to S Ltd. on 25th March, 2023 but at the request of S Ltd., these were delivered on 15th April, 2023.

(iii) On 1st November, 2022, toys worth ₹3,50,000 were sold on approval basis. The period of approval was 4 months' after which they were considered sold. Buyer sent approval for 5% goods upto 31st December, 2022 and no approval or disapproval received for the remaining goods till 31st March, 2023:

You are required to advise the accountant of Toy Ltd., the amount to be recognised as revenue in above cases in the context of AS-9

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

CHAPTER 10

Accounting Standard 10 Property, Plant and Equipment

<u>Question 1</u> **(Capitalising the cost of "Remodelling" a Supermarket)**

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalised or not.

(*Source: Illustration 1, Study Material*)

Answer

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

Treatment of Spare Parts, Stand by Equipment and Servicing Equipment

Case I If they meet the definition of PPE as per AS 10 (Revised):

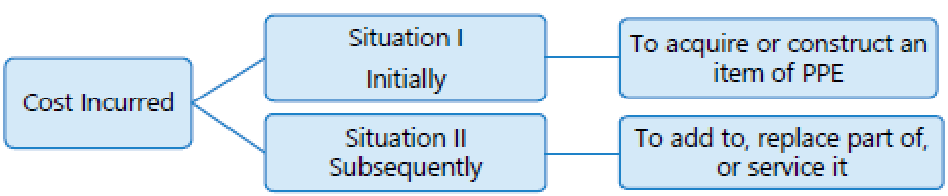
- Recognised as PPE as per AS 10 (Revised)

Case II If they do not meet the definition of PPE as per AS 10 (Revised):

- Such items are classified as Inventory as per AS 2 (Revised)

When do we apply the above criteria for Recognition?

An enterprise evaluates under this recognition principle all its costs on PPE at the time they are incurred. These costs include costs incurred:



<u>Question 2</u>

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1 *Setup costs of ₹5,00,000 to install machinery in the new location.*

2. *Rent of ₹15,00,000*

3. *Removal costs of ₹3,00,000 to transport the machinery from the old location to the temporary location.*

Can these costs be capitalised into the cost of the new building?

(*Source: Illustration 2, Study Material*)

Answer

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

Question 3

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹45,000 per month. The machine was purchased at ₹1,58,00,000 and ₹50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized.

(*Source: Illustration 3, Study Material*)

Answer

Particulars			₹
Purchase Price		Given	1,58,00,000
Add:	Site Preparation Cost	Given	1,40,000
	Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x 3)	1,35,000
	Initial Delivery Cost	Transportation	50,000
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Machinery			1,61,55,000

Question 4 (Capitalisation of directly attributable costs)

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

(*Source: Illustration 4, Study Material*)

Answer

Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

Question 5 (Operating costs incurred in the start-up period)

An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

(*Source: Illustration 5, Study Material*)

Answer

The net operating costs should not be capitalised but should be recognised in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

A. Decommissioning, Restoration and similar Liabilities:

Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Exception: An enterprise applies AS 2 (Revised) "Valuation of Inventories", to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period.

Note: The obligations for costs accounted for in accordance with AS 2 (Revised) or AS 10 (Revised) are recognised and measured in accordance with AS 29 (Revised) "Provisions, Contingent Liabilities and Contingent Assets".

Question 6 (Consideration received comprising a combination of non-monetary and monetary assets)

Entity A exchanges land with a book value of ₹10,00,000 for cash of ₹20,00,000 and plant and machinery valued at ₹25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

(*Source: Illustration 6, Study Material*)

Answer

In the given case, Plant & Machinery is valued at ₹25,00,000, which is assumed to be fair value in absence of information. Further, since fair value of land (asset given up) is not given, the transaction will be recorded at fair value of assets acquired of ₹45,00,000 (₹ Cash 20,00,000 + ₹ Plant & Machinery 25,00,000). Since land of book value ₹10,00,000 is transferred in exchange of assets worth ₹45,00,000, a gain of ₹35,00,000 will be recognised in the books of Entity A.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	20,00,000	
Plant & Machinery A/c	Dr.	25,00,000	
To Land			10,00,000
To Profit on Sale of Land (balancing figure)			35,00,000

Question 7 (Exchange of assets that lack commercial substance)

Entity A exchanges car X with a book value of ₹13,00,000 and a fair value of ₹13,25,000 for cash of ₹15,000 and car Y which has a fair value of ₹13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

(*Source: Illustration 7, Study Material*)

Answer

Since the transaction lacks commercial substance, the entity recognises the assets received at the book value of car X. Therefore, it recognises cash of ₹15,000 and car Y as PPE with a carrying value of ₹12,85,000.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	15,000	
Car Y A/c (balancing figure)	Dr.	12,85,000	
To Car X A/c			13,00,000

Question 8

What happens if the cost of the previous part/inspection was/ was not identified in the transaction in which the item was acquired or constructed?

(*Source: Illustration 8, Study Material*)

Answer

De-recognition of the carrying amount occurs regardless of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

Question 9

What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

(*Source: Illustration 9, Study Material*)

Answer

It may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/existing inspection component was when the item was acquired or constructed.

Question 10 (Revaluation on a class by class basis)

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management want to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

State whether this is acceptable under AS 10 (Revised) or not with reasons?

(*Source: Illustration 10, Study Material*)

Answer

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location. AS 10 (Revised) permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

However, all properties within the class of office buildings must be carried at revalued amount.

Question 11

Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

(*Source: Illustration 11, Study Material*)

Answer

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

Question 12 (Change in estimate of useful life)

Entity A purchased an asset on 1st January 20X1 for ₹1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 20X5, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(*Source: Illustration 12, Study Material*)

Answer

The entity has charged depreciation using the straight-line method at ₹10,000 per annum i.e. (1,00,000/10 years).

On 1st January 20X5, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹60,000.

The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.

Consequently, it should charge depreciation for the next 4 years at ₹15,000 per annum i.e. (60,000 / 4 years).

Note: Depreciation is recognised even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

Question 13

Entity B constructs a machine for its own use. Construction is completed on 1st November 20X1 but the company does not begin using the machine until 1st March 20X2. Comment.

(*Source: Illustration 13, Study Material*)

Answer

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 20X1. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

Question 14 (Depreciation where residual value is the same as or close to Original cost)

A property costing ₹10,00,000 is bought in 20X1. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 20X1 prices, is: Case (a) ₹10,00,000

Case (b) ₹9,00,000.

Calculate the amount of depreciation.

Answer

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹9,00,000 and the depreciable amount is, therefore,

₹1,00,000.

Annual depreciation (on a straight-line basis) will be ₹5,000 [{10,00,000 – 9,00,000} ÷ 20].

Question 15 (Determination of appropriate Depreciation Method)

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.

However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

Answer

The straight-line depreciation method should be adopted because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

Changes in Existing Decommissioning, Restoration and other Liabilities

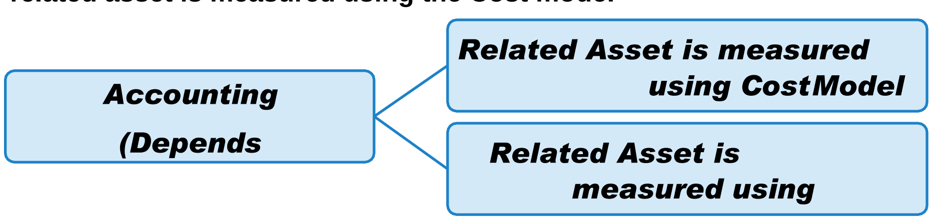
The cost of PPE may undergo changes subsequent to its acquisition or construction on account of:

- Changes in Liabilities
- Price Adjustments
- Changes in Duties
- Changes in initial estimates of amounts provided for Dismantling, Removing, Restoration, and
- Similar factors

The above are included in the cost of the asset.

Accounting for the above changes:

A. If the related asset is measured using the Cost model



Changes in the Liability should be added to, or deducted from, the cost of the related asset in the current period

> **Note:** Amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the Statement of Profit and Loss.

Question 16

A company changed its method of depreciation from SLM to WDV. How should the change be recognised?

Answer

As per AS 10, Property, Plant and Equipment, the depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

Accordingly, the change in method of depreciation should be accounting for as a change in accounting estimate, prospectively.

(*Source: Question 7, Study Material*)

Question 17

A company has debited the Building Account with the Cost of the Land on which the building stands and has provided depreciation on such total cost. Comment on the accounting treatment.

(*Source: Question 8, Study Material*)

Answer

As per AS 10, Property, Plant and Equipment, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. Further, Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets.

In the given case, land should not be depreciated unless it has a limited useful life. Accordingly, it is incorrect to debit the cost of land to the Building Account and provide depreciation on the aggregate cost.

Question 18

An entity is setting up a manufacturing plant. Construction of the plant is completed in August and the plant is ready for commercial production in November. However, the entity commences production in March. When should be company start charging depreciation.

(*Source: Question 9, Study Material*)

Answer

As per AS 10, Property, Plant and Equipment, depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, since the plant is ready for commercial production in November, depreciation shall commence from November. The date of commencement of commercial production is irrelevant for charging depreciation.

Question 19

Which factors should be considered by a company while determining useful life?

(*Source: Question 10, Study Material*)

Answer

All the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Question 20

An entity gave the following Note in its Financial Statements:

The company chooses not to charge depreciation on Property, Plant and Equipment on account of:

(a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery.

(b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

(c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

(d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.

You are required to state the appropriateness of the above accounting policy in line with the relevant Accounting Standards.

(*Source: Question 11, Study Material*)

Answer

Depreciation refers to writing off the value of the asset over its useful life. Such write-off is necessitated on account of normal wear-and-tear, usage, or obsolescence. Since items of Property, Plant and Equipment are generally used in generating revenue, the pro-rated write-off in value of such item should be recorded in the books against the income earned by such an asset.

Providing depreciation is mandatory, in spite of the fact that repairs are expensed in the Statement of Profit and Loss, or the value of the Property is appreciating. Depreciation is a systematic allocation of cost of the asset against the income generated from the continued use of the asset. Further, the Companies Act, 2013 mandates depreciation to be charged in order to determine the correct profits. Thus, not charging depreciation would result in non-compliance with the Companies Act provisions as well.

The argument laid down by the company and the reasons for the same being invalid are discussed below.

(a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery:

The fact that the company enters into Annual Maintenance Contracts for timely repairs can be regarded as a running cost. Such expense is incurred in order to ensure that the machine continues to run as intended. Thus, it implies that because the machine is being utilized, it will need regular repairs. In other words, continuous use is resulting in normal wear-and-tear which is the reason why depreciation should be charged by the company. By stating that the company incurs Annual Maintenance Expenses, the company is recording only the 'maintenance expenses', but not the wear-and-tear requiring the maintenance in the first place. Hence, this argument put forth by the company is not valid.

(b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

When viewed from the prism of depreciation alone, it appears that the fact that depreciation is a non-cash item is correct. However, it must be noted that at the time of procurement of the asset, the company would have paid cash. Depreciation is after all writing off this amount over the life of the asset. Hence the argument that depreciation is a non-cash item is not valid. Depreciation is writing off the cost of the asset (which was already paid for) over the useful life of the asset, and hence is mandatory.

(c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

Certain assets like immovable property do increase in value with the passage of time. However, such assets are 'used for the purposes of business' and are not 'held for sale' or held as investment property. Accordingly, since the asset is being used for carrying on business, providing depreciation will give a true and fair view of the results of the company, and hence the argument that the value of the property appreciates is not valid.

If the company wants to show the fair market value of the PPE, then it has the option to apply Revaluation model. However, depreciation is mandatory to be charged in Revaluation model also.

(d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.

The value of any asset, after usage, will reduce. Accordingly, the argument that the 'exact profit or loss on sale of the asset' will be obtained is incorrect. Due to usage of the asset, the value of the asset would be lower than the cost. Charging depreciation would seek to bring the book value approximating to such reduced value. Thereafter, on sale of the asset, the true profit or loss would be available. Accordingly, this argument is also invalid.

It may be pertinent to note that Accounting Standard 1, Disclosure of Accounting Policies states that Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts. In other words, the company cannot be absolved of the fact that it has not complied with the relevant accounting standards merely by giving a disclosure of incorrect policies or practices being followed.

Thus, the company's stand of disclosing the incorrect policy as a remedy is not correct. The company is suggested to charge depreciation on a systematic basis over the useful life of the asset thereby complying with the Accounting Standards.

Question 21

With reference to AS-10 Revised, classify the items under the following heads:

HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) Import duties and non-refundable purchase taxes.

(2) Initial delivery and handling costs.

(3) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(4) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.

(5) Trade discounts and rebates.

(6) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(7) Installation and assembly costs.

(8) Administration and other general overhead costs.

(*Source: Question 12, Study Material*)

Answer

Heads

(i) Purchase price of PPE

(iii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

Items		**Classified under Head**
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5	Trade discounts and rebates (deducted for computing purchase price)	(i)
6	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)

7	Installation and assembly costs	(ii)
8	Administration and other general overhead costs	(iii)

Question 22

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	*Cost of the plant (cost per supplier's invoice plus taxes)*	*₹25,00,000*
2.	*Initial delivery and handling costs*	*₹2,00,000*
3.	*Cost of site preparation*	*₹6,00,000*
4.	*Consultants used for advice on the acquisition of the plant*	*₹7,00,000*
5.	*Interest charges paid to supplier of plant for deferred credit*	*₹2,00,000*
6.	*Estimated dismantling costs to be incurred after 7 Years*	*₹3,00,000*
7.	*Operating losses before commercial production*	*₹4,00,000*

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*Source: Question 13, Study Material*)

Answer

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹25,00,000
2.	Initial delivery and handling costs	₹2,00,000
3.	Cost of site preparation	₹6,00,000
4.	Consultants' fees	₹7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹3,00,000
		₹43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹2,00,000 and operating losses before commercial production amounting to ₹4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 23

Arka Ltd. purchased machinery for ₹3,000 lakhs. Depreciation was charged at 10% on SLM basis for a useful life of 10 years. At the end of Year 4, the machinery was revalued to ₹2,700 lakhs and the same was adopted. What will be the carrying amount of the asset at the end of Year 5 and Year 6? Assume no change in the useful life.

(*Source: Question 14, Study Material*)

Answer

Particulars	***₹ in lakhs***
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years (₹3,000 lakhs x 10% x 4 years)	(1,200.00)
Book Value at the end of Year 4	1,800.00
Add: Revaluation Surplus (balancing figure)	900.00
Revalued Amount as given (= revised depreciable value)	2,700.00
Less: Depreciation for Year 5 (₹2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 (₹2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 6	1,800.00

Question 24

Skanda Ltd. acquired a machinery for ₹2,50,00,000 five years ago. Depreciation was charged at 10% p.a. on SLM basis, useful life being 10 years. At the beginning of Year 3, the machinery was revalued to ₹3,00,00,000 with the surplus on revaluation being credited to Revaluation Reserve. Depreciation was provided on the revalued amount over the balance useful life of 8 years. The machinery was sold in the current year for ₹1,12,50,000. Give the accounting treatment for the above in the Company's accounts. What will be the treatment if the machinery fetched only ₹42,50,000 now?

(*Source: Question 15, Study Material*)

Answer

Particulars	**₹**
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (₹2,50,00,000 x 10% x 2 years)	50,00,000
Book Value at the beginning of Year 3	2,00,00,000
Add: Revaluation Surplus (balancing figure)	1,00,00,000
Revalued Amount as given (= revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3-5 (₹3,00,00,000 ÷ 8 yrs x 3 yrs)	1,12,50,000
Carrying Amount at the end of Year 5	**1,87,50,000**

The treatment of Gain / Loss on Disposal / Revaluation is as below:

Particulars	**Disposal Proceeds = ₹1,12,50,000**	**Disposal Proceeds = ₹42,50,000**
Book Value Less Disposal Proceeds = Loss recognized in Profit or Loss	₹1,87,50,000 – ₹ 1,12,50,000 = ₹75,00,000 (**Loss**)	₹1,87,50,000 – ₹42,50,000 = ₹1,45,00,000 (**Loss**)
Revaluation Surplus directly transferred to Retained Earnings	₹1,00,00,000	₹1,00,00,000

Question 25

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

- *Cost of the Plant (as per supplier's invoice): ₹30,00,000*
- *Initial delivery and handling costs: ₹1,00,000*
- *Cost of site preparation: ₹2,00,000*
- *Consultant fee for advice on acquisition of Plant: ₹50,000*
- *Interest charges paid to supplier against deferred credit: ₹1,00,000*
- *Estimate of Dismantling and Site Restoration costs: ₹50,000 after 10 years (Present Value is ₹30,000)*
- *Operating losses before commercial production: ₹40,000*

The company identified motors installed in the Plant as a separate component and a cost of ₹5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of ₹6,00,000 and estimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is ₹25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a whole for ₹6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

(*Source: Question 16, Study Material*)

Answer

1. Cost at Initial Recognition:

Particulars	**₹**
Cost of the Plant (as per Invoice)	30,00,000
Initial Delivery and Handling Costs	1,00,000
Cost of Site Preparation	2,00,000
Consultants' Fees	50,000
Estimated Dismantling and Site Restoration Costs	30,000
Total Cost of Plant including Motors	33,80,000
Less: Cost of Motors identified as a separate component (1/6)*	5,63,333

Particulars	₹
Cost of the Plant (excluding Motors – balance 5/6)	**28,16,667**

* Purchase price of Motors = ₹5,00,000 out of ₹30,00,000 i.e., 1/6 of value of Plant

Note: Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of ₹40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

2. Recognition of Motors Replacement

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM) 5,63,333 ÷ 6 years x 4 years	3,75,555
Carrying Amount of Motors at the end of Year 4	**1,87,778**

Accounting: The company should derecognize the existing Carrying Amount of Motors replaced of ₹1,87,778. Further, the acquisition cost of new motors of ₹6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at ₹6,00,000 ÷ 5 years = ₹1,20,000 p.a.

3. Revaluation

Particulars	₹
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹28,16,667 ÷ 10 years x 4 years	11,26,667
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since the same is treated as a separate component: ₹25,00,000 – ₹6,00,000)	19,00,000
Therefore, Gain on Revaluation credited to Revaluation Reserve	**2,10,000**
Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years	**3,16,667**

4. Derecognition

Particulars	***Motors***	***Plant (excluding Motors)***
Cost/Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5-8	1,20,000 x 4 = 4,80,000	3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / De- recognition	1,20,000	6,33,332
Less: Disposal Proceeds ₹6,00,000 allocated in ratio of carrying amount	95,575	5,04,425
Loss to be written off to P/L	**24,425**	**1,28,907**

Notes:

(a) The Revaluation Surplus of ₹2,10,000 would be transferred directly to Retained Earnings.

(b) The allocation of disposal proceeds of ₹6,00,000 for the plant as whole is apportioned based on carrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on the reasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

Question 26

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of ₹1,000 lakhs, the breakdown of its components is not provided. The estimated useful life of the machinery is 10 years. At the end of Year 6, the turbine, which is a major component of the machinery, needed replacement, as further usage and *maintenance was uneconomical. The remainder of the machine is in good condition and is expected to last for the remaining 4 years. The cost of the new turbine is ₹450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.*

(*Source: Question 17, Study Material*)

Answer

As per AS 10, Property, Plant and Equipment, the derecognition of the carrying amount of components of an item of Property, Plant and Equipment occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

In the given case, the new turbine will produce economic benefits to Bharat Infrastructure Ltd. and the cost is measurable. Since the recognition criteria is fulfilled, the same should be recognised as a separate item of Property, Plant and Equipment. However, since the initial breakup of the components is not available, the cost of the replacement of ₹450 lakhs can be used as an indication based on the guidance given above, discounted at 8% for the 6-year period lapsed.

Thus, estimate of cost 6 years back = ₹450 lakhs ÷ 1.08^6 = ₹283.58 lakhs Current carrying amount of turbine (to be de-recognised) = Estimated cost ₹283.58 lakhs (–) SLM depreciation at 10% (useful life 10 years) for 6 years ₹170.15 lakhs= ₹113.43 lakhs.

Hence revised carrying amount of the machinery will be as under:

Particulars	**₹ in lakhs**
Historical Cost [₹1,000 lakhs (–) SLM Depreciation at 10% (10 year life) for 6 years]	400.00
Add: Cost of new turbine	450.00
Less: Derecognition of current carrying amount of old turbine	(113.43)
New Carrying Amount of Machinery	**736.57**

Question 27

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factor having an area of 5,000 acres at a cost of ₹60,000 per acre. Preet Ltd. has incurred ₹1.10 crores on demolishing the old Factory Building thereon. A sum of ₹63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹8,00,000 for land acquisition and incurred ₹1,25,000 on title guarantee insurance. Compute the value of the land acquired.

(*Source: Question 18, Study Material*)

Answer

Particulars	**₹**
Purchase Price: 5,000 acres x ₹60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7%	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income)	50.00
[₹110 lakhs (–)₹60 lakhs (₹63 lakhs x 100/105)]	
Cost of Land	**3,269.25**

QUESTION BANK

Question 28

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period—

Salaries of the staff engaged in preparation of restaurant before its opening	₹7,50,000
Construction and remodelling cost of restaurant	₹30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

(*November 2018*) (*5 Marks*)

Answer:

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

Question 29

Preet Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 50,00,000
2.	Initial delivery and handling costs	₹ 4,00,000
3.	Cost of site preparation	₹ 12,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 14,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 4,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 6,00,000
7.	Operating losses before commercial production	₹ 8,00,000

Please advise Preet Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*RTP May 2019*)

Answer:

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹ 50,00,000
2.	Initial delivery and handling costs	₹ 4,00,000
3.	Cost of site preparation	₹ 12,00,000
4.	Consultants' fees	₹14,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 6,00,000
		₹ 86,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 4,00,000 and operating losses before commercial production amounting to ₹ 8,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 30

ABC Ltd. is installing a new plant at its production facility. It provides you the following information:

	₹
Cost of the plant (cost as per supplier's invoice)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial Operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000

You are required to compute the costs that can be capitalised for plant by ABC Ltd., in accordance with AS 10: Property, Plant and Equipment.

(*RTP November 2018*)

Answer:

According to AS 10 on Property, Plant and Equipment, the costs which will be capitalized by ABC Ltd.:

	₹
Cost of the plant	31,25,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants' fees	6,50,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Total cost of Plant	46,60,000

Note: Operating losses before commercial production amounting to ₹3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 31

In the year 2016-17, an entity has acquired a new freehold building with a useful life of 50 years for ₹ 90,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	₹ 20,00,000
Roof	25	₹ 10,00,000
Lifts	20	₹ 5,00,000
Fixtures	10	₹ 5,00,000
Remainder of building	50	₹ 50,00,000
		₹ 90,00,000

You are required to calculate depreciation for the year 2016-17 as per componentization method.

(*RTP May 2018*)

Answer:

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum) (₹)
Land	Nil
Roof	40,000
Lifts	25,000
Fixtures	50,000
Remainder of Building	1,00,000
	2,15,000

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognized as a new component.

Question 32

Mohan Ltd. purchased an asset on 1st January 2013 for ₹ 5,00,000 and the asset had an estimated useful life of 5 years and a residual value of nil. On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

You are required to compute the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(*MTP April 2019*) (*5 Marks*)

Answer:

The entity has charged depreciation using the straight-line method at ₹ 1,00,000 per annum i.e (5,00,000/5 years). On 1st January 2017, the asset's net book value is [5,00,000–(1,00,000 x 4)] ₹ 1,00,000. The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at ₹ 25,000 per annum i.e. (1,00,000/4 years).

Question 33

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom -made machine amounting to ₹ 4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Explain the treatment of machine in the books of ABC Ltd.

(*MTP August, 2018*) (*5 Marks*)

Answer:

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense.

Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

Question 34

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
Initial delivery and handling costs	₹ 2,00,000
Cost of site preparation	₹ 6,00,000
Consultants used for advice on the acquisition of the plant	₹ 7,00,000
Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*MTP August, 2018*) (*5 Marks*)

Answer:

According to AS 10 (Revised), the following costs can be capitalized:

Cost of the plant	₹ 25,00,000
Initial delivery and handling costs	₹ 2,00,000
Cost of site preparation	₹ 6,00,000
Consultants' fees	₹ 7,00,000
Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
	₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 35

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of ₹ 5,00,000 to install machinery in the new location.

Rent of ₹ 15,00,000.

Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment".

(*MTP October, 2018*) (*5 Marks*)

Answer:

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 36

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom -made machine amounting to ₹ 4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

(*MTP October, 2018*) (*5 Marks*)

Answer:

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

Question 37

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of ₹ 5,00,000 to install machinery in the new location.

Rent of ₹ 15,00,000

Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

You are required to examine in line with AS 10 "Property, Plant and Equipment" whether these costs can be capitalized into the cost of the new building.

(*MTP March 2018*) (*5 Marks*)

Answer:

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 38

Ram Ltd. purchased machinery for ₹ 80 lakhs, (useful life 4 years and residual value ₹ 8 lakhs). Government grant received is ₹ 32 lakhs.

You are required to show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant is credited to Fixed Assets A/c.

(*MTP April, 2018*) (*5 Marks*)

Answer:

In the books of Ram Ltd.

If the grant is credited to Fixed Assets Account:

1. **Journal Entry (at the time of refund of grant)**

			In lakhs ₹	**In lakhs ₹**
I	Fixed Assets To Bank A/c (Being grant refunded)	Dr.	32	 32

2. **Value of Fixed Assets after two years but before refund of grant**

Fixed assets initially recorded in the books	= ₹ 80 lakhs - ₹ 32 lakhs
	= ₹ 48 lakhs
Depreciation for each year	= (₹ 48 lakhs - ₹8 lakhs)/4 years
	= ₹ 10 lakhs per year for first two years.
Value of the assets before refund of grant	= ₹ 48 lakhs - ₹ 20 lakhs
	= ₹ 28 lakhs

3. **Value of Fixed Assets after refund of grant**

Value of Fixed Assets before refund of grant	₹ 28 lakhs
Add Refund of grant	₹ 32 lakhs
	₹ 60 lakhs

4. **Amount of depreciation for remaining two years**

Value of the fixed assets after refund of grant -residual value of the assets/No. of years

= ₹ 60 lakhs - ₹ 8 lakhs/2

= ₹ 26 lakhs per annum will be charged for next two years.

Question 39

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

(*RTP November 2019*)

Answer

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		***₹***
Purchase Price	Given (₹ 158,34,000 x 100/112)	1,41,37,500
Add: Site Preparation Cost	Given	1,41,870
Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x3)	1,35,000
Initial Delivery Cost	Transportation	55,770
Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset		1,45,00,140

Question 40

(a) Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

(b) Entity A purchased an asset on 1st January 2016 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(c) The following items are given to you:

ITEMS

(1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training);

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management

(4) Costs of opening a new facility or business, such as, inauguration costs;

(5) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "Property, Plant and Equipment", classify the above items under the following heads:

HEADS

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

[*RTP May 2020*]

Answer

(a) The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

(b) The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (1,00,000/10 years). On 1st January 2020, the asset's net book value is [1,00,000 – (10,000 x 4)] = ₹ 60,000.

The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000/4 years). Depreciation is recognized even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

(c) (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as “Directly attributable cost of PPE”.

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carrying amount of an item of PPE.

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE

(4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.

(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

Question 41

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month.

The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

You are required to ascertain the amount at which the Machinery should be capitalized under AS 10.

[*RTP, November 2020*]

Answer

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		**₹**
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000
Technician’s Salary	Specific/Attributable overheads for 3 months (45,000 x3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for Installation	Architect’s Fees	30,000
Total Cost of Asset		1,61,55,000

Question 42

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The details of the incremental costs which will be incurred are: Setup costs of ₹ 5,00,000 to install machinery in the new location; Rent of ₹ 15,00,000; Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 “Property, Plant and Equipment”.

(MTP, May 2020)/(MTP April, 2022) (5 Marks)

Answer

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the company. These costs do not meet that requirement of AS 10 “Property, Plant and Equipment” and cannot, therefore, be capitalized.

Question 43

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The details of the incremental costs which will be incurred are: Setup costs of ₹ 5,00,000 to install machinery in the new location; Rent of ₹ 15,00,000; Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 “Property, Plant and Equipment”.

(*5 Marks*)

Answer

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 44

(i) A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹35,000 per month. The machinery was purchased for ₹1,27,50,000 and a sum of ₹2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fees of ₹37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited.

(ii) B Limited, which operates a major chain of retail stores, has acquired a new store locations. The new location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited? (*5 Marks*)

Question 45

You are required to give the correct accounting treatment for the following in line with provisions of AS 10:

(a) Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this period, including expenditure related to construction and remodelling costs (₹ 18 lakhs), salaries of staff (₹ 2 lakhs) who will be preparing the store before its opening and related utilities costs (₹ 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?

(b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/ development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)?

Answer

(a) Trozen Ltd. should capitalize the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended. The supermarket cannot be opened without incurring the remodelling expenditure. Therefore, this construction and remodelling expenditure of ₹ 18 lakh should be considered as part of the cost of the asset. However, the cost of salaries of the staff ₹ 2 lakh and utilities cost ₹ 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by the management and should be expensed.

(b) AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

Question 46

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only.

(*5 Marks*) (*November 2020*)

Answer

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (50,000/5 years). On 1st April, 2019 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

Question 47

Explain 'Bearer Plant' and 'Biological Asset' as per Accounting Standard 10.

(*Old Study Material*)

Answer

As per AS 10 Property, Plant and Equipment, biological asset is a living animal or plant. Bearer plant is a plant that (a) is used in the production or supply of agricultural produce; (b)is expected to bear produce for more than a period of twelve months; and (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber); plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and annual crops (for example, maize and wheat) are not bearer plants.

Question 48

With reference to AS-10 Revised, classify the items under the following heads:

HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) Import duties and non-refundable purchase taxes.

(2) Initial delivery and handling costs.

(3) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(4) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.

(5) Trade discounts and rebates.

(6) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(7) Installation and assembly costs.

(8) Administration and other general overhead costs.

(*Old Study Material*)

Answer

Heads

(i) Purchase price of PPE

(ii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

Items		Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5	Trade discounts and rebates (deducted for computing purchase price)	(i)
6	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
7	Installation and assembly costs	(ii)
8	Administration and other general overhead costs	(iii)

Question 49

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
4. Inauguration costs for the factory
5. Professional fees charged by consulting engineer for the installation process
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs
8. Cost of site preparation.

(RTP May, 2022)

Answer

Included in Cost**:**

Point no. 1, 2, 3, 5, 8 Excluded from Cost:

Point no. 4, 6, 7

Question 50

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7.	Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*Old Study Material*)

Answer

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants' fees	₹ 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
		₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 51

A Ltd. has entered into a binding agreement with Gamma Ltd. to buy a custom-made machine ₹ 1,00,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.

You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2.

[*RTP May 2020*]

Answer

A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, A Ltd. should recognise a liability of ₹ 1,00,000 to Gamma Ltd..

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense.

Journal entry

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

Question 52

(i) In the year 2018-19, an entity has acquired a new freehold building with a useful life of 50 years for ₹75,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	**Useful life (Years)**	**Cost**
Land	Infinite	₹10,00,000
Roof	25	₹15,00,000
Lifts	20	₹7,50,000
Fixtures	10	₹2,50,000
Remainder of building	50	₹40,00,000
		₹75,00,000

Calculate depreciation for the year 2018-19 as per componentization method. Also state the treatment, in case Roof requires replacement at the end of its useful life.

(ii) Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether the remodeling cost will be capitalized or not as per provision of AS 10 "Property plant & Equipment".

[MTP October, 2019, 5 marks]

Answer

(i) Statement showing amount of depreciation as per Componentization Method

Component	**Depreciation (Per annum) (₹)**
Land	Nil
Roof	60,000
Lifts	37,500
Fixtures	25,000
Remainder of Building	80,000
	2,02,500

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognised as a new component.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10 PPE.

Question 53

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

[*MTP October, 2019, 5 marks*] (*MTP March, 2022, 5 marks*)

Answer

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

Question 54

(i) Entity A carried plant and machinery in its books at ₹ 2,00,000 which were destroyed in a fire. These machines were insured 'New for old' and were replaced by the insurance company with new machines of fair value ₹ 20,00,000. The old destroyed machines were acquired by the insurance company and the company did not receive any cash compensation. State, how Entity A should account for the same?

(MTP, October, 2020) (MTP March, 2022) (*5 Marks*)

(ii) Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether Omega Ltd. can capitalize the remodelling cost or not as per provisions of AS 10 “Property plant & Equipment”.

(MTP, October, 2020) (MTP March, 2022) (*5 Marks*)

Answer

(i) Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10 on Property, Plant and Equipment. Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets provided by the insurer.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10.

Question 55

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹ 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is ‘NIL’. Show the treatment of machine in the books of ABC Ltd.

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

Answer

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

Question 56

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period –

Salaries of the staff engaged in preparation of restaurant before its opening	₹ 7,50,000
Construction and remodelling cost of restaurant	₹ 30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

Answer

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

Question 57

Arush Ltd. is installing a new plant in its factory. It provides you the following information:

Cost of the plant (cost as per supplier's invoice)	₹ 31,25,000
Estimated dismantling costs to be incurred after 5 years	₹ 2,50,000
Initial delivery and handling costs	₹ 1,85,000
Cost of site preparation	₹ 4,50,000
Consultants used for advice on the acquisition of the plant	₹ 6,50,000

You are required to advise Arush Ltd. on the costs that can be capitalised for plant in accordance with AS 10 'Property, Plant and Equipment'. (*MTP, November, 2021*) (*5 Marks*)

Answer

According to AS 10 'Property, Plant and Equipment', following costs will be capitalized by Arush Ltd.:

	₹
Cost of the plant	31,25,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants' fee	6,50,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Total cost of Plant	46,60,000

Question 58

A property costing ₹ 10,00,000 is bought on 1.4.2020. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 25 years.

The estimated residual value in 25 years' time, based on current year prices, is: Case (a) ₹ 10,00,000 Case (b) ₹ 9,00,000

You are required to compute the amount of depreciation charged for the year ended 31.3.2021.

(*RTP, November 2021*)

Answer

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹9,00,000 and the depreciable amount is, therefore, ₹1,00,000.

Annual depreciation (on a straight line basis) will be ₹ 4,000 [{10,00,000 – 9,00,000} ÷ 25].

Question 59

XYZ Limited provided you the following information for the year ended 31st March. 2022:-

(i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance on the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

You are required to calculate the revaluation loss as per AS-10 (Revised) and give its treatment in the books of accounts.

(ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.

You are required to explain how the disposal should be accounted for in the financial statements as per AS-10 (Revised). (*Question Paper, May 2022*) (*5 Marks*)

Question 60

(*i*) *Jared Limited purchased a Machine for US $ 20,000 on 31st December, 2021 payable after four months. It entered into a forward contract for four months @₹ 78.85 per US $. On 31st December, 2021 the exchange rate was ₹ 77.50 per US $.*

How will you recognize the Profit or Loss on Forward Contract for the yearended31st March, 2022 in the books of Jared Limited?

(ii) Trade Payables of Jared Limited includes amount due to Sterling Limited ₹9,75,000 recorded at the prevailing exchange rate on the date of purchase; transaction recorded at US$1 =₹75.00.The exchange rate on Balance Sheet date (31st March, 2022) was US $ 1 = 79.00 The payment was made on 1st May,2022 when the exchange rate was US $ 1 = ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as per AS 11 in the books of Jared Limited.

(Suggested November, 2022) (5 Marks)

Answer

(i)

	₹
Forward Rate	78.85
Less: Spot Rate	(77.50)
Premium on Contract	1.35
Contract Amount	US$ 20,000
Total Loss (20,000 x 1.35)	₹ 27,000

Contract period 4 months (3 months falling in the year ended 31st March, 2022)

Loss to be recognized (₹27,000x 3/4) = ₹ 20,250 in the year ended 31st March, 2022.

(ii) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Trade payables	***Foreign Currency Rate***	***Amount ₹***
Initial recognition US $13,000 (9,75,000/75)	1 US $ = ₹ 75	
Exchange Rate on Balance sheet date	1 US $ = ₹ 79	
Exchange Difference Loss US $ 13,000 X (79-75)		52,000
Exchange Rate on Settlement date	1 US $ = ₹ 78.30	
Exchange Difference Profit US $ 13,000x(79-78.30)		9,100

For the year ended 31st March, 2022 exchange difference loss amounting ₹ 52,000 will be charged to statement of Profit & Loss A/c.

However, there is exchange difference gain of ₹ 13,000 x (79-78.30) = 9,100 on 1st May, 2022. Thus gain of ₹ 9,100 will be credited to statement of Profit & Loss A/c for the year ended 31st March, 2023.

Question 61

RS Ltd. has acquired a heavy plant at a cost of ₹ 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e. the Boiler has become obsolete (which was acquired at price of ₹ 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000.

Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year?

(*RTP November, 2022*)

Answer

Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The cost old boiler should be de-recognized and the new boiler will be added.

Statement showing cost of new boiler and machine after year 2

Original cost of plant	₹ 2,00,00,000
Less: Accumulated depreciation [(2,00,00,000 /10) x 2]	₹ 40,00,000
Carrying value of the plant after two years	₹ 1,60,00,000
Less: Current Cost of Old Boiler to be derecognized	
Less: WDV of Boiler (replaced) after 2 years	
(50,00,000/10 x 8)	40,00,000
	1,20,00,000
Add: Cost of new Boiler to be recognized	60,00,000
Revised carrying amount of Plant	1,80,00,000

Question 62

Star Limited purchased machinery for ₹ 6,80,000 (inclusive of GST of ₹ 40,000). Input credit is available for entire amount of GST paid. The company incurred the following other expense for installation.

	₹
Cost of preparation of site for installation	21,200
Total Labour charges	56,000
(200 out of the total of 500 men hours worked, were spent on installation of the machinery)	
Spare parts and tools consumed in installation	5,000
Total salary of supervisor	26,000
(Time spent for installation was 25% of the total time worked)	
Total technical expense	34,000
(1/10 relates to the plant installation)	
Test run and experimental production expenses	18,000
Consultancy charges to architect for plant set up	11,000
Depreciation on assets used for installation	12,000

The machine was ready for use on 15.01.2021 but was used from 01.02.2021. Due to this delay further expenses of ₹ 8,900 were incurred. Calculate the value at which the plant should be capitalized in the books of Star Limited.

(*RTP May, 2023*)

Answer

Calculation of Cost of Plant

Particulars		**₹**
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour charges	(56,000×200/500) Given	22,400
Spare parts		5,000
Supervisor's Salary	25% of ₹ 26,000	6,500
Technical costs	1/10 of ₹ 34,000	3,400
Test run and experimental production charges	Given	18,000
Architect Fees for set up	Given	11,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		7,79,500
Less: GST credit receivable		(40,000)
Value to be capitalized		7,39,500

Note: Further Expenses of ₹ 8,900 from 15.1.2021 to 1.2.2021 to be charged to profit and loss A/c as plant was ready for production on 15.1.2021.

Question 63

In the books of Topmaker Limited, carrying amount of Plant and Machinery as on 1st April, 2022 is ₹56,30,000.

On scrutiny, it was found that a purchase of Machinery worth ₹21,12,000 was included in the purchase of goods on 1st June, 2022.

On 30th June, 2022 the company disposed a Machine having book value of ₹9,60,000 (as on 1st April, 2022) for ₹ 8,25,000 in part exchange of a new machine costing ₹15,65,000.

The company charges depreciation @ 10% p.a. on written down value method on Plant and Machinery.

You are required to compute:

(i) Depreciation to be charged to Profit & Loss Account;

(ii) Book value of Plant & Machinery as on 3st March, 2023; and

(iii) Profit/Loss on exchange of Plant & Machinery.

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

CHAPTER

11

Accounting Standard 11 The Effects of Changes in Foreign Exchange Rates

Question 1

Classify the following items as monetary or non-monetary item: Inventories
Trade Receivables Investment in Equity shares
Property, Plant and Equipment.

(*Source: Illustration 1, Study Material*)

Answer

Inventories	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Property, Plant and Equipment	Non-monetary

Question 2

	Exchange Rate per $
Goods purchased on 1.1.20X1 for US $ 15,000	*₹ 75*
Exchange rate on 31.3.20X1	*₹ 74*
Date of actual payment 7.7.20X1	*₹ 73*

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 20X1 and 31st March, 20X2 as per AS 11.

(*Source: Illustration 2, Study Material*)

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.20X1 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.20X1 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year ended 31st March, 20X1.

On 7.7.20X1, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year ended 31st March, 20X2.

Question 3

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. prepares financial statement ending on 31/03/20X1. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/20X1 1 US$ = ₹ 48.00
31/03/20X1 1 US$ = ₹ 49.00
31/07/20X1 1 US$ = ₹ 49.50

(*Source: Illustration 3, Study Material*)

Answer

Journal Entries in the Books of Kalim Ltd.

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1		216,00,000	
Jan. 01	Bank Account (4,50,000 x 48) Dr.		
	To Foreign Loan Account		216,00,000
March 31	Foreign Exchange Difference Account Dr.	4,50,000	
	To Foreign Loan Account [4,50,000 x (49-48)]		4,50,000
July 01	Foreign Exchange Difference Account Dr. [4,50,000 x (49.5-49)]	2,25,000	
	Foreign Loan Account Dr.	220,50,000	
	To Bank Account		2,22,75,000

Question 4

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

(*Source: Illustration 4, Study Material*)

Answer

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised (30,000/3) x 2 = ₹ 20,000 in the year ended 31st March, 20X1. Rest ₹ 10,000 will be recognised in the following year.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Question 5

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1 st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.

(*Source: Illustration 5, Study Material*)

Answer

Since the forward contract was for speculation purpose the premium on contract

i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	₹ 47.18
Less: Contract Rate	(₹ 47.10)
Premium on Contract	₹ 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	₹ 8,000

Question 6

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to the statement of profit and loss. Comment.

(*Source: Illustration 6, Study Material*)

Answer

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 ‘Accounting for Taxes on Income’.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

Question 7

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.20X4:

Account Name	***Amount in £***	
	Dr.	***Cr.***
Machinery (purchased on 01.04.20X1)	*5,000*	
Debtors	*1,600*	
Opening Stock	*400*	
Goods received from Head Office Account	*6,100*	
(Recorded in HO books as ₹ 4,02,000)		
Sales		*20,000*
Purchases	*10,000*	
Wages	*1,000*	
Salaries	*1,200*	
Cash	*3,200*	
Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	*2,900*	
Head Office Account (Recorded in HO books as ₹ 4,90,000) Creditors		*7,400*
		4,000

- *Closing stock at branch is £ 700 on 31.03.20X4.*
- *Depreciation @ 10% p.a. is to be charged on Machinery.*
- *Prepare the trial balance after been converted in Indian Rupees.*
- *Exchange rates of Pounds on different dates are as follow: 01.04.20X1 – ₹ 61; 01.04.20X3 – ₹ 63 & 31.03.20X4 – ₹ 67*

(*Source: Illustration 7, Study Material*)

Answer

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 20X4

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	₹ (Dr.)	₹ (Cr.)
Machinery	5,000		Transaction date rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	
Wages	1,000		Average Rate	65,000	
Salaries	1,200		Average Rate	78,000	
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

Question 8

A Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for.

(*Source: Illustration 8, Study Material*)

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{\text{Rs. 300 lakhs}}{\text{Rs. 40}}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars ₹ (42.50 – 40.00) = ₹187.50 lakhs (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

Note: The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has done the correct treatment.

Question 9

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 20X1 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/20X1 1 US$ = ₹ 48.00

31/03/20X2 1 US$ = ₹ 51.00

You are required to pass the journal entries in the following cases:

(i) *Option under Para 46A is not availed.*

(ii) *Option* under *Para 46A is availed.*

(iii) *The loan was taken to finance the operations of the entity (and not to procure a depreciable asset).*

In all cases, assume interest accrued on 31 March 20X2 is paid on the same date.

(*Source: Illustration 9, Study Material*)

Answer

Journal Entries in the Books of A Ltd.

(i) Option under Para 46A is not availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account (P/L)	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000

In this case, since the option under Para 46A is **NOT** availed, the Exchange Loss of ₹ 30,000 is recognised as an expense in the Statement of Profit and Loss for the year ending 31 March 20X2.

(ii) Option under Para 46A is availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000
Mar 31	Property, Plant and Equipment	Dr.	30,000	
	To Foreign Exchange Difference Account			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is capitalized in the cost of Property, Plant and Equipment, which will indirectly get recognized in the Profit & Loss A/c by way of increased depreciation over the remaining useful life of the asset.

(iii) Option under Para 46A is availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000
Mar 31	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA)	Dr.	30,000	
	To Foreign Exchange Difference Account			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is accumulated in the FCMITD A/c, which will be subsequently spread over and debited to P&L A/c over the tenure of the loan.

Question 10

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Question 11

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date?

Answer

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation. For details, refer para 2.5 of chapter.

Question 12

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3. 20X1.

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	**Foreign Currency Rate**	₹
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

QUESTION BANK

Question 13

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹30,00,000. It was recorded at US $1 = ₹60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., ₹10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹59.00. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd. (*November 2018*) (*5 Marks*)

Answer:

Amount of Exchange difference and its Accounting Treatment

Long term Loan		Foreign Currency Rate	₹
(i)	Initial recognition US $ 50,000 ₹ (30,00,000/60)	1 US $ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Loss US $ 50,000 x ₹ (62 – 60)		1,00,000
	Treatment: Credit Loan A/c		
	and Debit FCMIT D A/c or Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial recognition US $ 16,949.152* (₹10,00,000/59)		
	Rate on Balance sheet date	1 US $ = ₹ 59	10,00,000
	Exchange Difference Gain US $ 16,949.152* x ₹ (62-59)	1 US $ = ₹ 62	
	Treatment: Credit Profit and Loss A/c by ₹ 50,847.456*		50,847.456*
	And Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting ₹ 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting ₹ 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 14

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st January 2018 from an American company M/s M & M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2018	₹60.75 per dollar
On 31st March, 2018	₹63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(*November 2018*) (*4 Marks*)

Answer:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate	₹ 62.50
Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 1.75
Contract Amount	US$ 5,00,000
Total Loss (5,00,000 x 1.75)	₹ 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹ 5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

Question 15

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2017	**1 US$ =**	**₹ 68.50**
31/03/2017	1 US$ =	₹ 69.50
31/07/2017	1 US$ =	₹70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

(*May 2018*) (*5 Marks*)

Answer

Journal Entries in the Books of ABC Ltd.

Date	Particulars		₹ (Dr.)	₹ (Cr.)
Jan. 01,2017	Bank Account (5,00,000 × 68.50)	Dr.	342,50,000	
	To Foreign Loan Account			342,50,000
Mar. 31,2017	Foreign Exchange Difference Account	Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 × (69.50-68.50)]			5,00,000
Jul. 31,2017	Foreign Exchange Difference Account [5,00,000 × (70-69.5)]	Dr.	2,50,000	
	Foreign Loan Account	Dr.	347,50,000	
	To Bank Account			350,00,000

Question 16

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2016, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

(*RTP May 2019*)

Answer:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months

Two falling the year 2016-17; therefore loss to be recognised (30,000/3) x 2 = ₹ 20,000. Rest ₹ 10,000 will be recognised in the following year.

Question 17

(i) Classify the following items as monetary or non-monetary item:

Share Capital

Trade Receivables

Investment in Equity shares

Fixed Assets.

(ii)

	Exchange Rate per $
Goods purchased on 1.1.2017 for US $ 15,000	₹75
Exchange rate on 31.3.2017	₹74
Date of actual payment 7.7.2017	₹73

You are required to ascertain the loss/gain for financial years 2016-17 and 2017-18, also give their treatment as per AS 11.

(*RTP November 2018*)

Answer:

(i)

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

(ii) As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2017 and corresponding creditor would be recorded at ₹ 11,25,000 (i.e. $15,000 x ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.2017 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 - 11,10,000) should be credited to Profit and Loss account in the year 2016-17.

On 7.7.2017, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 - 10,95,000) will be credited to Profit and Loss account in the year 2017-18.

Question 18

Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2016 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2016, the exchange rate was ₹ 61.50 per Dollar.

You are required to calculate the amount of the profit or loss on forward contract to be recognized in the books of the company for the year ended 31st March, 2017.

(*RTP May 2018*)

Answer:

Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract = ($ 50,000 × ₹ 2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2016 to 31st March, 2017 i.e. 5 months falling in the year 2016-2017	5 months
Hence, Loss for 5 months will be ₹ 1,37,500 × 5/6 =	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2017.

Question 19

(i) Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50. US $ 1 = ₹ 61.20 on 31.3.2019.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019.

(ii) Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @₹ 64.25 per Dollar. On 31st October, 2018, the exchange rate was ₹ 61.50 per Dollar.

You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019.

(*RTP November 2019*)

Answer

(i) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Accordingly, exchange difference on trade receivables amounting ₹ 23,076 {₹5,23,076(US $ 8547* x ₹ 61.20) less ₹ 5,00,000} should be charged to profit & Loss account.

(ii) Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract= ($ 50,000 × ₹ 2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019	5 months
Hence, Loss for 5 months will be ₹ $1{,}37{,}500 \times \frac{5}{6} =$	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

Question 20

(i) AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

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* US $ 8,547 = 5,00,000/58.50

On 1st January, 2018 ₹ 60.75 per dollar

On 31st March, 2018 ₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(ii) Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. You are required to comment in line with AS 11.

[*RTP May 2020*]

Answer

(i) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate		₹ 62.50
Less: Spot Rate		(₹ 60.75)
Premium on Contract		₹ 1.75
Contract Amount	US$ 5,00,000	
Total Loss (5,00,000 x 1.75)		₹ 8,75,000
Contract period 5 months		

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

(ii) Financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate. Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

Question 21

Classify the following items as monetary or non-monetary item:

Share Capital

Trade Receivables

Investment in Equity shares

Fixed Assets.

[*RTP, November 2020*]

Answer

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

Question 22

	Exchange Rate per $
Goods purchased on 1.1.2019 for US $ 15,000	₹ 75
Exchange rate on 31.3.2019	₹ 74
Date of actual payment 7.7.2019	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11.

[*RTP, November 2020*]

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2019 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.2019 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2018-19.

On 7.7.2019, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2019-20.

Question 23

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020

(i) Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 72.00
US $ 1=₹73.50 on 31st March,2020
US $ 1= ₹ 72.50 on 1st April,2019.

(ii) Long term loan taken on 1st April, 2019 from a U.S. company amounting to ₹ 75,00,000. ₹5,00,000 was repaid on 31st December, 2019, recorded at US $ 1 = ₹ 70.50. interest has been paid as and when debited by the US company.
US $1= ₹ 73.50 on 31st March,2020
US $1=1₹ 72.50 on 1st April, 2019. (*5 marks*)

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long - term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

	Foreign Currency Rate	***₹***
Debtors		
Initial recognition US $12,500 (9,00,000/72)	1 US $ = ₹72	9,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Gain US $ 12,500 X (73.50- 72)		18,750
Treatment: Credit Profit and Loss A/c by ₹ 18,750		
Long term Loan		
Initial recognition US $ 1,03,448.28 (75,00,000/72.50)	1 US $ = ₹ 73.50	75,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Loss after adjustment of exchange gain on repayment of ₹ 5,00,000		
₹ 67,987.48 [82,171.88 (US $ 96,356.08 X ₹ 73.5 less ₹ 70,00,000) less profit 14,184.40		
[US $ 7,092.2 (5,00,000/70.5) X ₹ 2)] NET LOSS		67,987.48*
Treatment: Credit Loan A/c and Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48		

Thus, Exchange Difference on Long term loan amounting ₹ 67,987.48 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of ₹ 9 lakhs has not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2020.

Question 24

(a) Classify the following items into Monetary and Non-monetary:

(i) Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment

(b) Trade payables of CAT Ltd. include amount payable to JBB Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US $1 = ₹ 80.00. The exchange rate on balance sheet date (31.03.2020) was US $1 = ₹ 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd.

Answer

(a) Share capital - Non-monetary; Trade Payables - Monetary
Cash balance – Monetary; Property, plant and equipment - Non-monetary

(b) Amount of Exchange difference and its Accounting Treatment

	Foreign Currency Rate	**₹**
Trade payables		
Initial recognition US $ 12,500 (₹10,00,000/80)	1 US $ = ₹ 80	10,00,000
Rate on Balance sheet date	1 US $ = ₹ 85	
Exchange Difference loss US $ 12,500 x ₹ (85-80)		62,500
Treatment:		
Debit Profit and Loss A/c by ₹ 62,500 and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting ₹ 62,500 is required to be transferred to Profit and Loss.

Question 25

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2020 ₹ 62 per US $. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards.

Answer

(i) Interest for the period 2019-20
= US $ 10 lakhs x 4% × ₹ 62 per US $ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs. Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 26

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognised at each Balance Sheet date?

(*Old Study Material*)

Answer

As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Question 27

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Answer

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation.

Question 28

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3.20X1. (*Old Study Material*)

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	***Foreign Currency Rate***	***₹***
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c		
And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

Question 29

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Rau Ltd.?

(5 Marks) (MTP, May 2020)

Answer:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000
Contract period 3 months	

Two months falling in the year ended 31st March, 2020; therefore loss to be recognized (30,000/3) x 2 = ₹ 20,000.

Balance amount of ₹ 10,000 will be recognized in the following financial year.

Question 30

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

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

Answer

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US $ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh US $ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 Iakh + 100 lakh) = ₹ 620 lakh.

Question 31

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.20 20 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2021 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold by the accountant. Om Ltd. provides depreciation on an item of property, plant and equipment at 20% on WDV basis and wants to exercise the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment.

You are required to calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

(MTP, October 2021) (5 Marks)

Answer

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2021 on payment of US $ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2021 = ₹ 40 lakh US $ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2020 - 2021 = 20% of (₹ 3,000 Iakh + 100 lakh) = ₹ 620 lakh.

Question 32

"Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Fixed Assets.

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

Answer

As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 33

Mona Ltd. purchased a plant for US$ 1,00,000 on 01st December 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st December was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Mona Ltd for the year ended 31st March, 2021?

(*RTP, November 2021*)

Answer

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000

Total Loss (1,00,000 x 0.30) ₹ 30,000 to be recognized in year ended 31.3.2021.

Question 34

(i) PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd, a U.S. company, amounting to ₹ 40,88,952. The transaction was recorded at US $1 = ₹ 72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹73,60.

(ii) Trade receivables of PP Ltd. include amount receivable from Preksha Ltd, ₹20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹73.40. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60. Exchange rate on 1st April, 2020 is US $1= ₹74.00

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of PP Ltd.

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

Answer

(i) Long term Finance

	Foreign Currency Rate	**₹**
Initial recognition US $ 56,791 (40,88,952/72)	1 US $ = ₹ 72	40,88,952
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Loss [US $ 56,791 x (73.60 – 72)]		90,866 (rounded off)

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over t he balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit and Loss A/c by ₹ 90,866 and Credit Loan A/c

(ii) Trade Receivables

	Foreign Currency Rate	₹
Initial recognition US $ 27,250 (20,00,150/ 73.40)	1 US $ = ₹ 73.40	20,00,150
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Gain [US $ 27,250 X (73.60-73.40)]		5,450

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences on trade receivables amounting ₹ 5,450 is required to be transferred to Profit and Loss A/c.

Treatment needed in this case: Credit Profit and loss account by ₹ 5,450.

Question 35

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2020-21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2021 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

(*RTP May, 2023*)

Answer

(i) Interest for the period 2020-21
= US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 15 lakhs × ₹ 72 x 9.5% = ₹ 102.60 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 102.60 lakhs less ₹ 57 lakhs = ₹ 45.60 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45.60 lakhs.

Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

CHAPTER 12

Accounting Standard 12 Accounting for Government Grants

Question 1

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

(*Source: Illustration 1, Study Material*)

Answer

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being Fixed Assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account			10,00,000
	(Being grant received from the government)			
	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P&L Account)			
	Depreciation Account	Dr.	7,00,000	
2nd	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P&L Account)			

Method II:

- Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
- Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.
- If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

Question 2

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

(*Source: Illustration 2, Study Material*)

Answer

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being fixed assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Deferred Government Grant Account			10,00,000
	(Being grant received from the government)			
	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account			9,00,000
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account			9,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grants Account	Dr.	2,00,000	
	To Profit & Loss Account			2,00,000
	(Being proportionate government grant taken to P/L			
2nd	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account			9,00,000
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account			9,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grant Account	Dr.	2,00,000	
	To Profit & Loss Account			2,00,000
	(Being proportionate government grant taken to P/L			

Question 3

Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.

(*Source: Illustration 3, Study Material*)

Answer

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS 12.

Question 4

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

You are required to pass the necessary journal entries in the books of the company for first year if the grant is:

(a) Shown separately as Other Income; and

(b) Deducted against the Salary costs.

(*Source: Illustration 4, Study Material*)

Answer

(a)

Particulars		**₹ (Dr.)**	**₹ (Cr.)**
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account To Bank Account	Dr.	30,00,000	30,00,000
(Being Salary expense paid for the year)			
Deferred Income Account	Dr.	18,00,000	
To Other Income Account			18,00,000
(Being Year 1 Grant income recognised in Profit & Loss)			

Note: The grant has been spread on a straight-line basis over a period of 5 years [₹90,00,000/5 years = ₹ 18,00,000].

(b)

Particulars		**₹ (Dr.)**	**₹ (Cr.)**
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	12,00,000	
To Bank Account			12,00,000
(Being Salary expense paid (net of grant income) for the year)			
Deferred Income Account	Dr.	18,00,000	
To Salary Expense Account			18,00,000
(Being Year 1 grant adjusted against Salary expense for the year)			

Question 5

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

(*Source: Illustration 5, Study Material*)

Answer

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

Question 6

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.

(*Source: Illustration 6, Study Material*)

Answer

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

Question 7

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

(*Source: Illustration 7, Study Material*)

Answer

Fixed Assets Account	Dr.	₹ 7,00,000	
To Bank Account			₹ 7,00,000
(Being government grant on asset refunded)			

Question 8

A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non- compliance with certain conditions. Pass journal entries for first two years.

(*Source: Illustration 8, Study Material*)

Answer

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account To Bank Account (Being fixed asset purchased)	Dr.	20	20
	Bank Account To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)	Dr.	8	8
	Depreciation Account (W.N.1) To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM))	Dr.	2	2
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	Dr.	2	2

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
2	Fixed Asset Account	Dr.	5	
	To Bank Account			5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.2)	Dr.	3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. **Depreciation for Year 1**

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation $\left[\frac{12-4}{4}\right]$	2

2. **Depreciation for Year 2**

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\left[\frac{12-4}{4}\right]$	2 10
Add: Government grant refundable	5 15
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	3.67

Question 9

On 1.4.20X1, ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of machinery costing ₹ 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20X4 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4?

(*Source: Illustration 9, Study Material*)

Answer

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 20X1	Acquisition cost of machinery (₹ 1,500 – ₹ 300)	1,200.00
31st March, 20X2	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 20X3	Less: Depreciation @ 20%	(192.00)
	Book value	768.00
31st March, 20X4	Less: Depreciation @ 20%	(153.60)
1st April, 20X4	Book value	614.40
May, 20X4	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 10

A Ltd. purchased a machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

(*Source: Illustration 10, Study Material*)

Answer

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account:

I.

	₹	₹
Fixed Assets A/c Dr.	16 lakhs	
To Bank A/c (Being grant refunded)		16 lakhs

II. The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = ₹12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹16 lakhs /4 years) = ₹4 lakhs p.a. x 2 years = ₹8 lakhs were credited to Profit and Loss Account and ₹8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

I

	₹	₹
Deferred Grant A/c Dr.	8 lakhs	
Profit & Loss A/c Dr.	8 lakhs	
To Bank A/c		16 lakhs
(Being Government grant refunded)		

II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at ₹24 lakhs (W.N.2) and depreciation will continue to be charged at ₹8 lakhs per annum for the remaining two years.

Working Notes:

1. **Balance of Fixed Assets after two years but before refund (under first alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs – ₹16 lakhs = ₹24 lakhs

   Depreciation p.a. = (₹24 lakhs – ₹8 lakhs)/4 years = ₹4 lakhs per year Value of fixed assets after two years but before refund of grant = ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under second alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs

   Depreciation p.a. = (₹40 lakhs – ₹8 lakhs)/4 years = ₹8 lakhs per year Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years) = ₹24 lakhs

Question 11

Co X runs a charitable hospital. It incurs salary of doctors, staff etc. to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required to refund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income.

(*Source: Illustration 11, Study Material*)

Answer

			₹	₹
	Deferred Grant A/c	Dr.	36 lakhs	
	Profit & Loss A/c	Dr.	54 lakhs	
	To Bank A/c			90 lakhs
	(Being Government grant refunded)			

Workings:

Total grant received:	₹ 90 Lakhs
Grant recognised as income for first 3 years:	₹ 18 lakhs × 3
	= ₹ 54 lakhs
Remaining Deferred Income	= ₹ 90 Lakhs – 54 lakhs
	= ₹ 36 lakhs

Reference: The students are advised to refer the full text of AS 12 “Accounting for Government Grants”.

Question 12

AS 12 deals with recognition and measurement of government grants. Please elaborate the parameters which are required to be met before an entity can recognise government grants in its books?

(*Source: Theory Question 6, Study Material*)

Answer

A government grant is recognised when there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Question 13

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1- 20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

(*Source: Practical Question 7, Study Material*)

Answer

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be first adjusted against the unamortised deferred income in the books and the excess if any will be debited to profit & loss account of the company as an extraordinary item in the year 20X2-20X3.

QUESTION BANK

Question 14

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

As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve. (*May 2019*) (*1 Marks*)

Answer

True: When grants in the nature of promoters' contribution becomes refundable, in part or in full to the government on non-fulfillment of some specified conditions, the relevant amount refundable to the government is reduced from the capital reserve.

Question 15

On 01.04.2014, XYZ Ltd. received Government grant of ₹100 Lakhs for an acquisition of new machinery costing ₹500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method.

The company had to refund the entire grant in 2nd April, 2017 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant.

How do you deal with the refund of grant to the Government in the books of XYZ Ltd., as per AS 12?

(*May 2018*) (*MTP March, 2022)* (*5 Marks*)

Answer

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 2014	Acquisition cost of machinery (₹ 500 - ₹ 100)	400.00
31st March, 2015	Less: Depreciation @ 20%	(80)
1st April, 2015	Book value	320.00
31st March, 2016	Less: Depreciation @ 20%	(64)
1st April, 2016	Book value	256.00
31st March, 2017	Less: Depreciation @ 20%	(51.20)
1st April, 2017	Book value	204.80
2nd April, 2017	Add: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 16

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2014- 15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(*RTP May 2019*)

Answer:

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 17

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12. (*RTP November 2018*)

Answer:

As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56 + 15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

Question 18

D Ltd. acquired a machine on 01-04-2012 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:

Particulars	**₹**
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2012-13- to 2014-15 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

You are required to explain how should the company deal with this asset in its accounts for 2015-16?

(*RTP May 2018*)

Answer:

From the above account, it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2015-16 or 2016-17 as the depreciable amount is now Nil.

Question 19

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the g rant had been credited to Deferred Grant A/c.

(*MTP April 2019*)/*(MTP April, 2022) (5 Marks)*

Answer

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹ 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		₹ lakhs	**₹ lakhs**
Deferred Grant A/c	Dr.	16	
Profit & Loss A/c	Dr.	16	
To Bank A/c			32
(Being Government grant refunded)			

1. Value of Fixed Assets after two years but before refund of grant

Fixed assets initially recorded in the books = ₹ 80 lakhs

Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year

Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs

2. Value of Fixed Assets after refund of grant

On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at ₹ 44 lakhs.

3. Amount of depreciation for remaining two years

Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

Question 20

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

(*RTP November 2019*)

Answer

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, *i.e.,* they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question 21

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area.

(iii) ₹ 10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment.

[*RTP May 2020*]

Answer

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

(iii) ₹ 10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, ₹ 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

Question 22

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area.

[*RTP, November 2020*]

Answer

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

Question 23

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2016- 17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2019-20, due to non- compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 in profit and loss account?

(5 Marks) (MTP, May 2020)

Answer:

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2019-20. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 24

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant had been credited to Deferred Grant A/c.

(*5 Marks*)

Answer

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		₹	₹
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
To Bank A/c			32 lakhs
(Being Government grant refunded)			

1. **Value of Fixed Assets after two years but before refund of grant**
   Fixed assets initially recorded in the books = ₹ 80 lakhs
   Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year
   Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs
2. **Value of Fixed Assets after refund of grant**
   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at ₹ 44 lakhs.
3. **Amount of depreciation for remaining two years**
   Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

Question 25

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

(i) ₹120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.

(ii) ₹15 Lacs Grant received from Central Government on installation of Effluent Treatment Plant.

(iii) ₹125 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants". (*5 Marks*)

Question 26

Suraj Limited provides you the following information:

(i) It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores,

(ii) It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region;

(iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.

(iv) It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.

(v) It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited. (*Question Paper, May 2022*) (*5 Marks*)

Question 27

(i) Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2020.

The company debited the said amount to its machinery account in 2020 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

(ii) ABC Ltd. received two acres of land received for set up of plant. It also received ₹2 lakhs received for purchase of machinery of ₹ 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis. How should ABC Ltd. recognize these government grants in its books of accounts?

Answer

(i) As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

(ii) ABC Ltd. should recognize the grants in the following manner:

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of ₹ 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹ 10 lakhs – ₹ 2 lakhs = ₹ 8 lakhs and depreciation will be charged on it as follows: ₹ 8 lakhs/ 5 years = ₹ 1.60 lakhs per year.

Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 40,000 [₹ 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 28

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019& 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation.

(*5 marks*)

Answer

As per 12 "Accounting for government grants", grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Amount of depreciation and grant to be recognized in the profit and loss account each year

Depreciation per year:

	₹ in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year (70lakhs/4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Question 29

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2016-17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2019-20, due to non- compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 in profit and loss account?

(*5 Marks*)

Answer

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2019-20. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 30

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1-20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

(*Old Study Material*)

Answer

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

Question 31

On 01.04.2017, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method. The company had to refund the entire grant in 2nd April, 2020 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant. How do you deal with the refund of grant to the Government in the books of XYZ Ltd. as per AS 12?

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

Answer

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 2017	Acquisition cost of machinery (₹ 500 – ₹ 100)	400.00
31st March, 2018	*Less*: Depreciation @ 20%	(80)
1st April, 2018	Book value	320.00
31st March, 2019	*Less*: Depreciation @ 20%	(64)

		(₹ in lakhs)
1st April, 2019	Book value	256.00
31st March, 2020	*Less*: Depreciation @ 20%	(51.20)
1st April, 2020	Book value	204.80
2nd April, 2020	*Add*: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 32

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non- compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20.

(*5 Marks*) (*November 2020*)

Answer

		(₹ in lakhs)
1st April, 2016	Acquisition cost of machinery Less: Government Grant	300.00 60.00 240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253
(Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)			

Question 33

Caseworker Limited received a specific grant of ₹ 6 crore for acquiring the plant of ₹ 30 crore during financial year 2015-2016 having useful life of 10 years. During the financial year 2020- 2021, due to non-compliance of conditions laid down for the grant of ₹ 6 crore, the company had to refund the grant to the Government. What should be the treatment of the refund if grant was deducted from the cost of the plant during financial year 2015-2016? Assume depreciation is charged on fixed assets as per Straight Line Method.

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

Answer

As per AS 12, the amount refundable in respect of grant related to specific fixed assets should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, *as appropriate*, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

Where grant was deducted from the cost of the asset, initial value of the plant after deduction of grant amount of ₹ 6 crore would have been = ₹ 30 crore – ₹ 6 crore = ₹ 24 crore.

Carrying value of the plant after 5 years on 1.4.2020 = [(₹ 24 crore/10 years) x 5 years] = ₹ 12 crore.

Annual depreciation charge would be ₹ 2.4 crore.

On refund of grant to the Government, the book value of the plant shall be increased by ₹ 6 crore i.e. ₹ 12 crore + ₹ 6 crore = ₹ 18 crore. The increased cost of ₹ 18 crore of the plant should be amortised prospectively over remaining 5 years of useful residual life. Depreciation charge in the year 2020-2021 would be ₹ 18 crore/5 years = ₹ 3.6 crore instead of earlier ₹ 2.4 crore.

Question 34

D Ltd. acquired a machine on 01-04-2017 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

You are required to explain how should the company deal with this asset in its accounts for 2020-21?

(*RTP, November 2021*)

Answer

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2020-21 or 2021-22 as the depreciable amount is now Nil.

Question 35

Ram Ltd. purchased machinery for ₹80 lakhs, (useful life 4 years and residual value ₹8 lakhs). Government grant received is ₹32 lakhs.

You are required to show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant is credited to Fixed Assets A/c.

(*MTP April, 2018*) (*5 Marks*)

Answer:

In the books of Ram Ltd.

If the grant is credited to Fixed Assets Account:

1. **Journal Entry (at the time of refund of grant)**

		In lakhs ₹	In lakhs ₹
I	Fixed Assets Dr. To Bank A/c (Being grant refunded)	32	 32

2. **Value of Fixed Assets after two years but before refund of grant**

Fixed assets initially recorded in the books	= ₹80 lakhs - ₹32 lakhs
	= ₹48 lakhs
Depreciation for each year	= (₹48 lakhs - ₹8 lakhs)/4 years
	= ₹10 lakhs per year for first two years.
Value of the assets before refund of grant	= ₹48 lakhs - ₹20 lakhs
	= ₹28 lakhs

3. **Value of Fixed Assets after refund of grant**

Value of Fixed Assets before refund of grant	₹28 lakhs
Add Refund of grant	₹32 lakhs
	₹60 lakhs

4. **Amount of depreciation for remaining two years**

   Value of the fixed assets after refund of grant-residual value of the assets/No. of years

   = ₹60 lakhs - ₹8 lakhs/2

   = ₹26 lakhs per annum will be charged for next two years.

Question 36

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2022. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

(*RTP November, 2022*)

Answer

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question 37

Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2022. The company debited the said amount to its machinery account in 2022 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2022 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

(*RTP May, 2023*)

Answer

As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

Question 38

On 1st April 2021, Eleanor Limited purchased a manufacturing Plant for ₹60 lakhs, which has an estimated useful life of 10 years with a salvage value of ₹10 lakhs. On purchase of the Plant, a grant of ₹20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

(i) If the grant amount is deducted from the value of Plant.

(ii) If the grant is treated as deferred income

(iii) If the grant amount is deducted from the value of Plant, but at the end of the year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions.

(iv) If the grant is treated as the promoter's contribution.

(Assume depreciation on the basis of Straight-Line Method.)

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

CHAPTER 13

Accounting Standard 16 Borrowing Costs

Question 1

PRM Ltd. obtained a loan from a bank for ₹120 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	***Amount (₹ in lakhs)***
Construction of a shed	*50*
Purchase of a machinery	*40*
Working Capital	*20*
Advance for purchase of truck	*10*

Construction of shed was completed in March 20X2. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-20X2 was ₹18 lakhs. Show the treatment of interest.

(*Source: Illustration 1, Study Material*)

Answer

Qualifying Asset as per AS 16 = ₹50 lakhs (construction of a shed) Borrowing cost to be capitalised = 18 x 50/120 = ₹7.5 lakhs

Interest to be debited to Profit or Loss account = ₹(18 – 7.5) lakhs = ₹10.5 lakhs

Question 2

X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹1 lakh special loan to finance the construction of the building on 1st January, 20X1 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	***Rate of Interest***
₹5,00,000	*11%*
₹9,00,000	*13%*

The expenditures that were made on the building project were as follows:

		₹
January	*20X1*	*2,00,000*
April	*20X1*	*2,50,000*
July	*20X1*	*4,50,000*
December	*20X1*	*1,20,000*

Building was completed by 31st December 20X1*. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.*

(*Source: Illustration 2, Study Material*)

Answer

(i) Computation of weighted average accumulated expenses

		₹
₹2,00,000 x 12 / 12	=	2,00,000
₹2,50,000 x 9 / 12	=	1,87,500
₹4,50,000 x 6 / 12	=	2,25,000
₹1,20,000 x 1 / 12	=	10,000
		6,22,500

(ii) Calculation of weighted average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
5,00,000	11%	=	55,000
9,00,000	13%	=	1,17,000
14,00,000			1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000}\times 100\right)$		=	12.285% (approx.)

(iii) Interest on weighted average accumulated expenses

		₹
Specific borrowings (₹1,00,000 x 10%)	=	10,000
Non-specific borrowings (₹5,22,500 x 12.285%)	=	64,189
Amount of interest to be capitalised	=	74,189

(iv) Total expenses to be capitalized for building

	₹
Cost of building ₹(2,00,000 + 2,50,000 + 1,20,000) + 4,50,000 +	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	Particulars		Dr. (₹)	Cr. (₹)
31.12. 20X1	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building And borrowing cost thereon capitalised)			

Question 3

The company has obtained Institutional Term Loan of ₹580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to ₹406 lakhs, ₹58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹580 lakhs.

(*Source: Illustration 3, Study Material*)

Answer

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of ₹52.20 lakhs can be given as:

Purpose	**Nature**	**Interest to be capitalised**	**Interest to be charged to profit and loss account**
		₹ in lakhs	**₹in lakhs**
Modernisation and renovation of plant and machinery	Qualifying asset	$**52.20\times\frac{406}{580}=36.54$	
Advance to Supplies for additional assets	Qualifying asset	$**52.20\times\frac{58}{580}=5.22$	
Working Capital	Not a qualifying asset		$**52.20\times\frac{116}{580}=10.44$
		41.76	10.44

* *A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.*

** *It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 20X2.*

Question 4

Take Ltd. has borrowed ₹30 lakhs from State Bank of India during the financial year 20X1-20X2. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹50 lakhs. As on 31st March, 20X2, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹4 lakhs and add it to the cost of investments. Comment.

(*Source: Illustration 4, Study Material*)

Answer

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 20X2.

Reference: The students are advised to refer the full text of AS 16 “Borrowing Costs” (issued 2000).

Question 5

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain the provision.

(*Source: Question 6, Study Material*)

Answer

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 6

H Ltd. incurs borrowing costs for the purpose of construction of a qualifying asset for its own use. The construction gets completed on May 31, 20X1. However, decoration work is under process which is expected to be completed by November 20X1 after which H Ltd. will be able to start using the said asset for its own use. H Ltd. wants to capitalize the eligible borrowing costs incurred up to November 20X1.

(*Source: Question 7, Study Material*)

Answer

The capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale is completed.

In the given case, H Ltd. should capitalize borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 20X1. The fact that decoration work was being carried out should not be considered as the asset was ready for its intended use on May 31, 20X1.

Question 7

ABC Ltd. is in the process of getting an entertainment park constructed. For this purpose, it has taken loan from a bank. The said park consists of several rides and facilities, each of which can be used individually. Three fourth part of the park has been constructed and can be opened up for public, while construction on the remaining part is continuing. Whether the capitalization of borrowing cost should continue for the whole park until construction continues?

(*Source: Question 8, Study Material*)

Answer

ABC Ltd. is in process of constructing an entertainment park which consists of several rides and facilities that can operate independently for their intended use. Even though the park as whole is not complete, the individual facilities are ready for their intended use.

The cessation of capitalization depends upon the nature of the qualifying assets, particularly where the qualifying assets consists of various parts. There are qualifying assets where each part is capable of being used while the construction continues on other parts. There are qualifying assets where all parts have to be completed before any earlier completed part can be put to use.

Since in the given scenario, the individual facilities are capable of operating independently and are ready for their intended use, therefore the borrowing costs shall cease to be capitalized for the three-fourth part of the project.

Question 8

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹32 crores to be utilised as under:

(i)	*Construction of sealink across two cities:* *(work was held up totally for a month during the year due to high water levels)*	*: ₹25 crores*
(ii)	*Purchase of equipments and machineries*	*: ₹3 crores*
(iii)	*Working capital*	*: ₹2 crores*
(iv)	*Purchase of vehicles*	*: ₹50,00,000*
(v)	*Advance for tools/cranes etc.*	*: ₹50,00,000*
(vi)	*Purchase of technical know-how*	*: ₹2 crores*
(vii)	*Total interest charged by the bank for the year ending 31st March, 20X2*	*: ₹80,00,000*

Show the treatment of interest by Amazing Construction Ltd.

(*Source: Question 9, Study Material*)

Answer

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalised ₹	Interest to be charged to Profit & Loss A/c ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000x(25/32)]
Purchase of equipment and machineries	No		7,50,000	[80,00,000x(3/32)]
Working capital	No		5,00,000	[80,00,000x(2/32)]
Purchase of Vehicles	No		1,25,000	[80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000x(0.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000x(1/32)]
Total		62,50,000	17,50,000	

*It is assumed that work held up for a month due to high water level is normal during the construction of sealink and capitalization of borrowing cost should not be suspended for necessary temporary delay.

Question 9

Rainbow Limited borrowed an amount of ₹150 crores on 1.4.20X1 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹19.50 crores for the accounting period ending on 31.3.20X2. Due to surplus fund out of ₹150 crores, income of ₹3.50 crores were earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(*Source: Question 10, Study Material*)

Answer

Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings."

The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Thus, the treatment of accountant of Rainbow Ltd. is incorrect.

Amount of borrowing costs capitalized should be calculated as follows:

Particulars	₹ in crores
Actual interest for 20X1-20X2 (11% of ₹150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 20X1-20X2	13.00

Question 10

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I ***₹***	***Phase II*** ***₹***	***Phase III*** ***₹***	***Phase IV*** ***₹***
Cash expenditure	*10*	*30*	*25*	*30*
Building purchased	*24*	*34*	*30*	*38*
Total expenditure	*34*	*64*	*55*	*68*
Total expenditure of all phases				*221*
Loan taken @ 15% at the beginning of the year				*200*

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

(*Source: Question 11, Study Material*)

Answer

Computation of amount to be capitalized

No.	**Particulars**	**₹**
1.	Interest expense on loan ₹2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (₹34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹55,00,000 + ₹68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	3,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹6,65,158.50 (i.e. ₹13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹6,65,158.50 (i.e. ₹13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

For Phase III and Phase IV

Interest of ₹16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

QUESTION BANK

Question 11

M/s First Ltd. began construction of a new factory building on 1st April, 2017. It obtained ₹ 2,00,000 as a special loan to fiancé the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (₹)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (₹)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS-16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

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

Answer

(i) Computation of average accumulated expenses

		₹
₹ 3,00,000 x 12 / 12	=	3,00,000
₹ 2,40,000 x 10 / 12	=	2,00,000
₹ 4,00,000 x 8 / 12	=	2,66,667
₹ 3,60,000 x 3 / 12	=	90,000
		8,56,667

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
4,00,000	9%	=	36,000
5,00,000	12%	=	60,000
3,00,000	14%	=	42,000
			1,38,000
Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000}\times 100\right)$		=	11.5%

(iii) Amount of interest to be capitalized

		₹
Interest on average accumulated expenses:		
Specific borrowings (₹ 2,00,000 x 8%)	=	16,000
Non-specific borrowings (₹ 6,56,667* x 11.5%)	=	75,517
Amount of interest to be capitalized	=	91,517

* (₹ 8,56,667 – ₹ 2,00,000)

(iv) Total expenses to be capitalised for building

	₹
Cost of building ₹ (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517
	13,91,517

(v) **Journal Entry**

Date	**Particulars**		**Dr. (₹)**	**Cr. (₹)**
31.3.2018	Building A/c	Dr.	13,91,517	
	To Building WIP** A/c			13,00,000
	To Borrowing costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

*** Considering that ₹ 13,00,000 was debited to Building WIP A/c earlier.*

Question 12

Zebra Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

	₹
1st April, 2021	10,00,000
1st August, 2021	24,00,000
1st January, 2022	4,00,000

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2022.

You are required to:

(a) Calculate the amount of interest to be capitalized as per the provisions of AS-16 "Borrowing Cost".

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

(*Question Paper, May 2022*) (*5 Marks*)

Question 13

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores
(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ 1crore
(v)	Advances for tools/cranes etc .	₹ 1crore
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2018	₹ 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(*RTP May 2019*)

Answer:

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	***Interest to be capitalized ₹ in crores***	***Interest to be charged to Profit & Loss A/c ₹ in crores***	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No	___	0.05	1.6/64 x 2
Total		1.25	0.35	

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

Question 14

A company incorporated in June 2017, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

(*RTP November 2018*) (*MTP April, 2022*) (*5 Marks*)

Answer:

As per para 3.2 to AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Further, Explanation to the above para states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 15

In May, 2016, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2017 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2017 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP May 2018*)

Answer:

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2017) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 16

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US $ and the rate as on31st March, 2017 was ₹ 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(*MTP March 2019*) (*5 Marks*)

Answer:

(i) Interest for the period 2016-17
= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 17

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

Particulars	Amount (₹ in lakhs)
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹11,00,000. During the year 2016-17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹2,00,000.

Explain the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(*MTP August, 2018*) (*5 Marks*)

Answer

As per AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be Capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
(i)	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
(ii)	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000 x 35/100 = ₹ 3,15,000
(iii)	Working Capital	Not a Qualifying Asset	NIL	9,00,000 x 25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 18

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

Particulars	*Amount (₹ in lakhs)*
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹ 11,00,000. During the year 2016 -17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(*MTP October, 2018*) (*5 Marks*)

Answer:

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	***Particulars***	***Nature of assets***	***Interest to be Capitalized (₹)***	***Interest to be charged to Profit & Loss Account (₹)***
(i)	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
(ii)	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000
(iii)	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 19

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2017 was ₹ 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(*MTP March 2018*) (*5 Marks*)

Answer:

(i) Interest for the period 2016-17
= US $ 10 lakhs x 4% x ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs x ₹ (62 - 56) = ₹60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs x ₹56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹58.80 lakhs 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 20

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath: (work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved)	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores
(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ Icrore
(v)	Advances for tools/cranes etc.	₹ Icrore
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2016	₹ 1.6 crores

You are required to show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(*MTP April, 2018*) (*5 Marks*)

Answer:

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	**Interest to be Capitalized ₹ in crores**	**Interest to be charged to Profit & Loss A/c ₹ in crores**	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64x6
Working capital	No		0.10	1.6/64x4
Purchase of vehicles	No		0.025	1.6/64x1
Advance for tools, cranes etc.	No		0.025	1.6/64x1
Purchase of technical know-how	No		0.05	1.6/64x2
Total		1.25	0.35	

***Note**: It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

Question 21

In May, 2018, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2019 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2019 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP November 2019*)

Answer

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2019) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 22

Govind Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.04.2018, to be utilized as under:

Particulars	*Amount (₹ in lakhs)*
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹ 12,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 3,00,000.

You are required to show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

[*RTP May 2020*]

Answer

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 12,00,000 – ₹ 3,00,000

= ₹ 9,00,000

Sr. No.	***Particulars***	***Nature of assets***	***Interest to be capitalized (₹)***	***Interest to be charged to Profit & Loss Account (₹)***
(i)	Construction of factory building	Qualifying Asset	9,00,000x40/100 = ₹ 3,60,000	NIL
(ii)	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000

Sr. No.	***Particulars***	***Nature of assets***	***Interest to be capitalized (₹)***	***Interest to be charged to Profit & Loss Account (₹)***
(iii)	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

Question 23

Vital Limited borrowed an amount of ₹150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund out of ₹150 crores, an income of ₹ 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

[*RTP, November 2020*]

Answer

Para 10 of AS 16 'Borrowing Costs' states that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2019-20 should be calculated as follows:

Actual interest for 2019-20 (10% of ₹ 150 crores)	₹ 15.00 crores
Less: Income on temporary investment from specific borrowings	(₹ 1.50 crores)
Borrowing costs to be capitalized during year 2019-2020	₹ 13.50 crores

Question 24

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

[*RTP, November 2020*]

Answer

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 25

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

(*5 Marks*)

Answer

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 26

When capitalisation of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

Answer

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 27

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

	₹ (in lakhs)
Construction for factory shed	240
Purchase of Machinery	30
Working capital	24
Purchase of Vehicles	12
Advance for tools/cranes etc.	8
Purchase of technical know how	6

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was ₹ 40 lakhs.

In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets.

(5 Marks) (November 2020)

Answer

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are non-qualifying assets and related borrowing cost will be charged to Profit and Loss statement.

Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs.

Note: Assumed that construction of factory shed completed on 31st March, 2020.

Question 28

When capitalisation of borrowing cost should cease as per Accounting Standard 16?

(*Old Study Material*)

Answer

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 29

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under:

(i)	Construction of sealink across two cities: (work was held up totally for a month during the year due to high water levels)	:	₹ 25crores
(ii)	Purchase of equipments and machineries	:	₹ 3 crores
(iii)	Working capital	:	₹ 2 crores
(iv)	Purchase of vehicles	:	₹ 50,00,000
(v)	Advance for tools/cranes etc.	:	₹ 50,00,000
(vi)	Purchase of technical know-how	:	₹ 1 crores

(vii) Total interest charged by the bank for the year ending 31st March, 20X2 : ₹ 80,00,000

Show the treatment of interest by Amazing Construction Ltd.

(*Old Study Material*)

Answer

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	***Interest to be capitalised ₹***	***Interest to be charged to Profit & Loss A/c ₹***	
Construction of sea-link	Yes	62,50,000		[80,00,000x(25/32)]
Purchase of equipments and machineries	No		7,50,000	[80,00,000x(3/32)]
Working capital	No		5,00,000	[80,00,000x(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000x(0.5/32)]
Purchase of technical know- how	No		2,50,000	[80,00,000x(1/32)]
Total		62,50,000	17,50,000	

Question 30

Suhana Ltd. issued 12% secured debentures of ₹100 Lakhs on 01.05.2018, to be utilized as under:

Particulars	**Amount (₹ in lakhs)**
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹11,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

[MTP October, 2019, 5 marks]

Answer

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000-₹ 2,00,000

= ₹ 9,00,000

Sr. No.	**Particulars**	**Nature of assets**	**Interest to be Capitalized (₹)**	**Interest to be charged to Profit & Loss Account (₹)**
i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹3,60,000	Nil
ii	Purchase of Machinery	Not a Qualifying Asset	Nil	9,00,000x35/100 = ₹3,15,000
iii	Working Capital	Not a Qualifying Asset	Nil	9,00,000x25/100 = ₹2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 31

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment of loan exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2020 was ₹ 62 per US $. If Omega Limited had borrowed the loan in India in

Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards. (*4 Marks*)

Answer

(i) Interest for the period 2019-20
= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 32

ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'.

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

Answer

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	***Period of outstanding balance***	***Amount of loan (₹)***	***Rate of interest p.a.***	***Weighted average amount of interest (₹)***
	a	***b***	***c***	***d = [(b x c) x (a/12)]***
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		2,26,000

Weighted average cost of borrowings
= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest/Weighted average of general borrowings) x 100] = [(2,26,000/24,33,334) x 100] = 9.29% p.a.

Question 33

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2021 amounted to ₹ 25 lakhs. The company wants to treat ₹ 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP, November 2021*)

Answer

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 34

(a) An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?

(b) Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress?

(RTP May, 2022)

Answer

(a) As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

(b) As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete". The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the cost of the asset.

Question 35

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I ₹	Phase II ₹	Phase III ₹	Phase IV ₹
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

(*RTP November, 2022*)

Answer

	Particulars	₹
1.	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (₹ 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹ 55,00,000 + ₹ 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate $\text{Loan amount} = \frac{30,00,000}{2,21,00,000} \times 98,00,000$	3,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on $\text{proportionate Loan amount} == \frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment:

1. For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

2. For Phase III and Phase IV

Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Question 36

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2021. Money raised from debentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:

(i) Interest on debentures for the Financial Year 2021-2022 was paid by the Company.

(ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

(iii) In March, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).

(iv) In March 2022, Machinery was installed and ready for its intended use.

(v) Furniture was put to use at the end of March 2022.

(vi) Truck is going to be received in April, 2022.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2022 in the Books of Expert Limited.

(*RTP May, 2023*)

Answer

According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As per the Standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = ₹ 10,00,000 (100 lakhs x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory building	Qualifying Asset	9,50,000 x 40/100 = ₹ 3,80,000	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100 = 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	9,50,000x2/100 =19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100 = 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100 = ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

Question 37

On 1st April, 2022 Workhouse Limited took a loan from a Financial Institution for ₹25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

(i)	8% Debentures	₹15,00,000
(ii)	15% Term Loan	₹30,00,000
(iii)	10% Other Loans	₹18,00,000

The company has utilised the above funds in construction/purchase of the following assets :

(i) Building	₹70,00,000
(ii) Furniture	₹22,00,000
(iii) Plant & Machinery	₹90,00,000
(iv) Factory Shed	₹43,00,000

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 151 April 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets.

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

CHAPTER

14

Accounting Standard 17 Segment Reporting

Question 1

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

₹ in lakhs

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

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

(*Source: Illustration 1, Study Material*)

Answer

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

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

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

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

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

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments.

On the basis of turnover criteria segments M and N are reportable segments.

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

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

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

Question 2

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

(*Source: Illustration 2, Study Material*)

Answer

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

Question 3

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

(*Source: Illustration 3, Study Material*)

Answer

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

Question 4

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

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

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

(*Source: Illustration 4, Study Material*)

Answer

Diversifiers Ltd. Segmental Report

(₹'000)

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

Sales Revenue by Geographical Market

(₹'000)

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

Question 5

Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?

(*Source: Illustration 5, Study Material*)

Answer

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

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

Question 6

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

(*Source: Question 6, Study Material*)

Answer

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

Therefore, the revised total assets are 12.3 crores [₹15 - (₹1 +0.9 + 0.8).

Details of Segment wise assets:

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

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

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments.

Hence, the contention of the Accountant that all three segments are reportable segments is correct.

Question 7

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

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

(*Source: Question 7, Study Material*)

Answer

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

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

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

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

Question 8

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

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

(*Source: Question 8, Study Material*)

Answer

As per AS 17, if primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

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

Question 9

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

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

(*Source: Question 9, Study Material*)

Answer

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

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

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

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

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

Question 10

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

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

Identify the Reportable segments.

(*Source: Question 10, Study Material*)

Answer

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

(i) All segments in profit, i.e., A, B and E - Total profit ₹8,280 crores.

(ii) All segments in loss, i.e., C and D - Total loss ₹6,800 crores.

Greater of the above - ₹8,280 crores.

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

Segment	**Profit/(Loss)**	**Absolute Profit/Loss as a % of 8,280**	**Reportable Segment**
A	780	9%	No
B	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes
E	6,000	72%	Yes
Total	**1,480**		

Question 11

Heavy Goods Ltd. has 6 segments namely L-Q (below).

The total revenues (internal and external), profits or losses and assets are set out below:

(In ₹)

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

Heavy Goods Ltd. needs to determine how many reportable segments it has.

You are required to advice Heavy Goods Ltd. as per the criteria defined in AS 17.

(*Source: Question 11, Study Material*)

Answer

Quantitative Threshold Test:

Revenue Test:

Combined total sales of all the segment = ₹10,400 + ₹35,350 = ₹45,750.

10% thresholds = 45,750 x 10% = 4,575.

Profitability Test:

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

10% thresholds = ₹6,000 x 10% = ₹600

Asset Test:

Combined total assets of all the segment = ₹1,02,750 10% thresholds = ₹1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:

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

Conclusion:

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

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

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

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

Question 12

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

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

Segments	***A***	***B***	***C***	***Total***
Expenses on transactions with other segments				
Transaction from B	*75,000*		*30,000*	
Transaction from C	*6,000*	*40,000*		
Transaction from A		*18,000*	*82,000*	

(*Source: Question 12, Study Material*)

Computation of segment result:

Segments	**A** ₹	**B** ₹	**C** ₹	**Total** ₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 :4 :2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue (1)	**6,60,000**	**4,15,000**	**2.70,000**	**13,45,000**
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 :4 :2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses (2)	**4,16,000**	**2,36,000**	**2,01,000**	**8,53,000**
Segment result (1-2)	**2,44,000**	**1,79,000**	**69,000**	**4,92,000**

QUESTION BANK

Question 13

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

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

(*RTP November 2021*)

Answer

(a) As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products of services;

(b) the nature of the productions processes;

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

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

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

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors.

In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

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

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

Question 14

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

(*RTP November, 2022*)

Answer

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

Question 15

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

(*₹ in lakhs*)

Particulars	P	Q	R	S	T	Total
	(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
Segment Assets	80	30	20	20	10	160
Segment Results	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'.

(*RTP May, 2023*)

Answer

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

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

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

  (1) The combined result of all segments in profit; or

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

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

Accordingly,

  (a) On the basis of revenue from sales criteria, segment P is a reportable segment.

  (b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 Lakhs).

  (c) On the basis of asset criteria, all segments except T are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

Question 16

The Accountant of X. Ltd. provides the following data regarding its five segments:

Particulars	A	B	C	D	E	Total (₹in Crore)
Segment Assets	50	20	15	10	5	100
Segment Results	(85)	10	10	(15)	5	(75)
Segment Revenue	250	50	40	60	30	430

The accountant is of the opinion that segment 'A' alone should be reported,

Is he justified in his view ? Examine his option in the light' of provisions of AS-17 Segment Reporting.

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

CHAPTER 15

Accounting Standard 20 Earnings Per Share

Question 1

Date	*Particulars*			*Balance*
1st January	*Balance at beginning of year*	*1,800*	*-*	*1,800*
31st May	*Issue of shares for cash*	*600*	*-*	*2,400*
1st November	*Buy Back of shares*	*-*	*300*	*2,100*

Calculate Weighted Number of Shares.

(*Source: Illustration 1, Study Material*)

Answer

Computation of Weighted Average:

(1,800 x 5/12) + (2,400 x 5/12) + (2,100 x 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as follows: (1,800 x12/12) + (600 x 7/12) - (300 x 2/12) = 2,100 shares

Question 2

Date	*Particulars*	*No. of Shares*	*Face Value*	*Paid up Value*
1st January	*Balance at beginning of year*	*1,800*	*₹10*	*₹10*
31st October	*Issue of Shares*	*600*	*₹10*	*₹5*

Calculate Weighted Number of Shares.

(*Source: Illustration 2, Study Material*)

Answer

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.

Computation of weighted average would be as follows:

(1,800 x 12/12) + (300 x 2/12) = 1,850 shares.

Where an enterprise has equity shares of **different nominal values** but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

Question 3

Net profit for the year 20X1	*₹18,00,000*
Net profit for the year 20X2	*₹60,00,000*
No. of equity shares outstanding until 30th September 20X2	*20,00,000*

Bonus issue 1st October 20X2 was 2 equity shares for each equity share outstanding at 30th September, 20X2

Calculate Basic Earnings Per Share.

(*Source: Illustration 3, Study Material*)

Answer

No. of Bonus Issue 20,00,000 x 2 = 40,00,000 shares

$$\text{Earnings per share for the year 20X2} \quad \frac{₹60,00,000}{₹20,00,000 + 40,00,000} = ₹1.00$$

$$\text{Adjusted earnings per share for the year 20X1} \quad \frac{₹18,00,000}{₹20,00,000 + 40,00,000} = ₹0.30$$

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

Question 4

Net profit for the year 20X1	*₹11,00,000*
Net profit for the year 20X2	*₹15,00,000*
No. of shares outstanding prior to rights issue	*5,00,000*
shares Rights issue price	*₹15.00*
Last date to exercise rights	*1st March 20X2*

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was ₹21.00. Compute Basic Earnings Per Share.

(*Source: Illustration 4, Study Material*)

Answer

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise +Number of shares issued in the exercise}}$$

$$\frac{(₹21.00\times5,00,000 \text{ shares}) + (₹15.00 \times1,00,000 \text{ Shares})}{5,00,000 \text{ Shares} +1,00,000 \text{ Shares}}$$

Theoretical ex-rights fair value per share = ₹20.00

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} \quad \frac{₹(21.00)}{₹(20.00)} = 1.05$$

Computation of earnings per share:

EPS for the year 20X1 as originally reported: ₹11,00,000/5,00,000 shares = ₹2.20

EPS for the year 20X1 restated for rights issue: ₹11,00,000/ (5,00,000 shares x 1.05)

= ₹2.10

EPS for the year 20X2 including effects of rights issue:

(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12) = 5,87,500 shares

EPS = 15,00,000/5,87,500 = ₹2.55

Question 5

Net profit for the current year	*₹1,00,00,000*
No. of equity shares outstanding	*50,00,000*
Basic earnings per share	*₹2.00*

No. of 12% convertible debentures of ₹100 each	*1,00,000*
Each debenture is convertible into 10 equity shares	
Interest expense for the current year	*₹12,00,000*
Tax relating to interest expense (30%)	*₹3,60,000*

Compute Diluted Earnings Per Share.

(*Source: Illustration 5, Study Material*)

Answer

Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = ₹1,08,40,000

No. of equity shares resulting from conversion of debentures: 10,00,000 Shares No. of equity shares used to compute diluted EPS: (50,00,000 + 10,00,000) = 60,00,000 Shares

Diluted earnings per share: (1,08,40,000/60,00,000) = ₹1.81

Question 6

Net profit for the year 20X1	*₹12,00,000*
Weighted average number of equity shares outstanding during the year 20X1	*5,00,000 shares*
Average fair value of one equity share during the year 20X1	*₹20.00*
Weighted average number of shares under option during the year 20X1	*1,00,000 shares*
Exercise price for shares under option during the year 20X1	*₹15.00*

Compute Basic and Diluted Earnings Per Share.

(*Source: Illustration 6, Study Material*)

Answer

Computation of earnings per share

	Earnings ₹	***Shares***	***Earnings/Share*** ₹
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares during year 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at			
fair value (100,000 x 15.00)/20.00	—	(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 7

X Limited, during the year ended March 31, 20X1, has income from continuing ordinary operations of ₹ 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 20X1.

You are required to compute Basic and Diluted EPS?

(*Source: Illustration 7, Study Material*)

Answer

As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations".

As income from continuing ordinary operations, ₹ 2,40,000 would be considered and not ₹ (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹ 240 to ₹ 200. Thus, the basic E.P.S would be ₹ (120) and diluted E.P.S. would be ₹ (100).

Question 8

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

(*Source: Question 6, Study Material*)

Answer

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given cases:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles or may entitle its holder to equity shares.

Question 9

Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS.

Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

(*Source: Question 7, Study Material*)

Answer

As per AS 20 "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares".

Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

Question 10

Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?

(*Source: Question 8, Study Material*)

In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, *the issue is treated as if it had occurred prior to the beginning of the earliest period reported.*

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Question 11

NAT, a listed entity, as on 1st April, 20X1 had the following capital structure:

Particulars	***₹***
10,00,000 Equity Shares having face value of ₹1 each	*10,00,000*
10,00,000 8% Preference Shares having face value of ₹10 each	*1,00,00,000*

During the year 20X1-20X2, the company had profit after tax of ₹ 90,00,000.

On 1st January, 20X2, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December, 20X1.

On 1st January, 20X2, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.

NAT's shares were trading at ₹ 8.05 per share on 31st March, 20X2.

Further it has been provided that the basic earnings per share for the year ended 31st March, 20X1 was previously reported at ₹ 62.30.

You are required to:

(i) *Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March, 20X2 including the comparative figure, in accordance with AS-20 Earnings Per Share.*

(ii) *Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?*

(*Source: Question 9, Study Material*)

Answer

(i) Computation of Basic Earnings per share for the year ended 31st March, 20X2:

(including the comparative figure)

Working Note – I:

Earnings for the year ended 31st March, 20X1:

= EPS x Number of shares outstanding during 20X0-20X1

= ₹62.30 x 10,00,000 equity shares

= ₹6,23,00,000

Adjusted/Restated Earnings per share for the year ended 31st March 20X1:

(after taking into consideration bonus issue) Adjusted/Restated Basic EPS:

= Earnings for the year 20X0-20X1 / (Total outstanding shares +Bonus issue)

= ₹6,23,00,000 / (10,00,000+ 5,00,000)

= ₹6,23,00,000 / 15,00,000

= ₹41.53 per share

Computation of Basic EPS for the year 20X1-20X2:

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 20X2)

= (₹90,00,000 – ₹(1,00,00,000 x 8%)) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= ₹82,00,000 / 15,50,000 shares

= ₹5.29 per share

(ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, *the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.*

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Question 12

X Ltd. supplied the following information. You are required to compute the basic earnings per share:

(Accounting year 1.1.20X1 – 31.12.20X1)		
Net Profit	:	*Year 20X1: ₹20,00,000*
	:	*Year 20X2: ₹30,00,000*
No. of shares outstanding prior to Right Issue	:	*10,00,000 shares*
Right Issue	:	*One new share for each four outstanding i.e., 2,50,000 shares.*
		Right Issue price – ₹20
		Last date of exercise rights – 31.3.20X2.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2	:	*₹25*

(*Source: Question 10, Study Material*)

Answer

Computation of Basic Earnings Per Share

(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 20X1 ₹	***Year 20X1*** ₹
EPS for the year 20X1 as originally reported		
$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (₹20,00,000 / 10,00,000 shares)	2.00	
EPS for the year 20X1 restated for rights issue		
= [₹20,00,000 / (10,00,000 shares ₹1.04[1])]	1.91 (approx.)	
EPS for the year 20X2 including effects of rights issue		
$\frac{₹30,00,000}{(10,00,000\text{shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$		
$\frac{₹30,00,000}{11,97,500 \text{ shares}}$		2.51 (approx.)

1 Refer working note 2.

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise+ Number of shares issued in the exercise}}$$

$$= \frac{(₹25 \times 10{,}00{,}000 \text{ shares}) + (₹20 \times 2{,}50{,}000) \text{ shares}}{10{,}00{,}000 \text{ shares} + 2{,}50{,}000 \text{ shares}} = \frac{₹30{,}000{,}000}{\text{shares } 000{,}50{,}12} ₹24$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{₹25}{₹24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

Question 13

On 1st April, 20X1 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 20X1 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 20X2 was ₹21,96,000 after considering dividend on preference shares of ₹3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 20X2 as per Accounting Standard 20 "Earnings Per Share".

(*Source: Question 11, Study Material*)

Answer

11. Basic Earnings per share (EPS) =

$$\frac{\text{Weighted average number of equity shares outstanding during the year}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{21{,}96{,}000}{4{,}57{,}500 \text{ Shares (as per working note)}} = ₹4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 ‘Earnings Per Share’, partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	***No. of equity shares***	***Amount paid per share***	***Weighted average no. of equity shares***
	₹	₹	₹
1.4.20X1	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.20X1	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.20X1	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 14

No. of equity shares outstanding = 30,00,000

Basic earnings per share ₹5.00

No. of 12% convertible debentures of ₹100 each; 50,000

Each debenture is convertible into 10 equity shares

Tax Rate 30%

Compute Diluted Earnings per Share.

Working notes should form part of the answer.

(*Source: Question 12, Study Material*)

Answer:

Earnings for the year:

= No. of Shares x Basic EPS

= 30,00,000 shares x ₹ 5 per share = ₹ 1,50,00,000

Computation of Adjusted Net Profit:

= Earnings for the year + Interest on debentures net of tax

= 1,50,00,000 + (6,00,000 - 1,80,000) = ₹ 1,54,20,000

Computation of Adjusted Denominator:

No. of equity shares resulting from conversion of debentures:

= 50,000 x 10 shares = 5,00,000 shares

No. of equity shares for diluted EPS = 30,00,000 + 5,00,000

= 35,00,000 shares

Computation of Diluted EPS:

= ₹ 1,54,20,000/35,00,000 shares = ₹ 4.4 per share.

QUESTION BANK

Question 15

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

(*November 2014, 4 Marks*)

Question 16

M/s. A Ltd. had 8,00,000 Equity Shares outstanding on 1st April, 2013. The Company earned a profit of ₹20,00,000 during the year 2013-14. The average fair value per share during 2013-14 was ₹40. The Company has given Share Option to its employees of 1,00,000 Equity Shares at option price of ₹20.

Calculate Basic EPS and Diluted EPS.

(*May, 2015, 5 Marks*)

Answer

Computation of Earnings Per Share

	Earnings ₹	*Shares*	*Earnings per share* ₹
Net Profit for the year 2013-14	20,00,000		
Number of shares outstanding during the year 2013-14		8,00,000	
Basic Earnings Per Share $= \frac{20,00,000}{8,00,000}$			2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (Refer Note) [1,00,000 x 20/40]		(50,000)	
Diluted Earnings Per Share $= \frac{20,00,000}{8,50,000}$	20,00,000	8,50,000	2.35

Note:

The earnings have not been increased as the total number of shares has been increased only by the number of shares (50,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 17

What do you mean by "Weighted average number of equity shares outstanding during the period" and why is it required to be calculated? Compute weighted average number of equity shares in the following case:

		No. of shares
1st April, 2014	Balance of Equity Shares	5,00,000
30th June, 2014	Equity Shares issued for cash	1,00,000
15th January, 2015	Equity Shares bought back	50,000
31st March, 2015	Balance of Equity Shares	5,50,000

(*November 2015, 4 Marks*)

Answer

As per AS 20, “Earnings Per Share”, the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders’ capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time.

For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Computation of weighted average number of shares outstanding during the period

Date	No. of equity shares	Period outstanding	Weights (months)	Weighted average number of shares
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1st April, 2014	5,00,000 (Opening)	3 months	3 /12	1,25,000
30th June 2014	6,00,000 (after Additional issue)	6.5 months	6.5/12	3,25,000
15th Jan, 2015	5,50,000 (after Buy back)	2.5 months	2.5/12	1,14,583
31st March, 2015	5,50,000 (Balance)	0 month	0/12	-
Total				5,64,583

Question 18

"While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period." Explain this statement in the light of relevant AS.

Also calculate the diluted EPS from the following information:

Net Profit for the current year (After Tax)	₹1,00,00,000
No. of Equity shares outstanding	10,00,000
No. of 10% Fully Convertible Debentures of ₹100 each	1,00,000
(Each Debentures is compulsorily & fully convertible into 10 equity shares)	
Debenture interest expense for the current year	₹5,00,000
Assume applicable Income Tax rate @ 30%	

(*November, 2016, 5 Marks*)

Answer

As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year (after tax)	1,00,00,000
Add: Interest expense for the current year	5,00,000
Less: Tax relating to interest expense (30% of ₹5,00,000)	(1,50,000)
Adjusted net profit for the current year	1,03,50,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$= \frac{1,00,000 \times 100}{10}$ = 10,00,000 Equity shares

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

= [(10,00,000 x 12) + (10,00,000 x 6)]/12 = 15,00,000 equity shares

Diluted earnings per share = ₹1,03,50,000 / 15,00,000 shares = ₹6.90 per share

Note: Interest on debentures for full year amounts to ₹10,00,000 (i.e. 10% of ₹1,00,00,000). However, interest expense amounting ₹5,00,000 has been given in the question. It may be concluded that debentures have been issued at the mid of the year and interest has been provided for 6 months.

Question 19

From the following information, you are required to compute the basic and adjusted Earnings per share:

Net profit for 2015-16	11 lakh
Net profit for 2016-17	15 lakh
No. of shares issued before rights issue	5 lakhs
Right issue	One for every 5 held
Right issue price	15 per share
Last date of exercising right option	1-06-2016
Fair value of shares before right issue	21 per share

(MTP March 2018/MTP-March 2019) (5 Marks)

Answer:

Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$\frac{(₹\ 21.00 \times 5,00,000 \text{shares}) + (₹15.00 \times 1,00,000 \text{shares})}{5,00,000 \text{shares} + 1,00,000 \text{shares}}$$

Theoretical ex-rights fair value per share = ₹20.00

(a) Computation of adjustment factor

$$\frac{\text{Fair value per share prior b exercise of rights}}{\text{Theorelica lex - righte value per share}} = \frac{\text{Rs. (21.00)}}{\text{Rs. (20.00)}} = 1.05$$

Computation of earnings per share

	Year 2015-16	Year 2016-17
EPS for the year 2015-16 as originally reported: (₹11,00,000/5,00,000 shares)	₹2.20	
EPS for the year 2015-16 restated for rights issue: [₹11,00,000/(5,00,000 shares x 1.05)]	₹2.10	
EPS for the year 2016-17 including effects of rights issue $\frac{\text{Rs. } 15,00,000}{(5,00,000 \times 1.05 \times 2/12) + (6,00,000 \times 10/12)}$		₹2.55

Question 20

As at 1st April, 2016 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2016 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2017 was ₹21,96,000 after considering dividend on preference shares totalling to ₹3,40,000.

Compute Basic EPS for the year ended 31st March, 2017 as per Accounting Standard 20 "Earnings Per Share".

(May 2018) (5 Marks)

Answer:

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = \text{Rs. 4.80 per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
	₹	₹	₹
1.4.2016	6,00,000	5	6,00,000x5/10x5/12 = 1,25,000
1.9.2016	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2016	60,000	5	60,000x5/10x7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 21

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2017:

Net Profit for the year after tax:	₹75,00,000
Number of Equity Shares of ₹10 each outstanding:	₹10,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	**Nos.**
8% Convertible Debentures of ₹100 each	1,00,000
Equity Shares to be issued on conversion	1,10,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP May 2018*)

Answer:

Computation of basic earnings per share

Net profit for the current year/Weighted average number of equity shares outstanding during the year

₹75,00,000/10,00,000 = ₹7.50 per share

Computation of diluted earnings per share $\dfrac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

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

Number of equity shares resulting from conversion of debentures

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

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

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

Diluted earnings per share

= 80,60,000/11,10,000 = ₹7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 22

The following information is available for TON Ltd. for the accounting year 2015-16 and 2016-17:

	Net profit for	₹
Year	2015-16	35,00,000
Year	2016-17	45,00,000

No of shares outstanding prior to right issue 15,00,000 shares.

Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares.

: Right Issue price ₹25

: Last date to exercise rights 31st July, 2016

Fair value of one equity share immediately prior to exercise of rights on 31.07.2016 is ₹35.

You are required to compute:

(i) Basic earnings per share for the year 2015-16.

(ii) Restated basic earnings per share for the year 2015-16 for right issue.

(iii) Basic earnings per share for the year 2016-17.

(*RTP November 2018*)

Answer: Computation of Basic Earnings per Share

		Year 2015-16 (₹)	Year 2016-17 (₹)
(i)	EPS for the year 2015-16 as originally reported = Net profit for the year attributable to equity share holder/weighted average number of equity shares outstanding during the year ₹35,00,000/15,00,000 shares	2.33	
(ii)	EPS for the year 2015-16 restated for the right issue ₹35,00,000/15,00,0000 shares × 1.08	2.16	
(iii)	EPS for the year 2016-17 (including effect of right issue) ₹45,00,000/[(15,00,000 × 1.08 × 4/12) + (20,00,000 × 8/12)]		2.40

Working Notes:

1. Computation of theoretical ex-rights fair value per share =

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

[(₹35 × 15,00,000) + [₹25 × 5,00,000)]/(15,00,000 + 5,00,000) = ₹32.5

2. Computation of adjustment factor

Fair value per share prior to exercise of rights Theoretical ex-rights value per share

= ₹35/32.50 = 1.08 (approx.)

Question 23

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2017:

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

Number of Equity Shares of ₹10 each outstanding: 10,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹100 each	1,00,000
Equity Shares to be issued on conversion	1,10,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*MTP October 2018*) (*5 Marks*)

Answer:

Computation of basic earnings per share

Net profit for the current year/Weighted average number of equity shares outstanding during the year

₹75,00,000/10,00,000 = ₹7.50 per share

Computation of diluted earnings per share

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year

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

Number of equity shares resulting from conversion of debentures

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

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

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

Diluted earnings per share

= 80,60,000/11,10,000 = ₹7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 24

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2019: Net Profit for the year after tax: ₹37,50,000

Number of Equity Shares of ₹10 each outstanding: ₹5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP November 2019*)

Answer:

Computation of basic earnings per share

Net profit for the current year/Weighted average number of equity shares outstanding during the year ₹37,50,000/ 5,00,000 = ₹7.50 per share

$$\text{Computation of diluted earnings per share } \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

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

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

= 40,30,000/ 5,55,000 = ₹7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 25

Following information is supplied by K Ltd.

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹98

Last date of exercising rights - 30-06-2018.

Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹102.

Net Profit to equity shareholders:

2017-2018 – ₹50,00,000

2018-2019 – ₹75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earning per Share.

(*November 2019, New Course, 5 Marks*)

Answer:

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{102 \text{ x } 2,50,000 \text{ Shares} + ₹98 \times 1,00,000 \text{ shares}}{3,50,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹100.86

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = 102 / 100.86 = 1.01$$

Computation of earnings per share:

EPS for the year 2017-18 as originally reported: ₹50,00,000/2,50,000 shares = ₹20

EPS for the year 2017-18 restated for rights issue: =₹50,00,000/ (2,50,000 shares x 1.01)

= ₹19.80

EPS for the year 2018-19 including effects of rights issue:

EPS = 75,00,000/3,25,625* = ₹23.03

** [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] = 63,125 + 2,62,500 = 3,25,625 shares*

Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

Question 26

Net Profit for financial year 2018-2019	30,00,000
Net Profit for financial year 2019-2020	50,00,000
No. of shares outstanding prior to rights issue	20,00,000 shares
Rights Issue Price	₹20
Last day to exercise rights	1st June, 2019

Right issue is one new share for each five equity share outstanding (i.e. 4,00,000 new shares).

Fair value of one equity share immediately prior to exercise of rights on 1st June, 2019 was ₹26.00.

Compute Basic Earnings Per Share for financial year 2018-19, 2019-2020 and restated EPS for 2018-19.

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

Answer:

Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)

	Year 2018-19 ₹	Year 2019-20 ₹
EPS for the year 2018-19 as originally reported $= \dfrac{\text{Net Profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ = (₹30,00,000 / 20,00,000 shares)	1.5	
EPS for the year 2018-19 restated for rights issue = [₹30,00,000 / (20,00,000 shares× 1.04 (W.N. 2)]	1.44 (approx.)	
EPS for the year 2019-20 including effects of rights issue $= \dfrac{\text{Rs. }50,00,000}{(20,00,000\ shares \times 1.04 \times 2/12) + (24,00,000\ shares \times 10/12)}$ **₹50,00,000/ 23,46,667 shares**		2.13 (approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$= \frac{(\text{Rs. 26 x 20,00,000 shares}) + (\text{Rs. 20 x 4,00,000 shares})}{\text{20,00,000 shares + 4,00,000 shares}}$$

$$= \frac{\text{Rs. 6,00,00,000}}{\text{24,00,000 shares}} = \text{Rs.25}$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{\textbf{\textit{Rs.26}}}{\textbf{\textit{Rs. (Refer Working Note1)}}} = 1.04\text{(approx.)}$$

Question 27

On 1st April, 2019 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2019 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net pro fit for the year ended 31st March, 2020 was ₹21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

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

Answer

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500\text{ Shares (as per working note)}} = ₹\ 4.80\text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	*No. of equity shares*	*Amount paid per share*	*Weighted average no. of equity shares*
	₹	₹	₹
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 28

A-One Limited supplied the following information. You are required to compute the basic earnings per share as per AS 20 'Earnings per Share':

Net profit attributable to equity shareholders — Year 2017-18: ₹1,00,00,000; Year 2018-19 : ₹1,50,00,000

Number of shares outstanding prior to

Right Issue	50,00,000 shares
Right Issue	One new share for each four outstanding shares i.e., 12,50,000 shares Right Issue Price - ₹96 Last date of exercising rights - 30-06-2018
Fair value of one equity share immediately prior to exercise of rights on 30-06-2018	₹101

(*RTP, November, 2020*)

Answer

Computation of Basic earnings per share

	2017-18 ₹	2018-19 ₹
EPS for the year 2017-18 as originally reported: (₹1,00,00,000/ 50,00,000 shares)	2.00	
EPS for the year 2017-18 restated for rights issue: ₹1,00,00,000/ (50,00,000 shares x 1.01)*	1.98	
EPS for the year 2018-19 including effects of rights issue $\frac{\text{Rs.}1{,}50{,}00{,}000}{(50{,}00{,}000 \times 1.01 \times 3/12)+(62{,}50{,}000 \times 9/12)}$		2.52

* *Computation of Basic Earnings per share in case of Rights Issue requires computation of adjustment factor which is given as working note.*

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{(₹101 \times 50{,}00{,}000 \text{ shares}) + (₹\ 96 \times 12{,}50{,}000 \text{ shares})}{50{,}00{,}000 \text{ shares} + 12{,}50{,}000 \text{ shares}}$$

= ₹62,50,00,000/62,50,000 = ₹100

Therefore, theoretical ex-rights fair value per share is = ₹100

2. Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = \frac{₹(101}{₹(100)} = 1.01$$

Question 29

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case:

		No. of shares
1st April, 2020	Balance of equity shares	7,20,000
31st August, 2020	Equity shares issued for cash	2,40,000
1st February, 2021	Equity shares bought back	1,20,000
31st March, 2021	Balance of equity shares	8,40,000

(*MTP, April, 2021*) (*5 marks*)

Answer

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares:

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	= 8,40,000 shares

Question 30

On 1st April, 2019 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2019 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2020 was ₹21,96,000 after considering dividend ₹3,40,000 on preference shares.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

(*MTP*, *October 2021*) (*5 Marks*)

Answer

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21{,}96{,}000}{4{,}57{,}500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	***No. of equity shares***	***Amount paid per share***	***Weighted average no. of equity shares***	
	₹	**₹**	**₹**	
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12	= 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12	= 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12	= 17,500
Total weighted average equity shares				4,57,500

Question 31

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20?

(*RTP November 2021*)

Answer

The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period". With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still attributable to equity shareholders. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

Question 32

(a) Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

(b) X Limited, as at March 31, 2021, has income from continuing ordinary operations of ₹2,40,000, a loss from discontinuing operations of ₹3,60,000 and accordingly a net loss of ₹1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

(*RTP May, 2022*)

Answer

(a) The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares". Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

(b) As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations". As income from continuing ordinary operations, ₹2,40,000 would be considered and not ₹(1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹240 to ₹200. Thus the basic E.P.S would be ₹(120) and diluted E.P.S. would be ₹(100).

Question 33

"At the time of calculating diluted earnings per share, effect is given to all dilutive potential equity shares that are outstanding during the period."

Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

(i)	Net profit after tax for the year	₹64,12,500
(ii)	No. of equity shares outstanding	15,00,000
(iii)	No. of 9% convertible debentures of ₹100 issued on 1st July, 2020	75,000
(iv)	Each debenture is convertible into 8 Equity Shares	
(v)	Tax relating to interest expenses	35%

(*Question Paper of December 2021*) *(5 Marks)*

Answer

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding* during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Basic EPS for the year 2020-21= 64,12,500/15,00,000 = ₹4.275 or ₹4.28

Computation of diluted earnings per share for year 2020-21

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹67,41,562

No. of equity shares resulting from conversion of debentures: 6,00,000 Shares (75,000 × 8)

Weighted average no. of equity shares used to compute diluted EPS: (15,00,000 X 12/12 + 6,00,000 X 9/12) = 19,50,000 Shares

Diluted earnings per share: (67,41,562/19,50,000) = ₹3.46

Working Note:

Interest expense for 9 months = 75,00,000 × 9% × 9/12 = ₹5,06,250 Tax expense 35% on interest is ₹1,77,188 (5,06,250 x 35%)

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* Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

Question 34

The following information is provided to you:

Net profit for the year 2022: ₹ 72,00,000

Weighted average number of equity shares outstanding during the year 2022: 30,00,000 shares

Average Fair value of one equity share during the year 2022: ₹ 25.00

Weighted average number of shares under option during the year 2022: 6,00,000 shares

Exercise price for shares under option during the year 2022: ₹ 20.00

You are required to compute Basic and Diluted Earnings Per Share as per AS 20.

(*Suggested November, 2022*) (*5 Marks*)

Answer

Computation of Basic earnings per share

	Earnings ₹	***Shares***	***Earnings/ Share*** ₹
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Basic earnings per share (72,00,000/30,00,000)			2.40

Computation of Diluted earnings per share

	Earnings ₹	***Shares***	***Earnings/Share*** ₹
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Number of shares under option		6,00,000	
Number of shares that would have been issued at fair value (6,00,000 x 20.00)/25.00		(4,80,000)	
Diluted earnings per share	72,00,000	31,20,000	2.31 (rounded-off)

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 35

The following information relates to XYZ Limited for the year ended 31st March, 2022: Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10 each outstanding: ₹ 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	**Nos.**
8% Convertible Debentures of ₹ 100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP November, 2022*)

Answer

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year ₹ 37,50,000/ 5,00,000 = ₹ 7.50 per share

Computation of diluted earnings per share $\dfrac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

Weighted average number of equity shares

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹ 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

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

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

= 40,30,000/ 5,55,000 = ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 36

Following information is supplied by K Ltd.:

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹ 98

Last date of exercising rights - 30-06-2021.

Fair value of one equity share immediately prior to exercise of right on 30-06-2021 is ₹ 102.

Net Profit to equity shareholders:

2020-2021 - ₹ 50,00,000

2021-2022 -₹ 75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earnings per Share.

(*RTP May, 2023*)

Answer

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{102 \times 2{,}50{,}000 \text{ Shares} + ₹\ 98 \times 1{,}00{,}000 \text{ shares}}{3{,}50{,}000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 100.86

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = 102/100.86 = 1.01$$

Computation of earnings per share:

EPS for the year 2020-21 as originally reported: ₹ 50,00,000/2,50,000 shares = ₹ 20

EPS for the year 2020-21 restated for rights issue: =₹ 50,00,000/ (2,50,000 shares x 1.01) = ₹ 19.80

EPS for the year 2021-22 including effects of rights issue:

EPS = 75,00,000/3,25,625* = ₹ 23.03

** [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] =63,125 + 2,62,500 = 3,25,625 shares*

Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

CHAPTER 16

Accounting Standard 24 Discontinuing Operations

Question 1

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

Answer

(i) An enterprise should include prescribed information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15 of AS 24) occurs. For details, please refer Section 6.5 of this Chapter above.

(ii) Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do so in combination with other circumstances, include:

- (a) Gradual or evolutionary phasing out of a product line or class of service;
- (b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- (c) Shifting of some production or marketing activities for a particular line of business from one location to another; and
- (d) Closing of a facility to achieve productivity improvements or other cost savings.

Question 2

What are the initial disclosure requirements of AS 24 for discontinuing operations?

Answer

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) A description of the discontinuing operation(s)

(b) The business or geographical segment(s) in which it is reported as per AS 17.

(c) The date and nature of the initial disclosure event.

(d) The date or period in which the discontinuance is expected to be completed if known or determinable

(e) The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.

(f) The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.

(g) The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.

(h) The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 3

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the *division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.*

You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to (ii) above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

Answer

(i) A discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

QUESTION BANK

Question 4

A consumer goods producer has changed the product line as follows:

	Dish washing Bar (Per month)	Clothes washing Bar (Per month)
January 2016 - September 2016	2,00,000	2,00,000
October 2016 - December 2016	1,00,000	3,00,000
January 2017 - March 2017	Nil	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The Board of Directors has passed a resolution in March 2016 to this effect. The company follows calendar year as its accounting year.

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24?

(*MTP August 2018/April 2019 & RTP May 2018*)

Answer:

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

(i) that the enterprise, pursuant to a single plan, is:
  (1) disposing of substantially in its entirety,
  (2) disposing of piecemeal, or
  (3) terminating through abandonment; and
(ii) that represents a separate major line of business or geographical area of operations; and
(iii) that can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

Question 5

What are the initial disclosure requirements of AS 24 for discontinuing operations?

(November 2018) (5 marks)

Answer*:*

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

A. A description of the discontinuing operation(s)
B. The business or geographical segment(s) in which it is reported as per AS 17
C. The date and nature of the initial disclosure event.
D. The date or period in which the discontinuance is expected to be completed if known or determinable
E. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled
F. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period
G. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto
H. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period

Question 6

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

(*RTP November 2018*)

Answer:

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;
(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 7

What do you understand by Discontinuing Operations? What are the disclosure and presentation requirements of AS 24 for discontinuing operations? Explain in brief.

(*RTP, November, 2020*)

Answer

As per AS 24 "Discontinuing Operations", a discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:
  (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
  (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
  (iii) Terminating through abandonment and
(b) That represents a separate major line of business or geographical area of operations.
(c) That can be distinguished operationally and for financial reporting purposes.

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s);
- The business or geographical segment(s) in which it is reported as per AS 17;
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable,
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 8

Arzoo Ltd. is in the business of manufacture of passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment to the commercial vehicles segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan, it has planned that it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

Answer

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service;
(2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(3) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(4) Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above, mere gradual phasing out in itself cannot be considered as discontinuing operation. The companies' strategic plan also has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

Question 9

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

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

Answer

(i) As per AS 24, a discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(a) Gradual or evolutionary phasing out of a product line or class of service;

(b) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(c) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Question 10

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

(*RTP November 2021*)

Answer

A discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:

(i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

(ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

(iii) Terminating through abandonment and

(b) That represents a separate major line of business or geographical area of operations.

(c) That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

Question 11

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

(*RTP May, 2022*)

Answer

(i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17 'Segment Reporting';
(c) the date and nature of the initial disclosure event;
(d) the date or period in which the discontinuance is expected to be completed if known or determinable;
(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and
(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

(ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;
(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 12

What are the disclosure requirement in interim financial reports as per AS 24 for discontinuing operations?

(*RTP November, 2022*)

Answer

Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

(a) Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and
(b) Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

CHAPTER 17

Preparation of Financial Statements

Question 1

In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of ₹ 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment.

(*Source: Example 1, Study Material*)

Solution

Schedule III has come into force for the Balance Sheet and Profit and Loss Account prepared for the financial year commencing on or after 1st April, 20X1. As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 20X2 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. Schedule III does not require a company to disclose the source from which bonus shares have been issued. Therefore, non- disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

Question 2

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

(*Source: Example 2, Study Material*)

Solution

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

Question 3

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 20X1:

	Amount ₹ in lakhs
Securities Premium Account	*80*
Capital Reserve	*60*
General Reserve	*90*

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

(*Source: Example 3, Study Material*)

Solution

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

Question 4

Sumedha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30 09.20X1 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III.

(*Source: Example 4, Study Material*)

Solution

In the given case, instalments due on 30.09.20X1 and 31.03.20X2 will be shown under the head 'short term borrowings' as current maturities of loan from bank as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Therefore, in the balance sheet as on 31.3.20X1, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'short term borrowings'.

Question 5

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

(*Source: Example 5, Study Material*)

Solution

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

As per AS-29, a ₹provision' is "a liability which can be measured only by using a substantial degree of estimation". A 'liability' is "a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits." Present obligation' – "an obligation is a present obligation if, based on the evidence available, its existence at the Balance Sheet date is considered probable, i.e., more likely than not."

Question 6

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

(*Source: Example 6, Study Material*)

Solution

Under Schedule III, trade receivables are required to be classified into long-term (non-current) trade receivables and short-term (current) trade receivables. Trade Receivables, shall be sub-classified as:

(i) (a) Secured, considered good;

(b) Unsecured considered good;

(c) Doubtful

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

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

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

Particulars	**Outstanding for following periods from due date of payment#**					**Total**
	Less than 6 months	**6 months- 1 year**	**1-2 years**	**2-3 years**	**More than 3 years**	
(i) Undisputed Trade Receivables – considered good						
(ii) Undisputed Trade Receivables – considered doubtful						
(iii) Disputed Trade Receivables– considered good						
(iv) Disputed Trade Receivables– considered doubtful						

similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Note: Students may note that the questions based on preparation of Statement of Profit and Loss and Balance Sheet and explanatory notes as per Schedule III have been given in this Unit. However, questions requiring preparation of cash flow statements have been separately given in the next unit of this chapter.

Question 7

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilised from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	₹
17,500 9% Preference shares of ₹ 100 each, fully paid up	*17,50,000*
8,00,000 Equity shares of ₹ 10 each, fully paid up	*80,00,000*
General Reserves as on 1.4.20X1	*25,00,000*
Capital Reserves as on 1.4.20X1	*3,00,000*
Revaluation Reserves as on 1.4.20X1	*3,50,000*
Net profit for the year ended 31st March, 20X2	*3,00,000*
Average rate of dividend during the last three years has been 12%.	

(*Source: Illustration 1, Study Material*)

Solution

Amount that can be drawn from reserves for 10% dividend		
10% dividend on ₹ 80,00,000		₹ 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilised from reserves		6,57,500

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

Condition I

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

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves i.e. ₹ 12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III

The balance of reserves after drawl ₹ 18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15 % of its paid up capital i.e. ₹ 14,62,500 (15% of ₹ 97,50,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated reserves (as per Declaration and Payment of Dividend Rules, 2014.)

Question 8

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures in ₹ '000)

	Debit		Credit
Land at cost	*220*	*Equity Capital (Shares of ₹ 10 each)*	*300*
Plant & Machinery at cost	*770*	*10% Debentures*	*200*
Trade Receivables	*96*	*General Reserve*	*130*
Inventories (31.3.X2)	*86*	*Profit & Loss A/c*	*72*
Bank	*20*	*Securities Premium*	*40*
Adjusted Purchases	*320*	*Sales*	*700*
Factory Expenses	*60*	*Trade Payables*	*52*
Administration Expenses	*30*	*Provision for Depreciation*	*172*
Selling Expenses	*30*	*Suspense Account*	*4*
Debenture Interest	*20*		
Interim Dividend Paid	*18*		
	1670		*1670*

Additional Information:

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

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

(iii) Declared final dividend @ 10% on 2nd April, 20X2.

(iv) Suspense account of ₹ 4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.

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

You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

(*Source: Illustration 2, Study Material*)

Solution

Omega Limited

Balance Sheet as at 31st March, 20X2

Particulars	*Note No.*	*(₹ in 000)*
Equity and Liabilities		
1. Shareholders' funds		
A Share capital	1	300
B Reserves and Surplus	2	530
2. Non-Current liabilities		
A Long term borrowings	3	200
3. Current liabilities		
A Trade Payables		52
Total		**1082**

Particulars	***Note No.***	***(₹ in 000)***
Assets		
1. Non-current assets		
A PPE (Property, Plant & Equipment)	4	880
2. Current assets		
A Inventories		86
B Trade receivables		96
C Cash and bank balances		20
Total		**1082**

Omega Limited

Statement of Profit and Loss for the year ended 31st March, 20X2

	Particulars	***Notes***	***(₹ in 000)***
I.	Revenue from operations		700
II.	Other Income	5	2
III	**Total Revenue**		**702**
IV	Expenses:		
	Purchases		320
	Finance costs	6	20
	Depreciation (10% of 760)*		76
	Other expenses	7	120
	Total Expenses		**536**
V.	**Profit (Loss) for the period** (III – IV)		**166**

Notes to accounts

				(₹ in 000)
1.	**Share Capital**			
	Equity share capital			
	Authorised			
	40,000 shares of ₹ 10 each			400
	Issued & subscribed & called up			
	30,000 shares of ₹ 10 each			300
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	Revaluation reserve (360 – 220)			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	220
				530

* 770 (Plant and machinery at cost) – 10 (Cost of plant and machinery sold)

			(₹ in 000)
3.	**Long term borrowing**		
	10% Debentures		200
4.	**PPE**		
	Land		
	Opening balance	220	
	Add: Revaluation adjustment	140	
	Closing balance		360
	Plant and Machinery		
	Opening balance	770	
	Less: Disposed off	(10)	
		760	
	Less: Depreciation (172-8+76)	(240)	
	Closing balance		520
	Total		880
5.	**Other Income**		
	Profit on sale of machinery:		
	Sale value of machinery	4	
	Less: Book value of machinery (10-8)	(2)	2
6.	**Finance costs**		
	Debenture interest		20
7.	**Other expenses:**		
	Factory expenses	60	
	Selling expenses	30	
	Administrative expenses	30	120

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 9

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemicals Ltd.

Trial Balance as at 31st March, 20X1

Particulars	***₹***	***Particulars***	***₹***
Inventory	*6,80,000*	*Equity Shares*	
Furniture	*2,00,000*	*Capital (Shares of ₹ 10 each)*	*25,00,000*
Discount	*40,000*	*11% Debentures*	*5,00,000*
Loan to Directors	*80,000*	*Bank loans*	*6,45,000*
Advertisement	*20,000*	*Trade payables*	*2,81,000*
Bad debts	*35,000*	*Sales*	*42,68,000*
Commission	*1,20,000*	*Rent received*	*46,000*
Materials consumed	*23,19,000*	*Transfer fees*	*10,000*

Particulars	***₹***	***Particulars***	***₹***
Plant and Machinery	*8,60,000*	*Profit & Loss account*	*1,39,000*
Rentals	*25,000*	*Depreciation provision:*	
Current account	*45,000*	*Machinery*	*1,46,000*
Cash	*8,000*		
Interest on bank loans	*1,16,000*		
Preliminary expenses	*10,000*		
Fixtures	*3,00,000*		
Wages	*9,00,000*		
Consumables	*84,000*		
Freehold land	*15,46,000*		
Tools & Equipment	*2,45,000*		
Goodwill	*2,65,000*		
Trade receivables	*4,40,000*		
Dealer aids	*21,000*		
Transit insurance	*30,000*		
Trade expenses	*37,000*		
Distribution freight	*54,000*		
Debenture interest	*55,000*		
	85,35,000		*85,35,000*

Additional information: Closing Inventory on 31-3-20X1: ₹ 8,23,000.

(*Source: Illustration 3, Study Material*)

Solution

Haria Chemicals Ltd.
Balance Sheet as at 31st March, 20X1

		Schedule No. (1)	***Rupees as at the end of 31st March 20X1 (2)***
Equity and Liabilities			
(1)	**Shareholders' funds**:		
(a)	Share Capital	1	25,00,000
(b)	Reserves and Surplus	2	7,40,000
(2)	**Non Current Liabilities**		
(a)	Long term borrowings	3	11,45,000
(3)	**Current Liabilities**		
(a)	Trade payables		2,81,000
Total			**46,66,000**
Assets			
(1)	**Non current assets**		
(a)	PPE	4	30,05,000
(b)	Intangible assets (goodwill)		2,65,000
(2)	**Current assets**		
(a)	Inventories		8,23,000
(b)	Trade receivables		4,40,000
(c)	Cash and bank balances	5	53,000
(d)	Short term loans and advances	6	80,000
	Total		**46,66,000**

Haria Chemicals Ltd.

Statement of Profit and Loss for the year ended 31st March, 20X1

		Schedule	*Figures*	
Revenue from operations			42,68,000	
Other income		7	56,000	
	(A)		43,24,000	
Expenses				
Cost of materials consumed			23,19,000	
Change in inventory of finished goods		8	(1,43,000)	
Employee benefit expenses		9	9,00,000	
Finance cost		10	1,71,000	
Other expenses		11	4,76,000	
	(B)		37,23,000	
Profit before tax (A – B)				6,01,000
Provision for tax				—
Profit for the period				6,01,000

Notes to Accounts

		₹
1.	**Share capital**	
	Authorised:	
	Equity share capital of ₹ 10 each	25,00,000
	Issued and Subscribed:	
	Equity share capital of ₹ 10 each	25,00,000
2.	**Reserves and Surplus**	
	Balance as per last balance sheet	1,39,000
	Balance in profit and loss account	6,01,000
		7,40,000
3.	**Long term Borrowings**	
	11% Debentures	5,00,000
	Bank loans (assumed long-term)	6,45,000
		11,45,000
4.	**PPE**	

	Gross block	*Depreciation*	*Net Block*
Freehold land	15,46,000		15,46,000
Furniture	2,00,000		2,00,000
Fixtures	3,00,000		3,00,000
Plant & Machinery	8,60,000	1,46,000	7,14,000
Tools & Equipment	2,45,000		2,45,000
Total	31,51,000	1,46,000	30,05,000

5.	**Cash and bank balances**	
	Cash and cash equivalents	
	Current account balance	45,000
	Cash	8,000
	Other bank balances	Nil
		53,000

6.	**Short-term loans and Advances**		
	Loan to directors		80,000
7.	**Other Income**		
	Rent received		46,000
	Transfer fees		10,000
			56,000
8.	**Changes in inventory of finished goods, WIP & Stock in trade**		
	Opening inventory	6,80,000	
	Closing inventory	(8,23,000)	(1,43,000)
9.	**Employee benefit expense**		
	Wages		9,00,000
10.	**Finance cost**		
	Interest on bank loans		1,16,000
	Debenture interest		55,000
			1,71,000
11.	**Other Expenses**		
	Consumables		84,000
	Preliminary expenses		10,000
	Bad debts		35,000
Discount			40,000
Rentals			25,000
Commission			1,20,000
Advertisement			20,000
Dealers' aids			21,000
Transit insurance			30,000
Trade expenses			37,000
Distribution freight			54,000
			4,76,000

Question 10

You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 20X2:

	Dr. ***₹***	***Cr.*** ***₹***
Authorised Capital-divided into 5,000 6% Preference Shares		
of ₹ 100 each and 10,000 equity Shares of ₹ 100 each		*15,00,000*
Subscribed Capital -		
5,000 6% Preference Shares of ₹ 100 each		*5,00,000*
Equity Capital		*8,05,000*
Purchases - Wines, Cigarettes, Cigars, etc.	*45,800*	
- Foodstuffs	*36,200*	
Wages and Salaries	*28,300*	
Rent, Rates and Taxes	*8,900*	
Laundry	*750*	
Sales - Wines, Cigarettes, Cigars, etc.		*68,400*
- Food		*57,600*
Coal and Firewood	*3,290*	
Carriage and Cooliage	*810*	

		Dr. ₹	Cr. ₹
Sundry Expenses		*5,840*	
Advertising		*8,360*	
Repairs		*4,250*	
Rent of Rooms			*48,000*
Billiard			*5,700*
Miscellaneous Receipts			*2,800*
Discount received			*3,300*
Transfer fees			*700*
Freehold Land and Building		*8,50,000*	
Furniture and Fittings		*86,300*	
Inventory on hand, 1st April, 20X1			
Wines, Cigarettes. Cigars, etc.		*12,800*	
Foodstuffs		*5,260*	
Cash in hand		*2,200*	
Cash with Bankers		*76,380*	
Preliminary and formation expenses		*8,000*	
2,000 Debentures of ₹ 100 each (6%)			*2,00,000*
Profit and Loss Account			*41,500*
Trade payables			*42,000*
Trade receivables		*19,260*	
Investments		*2,72,300*	
Goodwill at cost		*5,00,000*	
General Reserve			*2,00,000*
		19,75,000	*19,75,000*
Wages and Salaries Outstanding	*1,280*		
Inventory on 31st March, 20X2			
Wines, Cigarettes and Cigars, etc.	*22,500*		
Foodstuffs	*16,400*		

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

The Equity capital on 1st April, 20X1 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹60 paid. The directors made a call of ₹ 40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid. The Directors declared a dividend of 8% on equity shares on 2nd April, 20X2, transferring any amount that may be required from General Reserve. Ignore Taxation. (*Source: Illustration 4, Study Material*)

Solution

Balance Sheet of International Hotels Ltd. as at 31st March, 20X2

Particulars	***Note No***	***₹***
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	13,00,000
(b) Reserves and Surplus	2	2,68,745
2 Non-current liabilities		
(a) Long-term borrowings	3	2,00,000
3 Current liabilities		
(a) Trade Payables	4	42,000
(b) Other current liabilities	5	13,280
Total		**18,24,025**

Particulars	***Note No***	**₹**
ASSETS		
1 Non-current assets		
(i) PPE	6	9,14,985
(ii) Intangible assets (Goodwill)		5,00,000
(iii) Non-current investments		2,72,300
2 Current assets		
(i) Inventories	7	38,900
(ii) Trade receivables		19,260
(iii) Cash and bank balances	8	78,580
Total		**18,24,025**

Statement of Profit and Loss of International Hotels Ltd.
for the year ended 31st March, 20X2

	Particulars	***Notes***	***Amount***
I.	Revenue from operations	9	1,79,700
II.	Other income	10	6,800
III.	**Total Income (I + II)**		**1,86,500**
IV.	**Expenses:**		
	Cost of materials consumed	11	25,060
	Purchases of Inventory-in-Trade	12	45,800
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	13	(9,700)
	Employee benefits expense	14	29,580
	Other operating expenses	15	18,000
	Selling and administrative expenses	16	14,200
	Finance costs	17	12,000
	Depreciation and amortisation expense	18	21,315
	Other expenses (Preliminary expenses written off)		8,000
	Total expenses		**1,64,255**
V.	**Profit (Loss) for the period (III - IV)**		**22,245**

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	Authorised	
	10,000 Equity shares of ₹ 100 each	10,00,000
	Issued & subscribed	
	8,000 Equity Shares of ₹ 100 each (A)	8,00,000
	Preference share capital	
	Authorised	
	5,000 6% Preference shares of ₹ 100 each	5,00,000
	Issued & subscribed	
	5,000 6% Preference shares of ₹ 100 each (B)	5,00,000
	Total (A + B)	**13,00,000**

			₹
2	**Reserves and Surplus**		
	Capital reserve [100 x (90 – 40)]		5,000
	General reserve	2,00,000	
	Surplus (Profit & Loss A/c)	22,245	2,00,000
	Add: Balance from previous year	41,500	
			63,745
	Total		**2,68,745**
3	**Long-term borrowings**		
	Secured		
	6% Debentures		2,00,000
	Total		**2,00,000**
4	**Trade Payables**		42,000
5	**Other current liabilities**		
	Wages and Salaries Outstanding	1,280	
	Interest on debentures	12,000	13,280
	Total		**13,280**
6	**PPE**		
	Freehold land & Buildings	8,50,000	
	Less: Depreciation	(17,000)	8,33,000
	Furniture and Fittings	86,300	
	Less: Depreciation	(4,315)	81,985
	Total		**9,14,985**
7	**Inventories**		
	Wines, Cigarettes & Cigars, etc.		22,500
	Foodstuffs		16,400
	Total		**38,900**
8	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		76,380
	Cash in hand		2,200
	Other bank balances		Nil
	Total		**78,580**
9	**Other expenses**		
	Preliminary Expenses*		8,000
	Total		**8,000**
10	**Revenue from operations**		
	Sale of products		
	Wines, Cigarettes, Cigars etc.	68,400	
	Food	57,600	1,26,000
	Sale of services		
	Room Rent	48,000	
	Billiards	5,700	
	Transfer fees	700	
	Miscellaneous Receipts	2,800	
			57,200
	Total		**1,83,200**

* As per AS 26, preliminary expenses are not shown in the balance sheet.

			₹
11	**Cost of materials consumed**		
	Opening Inventory	5,260	
	Add: Purchases during the year	36,200	
	Less: Closing Inventory	(16,400)	25,060
	Total		**25,060**
12	**Purchases of Inventory-in-Trade**		
	Wines, Cigarettes etc.		45,800
	Total		**45,800**
13.	**Changes in inventories of finished goods work-in-progress and Inventory-in-Trade**		
	Wines, Cigarettes etc.		
	Opening Inventory	12,800	
	Less: Closing Inventory	(22,500)	(9,700)
	Total		**(9,700)**
14	**Employee benefits expense**		
	Wages and Salaries	28,300	
	Add: Wages and Salaries Outstanding	1,280	29,580
	Total		**29,580**
15	**Other operating expenses**		
	Rent, Rates and Taxes		8,900
	Coal and Firewood		3,290
	Laundry		750
	Carriage and Cooliage		810
	Repairs		4,250
	Total		**18,000**
16	**Selling and administrative expenses**		
	Advertising		8,360
	Sundry Expenses		5,840
	Total		**14,200**
17	**Finance costs**		
	Interest on Debentures (2,00,000 x 6%)		12,000
	Total		**12,000**
18	**Depreciation and amortisation expense**		
	Land and Buildings (8,50,000 x 2%)	17,000	
	Furniture & Fittings (86,300 x 5%)	4,315	21,315
	Total		**21,315**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 11

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary –

		Debit	Credit
		₹	₹
Equity Capital (Face value of ₹ 100)			*10,00,000*
Calls in Arrears		*1,000*	
Land		*2,00,000*	
Building		*3,50,000*	
Plant and Machinery		*5,25,000*	
Furniture		*50,000*	
General Reserve			*2,10,000*
Loan from State Financial Corporation			*1,50,000*
Inventory :			
Finished Goods	*2,00,000*		
Raw Materials	*50,000*	*2,50,000*	
Provision for Taxation			*68,000*
Trade receivables		*2,00,000*	
Advances		*42,700*	
Dividend Payable			*60,000*
Profit and Loss Account			*86,700*
Cash Balance		*30,000*	
Cash at Bank		*2,47,000*	
Loans (Unsecured)			*1,21,000*
Trade payables (For Goods and Expenses)			*2,00,000*
		18,95,700	*18,95,700*

The following additional information is also provided :

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

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

(3) The cost of assets:

Building	*₹ 4,00,000*
Plant and Machinery	*₹ 7,00,000*
Furniture	*₹ 62,500*

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

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

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

(*Source: Illustration 5, Study Material*)

Solution

Pioneer Ltd.

Balance Sheet as at 31st March, 20X1

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	9,99,000
	(b)	Reserves and Surplus	2	2,96,700
2		**Non-current liabilities**		
	(a)	Long-term borrowings	3	2,63,500

		Particulars	Notes	₹
3		**Current liabilities**		
	(a)	Trade Payables		2,00,000
	(b)	Other current liabilities	4	67,500
	(c)	Short-term provisions	5	68,000
		Total		**18,94,700**
		Assets		
1		**Non-current assets**		
	(a)	PPE	6	11,25,000
2		**Current assets**		
	(a)	Inventories	7	2,50,000
	(b)	Trade receivables	8	2,00,000
	(c)	Cash and bank balances	9	2,77,000
	(d)	Short-term loans and advances		42,700
		Total		**18,94,700**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	10,000 Equity Shares of ₹ 100 each (Of the above 2,000 shares have been issued for consideration other than cash)	10,00,000	
	Less: Calls in arrears	(1,000)	9,99,000
	Total		**9,99,000**
2	**Reserves and Surplus**		
	General Reserve		2,10,000
	Surplus (Profit & Loss A/c)		86,700
	Total		**2,96,700**
3	**Long-term borrowings**		
	Secured		
	Term Loans		
	Loan from State Financial Corporation (1,50,000–7,500) (Secured by hypothecation of Plant and Machinery)		1,42,500
	Unsecured loan		1,21,000
	Total		**2,63,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		7,500
	Dividend Payable		60,000
	Total		**67,500**
5	**Short-term provisions**		
	Provision for taxation		68,000
	Total		**68,000**

			₹
6	**PPE**		
	Land		2,00,000
	Buildings	4,00,000	
	Less: Depreciation	(50,000) (b.f.)	3,50,000
	Plant & Machinery	7,00,000	
	Less: Depreciation	(1,75,000) (b.f.)	5,25,000
	Furniture & Fittings	62,500	
	Less: Depreciation	(12,500) (b.f.)	50,000
	Total		**11,25,000**
7	**Inventories**		
	Raw Material		50,000
	Finished goods		2,00,000
	Total		**2,50,000**
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		52,000
	Other Debts		1,48,000
	Total		**2,00,000**
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		
	with Scheduled Banks	2,45,000	
	with others (Perfect Bank Ltd.)	2,000	2,47,000
	Cash in hand		30,000
	Other bank balances		Nil
	Total		**2,77,000**

Note: Estimated amount of contract remaining to be executed on capital account and not provided for ₹1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Question 12

Following is the trial balance of Delta limited as on 31.3.20X2.

(Figures in ₹ '000)

Particulars	***Debit***	***Particulars***	***Credit***
Land at cost	*800*	*Equity share capital (shares of ₹ 10 each)*	*500*
Calls in arrears	*5*	*10% Debentures*	*300*
Cash in hand	*2*	*General reserve*	*150*
Plant & Machinery at cost	*824*	*Profit & Loss A/c (balance on 1.4.X1)*	*75*
Trade receivables	*120*	*Securities premium*	*40*
Inventories (31-3-X2)	*96*	*Sales*	*1200*
Cash at Bank	*28*	*Trade payables*	*30*
Adjusted Purchases	*400*	*Provision for depreciation*	*150*
Factory expenses	*80*	*Suspense Account*	*10*
Administrative expenses	*45*		
Selling expenses	*25*		
Debenture Interest	*30*		
	2455		*2455*

Additional Information:

(i) The authorized share capital of the company is 80,000 shares of ₹ 10 each.

(ii) The company revalued the land at ₹ 9,60,000.

(iii) Equity share capital includes shares of ₹ 50,000 issued for consideration other than cash.

(iv) Suspense account of ₹ 10,000 represents cash received from the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹ 24,000 and the accumulated depreciation thereon being ₹ 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.

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

(vi) Balance at bank includes ₹ 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.

(vii) Make provision for income tax @30%.

(viii) Trade receivables of ₹ 50,000 are due for more than six months.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous year's figures & taxation.

(*Source: Illustration 6, Study Material*)

Solution

Delta Limited

Balance Sheet as at 31st March 20X2

Particulars	**Note No.**	**(₹ in '000)**
A. Equity and Liabilities		
1. Shareholders' funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00
(b) Short- term provision	4	163.80
Total		1,796.00
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00
(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 20X2

Particulars	**Note No.**	**(₹ in '000)**
I. Revenue from Operations		1200.00
II. Other Income	8	6.00
III. Total Income (I +II)		1,206.00
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)		80.00
Other expenses	10	150.00
Total Expenses		660.00
V. Profit / (Loss) for the period before tax (III – IV)		546.00
VI. Tax expenses @30%		163.80
VII Profit for the period		382.20

Notes to Accounts

	Particulars		(₹ in '000)
1	Share Capital		
	Equity Share Capital Authorised 80,000 Shares of ₹10/- each		800
	Issued, Subscribed and Called -up		
	50,000 Shares of ₹ 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve ₹ (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance		
	Opening Balance	75.00	
	Add: Profit for the period	382.20	457.20
			807.20
3	Long-Term Borrowings		
	10% Debentures		300
4.	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	
		800	
	Less: Depreciation ₹ (150 – 20 + 80)	(210)	
	Closing Balance		590
	Total		1,550
6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less : Book value of machinery (24 – 20)	(4)	6
9	Finance Costs		
	Debenture Interest		30

Question 13

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

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

(ii) Share option outstanding account.

(iii) Unpaid matured debenture and interest accrued thereon.

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

(v) Calls unpaid.

(vi) Money received against share warrant.

(*Source: Question 6, Study Material*)

Answer

(i) Current Liabilities/Other Current Liabilities

(ii) Shareholders' Fund/Reserve & Surplus

(iii) Current liabilities/Other Current Liabilities

(iv) Contingent Liabilities and Commitments

(v) Shareholders' Fund/Share Capital

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

Question 14

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

***Credit Balances**:*

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

Debit Balances:

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

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

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

(ii) Cost of Building ₹ 28,00,000

(iii) Cost of Plant & Machinery ₹ 49,00,000 Cost of Furniture & Fixture ₹ 4,37,500

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

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

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

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

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

(*Source: Question 7, Study Material*)

Answer

Bose and Sen Ltd.
Balance Sheet as at 31st March, 20X1

		Particulars	***Notes***	***Figures at the end of current reporting period (₹)***
Equity and Liabilities				
1		**Shareholders' funds**		
	(a)	Share capital	1	69,93,000
	(b)	Reserves and Surplus	2	21,56,000
2		Non-current liabilities		
	(a)	Long-term borrowings	3	16,97,000
3		**Current liabilities**		
	(a)	Trade Payables		14,00,000
	(b)	Other current liabilities	4	2,00,000
	(c)	Short-term provisions	5	8,16,900
		Total		1,32,62,900
Assets				
1		**Non-current assets**		
	(a)	PPE	6	74,75,000
	(b)	Intangible assets (Patents & Trade Marks)		4,00,000
2		**Current assets**		
	(a)	Inventories	7	17,50,000
	(b)	Trade receivables	8	14,00,000
	(c)	Cash and bank balances	9	19,39,000
	(d)	Short-term loans and advances		2,98,900
		Total		1,32,62,900

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up	70,00,000	
	7,00,000 Equity Shares of ₹ 10 each (Out of the above 4,20,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(7,000)	69,93,000
	Total		69,93,000
2	**Reserves and Surplus**		
	General Reserve		15,49,100
	Surplus (Profit & Loss A/c)	7,00,000	
	Less: Preliminary expenses	(93,100)*	6,06,900
	Total		21,56,000
3	**Long-term borrowings**		
	Secured Term Loans		
	Loan from State Finance Corporation (₹ 10,50,000 - ₹ 2,00,000) (Secured by hypothecation of Plant and Machinery)		8,50,000
	Unsecured		
	Bank Loan	2,00,000	
	Loan from related parties	1,00,000	
	Others	5,47,000	8,47,000
	Total		16,97,000
4	**Other current liabilities**		
	Current maturities of long-term debt- loan Instalment repayable within one year		2,00,000
5	**Short-term provisions**		
	Provision for taxation		8,16,900
6	**Property, plant and equipment**		
	Land		14,00,000
	Buildings	28,00,000	
	Less: Depreciation	(7,50,000) (b.f.)	20,50,000
	Plant & Machinery	49,00,000	
	Less: Depreciation	(12,25,000) (b.f.)	36,75,000
	Furniture & Fittings	4,37,500	
	Less: Depreciation	(87,500) (b.f.)	3,50,000
	Total		74,75,000
7	**Inventories**		
	Raw Material		3,50,000
	Finished goods		14,00,000
			17,50,000

* *Preliminary expenses have been written off in line with Accounting Standards.*

			₹
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		3,80,000
	Other Debts		10,20,000
	Total		14,00,000
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank with Scheduled Banks	12,11,000	
	with others	18,000	12,29,000
	Cash in hand		2,10,000
	Other bank balances	5,00,000	
	Bank deposits for period of 9 months		5,00,000
	Total		19,39,000

Question 15

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

Particulars		*Debit ₹*	*Credit ₹*
Equity Share Capital (Face value of ₹ 100 each)			*50,00,000*
Call in Arrears		*5,000*	
Land & Building		*27,50,000*	
Plant & Machinery		*26,25,000*	
Furniture		*2,50,000*	
General Reserve			*10,50,000*
Loan from State Financial Corporation			*7,50,000*
Inventory:			
Raw Materials	*2,50,000*		
Finished Goods	*10,00,000*	*12,50,000*	
Provision for Taxation			*6,40,000*
Trade receivables		*10,00,000*	
Short term Advances		*2,13,500*	
Profit & Loss Account			*4,33,500*
Cash in Hand		*1,50,000*	
Cash at Bank		*12,35,000*	
Unsecured Loan			*6,05,000*
Trade payables (for Goods and Expenses)			*8,00,000*
Loans & advances from related parties			*2,00,000*
		94,78,500	*94,78,500*

The following additional information is also provided:

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

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

(iii) *The cost of the Assets were:*
Building ₹ 30,00,000, Plant & Machinery ₹ 35,00,000 and Furniture ₹ 3,12,500

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

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

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

(vii) *Board of directors declared dividend of 5% on the paid up capital on 2nd April, 20X1.*

(*Source: Question 8, Study Material*)

Answer

Alpha Ltd.
Balance Sheet as at 31st March, 20X1

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	49,95,000
	(b)	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	(a)	Trade Payables		8,00,000
	(b)	Other current liabilities	4	37,500
	(c)	Short-term provisions	5	6,40,000
	(d)	Short-term borrowings		2,00,000
		Total		**94,73,500**
		Assets		
1		**Non-current assets**		
		PPE	6	56,25,000
2		**Current assets**		
	(a)	Inventories	7	12,50,000
	(b)	Trade receivables	8	10,00,000
	(c)	Cash and bank balances	9	13,85,000
	(d)	Short-term loans and advances		2,13,500
		Total		**94,73,500**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	50,000 Equity Shares of ₹ 100 each (of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000
	Total		**49,95,000**
2	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	4,13,500
	Total		**14,83,500**
3	**Long-term borrowings**		
	Secured Term Loan		

			₹
	State Financial Corporation Loan (7,50,000- 37,500) (Secured by hypothecation of Plant and Machinery)		7,12,500
	Unsecured Loan		6,05,000
	Total		**13,17,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		37,500
			37,500
5	**Short-term provisions**		
	Provision for taxation		6,40,000
6	**Property, plant and equipment**		
	Land and Building	30,00,000	
	Less: Depreciation	(2,50,000) (b.f.)	27,50,000
	Plant & Machinery	35,00,000	
	Less: Depreciation	(8,75,000) (b.f.)	26,25,000
	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500) (b.f.)	2,50,000
	Total		**56,25,000**
7	**Inventories**		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		**12,50,000**
8	**Trade receivables**		
	Outstanding for a period exceeding six months		2,60,000
	Other Amounts		7,40,000
	Total		**10,00,000**
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		
	with Scheduled Banks	12,25,000	
	with others (Omega Bank Ltd.)	10,000	12,35,000
	Cash in hand		1,50,000
	Other bank balances		Nil
	Total		**13,85,000**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X1. Such dividends will be disclosed in notes only.

Question 16

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

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

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

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

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

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

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

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

(e) The directors declared a dividend @ 25% on 2nd April, 20X2 and transfer to General Reserve @ 10%.

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

(*Source: Question 9, Study Material*)

Answer

Ring Ltd.

Profit and Loss Statement for the year ended 31st March, 20X2

	Particulars	***Note No.***	***(₹ In lacs)***
I	**Revenue from operations**		10,40,000
II	**Other income** (interest on investment)		24,000
III	**Total Revenue [I + II]**		**10,64,000**
IV	**Expenses:**		
	Cost of purchase [4,20,000+ 1,60,000]		5,80,000
	Changes in inventories [20,000-1,80,000]		(1,60,000)
	Employee Benefits Expense		1,20,000
	Finance Costs (debenture interest)		56,000
	Depreciation and Amortisation Expenses		40,000
	Other Expenses	**8**	1,24,000
	Total Expenses		**7,60,000**
V	Profit before Tax (III-IV)		3,04,000
VI	**Tax Expenses @ 30%**		(91,200)
VII	**Profit for the period**		**2,12,800**

Balance Sheet of Ring Ltd. as at 31ST March, 20X2

		Particulars	Note No.	₹
I	**EQUITY AND LIABILITIES**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	4,00,000
		(b) Reserves and Surplus	2	3,42,800
	(2)	**Non-Current Liabilities**		
		(a) Long-term Borrowings (14% debentures)		4,00,000
	(3)	**Current Liabilities**		
		(a) Trade Payable (Sundry Creditors)		1,84,000
		(b) Other Current Liabilities	3	42,000
		(c) Short-Term Provisions	4	91,200
		Total		**14,60,000**
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) PPE	5	5,70,000
		(b) Non-current Investments		2,40,000
	(2)	**Current Assets**		
		(a) Inventories	6	2,26,000
		(b) Trade Receivables	7	2,40,000
		(c) Cash and bank balances		60,000
		(d) Short Term Loans and Advances (Advance Payment of Tax)		1,20,000
		(e) Other Current Assets (Interest accrued on investments)		4,000
		Total		**14,60,000**

Note: There is a Contingent Liability for bills discounted but not yet matured amounting to ₹ 20,000.

Notes to Accounts:

1.	**Share Capital**		
	Authorised Capital		
	10,000 Equity Shares of ₹ 100 each		10,00,000
	Issued Capital		
	4,000 Equity Shares of ₹ 100 each		4,00,000
	Subscribed Capital and fully paid		
	4,000 Equity Shares of ₹ 100 each		4,00,000
2.	**Reserve and Surplus**		
	General Reserve [₹ 80,000 + ₹ 21,280]		1,01,280
	Balance of Statement of Profit & Loss Account		
	Opening Balance	50,000	
	Add: Profit for the period	2,12,800	
	Appropriations	2,62,800	
	Transfer to General Reserve @ 10%	(21,280)	2,41,520
			3,42,800
3.	**Other Current Liabilities**		
	Unclaimed Dividend		10,000
	Outstanding Expenses		4,000
	Interest accrued on Debentures		28,000
			42,000
4.	**Short-Term Provision**		
	Provision for Tax		91,200
5	**Property, plant and equipment**		
	Buildings	5,80,000	
	Less: Provision for Depreciation	1,00,000	4,80,000

	Plant and Equipment	2,00,000	
	Less: Provision for Depreciation	1,10,000	90,000
6	**Inventories**		5,70,000
	Closing Stock of Finished Goods	1,80,000	
	Loose Tools	46,000	2,26,000
7	**Trade Receivables**		
	Sundry Debtors	2,50,000	
	Less: Provision for Doubtful Debts	(10,000)	2,40,000
8.	**Other Expenses**		
	Rent		52,000
	Directors' Fees		20,000
	Bad Debts		12,000
	Provision for Doubtful Debts (4% of ₹ 2,50,000 less ₹ 6,000)		4,000
	Sundry Expenses		36,000
			1,24,000

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 17

On 31st March, 20X1, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 20X1.

Particulars	***Amount (₹)***	
	Debit	*Credit*
Equity Share Capital, fully paid shares of ₹ 50 each		*80,00,000*
Calls in arrear	*15,000*	
Land	*25,00,000*	
Buildings	*30,00,000*	
Plant & Machinery	*24,00,000*	
Furniture & Fixture	*13,00,000*	
Securities Premium		*15,00,000*
General Reserve		*9,41,000*
Profit & Loss Account		*5,80,000*
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		*26,30,000*
Other Long Term Loans		*22,50,000*
Short Term Borrowings		*4,60,000*
Inventories: Finished goods	*45,00,000*	
Raw materials	*13,00,000*	
Trade Receivables	*17,50,000*	
Advances: Short Term	*3,75,000*	
Trade Payables		*8,13,000*
Provision for Taxation		*3,80,000*
Unpaid Dividend		*70,000*
Cash in Hand	*70,000*	
Balances with Banks	*4,14,000*	
Total	*1,76,24,000*	*1,76,24,000*

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

(1) 50,000 fully paid equity shares were allotted as consideration for land.

(2) The cost of assets were:

Building	₹ 32,00,000
Plant and Machinery	₹ 30,00,000
Furniture and Fixture	₹ 16,50,000

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

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

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

(6) The balance of ₹ 26,30,000 in the loan account with Public Finance Corporation is inclusive of ₹1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

(7) Other long term loans (unsecured) includes:

Loan taken from Nixes Bank	₹ 13,80,000
(Amount repayable within one year	₹ 4,80,000)
Loan taken from Directors	₹ 8,50,000

(8) Bills Receivable for ₹ 1,60,000 maturing on 15th June, 20X1 has been discounted.

(9) Short term borrowings includes:

Loan from Naya bank	₹ 1,16,000 (Secured)
Loan from directors	₹ 48,000

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

(11) Inventory of finished goods includes loose tools costing ₹ 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 20X1 as required under Part - I of Schedule III of the Companies Act, 2013.

You are not required to give previous year figures.

(*Source: Question 10, Study Material*)

Answer

SR Ltd.

Balance Sheet as at 31st March, 20X1

Particulars		***Notes***	***Figures at the end of current reporting period (₹)***
Equity and Liabilities			
1	**Shareholders' funds**		
(a)	Share capital	1	79,85,000
(b)	Reserves and Surplus	2	30,21,000
2	**Non-current liabilities**		
(a)	Long-term borrowings	3	42,66,000
3	**Current liabilities**		
(a)	Short-term borrowings	4	4,60,000
(b)	Trade Payables		8,13,000
(c)	Other current liabilities	5	6,84,000
(d)	Short-term provisions	6	3,80,000
	Total		1,76,09,000
Assets			
1	**Non-current assets**		
(a)	PPE	7	92,00,000

	Particulars	*Notes*	*Figures at the end of current reporting period (₹)*
2	**Current assets**		
(a)	Inventories	8	58,00,000
(b)	Trade receivables	9	17,50,000
(c)	Cash and cash equivalents	10	4,84,000
(d)	Short-term loans and advances		3,75,000
	Total		1,76,09,000

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up		
	1,60,000 Equity Shares of ₹ 50 each (Out of the above 50,000 shares have been issued for consideration other than cash)	80,00,000	
	Less: Calls in arrears	(15,000)	79,85,000
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss account	35,000	9,76,000
	Securities premium		15,00,000
	Surplus (Profit & Loss A/c)	5,80,000	
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	**Long-term borrowings**		
	Secured: Term Loans		24,96,000
	Loan from Public Finance Corporation [repayable after 3 years (₹ 26,30,000 - ₹ 1,34,000 for interest accrued but not due)] (secured by hypothecation of land)		
	Unsecured		
	Bank Loan (Nixes bank) 9,00,000		
	(₹ 13,80,000 - ₹ 4,80,000		
	repayable within 1 year)		
	Loan from Directors 8,50,000		
	Others 20,000		17,70,000
	Total		42,66,000
4.	**Short-term borrowings**		
	Loan from Naya bank (Secured)	1,16,000	
	Loan from Directors	48,000	
	Others	2,96,000	4,60,000
5.	**Other current liabilities**		
	Loan from Nixes bank repayable within one year	4,80,000	
	Unpaid dividend	70,000	
	Interest accrued but not due on borrowings	1,34,000	6,84,000

			₹
6.	**Short-term provisions**		
	Provision for taxation		3,80,000
7.	**PPE**		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	**Trade receivables**		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	**Cash and cash equivalents**		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000

Note: There is a contingent liability amounting to ₹ 1,60,000

QUESTION BANK

Question 18

Shweta Ltd. has the Authorised Capital of ₹15,00,000 consisting of 6,000 6% Preference shares of ₹100 each and 90,000 equity Shares of ₹10 each. The following was the Trial Balance of the Company as on 31st March, 2018:

Particulars	Dr.	Cr.
Investment in Shares at cost	1,50,000	
Purchases	14,71,500	
Selling Expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and Wages	1,56,000	
Cash on Hand	36,000	
Interim Preference dividend for the half year to 30th September	18,000	
Bills Receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on Debentures upto 30th Sep (1st half year)	11,250	
Debtors	1,50,300	
Trade payables		2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of ₹ 45,000	1,05,000	
6% Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on Freehold properties		4,50,000
Income tax paid in advance for the current year	30,000	
Dividends		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft secured by hypothecation of stocks and receivables		4,50,000
Technical knowhow fees at cost paid during the year	4,50,000	
Audit fees	18,000	
Total	**44,72,850**	**44,72,850**

You are required to prepare the Profit and Loss Statement for the year ended 31st March, 2018 and the Balance Sheet as on 31st March, 2018 as per Schedule III of the Companies Act, 2013 after taking into account the following –

1. Closing Stock was valued at ₹ 4,27,500.
2. Purchases include ₹ 15,000 worth of goods and articles distributed among valued customers.
3. Salaries and Wages include ₹ 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".
4. Bills Receivable include ₹ 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of ₹ 6,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Down Value.
7. Investment in shares is to be treated as non-current investments.
8. Interest on Debentures for the half year ending on 31st March was due on that date.
9. Provide Provision for taxation ₹12,000.
10. Technical Knowhow Fees is to be written off over a period of 10 years.
11. Salaries and Wages include ₹ 30,000 being Director's Remuneration.
12. Trade receivables include ₹ 18,000 due for more than six months.

(*RTP May 2019*)

Answer:

Statement of Profit and Loss of Shweta Ltd. for the year ended 31st March, 2018

	Particulars	*Note*	₹
I	Revenue from Operations		20,11,050
II	Other income (Divided income)		12,750
III	Total Revenue (I &+ II)		20,23,800

	Particulars	***Note***	₹
IV	Expenses:		
	(a) Purchases (14,71,500–Advertisement Expenses 15,000)		14,56,500
	(b) Changes in Inventories of finished Goods/Work in progress (4,35,600 – 4,27,500)		8,100
	(c) Employee Benefits expense	**9**	1,20,000
	(d) Finance costs	**10**	51,900
	(e) Depreciation & Amortization Expenses [10% of (1,05,000 + 6,000)]		11,100
	(f) Other Expenses	**11**	3,47,550
	Total Expenses		19,95,150
V	Profit before exceptional, extraordinary items and tax (III-IV)		28,650
VI	Exceptional items		-
VII	Profit before extra-ordinary items and tax (V-IV)		28,650
VIII	Extraordinary items		-
IX	Profit before tax (VII-VIII)		28,650
X	Tax expense: Current Tax		12,000
XI	Profit/Loss for the period (after tax)		16,650

Balance sheet of Shweta Ltd. as on 31st March, 2018

	Particulars as on 31st March	***Note***	
I			
(1)	**Shareholders' funds:**		
	(a) Share capital	**1**	12,00,000
	(b) Reserves and surplus	**2**	66,150
(2)	**Non-current liabilities:**		
	Long term borrowings	**3**	4,50,000
(3)	**Current liabilities:**		
	(a) Short term borrowings	**4**	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	**5**	29,250
	Total		24,58,950
II	**ASSETS**		
(1)	**Non-current Assets**		
	(a) Property, Plant & Equipment		
	(i) Tangible assets	**6**	11,49,900
	(ii) Intangible assets	**7**	4,05,000
	(b) Non-current investments (Shares at cost)		1,50,000
	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	**8**	2,72,550
	(c) Cash and Cash equivalents–Cash on hand		36,000
	(d) Short term loans and advances – Income tax (paid 30,000-Provision 12,000)		18,000
	Total		24,58,950

Note: There is a Contingent liability for Bills receivable discounted with Bank ₹ 6,000.

Notes to accounts

			(₹)
1.	**Share Capital**		
	Authorized		
	90,000 Equity Shares of ₹ 10 each	9,00,000	
	6,000 6% Preference shares of ₹ 100 each	6,00,000	15,00,000
	Issued, subscribed & called up		
	60,000, Equity Shares of ₹ 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	12,00,000

			(₹)
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2017	85,500	
	Add: Surplus for current year	16,650	1,02,150
	Less: Preference Dividend		36,000
	Balance as on 31st March, 2018		66,150
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		4,50,000
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		4,50,000
5.	**Other Current liabilities**		
	Interest Ac c rued and due on Borrowings (5% Debentures)	11,250	
	Unpaid Preference Dividends	18,000	29,250
6.	**Tangible Fixed assets**		
	Furniture		
	Furniture at Cost Less depreciation ₹ 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electric al Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Ac cumulated Depreciation Account: Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year:		
	On Opening WDV at 10% i.e. (10% x 1,05,000) 10,500		
	On additional purchase during the year at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Fixed Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors		
	(a) Debt outstanding for more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 -4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Amount as per Trial Balance	1,56,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors' Remuneration shown separately	30,000	
	Balance amount		1,20,000
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	51,900
11.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director's remuneration	30,000	
	Selling expenses	2,37,300	
	Technical knowhow written of (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x 50%)	2,250	3,47,550

Working Note

Calculation of Sundry Debtors-Other Debts

Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonoured	4,500
	1,54,800
Less: Bad Debts written off – 50% ₹ 4,500	(2,250)
Adjusted Sundry Debtors	1,52,550
Less: Debts due for more than 6 months (as per information given)	(18,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550

Managerial Remuneration – Effective Capital

Question 19

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

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory:			
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000

The following additional information is also provided:

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

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

(iii) The cost of the Assets were:
Building ₹ 30,00,000, Plant & Machinery ₹ 35,00,000 and Furniture ₹ 3,12,500

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

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

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

(*MTP August, 2018*) (*16 Marks*)

Answer:

Megha Ltd.
Balance Sheet as on 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	49,95,000
	(b)	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	(a)	Trade Payables		8,00,000
	(b)	Other current liabilities	4	37,500

		Particulars	Notes	₹
	(c)	Short-term provisions	5	6,40,000
	(d)	Short-term borrowings		2,00,000
		Total		**94,73,500**
		Assets		
1		**Non-current assets**		
		Fixed assets		
		Tangible assets	6	56,25,000
2		**Current assets**		
	(a)	Inventories	7	12,50,000
	(b)	Trade receivables	8	10,00,000
	(c)	Cash and bank balances	9	13,85,000
	(d)	Short-term loans and advances		2,13,500
		Total		**94,73,500**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	50,000 Equity Shares of ₹ 100 each		
	(of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000
	Total		49,95,000
2	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	4,13,500
	Total		14,83,500
3	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan (7,50,000-37,500)		7,12,500
	(Secured by hypothecation of Plant and Machinery)		
	Unsecured Loan		6,05,000
	Total		13,17,500
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		37,500
5	**Short-term provisions**		
	Provision for taxation		6,40,000
6	**Tangible assets**		
	Land and Building	30,00,000	
	Less: Depreciation	(2,50,000) (b.f.)	27,50,000
	Plant & Machinery	35,00,000	
	Less: Depreciation	(8,75,000) (b.f.)	26,25,000
	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500)(b.f.)	2,50,000
	Total		56,25,000
7	**Inventories**		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		12,50,000

			₹
8	**Trade receivables**		2,60,000
	Outstanding for a period exceeding six months		7,40,000
	Other Amounts Total		10,00,000
9	**Cash and bank balances**		
	Cash at bank		
	with Scheduled Banks	12,25,000	
	with others (Omega Bank Ltd.)	10,000	12,35,000
	Cash in hand		1,50,000
	Other bank balances		Nil
	Total		13,85,000

Question 20

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

(i) Share application money received in excess of issued share capital.
(ii) Share option outstanding account.
(iii) Unpaid matured debenture and interest accrued thereon.
(iv) Uncalled liability on shares and other partly paid investments.
(v) Calls unpaid.
(vi) Intangible Assets under development.
(vii) Money received against share warrant.
(viii) Cash equivalents.

(*MTP April 2019*) (*5 Marks*)

Answer:

(i) Current Liabilities/Other Current Liabilities
(ii) Shareholders' Fund/Reserve & Surplus
(iii) Current liabilities/Other Current Liabilities
(iv) Contingent Liabilities and Commitments
(v) Shareholders' Fund/Share Capital
(vi) Fixed Assets
(vii) Shareholders' Fund/Money received against share warrants
(viii) Current Assets

Question 21

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2019:

	Amount ₹ in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

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

(*MTP October, 2019*) (*4 Marks*)

Answer

Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

Question 22

On 31st March, 2020, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 2020.

Particulars	**Amount (₹)**	
	Debit	**Credit**
Equity Share Capital, fully paid shares of ₹ 50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	

Particulars	**Amount (₹)**	
	Debit	**Credit**
Plant & Machinery	24,00,000	
Furniture &Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		26,30,000
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	
Trade Payables		8,13,000
Provision for Taxation		3,80,000
Dividend payable		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	**1,76,24,000**	**1,76,24,000**

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

(1) 50,000 fully paid equity shares were allotted as consideration for land.

(2) The cost of assets were:

Building	₹ 32,00,000
Plant and Machinery	₹ 30,00,000
Furniture and Fixture	₹ 16,50,000

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

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

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

(6) The balance of ₹ 26,30,000 in the loan account with Public Finance Corporation is inclusive of ₹1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

(7) Other long-term loans (unsecured) include:

Loan taken from Nixes Bank	₹ 13,80,000
(Amount repayable within one year	₹ 4,80,000)
Loan taken from Directors	₹ 8,50,000

(8) Bills Receivable for ₹ 1,60,000 maturing on 15th June, 2020 has been discounted.

(9) Short term borrowings include:

Loan from Naya bank	₹ 1,16,000 (Secured)
Loan from directors	₹ 48,000

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

(11) Inventory of finished goods includes loose tools costing ₹ 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 2020 as required under Part-I of Schedule III of the Companies Act, 2013. Ignore previous year figures.

(20 Marks) (MTP, May 2020)

Answer:

SR Ltd.
Balance Sheet as on 31st March, 2020

Particulars	**Notes**	**Figures at the end of current reporting period (₹)**
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	79,85,000
(b) Reserves and Surplus	2	30,21,000

Particulars		**Notes**	**Figures at the end of current reporting period (₹)**
2	**Non-current liabilities**		
	(a) Long-term borrowings	3	42,66,000
3	**Current liabilities**		
	(a) Short-term borrowings	4	4,60,000
	(b) Trade Payables		8,13,000
	(c) Other current liabilities	5	6,84,000
	(d) Short-term provisions	6	3,80,000
	Total		1,76,09,000
Assets			
1	**Non-current assets**		
	A PPE	7	92,00,000
2	**Current assets**		
	A Inventories	8	58,00,000
	B Trade receivables	9	17,50,000
	C Cash and cash equivalents	10	4,84,000
	D Short-term loans and advances		3,75,000
	Total		1,76,09,000

Notes to accounts

				₹
1.	**Share Capital**			
	Equity share capital			
	Issued, subscribed and called up			
	1,60,000 Equity Shares of ₹ 50 each (Out of the above 50,000 shares have been issued for consideration other than cash)		80,00,000	
	Less: Calls in arrears		(15,000)	79,85,000
2.	**Reserves and Surplus**			
	General Reserve		9,41,000	
	Add: Transferred from Profit and loss account		35,000	9,76,000
	Securities premium			15,00,000
	Surplus (Profit & Loss A/c)		5,80,000	
	Less: Appropriation to General Reserve (proposed)		(35,000)	5,45,000
				30,21,000
3.	**Long-term borrowings**			
	Secured: Term Loans			
	Loan from Public Finance Corporation [repayable after 3 years (₹ 26,30,000 - ₹ 1,34,000 for interest accrued but not due)]			24,96,000
	Secured by hypothecation of land			
	Unsecured			
	Bank Loan (Nixes bank) (₹ 13,80,000 - ₹ 4,80,000 repayable within 1 year)	9,00,000		
	Loan from Directors	8,50,000		
	Others	20,000		17,70,000
		Total		42,66,000
4.	**Short-term borrowings**			
	Loan from Naya bank (Secured)		1,16,000	
	Loan from Directors		48,000	
	Others		2,96,000	4,60,000
5.	**Other current liabilities**			
	Loan from Nixes bank repayable within one year		4,80,000	
	Dividend payable		70,000	
	Interest accrued but not due on borrowings		1,34,000	6,84,000

			₹
6.	**Short-term provisions**		
	Provision for taxation		3,80,000
7.	**PPE**		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	**Trade receivables**		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	**Cash and cash equivalents**		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000

Note: There is a Contingent Liability amounting ₹ 1,60,000

Question 23

Shree Ltd. has authorized capital of ₹ 50 lakhs divided into 5,00,000 equity shares of ₹ 10 each. Their books show the following balances as on 31st March, 2020:

	₹		₹
Inventory 1.4.2019	6,65,000	Bank balance in Current Account	20,000
Discounts & Rebates allowed	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Interest (bank overdraft)	1,11,000
Patterns	3,75,000	Calls in Arrear @ ₹2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of ₹ 10 each)	
Purchases	12,32,500	Bank Overdraft	12,67,000
Wages	13,68,000		
Freehold Land	16,25,000	Trade Payables (for goods)	2,40,500
Plant & Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rent (Cr.)	30,000
Trade Receivables	4,00,500	Transfer fees received	6,500
Advertisement	15,000	Profit & Loss A/c (Cr.)	67,000
Commission & Brokerage (Dr.)	67,500	Repairs to Building	56,500
Business Expenses	56,000	Bad debts	25,500

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2020 and Balance Sheet as on that date in line with Schedule III to the Companies Act, 2013 after considering the following:

The inventory (valued at cost or market value, which is lower) as on 31st March, 2020 was ₹ 7,08,000. Outstanding liabilities for wages ₹ 25,000 and business expenses ₹ 36,000.

Charge depreciation on closing written down value of Plant & Machinery @ 5%, Engineering Tools @ 20%; Patterns @ 10%; and Furniture & Fixtures @10%. Provide 25,000 as doubtful debts after writing off ₹ 16,000 as additional bad debts. Provide for income tax @ 30%.

(MTP, October, 2020) (MTP March, 2022) (*16 Marks*)

Answer

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

		Particulars	Note No.	(₹)
I	**Equity and Liabilities**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	19,90,000
		(b) Reserves and Surplus	2	3,47,000
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	13,28,000
		(c) Short-Term Provisions	4	1,20,000
		Total		40,25,500
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(i) Property, plant and Equipment (PPE)	5	29,30,000
	(2)	**Current Assets**		
		(a) Inventories		7,08,000
		(b) Trade Receivables	6	3,59,500
		(c) Cash and Cash Equivalents	7	28,000
		Total		40,25,500

Shree Ltd.

Statement of Profit and Loss for the year ended 31st March, 2020

	Particulars	Note No.	(₹)
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,08,000]		(43,000)
	Employee Benefits Expenses	9	13,93,000
	Finance Costs	10	1,11,000
	Depreciation and Amortization Expenses		1,20,000
	Other Expenses	11	4,40,000
	Total Expenses		**32,53,500**
V	**Profit before Tax (III-IV)**		4,00,000
VI	**Tax Expenses @ 30%**		(1,20,000)
VII	**Profit for the period**		2,80,000

Notes to Accounts:

1. Share Capital

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

2. Reserves and Surplus

Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	2,80,000	3,47,000

3. Other Current Liabilities

Bank Overdraft	12,67,000
Outstanding Expenses [25,000+36,000]	61,000
	13,28,000

4. Short-term Provisions

Provision for Tax	1,20,000

5. PPE

Particulars	Value given (₹)	Depreciation rate	Depreciation Charged (₹)	Written down value at the end (₹)
Land	16,25,000		-	16,25,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Patterns	3,75,000	10%	37,500	3,37,500
Engineering Tools	1,50,000	20%	30,000	1,20,000
	30,50,000		1,20,000	29,30,000

6. Trade Receivables

Trade receivables (4,00,500-16,000)	3,84,500
Less: Provision for doubtful debts	(25,000)
	3,59,500

7. Cash & Cash Equivalent

Cash Balance	8,000
Bank Balance in current A/c	20,000
	28,000

8. Other Income

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

9. Employee benefits expenses

Wages	13,68,000
Add: Outstanding wages	25,000
	13,93,000

10. Finance Cost

Interest on Bank overdraft	1,11,000

11. Other Expenses

Carriage Inward	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,000] (Business Expenses)	92,000
Bad Debts [25,500+16,000]	41,500
Provision for Doubtful Debts	25,000
	4,40,000

Question 24

Medha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20 20 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Medha Ltd. for the year ended 31st March, 2020 according to Schedule III.

(MTP, October, 2020) (*4 Marks*)

Answer

As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria:

(i) it is expected to be settled in the company's normal operating cycle;

(ii) it is held primarily for the purpose of being traded;

(iii) it is due to be settled within twelve months after the reporting date; or

(iv) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

In the given case, instalments due on 30.09.2020 and 31.03.2021 will be shown under the head 'other current liabilities'. Therefore, in the balance sheet as on 31.3.2020, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'Other Current Liabilities' as current maturities of loan from bank.

Question 25

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

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

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

Average rate of dividend during the last five years has been 12%. (*MTP April, 2021*) (*5 marks*)

Answer

Amount that can be drawn from reserves for (10% dividend on ₹ 80,00,000 i.e. ₹ 8,00,000)

Profits available

Current year profit	₹ 1,42,500
Amount which can be utilized from reserves (₹ 8,00,000 – 1,42,500)	₹ 6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 2014:

Condition I

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

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves i.e. ₹ 10,50,000 [10% of (80,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl ₹ 18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15 % of its paid up capital i.e. ₹ 12,00,000 (15% of ₹ 80,00,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated reserve (as per Declaration and Payment of Dividend Rules, 2014).

Question 26

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

	Dr.	**Cr.**
Equity Capital (Shares of 100 each)		8,05,000
5,000, 6% preference shares of ₹ 100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000
Profit & Loss A/c. (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2020)	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	**1,30,29,000**

Additional Information:

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

5000, 6% preference shares of ₹100 each	5,00,000
10,000 equity shares of ₹100 each	10,00,000

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

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

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

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

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

(vi) Amortize 1/5th of Goodwill.

You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures & taxation. (*Question Paper, July 2021*) (*20 Marks*)

Answer

H Ltd

Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in ₹
Equity and Liabilities		
I. Shareholders' Funds		
(a) Share Capital	1	13,00,000
(b) Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
(a) Long Term Borrowings	3	4,00,000
III. Current Liabilities		
(a) Trade Payables	4	10,40,000
(b) Other Current Liabilities	5	70,000
Total		82,01,900
Assets		
I. Non-Current Assets		
(a) Property, Plant and Equipment	6	40,61,000
(b) Intangible Assets	7	10,00,000
II. Current Assets		
(a) Inventories		9,50,000
(b) Trade Receivables		19,60,000
(c) Cash and Cash equivalents		2,30,900
Total		82,01,900

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No	Amount in ₹
I. Revenue from operations		60,00,000
Total Revenue		60,00,000
II. Expenses		
Purchases (adjusted)		22,32,100
Finance Costs	8	36,000
Depreciation and Amortization	9	3,17,000
Other Expenses	10	32,30,000
Total Expenses		58,15,100
III. Profit/(Loss) for the period		1,84,900

Notes to Accounts **(Amount in ₹)**

1	**Share Capital**		
	(a) Authorized Capital		
	5,000, 6% Preference shares of ₹ 100/- each		5,00,000
	10,000 Equity Shares of ₹100/- each		10,00,000

	(b) Issued & Subscribed Capital		15,00,000
	5,000, 6% Preference shares of ₹100/- each		5,00,000
	8,000, Equity shares of ₹100/- each		8,00,000
	Total		13,00,000
2	**Reserves & Surplus**		
	Capital Reserve (100 X (90-40))		5,000
	Revaluation Reserve (36,00,000-24,00,000)		12,00,000
	General Reserve		40,00,000
	Surplus	1,84,900	
	Add: Balance from previous year	72,000	
	Less:		
	Dividends declared	(70,000)	
	Profit/(Loss) carried forward to Balance Sheet		1,86,900
	Total		53,91,900
3	**Long-Term Borrowings**		
	Secured		
	9% Debentures		4,00,000
4	**Trade Payables**		10,40,000
5	**Other Current Liabilities**		
	Dividend Payable		
	Preference Dividend	30,000	
	Equity Dividend	40,000	
	Total		70,000
6	**Property, Plant and Equipment**		
	Land		
	Opening balance	24,00,000	
	Add: Revaluation Adjustment	12,00,000	
	Closing Balance		36,00,000
	Plant and Machinery		
	Opening Balance	7,70,000	
	Less: Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	
	Closing Balance		4,61,000
	Total		40,61,000
7	**Intangible Assets**		
	Goodwill	12,50,000	
	Less: Amortized (1/5th)	(2,50,000)	
	Total		10,00,000
8	**Finance Costs**		
	Debenture Interest	36,000	
9	**Depreciation and Amortization**		
	Plant and Machinery	67,000	
	Goodwill	2,50,000	
	Total		3,17,000
10	**Other Expenses**		
	Factory Expenses	15,00,000	
	Selling Expenses	14,00,000	
	Administrative Expenses	3,00,000	
	Loss on sale of Plant and Machinery		
	Book Value		
	(1,00,000-30,000) 70,000		
	Less: Sale Value (40,000)	30,000	
	Total		32,30,000

Note

1. The inventories (31.3.20) amounting ₹ 9,50,000 (given in the trial balance of the question) should have been as closing inventory i.e. as on 31.3.21. In the above solution, this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on 31.3.21 and in that case, the balance sheet will not tally without using suspense account amounting ₹ 9,50,000.
2. The financial statements given in the above answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the question. However, practically dividends are declared in the annual general meetings which take place after the reporting date.

Question 27

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

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

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

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

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

Answer

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

		Particulars	Note No.	(₹)
I	**Equity and Liabilities**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	19,90,000
		(b) Reserves and Surplus	2	3,82,000
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	61,500
		(c) Short-Term Provisions	4	1,35,000
		Total		28,09,000
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) Property, Plant and Equipment	5	16,97,500
	(2)	**Current Assets**		
		(a) Inventories		7,05,000
		(b) Trade Receivables	6	3,75,500
		(c) Cash and Cash Equivalents	7	31,000
		Total		28,09,000

Statement of Profit and Loss of Om Ltd. for the year ended 31st March, 2021

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

Notes to Accounts:

1. Share Capital

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

2. Reserves and Surplus

General Reserve		10,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	3,15,000	
Less: Transfer to Reserve	(10,000)	3,72,000
		3,82,000

3. Other Current Liabilities

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

4. Short-term Provisions

Provision for Tax	1,35,000

5. Property, Plant and Equipment

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

6. Trade Receivables

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

7. Cash & Cash Equivalent

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

8. Other Income

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

9. Employee benefits expenses

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

10. Other Expenses

Carriage Inwards	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,500] (Business Expenses)	92,500
Bad Debts	25,500
Provision for Doubtful Debts	25,000
	4,24,500

Question 28

XYZ Ltd. is having inadequacy of profits in the year ending 31-03-2021 and it proposes to declare 10% dividend out of General Reserves.

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

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

Average rate of dividend during the last five years has been 12%. (*RTP, May, 2021*)

Answer

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

Profits available

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

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

Condition I

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

Condition II

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

Condition III

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

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

Question 29

From the following information, prepare extract of Balance Sheet of A Limited along with notes making necessary compliance of Schedule III to the Companies Act, 2013:

		Amount (₹)
Loan Funds		
(a) Secured Loans		18,12,000
(b) Unsecured Loan - Short term from bank		2,25,000
Other information is as under:		
Secured Loans		
Term Loans from:		
Banks		8,95,000
Others		9,17,000
		18,12,000
Current Maturities of long-term loan from Bank		1,24,000
Current Maturities of long- term loan from Others		85,000

There was no interest accrued/due as at the end of the year. Current maturities of long-term loans amounting ₹ 2,09,000 is included in the value of secured loans of ₹ 18,12,000.

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

Answer

Extract of Balance Sheet of A Ltd.

Particulars	Note No	Amount
Non - Current Liabilities		
Long term borrowings	1	16,03,000
Current Liabilities		
Short term borrowings	2	2,25,000
Other current liabilities	3	2,09,000

Notes to Accounts

1.	**Long-Term Borrowings**	
	Term loans – Secured	
	- From banks	8,95,000
	- From other parties	9,17,000
		18,12,000
	Less: Current maturities of long-term debt (Refer Note 3)	(2,09,000)
		16,03,000
2.	**Short-Term Borrowings**	
	(Unsecured loan)	
	- from bank	2,25,000
3.	**Other Current Liabilities**	
	Current maturities of long-term debt	
	- From banks	1,24,000
	- From others	85,000
		2,09,000

Question 30

Om Ltd. has the Authorised Capital of ₹ 15,00,000 consisting of 6,000 6% Redeemable Preference shares of ₹ 100 each and 90,000 equity Shares of ₹10 each. The following was the Trial Balance of the Company as on 31st March, 2021:

Particulars	Dr.	Cr.
Investment in shares at cost (non-current investment)	1,50,000	
Purchases	14,71,500	
Selling expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and wages (included ₹ 30,000 being Director's Remuneration)	1,56,000	
Cash on hand	84,000	
Bills receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on debentures upto 30th Sep (1st half year)	11,250	
Sundry Debtors and Sundry Creditors	1,50,300	2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of ₹ 45,000	1,05,000	
6% Redeemable Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on freehold properties		4,50,000
Dividends received		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft (secured by hypothecation of stocks and receivables)		4,50,000
Technical knowhow fees (cost paid during the year)	4,50,000	
Audit fees	18,000	
Total	44,72,850	44,72,850

Other Information:

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

You are required to prepare the Balance Sheet as at 31st March, 2021 and Statement of Profit and Loss for the year ended 31st March, 2021 as per Schedule III to the Companies Act, 2013 after taking into account the above information. Ignore taxation.

(*RTP, November 2021*)

Answer

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

		Note	**(₹)**
I	**Equity and Liabilities**		
(1)	Shareholders' funds:		
	(a) Share capital	1	12,00,000
	(b) Reserves and surplus	2	1,14,150
(2)	Non-current liabilities:		
	Long term borrowings	3	4,50,000
(3)	Current liabilities:		
	(a) Short term borrowings	4	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	5	11,250
	Total		24,88,950
II	**ASSETS**		
(1)	Non- Current Assets:		
	(a) Property, plant and equipment	6	11,49,900
	(b) Intangible assets	7	4,05,000
	(c) Non-current investments (Shares at cost)		1,50,000
(2)	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	8	2,72,550
	(c) Cash and Cash equivalents – Cash on hand		84,000
	Total		24,88,950

Note: There is a Contingent liability for Bills receivable discounted with Bank ₹ 6000.

Statement of Profit and Loss of Om Ltd. for the year ended 31st March, 2021

	Particulars	***Note***	**₹**
I	Revenue from Operations		20,11,050
II	Other income (Dividend income)		12,750
III	Total Revenue (I &+ II)		20,23,800
IV	Expenses:		
	(a) Purchases of Inventory (14,71,500 – Advertisement Expenses 15,000)		14,56,500
	(b) Changes in Inventories of finished Goods/Work in progress & inventory (4,35,600 – 4,27,500)		8,100
	(c) Employee Benefits expense	9	1,20,000
	(d) Finance costs	10	51,900
	(e) Depreciation & Amortization Expenses	11	56,100
	(f) Other Expenses	12	3,02,550
	Total Expenses		19,95,150

	Particulars	Note	₹
V	Profit before exceptional, extraordinary items and tax		28,650
VI	Exceptional items		-
VII	Profit before extra-ordinary items and tax		28,650
VIII	Extraordinary items		-
IX	Profit before tax		28,650

Notes to accounts

			(₹)
1.	**Share Capital**		
	Authorized capital:		
	90,000 Equity Shares of ₹ 10 each.	9,00,000	
	6,000 6% Preference shares of ₹ 100 each	6,00,000	
	Issued, subscribed & called up:		
	60,000, Equity Shares of ₹ 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	12,00,000
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2020	85,500	
	Add: Surplus for current year	28,650	
	Balance as on 31st March, 2021		1,14,150
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		4,50,000
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		4,50,000
5.	**Other Current liabilities**		
	Interest due on Borrowings (5% Debentures)		11,250
6.	**Property, plant and equipment**		
	Furniture		
	Furniture at Cost Less depreciation ₹ 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Accumulated Depreciation Account:		
	Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year:		
	On Opening WDV at 10% i.e. (10% x 1,05,000) 10,500		
	On additional purchase during the year at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors (a) Debt outstanding due more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 - 4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Salaries & Wages	1,56,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors' Remuneration shown separately	30,000	
	Balance amount		1,20,000

			(₹)
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	
			51,900
11.	**Depreciation & Amortisation Expenses**		
	Depreciation [10% of (1,05,000 + 6,000)]	11,100	
	Technical knowhow written of (4,50,000/10)	45,000	56,100
12.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director's remuneration	30,000	
	Selling expenses	2,37,300	
	Advertisement (Goods and Articles Distributed)	15,000	3,02,550
	Bad Debts (4,500 x 50%)	2,250	

Working Note:

Calculation of Sundry Debtors-Other Debts	
Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonoured	4,500
	1,54,800
Less: Bad Debts written off – 50% ₹ 4,500	(2,250)
Adjusted Sundry Debtors	1,52,550
Less: Debts due for more than 6 months (as per information given)	(18,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550

Question 31

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

Debit Balance	*Amount (₹)*	*Credit Balances*	*Amount (₹)*
Purchases	*82,95,000*	*Sales*	*1,25,87,000*
Wages and Salaries	*12,72,000*	*Commission*	*72,500*
Rent	*2,20,000*	*Equity Share Capital*	*10,00,000*
Rates and Taxes	*50,000*	*General Reserve*	*10,00,000*
Selling &Distribution Expenses	*4,36,000*	*Surplus (P&L A/c) 01.04.2021*	*8,75,500*
Directors Fees	*32,000*	*Securities Premium*	*2,50,000*
Bad Debts	*38,500*	*Term Loan from Public Sector*	*1,02,00,000*
Interest on Term Loan	*8,05,000*	*Bank*	
Land	*24,00,000*	*Trade Payables*	*55,08,875*
Factory Building	*36,80,000*	*Provision for Depreciation:*	
Plant and Machinery	*62,50,000*	*On Plant& Machinery*	*9,37,500*
Furniture and Fittings	*8,25,000*	*On Furniture and Fittings*	*82,500*
Trade Receivables	*64,75,000*	*On Factory Building*	*1,84,000*
Advance Income Tax Paid	*37,500*	*Provision for Doubtful Debts*	*25,000*
Stock (1st April,2021)	*9,25,000*	*Bills Payable*	*1,25,000*
Bank Balances	*9,75,000*		
Cash on Hand	*1,31,875*		
Total	*3,28,47,875*	*Total*	*3,28,47,875*

Following information is provided:

(1) *The Authorized Share Capital of the Company is 2,00,000 Equity Shares of ₹ 10 each. The Company has issued 1,00,000 Equity Shares of ₹ 10 each.*

(2) *Rent of ₹ 20,000 and Wages of ₹ 1,56,500 are outstanding as on 31st March, 2022.*

(3) *Provide Depreciation @ 10% per annum on Plant and Machinery, 10% on Furniture and Fittings and 5% on Factory Building on written down value basis.*

(4) *Closing Stock as on 31st March, 2022 is ₹ 11,37,500.*

(5) *Make a provision for Doubtful Debt @ 5% on Debtors.*

(6) *Make a provision of 25% for Corporate Income Tax.*

(7) *Transfer ₹ 1,00,000 to General Reserve.*

(8) Term Loan from Public Sector Bank is secured against Hypothecation of Plant and Machinery. Installment of Term Loan falling due within one year is ₹ 17,00,000.

(9) Trade Receivables of ₹ 85,600 are outstanding for more than six months.

(10) The Board declared a dividend @10% on Paid up Share Capital on 5th April, 2022.

You are required to prepare Balance Sheet as on 31st March 2022 and Statement of Profit and Loss with Note to Accounts for the year ending 31st March, 2022 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures. (*20 Marks*)

Answer

Balance Sheet of Anmol Ltd. as at 31st March, 2022

Particulars	***Note No***	***₹***
Equity and Liabilities		
1 **Shareholders' funds**		
a Share capital	1	10,00,000
b Reserves and Surplus	2	24,76,462
2 **Non-current liabilities**		
a Long-term borrowings	3	85,00,000
3 **Current liabilities**		
a Short term borrowings (Installment of term loan falling due in one year)		17,00,000
b Trade Payables	4	56,33,875
c Other current liabilities	5	1,76,500
d Short term provisions (provision for tax)		1,16,988
Total		1,96,03,825
ASSETS		
1 **Non-current assets**		
a PPE	6	1,11,70,700
2 **Current assets**		
a Inventories		11,37,500
b Trade receivables	7	61,51,250
c Cash and bank balances	8	11,06,875
d Short term loans & advances (Advance tax paid)		37,500
		1,96,03,825

Statement of Profit and Loss of Anmol Ltd.
for the year ended 31st March, 2022

	Particulars	***Notes***	***Amount***
I.	Revenue from operations		1,25,87,000
II.	Other income (Commission income)		72,500
III.	Total Income (I + II)		1,26,59,500
IV.	Expenses:		
	Purchases of Inventory-in-Trade		82,95,000
	Changes in inventories of finished goods work-in- progress and Inventory-in-Trade	9	(2,12,500)
	Employee benefits expense	10	14,28,500
	Finance costs (interest on term loan)		8,05,000
	Depreciation		7,80,300
	Other operating expenses	11	10,95,250
	Total expenses		1,21,91,550
V.	Profit (Loss) for the period (III - IV)		4,67,950
VI.	(-) Tax (25%)		(1,16,988)
VII.	PAT		3,50,962

Notes to accounts

	₹
1 Share Capital	
Equity share capital	
Authorized	

			₹
	2,00,000 equity shares of ₹ 10 each		20,00,000
	Issued & subscribed		
	1,00,000 equity shares of ₹ 10 each		10,00,000
2	Reserves and Surplus		
	General Reserve	10,00,000	
	Add: current year transfer	1,00,000	11,00,000
	Profit & Loss balance		
	Opening balance: Surplus P & L A/c	8,75,500	
	Profit for the year	3,50,962	
	Less: Appropriations:		
	Transfer to General reserve	(1,00,000)	11,26,462
	Securities premium		2,50,000
			24,76,462
3	Long-term borrowings		
	Term loan from public sector bank (Secured by hypothecation)		1,02,00,000
	Less: Installment of Term loan falling due within one year		(17,00,000)
	Total		85,00,000
4	Trade payables		
	Trade payables	55,08,875	
	Bills payable	1,25,000	56,33,875
5	Other current liabilities		
	Rent outstanding	20,000	
	Wages and Salaries Outstanding	1,56,500	1,76,500
6	PPE (Note 2)		
	Land		24,00,000
	Factory Buildings		33,21,200
	Plant & Machinery		47,81,250
	Furniture & Fittings		6,68,250
	Total		1,11,70,700
7	Trade receivables		
	Debtors Outstanding for period exceeding 6 months	85,600	
	Other debts	63,89,400	
	Less: Provision for doubtful debt	(3,23,750)	61,51,250
8	Cash and bank balances		
	Cash and cash equivalents		
	Bank balance	9,75,000	
	Cash on hand	1,31,875	11,06,875
9	Changes in Inventories		
	Opening Inventory	9,25,000	
	Less: Closing Inventory	(11,37,500)	
	Change		(2,12,500)
10	Employee benefit expense		
	Wages and Salaries	12,72,000	
	Add: Wages and Salaries Outstanding	1,56,500	14,28,500
11	Other operating expenses		
	Rent	2,20,000	
	Add: outstanding	20,000	2,40,000
	Rates and Taxes		50,000
	Selling & Distribution expenses		4,36,000
	Bad debts		38,500
	Provision for Doubtful Debts (3,23,750-25,000)		2,98,750
	Director's fee		32,000
	Total		10,95,250

Note:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2022. Such dividends will be disclosed in notes only.
2. **Calculation of depreciation:**

	Book value	Accumulated depreciation	WDV	Current year Depreciation	Current year WDV
Land	24,00,000	-	24,00,000	-	24,00,000
Factory building	36,80,000	1,84,000	34,96,000	1,74,800	33,21,200
Plant & Machinery	62,50,000	9,37,500	53,12,500	5,31,250	47,81,250
Furniture & Fittings	8,25,000	82,500	7,42,500	74,250	6,68,250
Total				7,80,300	1,11,70,700

Question 32

Preparation of Balance Sheet of a Company

On 31st March 2022, Hari Ltd. provides you the following particulars:

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			12,50,000
Call in Arrears		1,250	
Land & Building		6,87,500	
Plant & Machinery		6,56,250	
Furniture		62,500	
General Reserve			2,62,500
Loan from State Financial Corporation			1,87,500
Inventory:			
Raw Materials	62,500		
Finished Goods	<u>2,50,000</u>	3,12,500	
Provision for Taxation			1,60,000
Trade Receivables		2,50,000	
Advances		53,375	
Profit & Loss Account			1,08,375
Cash in Hand		37,500	
Cash at Bank		3,08,750	
Unsecured Loan (Long-term)			1,51,250
Trade Payables			2,50,000

The following additional information is also provided:

(i) 2,500 Equity shares were issued for consideration other than cash.

(ii) Debtors of ₹ 65,000 (included in trade receivables) are due for more than 6 months.

(iii) The cost of the assets were:
Building ₹ 7,50,000, Plant & Machinery ₹ 8,75,000 and Furniture ₹ 78,125

(iv) The balance of ₹ 1,87,500 in the Loan Account with State Finance Corporation is inclusive of ₹ 9,375 for Interest accrued but not due. The loan is secured by hypothecation of Plant & Machinery.

(v) Balance at Bank includes ₹ 2,500 with Global Bank Ltd., which is not a Scheduled Bank.

You are required to prepare the Balance sheet of Hari Ltd. as on 31st March, 2022 as per Schedule III to the Companies Act, 2013. (*RTP May, 2023*)

Answer

Hari Ltd.
Balance Sheet as on 31st March, 2022

		Particulars	*Notes*	*₹*
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,48,750
	b	Reserves and Surplus	2	3,70,875
2		**Non-current liabilities**		
		Long-term borrowings	3	3,29,375

		Particulars	Notes	₹
3		**Current liabilities**		
	a	Trade Payables		2,50,000
	b	Other current liabilities	4	9,375
	c	Short-term provisions	5	1,60,000
		Total		**23,68,375**
		Assets		
1		**Non-current assets**		
		Property, Plant & Equipment (PPE)	6	14,06,250
2		**Current assets**		
	a	Inventories	7	3,12,500
	b	Trade receivables	8	2,50,000
	c	Cash and cash equivalents	9	3,46,250
	d	Short-term loans and advances		53,375
		Total		**23,68,375**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	12,500 Equity Shares of ₹ 100 each (of the above 2,500 shares have been issued for consideration other than cash)	12,50,000	
	Less: Calls in arrears	(1,250)	12,48,750
	Total		**12,48,750**
2	**Reserves and Surplus**		
	General Reserve		2,62,500
	Surplus (Profit & Loss A/c)		1,08,375
	Total		**3,70,875**
3	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan (1,87,500–9,375)		1,78,125
	(Secured by hypothecation of Plant and Machinery)		
	Unsecured Loan		1,51,250
	Total		**3,29,375**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		9,375
5	**Short-term provisions**		
	Provision for taxation		1,60,000
6	**PPE**		
	Land and Building	7,50,000	
	Less: Depreciation	(62,500)	6,87,500
	Plant & Machinery	8,75,000	
	Less: Depreciation	(2,18,750)	6,56,250
	Furniture & Fittings	78,125	
	Less: Depreciation	(15,625)	62,500
	Total		**14,06,250**
7	**Inventories**		
	Raw Materials		62,500
	Finished goods		2,50,000
	Total		**3,12,500**
8	**Trade receivables**		
	Outstanding for a period exceeding six months		65,000
	Other Amounts		1,85,000
	Total		**2,50,000**

			₹
9	**Cash and cash equivalents**		
	Cash at bank		
	with Scheduled Banks	3,06,250	
	with others (Global Bank Ltd.)	2,500	3,08,750
	Cash in hand		37,500
	Total		**3,46,250**

Question 33

Preparation of Statement of Profit and Loss and Balance Sheet

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

Particulars		₹	Particulars		₹
Inventory 01-04-2021			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		21,000
Purchases of raw material		12,60,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans:		
			Short–term		
			Long-term	4,500	25,500
				21,000	
Salaries and wages		40,200	Fixed Deposits (unsecured):		
			Short-term	1,500	
General Charges		16,500	Long-term	3,300	4,800
			Trade payables		3,27,000
Building		1,01,000			
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Investments:					
Current	4,500				
Non-Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,07,200			
					24,07,200

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

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

(*RTP November, 2022*)

Answer

Oliva Ltd.
Balance Sheet as at 31.03.2022

	Particulars		Note	Amount
(1)	**Equity and Liabilities**			
	(i) Shareholders' funds			
	(a) Share Capital			3,15,000
	(b) Reserves and surplus		1	50,430
(2)	**Non-current liabilities**			
	(a) Long-term borrowings		2	23,300
(3)	**Current Liabilities**			
	(a) Short -term borrowings		3	7,000
	(b) Trade payables			3,27,000
	(c) Other current liability		4	72,000
	(d) Short term provision		5	19,620

	Particulars		Note	Amount
II	**ASSETS**			8,14,350
(1)	**Non-current assets**			
	(a) Property, Plant & equipment		6	2,04,160
	(b) Non-current investments			7,500
(2)	**Current assets**			
	(a) Current investments			4,500
	(b) Inventories		7	85,800
	(c) Trade receivables			2,38,500
	(d) Cash and cash equivalents			2,71,100
	(e) Short-term loans and advances		8	2,490
	(f) Other current assets		9	300
				8,14,350

Oliva Ltd.

Statement of Profit and loss for the year ended 31.03.2022

(₹)

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200
III	**Total income (I +II)**		17,14,200
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	3,51,510
	Total Expenses		16,65,150
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Notes to accounts

No.	Particulars		Amount	Amount
1.	**Reserve & Surplus**			
	Profit & Loss Account: Balance b/f		21,000	
	Net Profit for the year		29,430	50,430
2.	**Long term borrowings**			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits: Unsecured		3,300	23,300
3.	**Short term borrowings**			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	
	Current maturities of long term borrowings		1,000	7,000
4.	**Other current liabilities**			
	Expenses Payable (67,500 + 4,500)		72,000	72,000
5.	**Short term provisions**			
	Provision for Income tax			19,620
6.	**Property, plant and equipment**			
	Building	1,01,000		
	Less: Depreciation @ 2%	(2,020)	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation @10%	(7,040)	63,360	
	Furniture	10,200		
	Less: Depreciation @10%	(1,020)	9,180	
	Motor vehicles	40,800		
	Less: Depreciation @20%	(8,160)	32,640	2,04,160

No.	Particulars		Amount	Amount
7	**Inventory**			
	Raw Material		25,800	
	Finished goods		60,000	85,800
8.	**Short term Loans & Advances**			
	General Charges prepaid			2,490
9.	**Other Current Assets**			
	Interest accrued			300
10.	**Cost of material consumed**			
	Opening inventory of raw Material	30,000		
	Add: Purchases	12,60,000	12,90,000	
	Less: Closing inventory		(25,800)	12,64,200
11.	**Changes in inventory of Finished Goods & WIP**			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		(46,500)	13,500
12.	**Employee Benefit expenses**			
	Salary & Wages (40,200 + 4,500)			44,700
13.	**Other Expenses:**			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	3,51,510

Question 34

The following balances are extracted from the books of Travese Limited as on 31st March 2023:

Particulars	Amount (₹)	
	Debit	Credit
7% Debentures		48,45,000
Plant & Machinery (at cost)	37,43,400	
Trade Receivables	35,70,000	
Land	97,37,000	
Debenture Interest	3,39,150	
Bank Interest	13,260	
Sales		47,22,600
Transfer Fees		38,250
Discount received		66,300
Purchases		28,86,600
Inventories 1.04.2022	4,97,250	
Factory Expenses	2,58,060	
Rates, Taxes and Insurance	65,025	
Repairs	1,49,685	
Sundry Expenses	1,27,500	
Selling Expenses	26,520	
Directors Fees	38,250	
Interest on Investment for the year 2022-2023		55,000
Provision for depreciation		5,96,700
Miscellaneous receipts		1,42,800

Additional information:

(i) Closing inventory on 31.03.2023 is ₹4,76,850.

(ii) Miscellaneous receipts represent cash received from the sale of the Plant on 01.04.2022. The cost of the Plant was ₹1,65,750 and the accumulated depreciation thereon is ₹24,865.

(iii) The Land is re-valued at ₹1,08,63,000.

(iv) Depreciation is to be provided on Plant & Machinery at 10% p.a. on cost.

(v) Make a provision for income tax @ 25%.

(vi) The Board of Directors declared a dividend of 10% on Equity shares on 4th April, 2023.

You are required to prepare a Statement of Profit and Loss as per Schedule III of the .Companies Act, 2013 for the year ended 31.03.2023. (Ignore previous year figures)

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