Assignment
AS-1
Disclosure of Accounting Policies

Q. No.	Questions and Solutions
1.	What are the three fundamental accounting assumptions recognized by Accounting Standard (AS)-1? Briefly describe each one of them. **(ICAI SM/ Nov. 2020 RTP /May 2013)**
Sol.	**Accounting Standard (AS-1) recognizes three fundamental accounting assumptions. These are as follows: -** **1) 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. **2) 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. **3) 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.
2.	In the books of M/s Prashant Ltd., closing inventory as on 31.03.20X2 amounts to ₹1,63,000 (on the basis of FIFO method). The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2. On the basis of weighted average method, closing inventory as on 31.3.20X2 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. **(ICAI SM/RTP/Nov. 2015)**
Sol.	**Provision: -** 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. **Analysis and Conclusion: -** In the given case 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.

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 contract, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt". And the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.

(ICAI SM/May 2017/Nov. 2013)

Sol. **Provision:** - As per 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.

Analysis and Conclusion: - In the given case 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 repayments is not correct.

4. ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.20X0.

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

Particulars	(₹)
• 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?

(May 2020 RTP /Nov. 2018/ March 2021 MTP)

Sol.	**Provision: -** As per AS-1 'Disclosure of Accounting Policies' recognises 'Any change in the accounting policies which have material affect in the current period or which is reasonably expected to have a material affect in a later period should be disclosed. **Analysis and conclusion: -** In the given case 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 20X0-X1.
5.	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: **1)** Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹30 crores). **2)** Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method. Was hitherto adopted. As a consequence, the charge for depreciation at ₹27 crores is lower than the amount of ₹45 crores which would have been provided had the old method been followed by ₹18 crores. **3)** 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 new decided to account for expenses as and when actually incurred Sales during the year total to ₹600 crores. **4)** Provide for permanent fall in the value of investments- which fall had taken place over the past five years- the provision being ₹10 crores. As Chief accountant of the company. You are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 20X1-20X2 **(ICAI SM/May 2021 RTP)**

Sol.

Provision: -As per AS-1, 'Disclosure of Accounting Policies' recognises 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.

Analysis and conclusion: - In the given case following notes to accounts are prepared-:
Notes to Accounts: -

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

2) In view of the heavy capital-intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change. Depreciation has been provided at ₹27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by ₹18 crores. To that extent, the profit for the year is increased by Rs.9 crores.
3) 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.

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

6.

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.

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.

(May 2020 RTP / April 2021 MTP)

Sol.	**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 i.e. in the notes to the accounts. **4) False: -** Any change in the accounting policies which has a material effect in the current period or which is reasonable 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.

Assignment
AS-2
Valuation of Inventories

Q. No.	Questions and Solution
1.	What are the items that are to be excluded in determination of the cost of inventories as per AS – 2? **(May 2008 RTP)** **Or,** "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 example of such costs as per AS-2; Valuation of Inventories. **(November 2012/ICAI SM/November 2020 RTP)**
Sol.	As per AS-2 Valuation of Inventories lists down the specific costs which are to be excluded from cost of inventories**.** **The list is as follows;** **1) Abnormal Amounts** of wasted materials, labour or other production cost. **2) Storage Costs,** unless those costs are necessary in the production process prior to a further production stage. **3) Administrative overheads** that do not contribute to bringing the inventories to their present location and condition. **4) Selling and distribution costs.** **5) Borrowing cost –** Interest and other borrowing cost are not relating to bringing the inventories to their present location and condition therefore these costs are not included in cost of inventory however it may be taken as part of inventory cost when inventory takes substantial period of time to get ready for intended sale.
2.	On 31st March 20X1, a business firm finds that cost of a partly finished unit on that date is ₹530. The unit can be finished in 20X1-X2 by an additional expenditure of ₹310. The finished unit can be sold for ₹750 subject to payment of 4% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 20X1 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further. **(ICAI SM/November 2021 RTP/May 2013)**
Sol.	<u>**Provision:**</u> **-** As per AS-2(Revised) "Valuation of inventories" Inventories should be valued at lower of cost and net realisable value. <u>Net realisable value is the estimated costs of completion and the estimated costs necessary to make the sale.</u> <u>**Analysis and conclusion:**</u> **-** In the given case the following computations are given:

Valuation of unfinished unit;

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

3. 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;

Particulars	(₹) 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: -

1) Total fixed overhead for the year was ₹4,00,000 on normal capacity of 20,000 units.
2) Closing balance of Raw Material X was 1,000 units and Chemical y was ₹2,400 units.

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

a) Net Realizable value of Chemical Y is ₹800 per unit.
b) Net Realizable value of Chemical Y is ₹600 per unit.

(November 2017/ May 2015 RTP)

Sol. **<u>Provision:</u> -** As per AS-2 (Revised) "Valuation of inventories" I<u>nventories should be valued at lower of cost and net realisable value.</u> <u>Raw Material is valued at cost if finished goods are sold at cost or above cost otherwise raw materials is valued at replacement cost.</u>

<u>Provision and conclusion:</u> - In the given case following computations are given:

Valuation of finished goods stock;

a) Cost per unit of finished goods;

✓ Material	440
✓ ***Add:*** Direct Labour	120
✓ Direct Overhead	80
✓ Fixed Production $\left[\frac{4,00,000}{20,000}\right]$	20
	₹ 660

∴ Cost per unit of finished goods = ₹ 660 per unit.

b) Valuation of finished goods will be;

- ✓ If NRV is ₹ 800 per unit,
- ✓ Value per unit (Lower of cost ₹ 660 & NRV) = 660
- ✓ Total value of finished goods stock = ₹ 660 × 2400 units
  = ₹ 15,84,000
- ✓ If NRV is ₹ 600 per unit,
- ✓ Value per unit (Lower of cost ₹ 660 & NRV) = 600
- ✓ Total value of finished goods stock = ₹ 600 × 2400 units
  = ₹ 14,40,000

Valuation of Raw Materials;

a) Cost per unit of Raw Material;

Particulars	Cost per unit
✓ Purchase Price	380
✓ ***Add:*** Freight Charges	40
✓ ***Add:*** Unloading cost per unit	20
	₹ 440

b) Total Value of Raw Materials (Closing Stock);

1) Finished Goods are valued at cost;

Particulars	(₹)
✓ Raw Materials cost per unit	₹ 440
✓ Replacement cost per unit	₹ 300
✓ Relevant value per unit	₹ 440 [Since finished goods are valued at cost.]
✓ Total value for ₹ 1,000 units	= 1000 × ₹ 440
	= ₹ 4,40,000

2) Finished goods are valued at NRV;

Particulars	(₹)
✓ Raw Materials cost per unit	₹ 440
✓ Replacement cost per unit	₹ 300
✓ Relevant value per unit	₹ 300 [Since finished goods are valued at NRV]
✓ Total value for ₹ 1,000 units	= 1000 × ₹ 300
	= ₹ 3,00,000

4. 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?

(November 2019 RTP/ICAI SM)

Sol.

Provision: - As per AS-2 (Revised) “Valuation of Inventories”, the inventories are to be valued at lower of cost or net realizable value.

Analysis and conclusion: - 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.

5.

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-X2 the Company used 12,000 MT of raw material costing ₹150 per MT.

At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books.

Explain in the context of AS 2 the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss if any.

(November 2014/ICAI SM)

Sol.

Provision: - 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 amount of normal loss will be included in computing the cost of inventories (finished goods) at the year end.

Analysis and conclusion: - In the case of capital cables Ltd. Amount of Abnormal Loss;

✓ Material used	12,000 MT @ ₹ 150 = ₹ 18,00,000
✓ Normal Loss (12,000 MT 4%)	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)]

*Therefore, ₹ 23,437.50 will be charged to the Profit and Loss Statement.

6.

The Company deals in three products. A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 20X1-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?

(ICAI SM/May 2011)

Sol. **Provision: -** As per AS-2 (Revised) "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.

Analysis and conclusion: - In the given case of company following computations are given below:

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
Total	**88**	**84**	**76**

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

7. You are required to value the inventory per kg of finished goods consisting of;

Particulars	(₹ 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.

(ICAI SM)

Sol. **Provision: -** As per AS-2 (Revised)," Valuation of inventories" the cost of conversion includes 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.

Analysis and conclusion: - In the given case following computations are given:

Cost per kg. of finished goods;

Particulars		(₹)
✓ 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 × ₹ 270 = ₹ 10,80,000.

8. The inventory of Rich Ltd. as on 31st March, 20X1 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 overheads 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.

(May 2021 RTP)

Sol. **Provision: -** As per AS-2 'Valuation of Inventories', Inventories should be valued at the lower of cost and net realizable value.

Analysis and conclusion: - In this case following computations are given:

Product-A;

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

Product-B;

Particulars		(₹)
✓ Material Cost	₹ 45 × 800 = 36,000	
✓ Wages Cost	₹ 35 × 800 = 28,000	
✓ Total Cost		64,000
✓ Realizable value (800 × 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**

9.

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.

(May 2020 RTP)

Sol. **<u>Provision:</u> -** As per AS-2(Revised) "Valuation of inventories" I<u>nventories should be valued at lower of cost and net realisable value.</u> <u>Raw Material is valued at cost if finished goods are sold at cost or above cost otherwise raw materials is valued at replacement cost.</u>

<u>Analysis and conclusion:</u> - In the given case Calculation of Cost for Closing inventory;

Particulars	(₹)
✓ Cost of consumption (1,100+10,000 -900) × 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 × 20) ₹24,000
Raw Materials (900 × 9.50) ₹ 8,550 = **<u>₹ 32,550</u>**

10. Raw materials inventory of a company includes certain material purchased at ₹100 per kg. The price of the material is on decline and replacement cost of the inventory at the year-end is ₹75 per kg. It is possible to convert the material into finished product at conversion cost of ₹125.

Decide whether to make the product or not to make the product, if selling price is i) ₹175 and ii) ₹225. Also find out the value of inventory in each case.

(May 2010)

Sol. **<u>Provision;</u> -** As perAS-2(Revised) 'Valuation of Inventories', materials and other supplies held for use in the production of <u>inventories are not written down below cost if the finished products</u> in which they will be incorporated are <u>expected to be sold at or above cost.</u> But when <u>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 replacement cost.</u>

<u>Analysis and Conclusion;</u> - In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

1) When the selling price be ₹175
- ✓ Incremental Profit = ₹ 175 – ₹ 125 = ₹ 50
- ✓ Current price of the material = ₹ 75
- ✓ Therefore, it is better not to make the product. <u>Raw material inventory would be value at net realisable value i.e., ₹75 because the selling price of the finished product is less than ₹225 (100 + 125) per kg.</u>

2) When the selling price be ₹225

- ✓ Incremental Profit = ₹225 – ₹ 125 = ₹ 100
- ✓ Current price of the raw material = ₹ 75
- ✓ Therefore, it is better to make the product.

<u>Raw material inventory would be valued at ₹ 100 per kg because the selling price of the finished product is not less than ₹ 225.</u>

11. HP 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. At the end of month following information is available:

✓ Sales	₹ 47,25,000
✓ General Overheads Cost	₹ 1,25,000

Inventory at beginning 1,00,000 litres @ 15/- per litre
Purchases;

✓ 1 June two lakh litres @	14.25
✓ 30 June one lakh litres @	15.15

Closing inventory 1.30 lakh litres
Compute the following by the FIFO as per AS-2;

1) Value of Inventory on June 30.
2) Amount of cost of goods sold for June.
3) Profit/Loss for the month of June.

(November 2010)

Sol.

1) Cost of Closing Inventory for 1,30,000 litres as on 30th June;

Particulars	(₹)
✓ 1,00,000 litres @ 15.15	15,15,000
✓ 30,000 litres @ 14.25	4,27,500
Total	**19,42,500**

2) Computation of Cost of Goods Sold;

Particulars	(₹)
✓ Opening inventories (1,00,000 litres @ 15)	15,00,000
✓ Purchases June-1 (2,00,000 litres @ 14.25)	28,50,000
✓ June-30 (1,00,000 litres @ 15.15)	<u>15,15,000</u>
	58,65,000
✓ *Less:* Closing Inventories	(19,42,500)
✓ Cost of goods sold	**39,22,500**

3) Computation of Profit;

Particulars	(₹)
✓ Sales (Given) (A)	<u>47,25,000</u>
✓ Cost of goods sold	39,22,500
✓ ***Add:*** General overheads	<u>1,25,000</u>
✓ Total Cost (B)	40,47,500
Profit (A– B)	**6,77,500**

12. From the following information ascertain the value of stock as on 31st March, 20X2:

Particulars	(₹)
✓ Stock as on 01.04.20X1	28,500
✓ Purchases	1,52,500
✓ Manufacturing Expenses	30,000
✓ Selling Expenses	12,100
✓ Administration Expenses	6,000
✓ Financial Expenses	4,300
✓ Sales	2,49,000

At the time of valuing stock as on 31st March, 20X1 a sum of ₹3,500 was written off on a particulars item, which was originally purchased for ₹10,000 and was sold during the year of ₹9,000. Barring the transaction relating to this item, the gross profit earn ed during the year was 20% on sales.

(November 2012)

Sol.

Statement Showing Valuation of Stock as on 31.03.20X2

Particulars	(₹)	(₹)
✓ Stock as on 01.04.20X1	28,500	
✓ ***Less:*** Book value of abnormal stock (₹ 10,000 – ₹ 3,500)	(6,500)	22,000
✓ ***Add:*** Purchases		1,52,500
✓ Manufacturing Expenses		30,000
		2,04,500
✓ ***Less:*** Cost of Sales;		
✓ Sales as per Books	2,49,000	
✓ ***Less:*** Sales of Abnormal item	(9,000)	
✓	2,40,000	
✓ ***Less:*** Gross Profit @ 20%	(48,000)	
		(1,92,000)
Value of Stock as on 31st March, 20X2		**12,500**

13. Mr. Mehul gives the following information relating to items forming part of inventory as on 31-03-20X1. His factory produces Product X using Raw material A.

1) 600 units of Raw Material A (purchased @ ₹120). Replacement cost of raw material A as on 31-03-20X1 is ₹90 per unit.

2) 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.

3) 1500 units of finished Product X and total cost incurred ₹320 per unit.

Expected selling price of Product X is ₹300 per unit.
1) Determined how each item of inventory will be valued as on 31-03-20X1.
2) Also calculate the value of total inventory as on 31-03-20X1.

(May 2015)

Sol.

Provision: - As per AS-2(Revised) "valuation of inventories" Inventory is to be valued at cost or realizable value whichever is lower. And if finished product is expected to be sold below cost then raw material should be valued at NRV if there is decline in price of material. In such circumstances, the replacement cost of materials may be best available measure of their net realizable value.

Analysis and conclusion: -

1) **Valuation of Raw Material;**
   - ✓ Here product X is expected to be sold at ₹300 per unit which is below than total cost per unit which is ₹320. Then raw material is to be valued at replacement cost.
   - ✓ So, valuation of raw material is done as follows;
   - ✓ No. of units × Replacement Cost/unit = 600 × 90 = ₹ 54,000
   - ✓ Raw material is to be valued at ₹54,000

2) **Valuation of WIP:** 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 ₹240 (Estimated selling price ₹300 per unit less additional cost of ₹60.)
   500 units × ₹240 = ₹ 1.20,000

3) **Cost of Finished Goods;** Here the cost of finished good is ₹320 per unit and finished good is expected to be sold at ₹300 which is less than the cost of finished goods. So, finished good is valued at expected selling price, as calculated follows;

   1500 units × ₹ 300 per unit = ₹ **4,50,000**
   So, finished good is valued at ₹4,50,000 to the year end.

***Valuation of total inventory as on 31.03.20X1**

Particulars	Amount (₹)
1) Valuation of raw material	54,000
2) Valuation of partly finished goods	1,20,000
3) Valuation of finished goods	4,50,000
Total valuation of inventory as on 31.03.20X1	**6,24,000**

14.

Z Limited ordered 13,000 kg. of chemicals at ₹90 per kg. The purchase price includes GST of ₹5 per kg. in respect of which full input credit is admissible. Freight incurred amounted to ₹30,000. Normal transit loss is 4%. The company actually received 12,400 kg. and consumed 10,000 kg. The company has received trade discount in the form of cash amounting to ₹1 per kg. The chemicals were delivered in containers.

The containers were not reusable, hence sold for ₹500. The administrative expenses incurred to bring the chemicals were ₹10,000.

Compute the value of inventory and allocate the material cost as per AS-2.

May 2016

Sol.

Cost of inventory and allocation of material cost is shown below;

Particulars	(₹)
✓ Purchase price (13,000 kg × ₹ 89)	11,57,000
✓ ***Less:*** Input Credit (13,000 kg. × ₹ 5)	(65,000)
	10,92,000
✓ ***Add:*** Freight	30,000
✓ Allocated Administrative Expenses	10,000
a) Total material cost	11,32,000
b) Number of units to be normally received = 96% of 13,000 kg.	Kg. 12,480
c) Normal cost per kg. (A/B)	90.705

Allocation of material cost;

Particulars	Kg.	₹/kg.	(₹)
Material consumed	10,000		9,07,050
Cost of inventory (12,400 – 10,000)	2,400	90.705 (approx.)	2,17,692
Abnormal loss	80		7,258*
Total material cost	**12,480**		**11,32,000**

*The difference due to rounding off of normal cost per kg. has been adjusted. Thus the inventory will be valued at ₹2,17,692.

Note: -

1) The company has received trade discount in the form of cash. Therefore, discount has been treated as trade discount in the given answer.
2) Abnormal losses are recognized as separate expenses.
3) Containers are used for delivery of the chemicals and are not reusable. Cost of these containers is treated as selling and distribution expenses. The sale value of these containers will be credited to Profit and Loss Account and shall not be considered for the purpose of valuation of inventory.

Alternatively. The sales value of container amount of ₹500 may be deducted, while computing material cost. In that case the material cost will be computed as ₹ 11,31,500 (11,32,000 – 500) instead of ₹ 11,32,000. Accordingly the allocation of material cost will get changed.

15.

The closing inventory at cost of a company amounted to INR 2,84,700. The following items were included at cost in total-

a) 400 coats, which had cost INR 80 each and normally sold for INR 150 each. Owing to a defect in manufacture, they were all sold after the Balance Sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

b) 800 shoes, which had cost INR 20 each. These too were found to be defective, remedial work in April cost INR 5 per shoes, and selling expenses for the batch totalled INR 800. They were sold for INR 28 each. What should the inventory value be according to AS 2 after considering the above items?

Sol.

Provision: - As per AS-2(Revised) "valuation of inventories" Inventory is to be valued at cost or realizable value whichever is lower.

Analysis and conclusion: -

Write-down required for coats:

a) Value of Stock at Cost (INR 80 × 400 units)	32,000
b) NRV of Coats INR 150 × 50% × 400 units) less 5% thereon	28,500
c) Write-down required for Coats (a – b)	3,500

Valuation of Stock as per AS-2:

	Value of Stock as given above	INR 2,84,700
Less:	Write down required for Coats	INR 3,500
Less:	Provision for repairing cost of shoes to incurred in future (800 x 5)	INR 4,000
	Value of Closing stock as per AS-2	INR 2,77,200

Assignment
AS-3
Cash Flow Statements

Q. No.	Question and Solutions
1.	What are the main features of the Cash Flow Statement? **(May 2021 RTP /ICAI SM/Nov. 1999)**
Sol.	**Main features of cash flow statements (As per AS-3):** **i)** According to AS-3, cash flow statement deals with the provisions of information about the historical changes in cash and cash equivalents of an enterprise during the stated period from operating, investing and financing activities. **ii)** Cash flow from operating activities can be reported using either: **a)** The direct method, in which mostly the classes of gross cash receipts and gross cash payments are disclosed. **b)** The indirect method, in this net profit or loss is adjusted for the purpose of transactions of non-cash nature. **iii)** According to AS-3, an enterprise must disclose the components of cash and cash equivalents and must present a reconciliation of amounts in its cash flow statement with the equivalent items reported in the balance sheet. **iv)** When the cash flow statement is used alongwith the other financial statements, it provides information that enables the user to evaluate the changes in net assets of an enterprise. This statement also enhances the comparability of the operating performances. For companies isted on stock exchanges compliance of AS-3 is compulsory due to the listing agreement.
2.	Classify the following activities as per AS-3 Cash Flow Statement: i) Interest paid by financial enterprise ii) Dividend paid iii) Tax deducted at source on interest received from subsidiary company iv) Deposit with Bank for a term of two years v) Insurance claim received towards loss of machinery by fire vi) Bad debts written off Which activity does the purchase of business falls under and whether netting off of aggregate cash flows from disposal and acquisition of business units is possible? **(ICAI SM/May 2016)**
Sol.	**Classification as per AS-3** **i) Interest paid by financial enterprise:** Cash flow from operating activities. **ii) Dividend paid:** Cash flow from financing activities. **iii) TDS on Interest received from subsidiary Company:** Cash flow from investing activities. **iv) Deposit with Bank for a term of 2 years:** Cash flow from investing activities. **v) Insurance claim received towards loss of machinery by fire :** Extraordinary items to be shown as a seprate heading under 'Cash flow from investing activities'. **vi) Bad debts written off:** Cash flow from operating activities. Purchase of business falls under cash flow from investing activities or operating activites depending upon situation. No cash flows from Disposal and acquisition of business.
3.	**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 (Conversion Rate: On the day of deposit ₹ 69/USD as on 31-03-20X2 ₹ 70/USD)	$ 1,000

(ICAI SM)

Sol.

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

Particulars	Amount (₹)
Cash balance with bank (₹ 25,000 less ₹ 15,000)	10,000
Short term investment in highly liquid sovereign debt mutual	1,00,000
Bank balance in foreign currency account ($1,000 × ₹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.

4. In the case of a manufacturing company:

i) List the items of "inflows" of cash receipts from operating activities

ii) List the items of "outflows" of investing activities. **(May 1998)**

Sol.

i) Inflows of cash receipts from operating activities:

a) Cash receipts from rendering of services.
b) Cash receipts from the sale of goods.
c) Refund of income-tax .
d) Royalties, fees, commission and other revenues.

ii) Outflows of investing activities:

a) Cash payment for acquiring fixed assets.
b) Cash advances and loans to third parties.
c) Cash payment for acquisition of shares, warrants or debt instruments of other enterprises and interest in joint ventures.

5. **Classity the following activities as**
i) Operating Activities, ii) Investing activities, iii) Financing 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

Underwriting commission paid.

(May 2018/ICAI SM)

Sol.

Classification of Activities

1)	Cash receipt from Trade receivables	Operating Activities
2)	Marketable Securities	Cash Equivalents
3)	Purchase of investment	Investing Activities
4)	Proceeds from long term borrowings	Financing Activities
5)	Wages and Salaries paid	Operating Activities
6)	Bank overdraft	Financing Activities
7)	Purchase of Goodwill	Investing Activities
8)	Interim dividend paid on equity shares	Financing Activities
9)	Short term Deposits	Investing Activities
10)	Underwriting Commission paid	Financing Activities

6. Define briefly the classification of activities, as suggested in Accounting Standard 3, to be used for preparing a cash flow statement. Give two examples of each such class of activities.

(May 2001)

Sol. **According to AS-3 (Cash Flow Statement), the cash flow statement must report cash flows by operating, investing and financing activities:**

1) **Operating Activities:** These are the principal revenue producing activities of the enterprise. This activity does not include in it the investing and financing activities. Examples of operating activities are, cash receipt from the sale of goods and cash payment to the supplier of goods.
2) **Investing Activities:** These activities include the acquisition and disposal of long-term assets and other investments which are not included in cash equivalents.
   Example of investing activities are payment made on acquiring building for business or cash received from the sale of furniture.
3) **Financing Activities:** Those activities that results in changes in the size and composition of the owner's capital and borrowing of the enterprise.
   Example of the financing activities are cash proceed from issue of shares and cash paid to redeem debentures.

7. 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.

(ICAI SM)

Sol. **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

8. X ltd. Purchased debenture of ₹10 lakh 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?

(ICAI SM)

Sol. As per AS 3, on cash flow statement cash and cash equivalent consists of cash in hand, balance with bank and short term, highly liquid investment. If investment of ₹10 lakh made in debenture is for short term period then it is an item of cash equivalent.

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

AS-4 Contingencies and Events occurring after the Balance Sheet Date Assignment

Q. No.	**Questions & Answers**
1.	The financial statements of Sri Radhe Radhe Ltd. for the year 20X0-X1 approved by the Board of Directors on 15th July, 20X1. The following information was provided: **i)** A suit against the company's advertisement was filed by a party on 20th April, 20X1, claiming damages of ₹ 25 lakhs. **ii)** The terms and conditions for acquisition of business of another company have been decided by March, 20X1. But the financial resources were arranged in April, 20X1 and amount invested was ₹ 50 lakhs. **iii)** Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 20X1 but was detected on 16th July, 20X1. **iv)** Company sends a proposal to sell an immovable property for ₹ 40 lakhs in March, 20X1. The book value of the property is ₹ 30 lakhs on 31st March, 20X1. However, the Sri Radhe Radhe Ltd. Deed was registered on 15th April, 20X1. **v)** A major fire has damaged the assets in a factory on 5th April, 20X1. However, the assets are fully insured. With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the above-mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date. **(May 2019/May 2016/July 2021/November 2020 RTP(M)/November 2013(M)/ICAI SM /May 2020 RTP(M)/December 2021(M))**
Sol.	**Provision: -** As per AS-4, "Contingencies" used in the standard is restricted to following conditions: a) There has been an existing event or situations b) result of which is not known on the balance sheet date c) result would be known in future on happening or non-happening of certain event d) result may be either gain or loss **Adjusting event: -** These are the events which have a contingency on balance sheet date but the event occurred after balance sheet date but before the approval of accounts by competent authority. **Non-adjusting event: -** These are the events on which there is no contingency on the balance sheet date and event is occurred after the balance sheet date but before the approval of accounts by competent authority. **i)** **Analysis and conclusion: -** In the given case Suit filed against the company is a contingent liability but it was not existing as on balance sheet date as the suit was filed on 20th April after the balance Sheet date. Hence, it will have no effect on financial statements and will be a non-adjusting event. **ii)** **Analysis and conclusion: -** In the given case, terms and conditions for acquisition of business were finalized and carried out before the closure of the books of accounts but transaction for payment of financial resources was affected in April, 20X1. This is clearly an adjusting event occurring after the balance sheet date. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 20X1. **iii)** **Analysis and conclusion: -** In the given case, theft of cash was detected on 16th July, 18 after approval of financial statements by the Board of Directors, hence no treatment is required because it is clearly the case of non-adjusting event, event occurring after balance sheet date and no contingency is available on the balance sheet date.

	iv) **Analysis and conclusion: -** In the given case, sale of immovable property was under proposal stage (negotiations also not started) on the balance sheet date so it is the case of non-adjusting event. Therefore, no adjustment to assets for sale of immovable property is required in the financial statements for the year ended 31st March, 20X1. **v)** **Analysis and condition: -**In the given case, the condition of fire occurrence was not existing on the balance sheet date. Only the disclosure regarding event of fire and loss being completely insured may be given in the report of approving authority.
2.	While preparing its final accounts for the year ended 31st March 20X1, a company made a provision for bad-debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 20X1 a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April 20X1 the debtor becomes bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 20X1. **(November 2010/ICAI SM/November 2016/November 2011)**
Sol.	**Provision: -** As per AS-4, "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet date. **Analysis and Conclusion: -** In the given case a debtor for ₹ 3,00,000 suffered heavy loss due to earthquake in the first week of March, 20X1, which was not covered by insurance. This information is already known to the company. The fact that he became bankrupt in April 20X1 (after the balance sheet date) is only an additional information related to the existing condition on the balance sheet date. Accordingly, full provision for bad debts amounting ₹ 3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March, 20X1.
3.	A company entered into an agreement to sell its immovable property to another company for 35 lakhs. The property was shown in the Balance Sheet at ₹ 7 lakhs. The agreement to sell was concluded on 15th February, 20X1 and sale deed was registered on 30th April, 20X1. The financial statements for the year ended 31st March 20X1 were approved by the board on 12th May, 20X1. You are required to state, how this transaction would be dealt with in the financial statements for the year ended 31st March, 20X1. **(November 2009/May 2016/November 2013(M)/RTP)**
Sol.	**Provision: -** As per AS-4, "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet or additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. **Analysis and Conclusion: -** In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was affected on 15th February 20X1 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 20X1, simply provides additional information relating to the conditions existing at the balance sheet date. Hence, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 20X2.
4.	Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 20X1. However same comes to the notice of company management during April, 20X1 only. Financial statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 20X1? What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Board of Directors of the company? **(May 2012/ICAI SM/July 2021/December 2021 (M))**

Sol.	**Provision: -** As per AS-4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet or additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. **Analysis and conclusion: -** In the given case, the theft, by the cashier ₹ 6,00,000 was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 20X1 for recognition of the loss amounting ₹ 6,00,000. When embezzlement of cash comes to the notice of company management only after approval of financial statements by Board of Directors of the company, then it would be a non-adjusting item. It will be taken as prior period item for year ending 31st March, 20X2.
5.	A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 20X1-20X2. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements were approved on 31st May, 20X2. Shall company account for such tax in the year 20X1-20X2 or shall it account for in the year 20X2-20X3? **(May 2021 RTP /May 2016)**
Sol.	**Provision: -** As per AS-4, "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet date but the result is not known on balance sheet date. **Analysis and conclusion: -** In the given case of ABC Ltd. Court order is conclusive evidence which has been received before approval of the financial statements means event occurring after balance sheet date but before the approval of accounts by competent authority, since the liability is related to earlier year and information is available at balance sheet date so the event will be considered as an adjusting event and accordingly the amount will be adjusted in accounts of 20X1-20X2.
6.	XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 20X0 and the financial statements were approved by their approving authority on 15th June, 20X0. The following material events took place: **a)** A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 20X0. The sale was completed on 15th May, 20X0 at a price of ₹ 26,50,000. **b)** On 2nd April, 20X0, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company. You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 202X0. **(Nov 2021 RTP/November 2020 RTP(M))**
Sol.	**Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'** **a)** The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.20X0 and the profit on sale of property ₹ 1,50,000 would be considered.

	b) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.
7.	Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 20X1, the company wants to recognize receipt of cheques bearing date 31st March, 20X1 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 20X1 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard. i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 20X1. ii) Cheques sent by the stockists through courier on or before 31st March, 20X1. **(May 2013/May 2010)**
Sol.	**Provision: -** As per AS-4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet or additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. **i)** Cheques collected by the marketing personnel of the company is **an adjusting event** as the marketing personnel are employees of the company and therefore, are representatives of the company. ✓ Handing over of cheques by the stockiest to the marketing employees discharges the liability of the stockist. ✓ Therefore, collection of cheques by the marketing personnel is an adjusting event as per AS-4. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques. **ii)** In case if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 20X1, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 20X1 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is **not an adjusting event.**
8.	An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at ₹30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company. **(ICAI SM/Nov. 2021 MTP)**
Sol.	**Provision: -** As per AS-4, "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements

	Analysis and conclusion: - In the given case the destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 20X1-20X2. As per the information given, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹30 lakhs should be disclosed in the report of the approving authority for financial year 20X1-X2 to enable users of financial statements to make proper evaluations and decisions.
9.	A company has filed a legal suit against the debtor from whom ₹15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹15 lakhs as provision for doubtful debts? Discuss. **(ICAI SM)**
Sol.	**Provision: -** As per AS-4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet or additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. **Analysis and conclusion: -** In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, full amount of provision for doubtful debts should be made for the year ended on 31st March, 20X1.
10.	In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements: The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year. **(ICAI SM)**
Sol.	**Provision: -** As per AS-4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company. **Analysis and conclusion: -** In the given case, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 20X1. The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹100 lakhs in April, 20X1 for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.
11.	A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1. **(ICAI SM)**

Sol.	**Provision: -** As per AS-4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. **Analysis and conclusion: -** In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.
12.	During the year 20X1-20X2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2 **(ICAI SM)**
Sol.	**Provision: -** As per AS-4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date if such events are related to conditions existing on the balance sheet or additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. **Analysis and conclusion: -** In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor. Had the judgment of the Court been delivered on 1st June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS-4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.
13.	The Board of directors of M/s. Sri Govindjee Ltd. In its Board Meeting held on 18th April, 20X2, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 20X2 and recommended a divided of ₹ 2 per equity share (on 2 crores fully paid-up equity shares of ₹ 10 each) for the year ended 31st March, 20X2 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 20X2, the same will be paid to all the eligible shareholders. Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 20X2 as per the applicable Accounting Standard and Other Statutory Requirements. **(May 2017)**
Sol.	**Provision: -** As per the amendment in AS-4(Revised) "Contingencies and Events Occurring After the Balance Sheet Date" Dividend in respect of period covered by the financial statements is and non-adjusting event. It shall not be recognized at the balance sheet date unless statue requires to do so, such dividends are disclosed in the notes to financial statements. **Analysis and conclusion: -** In the given case Provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹ 4 Crores recommended by Sri Govindjee Ltd. in its Board meeting on 18th April, 20X2 shall not be accounted for in the books for the year 20X1-20X2.

14. The accounting year of Sri Gopal Limited ended on 31st March, 20X1 but the accounts were approved on 30th April, 20X1. On 15th April, 20X1 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Sri Gopal Limited to start operation again.

State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS – 4 (Revised). **(November 2018)**

Sol. **Provision: -** As per AS-4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date," states an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

Analysis and conclusion: - A fire occurred in the factory and office premises of an enterprise after 31/03/20X1. But before approval of financial statement of 20X1-X2. The loss on fire is of such a magnitude that it is not reasonable to expect the company to start its operation again. i.e. the going concern assumption is not valid. Since the fire occurred after 31/3/20X1, the loss on fire is not a result of any condition existing on 31/03/20X1. In such a case, the entire accounts need to be prepared on a liquidation basis with adequate disclosures.

15. Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 20X3 are to be approved by the approving authority on 30th June 20X3. During the first quarter of 20X3-20X4, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March 20X3. On 31st March 20X3 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 20X3, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.

ii) A fire has broken out in the company's go down on 15th April 20X3. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

iii) The company has entered into a sale agreement on 30th March 20X3 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 20X3 when conveyance and possession get completed.

iv) The company has received, during the year 20X1-20X2, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15th June, 20X3 due to violation of some of the conditions of grant during the year 20X2-20X3.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 20X3.

(October 2021 MTP)

Sol.

Provision: - As per AS-4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date," Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30th June 20X3.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31st March 20X3:

i) Since on 31st March 20X3, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 20X3 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines × ₹ 4,000 = ₹ 2,00,000.

ii) A fire took place after the balance sheet date i.e. during 20X3 -20X4 financial year. Hence, corresponding financials of 20X2-20X3 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern, assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

iii) Since the transfer of risk and reward and sale was complete in the month of May, 20X3 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 20X2-20X3. However, a disclosure for the same should be given by the entity.

iv) Since the notice has been received after 31st March but before 30th June 20X3 (approval date), the said grant shall be adjusted in the financial statements for financial year 20X2 - 20X3 because the violation of the conditions took place in the financial year 20X2 - 20X3and the company must be aware of it.

16.

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.20X1 in the books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.20X1):

1) Equity Dividend for the year 20X0-X1 was declared at the rate of 7% on 15.05.20X1.

2) On 05.03.20X1, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.20X1.

3) One Building got damaged due to occurrence of fire on 23.05.20X1. loss was estimated to be ₹ 81,00,000.

(December 2021)

Sol.

Provision: - As per AS-4, "Contingencies" used in the standard is restricted to following conditions:

a) There has been an existing event or situations
b) result of which is not known on the balance sheet date
c) result would be known in future on happening or non-happening of certain event
d) result may be either gain or loss

Adjusting event: - These are the events which have a contingency on balance sheet date but the event occurred after balance sheet date but before the approval of accounts by competent authority.

Non-adjusting event: - These are the events on which there is no contingency on the balance sheet date and event is occurred after the balance sheet date but before the approval of accounts by competent authority.

1) **Analysis and conclusion: -** In the given case, dividend is declared after the balance sheet date so there is no contingency on balance sheet date so it is a non-adjusting event.
2) **Analysis and conclusion: -** In the given case, the fraud, by the cashier ₹ 53,000 was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date.

   Therefore, it is necessary to make the necessary adjustments in the financial statements of the company (Adjusting event) for the year ended 31st March, 20X1 for recognition of the loss amounting ₹ 53,000.
3) **Analysis and conclusion: -** In the given case the building got damaged due to fire did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to fire is not to be recognised (non-adjusting event) in the financial year 20X1-20X2.

AS-5
Net Profit or Loss for The Period, Prior Period Items and Changes in Accounting Policies
Assignment

Q. No.	Question & Answers
1.	**i)** During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary? **ii)** A company signed an agreement with the Employees Union on 1.9.20X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3? **(ICAI SM /May 2011/May 2012)**
Sol.	**i)** **Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to ascertain the performance of the enterprise for the period, Such items should be disclosed separately. **Analysis and conclusion: -** In the given case, consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs. **ii)** **Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to ascertain the performance of the enterprise for the period, such items should be disclosed separately. **Analysis and conclusion: -** It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore, wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) should be included in current year's wages. It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. Thus, necessary disclosure should be made for the additional liability amounting to ₹ 7,50,000.
2.	Explain whether the following will constitute a change in accounting policy or not as per AS 5. **i)** Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement. **ii)** Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization. **(May 2020 RTP /ICAI SM/November 2021 RTP)**
Sol.	**Provision: -**As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy Further, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial are not change in accounting policy **Analysis and conclusion: -** **i)** In the given case, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

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

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

(ICAI SM/November 2008)

Sol. **Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Analysis and conclusion: - In the given case, 2 pages of inventory sheets were missing in financial statements of 20X1 due to this the inventory of 20X1 was shown short by ₹ 14.5 lakhs as a result of which the opening inventory was understated resulting into an overvaluation of profit in 20X2. Therefore, separate disclosure of prior period items should be shown separately in the statement of trading band profit and loss A/c in a manner that the impact on the current profit or loss can be perceived.

4. Closing Stock for the year ending on 31st March, 20X3 is ₹ 1,50,000 which includes stock damaged in a fire in 20X1-X2. On 31st March, 20X2, the estimated net realizable value of the damaged stock was ₹ 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 20X2-X3 is ₹ 4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 20X2-X3, using provisions of Accounting Standard 5.

(May 2010/May 2013)

Sol. **Provision:** - As per AS-5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

Analysis and Conclusion: - In the given case, it is presumed that the loss by fire in the year ended 31.3.20X2 i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item. Reduction in estimated net realizable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate.

Thus, in the year 20X2-X3, revision in accounting estimate should also be classified as exceptional item in the profit and loss account and closing stock should be shown excluding the value of damaged stock. Value of closing stock for the year 20X2-X3 will be as follows:

Particulars	₹
Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods already done	(4,000)
Closing stock (excluding damaged goods)	1,46,000

5. Goods worth ₹ 5,00000 were destroyed due to flood in September, 20X0. A claim was lodged with insurance company and was accepted by insurance company. But no entry was passed in the books for insurance claim in the financial year 20X0.X1.

In March, 20X2, the claim was passed and the company received a Payment Of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 20X2.

(Nov 2009/May 2018)

Sol. **Provision: -** As per AS-5 "Net Profit for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are incomes or expenses, which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss:

Analysis and conclusion: - In the given case, it is clearly a case of error in preparation of financial statements for the financial year 20X1-X2. Therefore, claim received in the financial year 20X2-X3 is a prior period item and should be separately disclosed in the statement of profit and loss for the year ended 31st March, 20X3.

6.	There was a major theft of stores valued at ₹ 10 lakhs in the preceding year which was detected only during current financial year (20X1-20X2). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 20X2. **(November 2021 RTP)**
Ans.	**Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods". **Analysis and conclusion: -** In the given case, Due to major theft of stores in the preceding year (20X0-20X1) which was detected only during the current financial year (20X1–20X2), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 20X2.
7.	The Accountant of Virush Limited has sought your opinion, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard; **i)** Till the previous year the machinery was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years. **ii)** Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement. **(November 2020 RTP)**
Ans.	**i) Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", An Accounting Estimate may have to be revised (a) if there are changes in circumstances on which the estimate was based, or (b) as a result of new information, more experience or subsequent developments. **Analysis and conclusion: -** In the given case, change in useful life of machinery from 5 years to 3 years is a change in estimate and is not a change in accounting policy. **ii) Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial are not change in accounting policy. **Analysis and conclusion: -** In the given case, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.
8.	Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case. **(ICAI SM)**
Ans.	**Provision: -** As per AS-5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

	Analysis and conclusion: - In this case, the final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore, it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period.
9.	Explain the provisions of AS – 5 regarding accounting treatment of prior period items. **(May 2009)**
Sol.	**As per AS 5, prior periods items** are income or expenses, which arise, in the current period as a result of errors or omission in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period e.g. arrears payable to workers in current period as a result of revision of wages with retrospective revision of wages. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on profit or loss can be perceived. Prior period items are normally included in determination of net profit or loss for the current profit, they can be added (or deducted as the case may be) from current profit or loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.
10.	The accountant of Sri Sai Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 20X2. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard: **i)** Provision for doubtful debts was created @ 2% till 31st March, 20X1. From the Financial year 20X1-20X2, the rate of provision has been changed to 3%. **ii)** During the year ended 31st March, 20X2, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement. **iii)** Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years. **iv)** Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization. **v)** During the year ended 31st March, 20X2. there was change in cost formula in measuring the cost of inventories. **(November 2017)**
Sol.	**AS – 5 Changes in Accounting Policies** **i)** Creating a provision for doubtful debts is an Accounting Estimate. An Accounting Estimate may have to be revised (a) if there are changes in circumstances on which the estimate was based, or (b) as a result of new information, more experience or subsequent developments. Hence, this is not a change in Accounting Policy but change in an Accounting Estimate. **ii)** Adaptations of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions does not constitute a change in Accounting Policy. **iii)** As per AS 5 & AS 10 PPE, change in the estimate of useful life of fixed assets should be considered as changes Accounting Estimates. Hence, this is not a change in Accounting Policy. **iv)** Adoption of a new Accounting Policy for events or transactions which did not occur previously or that were immaterial does not constitute a change in Accounting Policy.

v) <u>Change in cost formula</u> in measuring the cost of inventories <u>is a change in **Accounting Policy.**</u>

11. Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 20X1-X2. Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.20X2. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra-ordinary item or prior period item?

(May 2018)

Sol. **<u>Provision:</u> -** As per AS-5(Revised), "Net Profit or Loss for the period, prior period Items and changes in Accounting policies", the preparation of financial statements involves making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be <u>necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within definitions of a prior period item or an extraordinary item.</u>

<u>Analysis and conclusion: -</u> In the given case**,** a limited company created 2.5% provision for doubtful debts for the year 20X1-X2. Subsequently in 20X2 the company revised the estimates based on the changed circumstances and wants to create 8% provision so this change in estimate is neither a prior period item nor an extraordinary item.

However**,** a <u>change in accounting estimate which has material effect in the current period</u>, <u>should be disclosed and quantified</u>. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed and quantified.

12. State whether the following items are examples of change in Accounting Policy / Change in Accounting Estimates / Extraordinary items / Prior period items / Ordinary Activity:

i) Actual bad debts turning out to be more than provisions.
ii) Change from Cost model to Revaluation model for measurement of carrying amount of PPE.
iii) Government grant receivable as compensation for expenses incurred in previous accounting period.
iv) Treating operating lease as finance lease.
v) Capitalisation of borrowing cost on working capital.
vi) Legislative changes having long term retrospective application.
vii) Change in the method of depreciation from straight line to WDV.
viii) Government grant becoming refundable.
ix) Applying 10% depreciation instead of 15% on furniture.
x) Change in useful life of fixed assets.

(Jan 2021)

Sol. **Classification of given items is as follows:**

Sr. No.	Particulars	Remarks
i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
iv)	Treating operating lease as finance lease.	Prior- period Items
v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
vi)	Legislative changes having long term retrospective application	Ordinary Activity

	vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
	viii)	Government grant becoming refundable	Extra -ordinary Items
	ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
	x)	Change in useful life of fixed assets	Change in Accounting Estimates

AS-7 Construction Contracts
Assignment

Q. No. | **Question and Answers**

1.

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

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

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

(ICAI SM/May 2018/ October 2021 MTP / November 2021 MTP)

Sol.

As per AS 7, "Construction Contracts" <u>when it is probable that total contract costs will exceed total contract revenue, the expected losses should be recognized as an expense immediately.</u>

<u>Analysis and conclusion: -</u>

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

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

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

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

d) Amount due from/to customers = (Contract costs + Recognised profits – Recognised Losses) – (Progress payments received + Progress payments to be received)
= (605 + Nil – 100) – (400 + 140) ₹ in lakhs
= [505 – 540] ₹ in lakhs
Amount due to customers = ₹ 35 lakhs

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

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

Particulars	₹ 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

2. On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)? **(ICAI SM/May 2012/May 2019)**

Sol. **Provision:** - As per AS 7, "Construction Contracts" when it is probable that total contract costs will exceed total contract revenue, the expected losses should be recognized as an expense immediately. Further standard provides that the percentage of completion would be estimated by comparing total cost incurred to date with total cost expected for the entire contract.

Analysis and conclusion: -

Particulars	₹
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 recognized as an expense.

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

Proportion of total contract value recognized as turnover:

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

3. 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	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(ICAI SM /May 2020 RTP /May 2015)

Sol.

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 × 26%)	2,340	-	2,340
Expenses (8,050 × 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 × 74%)	6,808	2,340	4,468
Expenses (8,200 × 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 × 100%)	9,200	6,808	2,392
Expenses (8,200 × 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 thereporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

4.

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.

(ICAI SM /May 2017/RTP)

Sol.

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

	Cost of Construction	**₹**	**₹**
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.20X2	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.20X2		1,34,00,000
Add:	Estimated future cost		33,50,000

	Total Estimated cost of construction	1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)	80%
	Revenue recognized (80% of 1,50,00,000)	1,20,00,000
	Total foreseeable loss (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**

5. 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. **(May 2021 RTP /November 2016/May 2019)**

Sol. **Provision: -**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.

Analysis and conclusion: - In the given case, ABC Ltd. has submitted separate proposals for each of the 3 units of commercial complex. though a single agreement is between the two. Also values for each contract is defined separately such as ₹ 50 lakh, ₹ 60 lakh and ₹ 75 lakh respectively. Thus ABC Ltd. is required to treat construction of each unit as a separate construction contract. Therefore, three separate contract accounts must be recorded and maintained in the books of ABC 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.

6. M/s. Highway Constructions undertook the construction of a highway on 01.04.20X0. The contract was to be completed in 2 years. The contract price was estimated at ₹ 150 crores. Up to 31.03.20X1 the company incurred ₹ 120 crores on the construction. The engineers involved in the project estimated that further ₹ 45 crores would be incurred for completing the work.

'What amount should be charged to revenue for the year 20X0-X1 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions. **(May 2014/November 2011)**

Sol. **Statement showing the amount to be charged to Revenue as per AS 7**

	₹ in crores
Cost of construction incurred upto 31.03.20X1	120
Add: Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165×100)	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)

Particulars	₹ in crores	Particulars	₹ in crores
To construction Costs	120	By Contract Price	109
To Provision for loss	4	By Net loss	15
	124		**124**

7. Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.20X1 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹ 12 crore with an escalation clause. You are given the following information for the year ended 31.03.20X1:

Cost incurred upto 31.03.20X1	₹ 4 crore
Further cost estimated to complete the contract	₹ 6 crore

Escalation in cost was by 5%. Hence, the contract price is also increased by 5%.
You are required to ascertain the stage of completion and compute the amount of revenue and profit to be recognized for the year as per AS 7.

(November 2020 RTP /May 2016)

Sol. **Provision: -** As per AS-7, "Construction Contracts", when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to stage of completion of the contract activity at the reporting date

Analysis and conclusion: -

Particulars	₹ in crore
Cost of construction of bridge incurred upto 31.3.20X1	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore × 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= (4/10) ×100 = 40%

Revenue and Profit to be recognized for the year ended 31st March, 20X1 as per AS 7:

Proportion of total contract value recognized as revenue

= Contract price × percentage of completion

= ₹ 12.60 crore × 40% = ₹ 5.04 crore

Profit for the year ended 31st March, 20X1 = ₹ 5.04 crore – ₹ 4 crore = 1.04 crore.

8. 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.

(Nov. 2021 RTP / May 2021 RTP)

Sol. **Provision: -** As per 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 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 the amount of the incentive payment can be measured reliably

Analysis and conclusion: - In the given case, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

9. An Amount of ₹ 9,90,000 was incurred on a contract work up to 31-3-20X0. Certificates have been received to date to the value of ₹ 12,00,000 against which ₹ 10,80,000 has been received in cash. The cost of work done but not certified amounted to ₹ 22,500. It is estimated that by spending an additional amount of ₹ 60,000 (Including provision for contingencies) the work can be completed in all respect in another two months. The agreed contract price of work is ₹ 12,50,000. Compute a conservative estimate of the profit to be taken to the Profit and Loss Account as per AS – 7. **[Nov. 2010]**

Sol. **Provision: -** As per AS-7, "Construction Contracts", when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to stage of completion of the contract activity at the reporting date

Analysis and conclusion: -

Computation of Estimated Profit as per AS -7

Particulars	**₹**
Expenditure incurred upto 31.3. 20X0	9,90,000
Estimated additional expenses (including provision for contingencies)	60,000
Estimated cost (A)	10,50,000
Contract price (B)	12,50,000
Total estimated profit [(B−A)]	2,00,000
Percentage of completion $\frac{9,90,000}{10,50,000} \times 100$	94.29%

Computation of estimate of the profit to be taken to Profit and Loss Account:

$= \text{Total estimated profit} \times \frac{\text{Expenses incurred till 31.3.2010}}{\text{Total estimated cost}}$

$= 2,00,000 \times \frac{9,90,000}{10,50,000} = 1,88,571$

Therefore, estimated profit amounting ₹ 1,88,571 should be recognized as revenue in the statement of profit and loss.

10. 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.

(Nov. 2021 RTP)

Sol. 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.

11. 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)**

Sol.

Provision: - As per AS-7, "Construction Contracts", when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to stage of completion of the contract activity at the reporting date.

Analysis and conclusion: -

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 = $\frac{\text{Cost incurred till date}}{\text{Estimated total cost}}$

$= \frac{₹\ 45,00,000}{₹\ 80,00,000}$

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000 × 56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

12.

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed.

Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year. **(Nov 2020)**

Sol.

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

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

Revenue to be recognized = 20,00,00 × 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
	17,35,000

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

Revenue to be recognized = 20,00,000 × 76.95%
= 15,39,000

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

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

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000.

Note: Calendar year has been considered as accounting year.

AS - 9 Revenue Recognition
Assignment

Q. No.	Question & Answers
1.	The following information of Meghna Ltd. is provided: i) Goods of ₹60,000 were sold on 20-3-20X1 but at the request of the buyer these were delivered on 10-4-20X1. ii) On 15-1-20X1 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 -3-20X1. iii) ₹1,20,000 worth of goods were sold on approval basis on 1-12-20XO. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X1 and no approval or disapproval received for the remaining goods till 31-3-20X1. 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. **(May 2020 RTP /ICAI SM/November 2019/May 2019/May 2015/ November 2021 MTP /November 2017/ November 2020 RTP)**
Sol.	As per AS 9 “Revenue Recognition”, Revenue is recognized in case of sale of goods only When the following conditions are fulfilled: **i)** The seller of goods has transferred to the buyer the property in the goods for a price. **ii)** Significant risks and rewards of ownership on goods transferred to the buyer. and the seller retains no effective control of the goods transferred. **iii)** No significant uncertainty in ultimate collection at the time of sales. **Case (i) Situation –** Delay in delivery at Buyer’s request. **Provision-:** As per AS-9, “Revenue Recognition” When the delivery is delayed at buyer’s request and buyer’s takes title and accepts billing revenue should be recognized immediately. **Analysis and conclusion:** - 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, 20X1. **Case (ii) Situation-** Consignment Sales. **Provision:** - As per AS-9, “Revenue Recognition” Revenue should be recognized only when the goods are sold by the agent to the third party. **Analysis and conclusion-**: In the given case 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). Because consignment sale revenue should not be recognized until the goods are sold to a third party. **Case (iii) Situation-** Sales on approval basis. **Provision:** - As per AS-9, “Revenue Recognition” revenue should be recognized only when the buyer confirms his desire to buy goods by communication. or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed **Analysis and conclusion: -** In the given case, total goods worth ₹ 1,20,000 are sold to customers on 1-12-20X0, on approval period of 3 months, Buyer sent approval for 75% goods upto 31-01-20X1 and no approval or disapproval received for remaining goods till 31-03-20X1. As the approval time is elapsed on 31-03-20X1., So the goods sold on 1-12-20X0 is to be considered as sales. So, ₹1,20,000 is to be recognized immediately.

Case (iv) Situation- Sale on discount.

<u>Provision:</u> - As per AS-9, "Revenue Recognition" Revenue should be recognized for sales should be net revenue means after allowing all discounts given to customer.

<u>Analysis and conclusion:</u>- In the given case, 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.

2. 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.

(November 2021 RTP /May 2008/November 2008)

Sol. **<u>Provision: -</u>** As per AS 9 "Revenue recognition", <u>When uncertainty of collection of revenues arises subsequently after the revenue recognition, it is better to make provision for the uncertainty in collection rather than adjustment in already recognized revenue</u>. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

<u>Analysis and conclusion: -</u> 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.

3. Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March,20X2:

- i) On 31st December, 20X1 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, 20X2.
- ii) On 10th January, 20X2, Tonk Tanner supplied shoes worth ₹4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 20X2.
- iii) On 21st March, 20X2 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, 20X2.

You are required to advise the accountant of Tonk Tanners, when amount is to be recognized as revenue in 20X1-X2 in above cases in the context of AS 9.

(May 2021 RTP /December 2021)

Sol. As per AS 9 "Revenue Recognition", Revenue is recognized in case of sale of goods only When the following conditions are fulfilled:

- **i)** The seller of goods has transferred to the buyer the property in the goods for a price.
- **ii)** <u>Significant risks and rewards of ownership on goods transferred to the buyer</u>. and the seller retains no effective control of the goods transferred.
- **iii)** <u>No significant uncertainty in ultimate collection at the time of sales</u>.

Case (i) Situation- Shoes sent to Mohan Shoes (consignee) for consignment sale

<u>Provision: -</u> As per AS-9, "Revenue Recognition" <u>Revenue should be recognized only when the goods are sold by the agent to the third party.</u>

	Analysis and conclusion: - 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 20X1-20X2, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for ₹3,20,000 × 75% = ₹2,40,000. **ii) Situation -** Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date **Provision: -** As per AS-9, "Revenue Recognition" transactions that are in substance of a financing agreement, the resulting cash inflow is not revenue and should not be recognized as revenue. **Analysis and conclusion: -** In the given case, transactions are in substance of a financing agreement, the resulting cash inflow is not revenue and should not be recognized as revenue in the year 20X1-20X2. Hence, sale of ₹4,50,000 to Shani Shoes should not be recognized as revenue. **iii) Situation-** Delivery is delayed at buyer's request. **Provision: -** As per AS-9, "Revenue Recognition" When the delivery is delayed at buyer's request and buyer's takes title and accepts billing revenue should be recognized immediately. **Analysis and conclusion: -**In the given case on 21st March, 20X2, 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 20X1-20X2 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.
4.	Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹10 lakhs and ₹15 lakhs as interest and royalties respective from Y Ltd. during the year 20X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd. **(ICAI SM /November 2008)**
Sol.	**Provision: -**As per AS 9, "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, Interest on a time basis proportion basis taking into account the amount outstanding and the rate applicable. Royalties on accrual basis in accordance with the terms of relevant agreement. **Analysis and conclusion: -**Interest revenue is recognized 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. Royalties' revenue is recognized on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.
5.	A Ltd. entered into a contract with B Ltd. to dispatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment, B Ltd. accordingly made the payment of ₹ 1,00,000 and A Ltd. started dispatching the goods. In third month, due to a natural calamity, B Ltd. requested A Ltd. not to dispatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for dispatch A Ltd. accounted ₹ 50,000 as sales and transferred the balance to Advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9. **(Nov 2013/May 2017)**

Sol.	**Provision: -** As per AS 9 “Revenue Recognition”, Revenue is recognized in case of sale of goods only When the following conditions are fulfilled: **i)** The seller of goods has transferred to the buyer the property in the goods for a price. **ii)** Significant risks and rewards of ownership on goods transferred to the buyer. and the seller retains no effective control of the goods transferred. **iii)** No significant uncertainty in ultimate collection at the time of sales. **Analysis and conclusion: -** 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. A Ltd. should recognize the entire sale of ₹ 1,00,000 (₹ 25,000 × 4) and no part of the same is to be treated as Advance Receipt against Sales.
6.	Arjun Ltd. Sold farm equipment to its dealers. One of the conditions at the time of sale is, payments of consideration in 14 days and in the event of delay interest chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.20X1, it wants to recognize interest due on the balance due from dealers. The amount is ascertained at ₹9 lakh. Decide whether the income by way of interest from dealers is eligible for recognition as per AS – 9. **[May 2006/November 2015]**
Sol.	**Provision: -** As per AS–9, “Revenue Recognition” revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as-: i) The sale of goods. ii) Rendering of services. iii) Use of the enterprises resources by others yielding interest, dividend and royalties. In other words, revenue is a charge made to customers/clients for goods supplied and services rendered. **Analysis and conclusion: -** In the given case, the amount of ₹ 9 lakh by way of interest is not revenue arising from sales of goods. It is not the amount i.e., charged from customers by sale of farm equipment. The amount of interest is charged from dealers on delay in payment of consideration in 14 days. So such amount is not income to be recognized as per AS – 9. such amount is to be disclosed as per AS -5.
7.	Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 20X0 issue of the magazine was sold in the month of February, 20X0. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 20X0 and ₹ 30,000 was received on 10th April, 20X0 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, 20X0. **(October 2021 MTP/November 2014)**
Sol.	**Provision: -** 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. In the case of advertising and insurance company, 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.

	Analysis and conclusion: - Old Era Publication publishes a popular monthly magazine on 15th of every month So 15.03.20X0, is the date of publication of the magazine or the advertisement appears for the public. **Accounting treatment for given situation:** Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 20X0. 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 31.03.20X0 and ₹ 2,70,000 will be treated as payment received against the sale.
8.	On 25th September, 20X1, Planet Advertising Limited obtained advertisement rights to World Cup Hockey Tournament to be held in Nov./Dec., 20X1 for ₹ 520 lakhs. They furnish the following information: 1) The company obtained the advertisements for 70% of available time for ₹ 700 lakhs by 30th September, 20X1. 2) for the balance time they got bookings in October, 20X1 for ₹ 240 lakhs. 3) All the advertisers paid the full amount at the time of booking the advertisements. 4) 40% of the advertisements appeared before the public in Nov. 20X1 and balance 60% appeared in the month of December, 20X1. You are required to calculate the amount of Profit/loss to be recognized for the month November andDecember, 20X1 as per Accounting Standard-9. **[Nov. 2010]**
Sol.	**Provision: -** As per AS 9," Revenue Recognition" Revenue from rendering of the service is to be recognized when the service should be performed and no significant uncertainty in ultimate collection at the time of recognition. Further standard provides revenue from advertising should be recognized when the service is completed when the related advertisements appear before the public. **Analysis and conclusion: -** In the given case 40% of the advertisements appeared before the public in November, and balance 60%in December. The amount of profit would be ₹ (700 + 240 – 520) = ₹ 420 lakhs to be recognized as follow:November ₹ 420 lakhs* 40% = ₹ 168 Lakhs December ₹ 420 lakhs * 60% = 252 lakhs
9.	According to Accounting Standard – 9, when revenue from sales should be recognized? **[May – 2010]**
Sol.	**As per AS 9 "Revenue Recognition"**, Revenue is recognized in case of sale of goods only When the following conditions are fulfilled: **i)** The seller of goods has transferred to the buyer the property in the goods for a price. **ii)** Significant risks and rewards of ownership on goods transferred to the buyer. and the seller retains no effective control of the goods transferred. **iii)** No significant uncertainty in ultimate collection at the time of sales.
10.	How will you recognize revenue in the following cases: **1)** Installation Fees; **2)** Advertising and insurance agency commissions; **3)** Subscriptions for publications. **(November 2021 RTP)**
Sol.	**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.
11.	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. **(ICAI SM)**
Sol.	**Provision: -** As per AS-9, “Revenue Recognition” revenue should be recognized in case of sale of goods when no significant uncertainty in ultimate collection at the time of sales. **Analysis and conclusion: -** In the given case the price revision was effected during the current accounting period 20X1-20X2. As a result, the company stands to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized in 20X1-20X2.
12.	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. **(ICAI SM)**
Sol.	**Provision: -** As per AS-9, “Revenue Recognition” states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognized. **Analysis and conclusion: -**In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹1,50,000 were collected against a claim of ₹2,00,000. So this transaction cannot be taken as a Prior Period Item. In the light of AS-5, it will not be treated as extraordinary item. However, AS-5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.
13.	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. **(ICAI SM)**
Sol.	**Provision: -** As per AS-9, “Revenue Recognition” In case of consignment sales revenue should be recognized only when the goods are sold by the agent to the third party. **Analysis and conclusion: -** In the given case XYZ supplied goods of ₹10,00,000 to ABC on consignment basis and out of only ₹ 5,50,000 goods are sold to the third party Therefore, XYZ can recognize revenue of ₹5,50,000 only.

14.	M/s. SEA Ltd. recognized ₹ 5.00 lakhs on accrual basis income from dividend during the year 20X0-X1, on shares of the face value of ₹ 25.0 lakhs held by it in Rock Ltd. as at 31st March, 20X1. Rock Ltd. proposed dividend @ 20% on 10th April, 20X1. However, dividend was declared on 30th June, 20X1. Please state with reference to relevant Accounting Standard, whether the treatment accorded by SEA Ltd. is in order. **(Nov 2011)**
Sol.	**Provision:** As per AS-9 "Revenue Recognition**",** dividends from investments in shares are not recognized in the statement of Profit and Loss until the right to receive dividends is established. **Analysis and Conclusion:** In the given situation the dividend is proposed on 10th April, 20X1, while it was declared on 30th June, 20X1. Hence, the right to receive dividend is established on 30th June, 20X1 only. Therefore, on applying the provisions stated in the standard, income from dividend on shares should be recognized by Sea Ltd. in the financial year 20X1-20X2 only. Therefore, the recognition of income from dividend of ₹ 5 lakhs, on accrual basis, in the financial year 20X0-X1 is not in accordance with AS-9.
15.	M/s. Moon Ltd. sold goods worth ₹ 6,50,000 to Mr. Star. Mr. Star asked for a trade discount amounting to ₹ 53,000 and same was agreed to by M/s. Moon Ltd. The sales was effected and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth ₹ 67,000 are defective. Mr. Star returned defective goods to M/s. Moon Ltd. and made payment due amounting to ₹ 5,30,000. The accountant of M/s. Moon Ltd. booked the sale for ₹ 5,30,000. Discuss the contention of the accountant with reference to Accounting Standard (AS) 9. **(May 2013)**
Sol.	**Provisions: -**As per AS-9, "Revenue Recognition" revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods. ✓ However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue. ✓ Revenue from sales should be recognized at the time of transfer of significant risks and rewards. ✓ If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched. **Analysis and Conclusion: -**In the given case, if trade discounts allowed by M/s. Moon Ltd. are given in the ordinary course of business, M/s. Moon Ltd. should record the sales at ₹ 5,97,000 (i.e. ₹ 6,50,000—₹ 53,000) and goods returned worth ₹ 67,000 are to be recorded in the form of sales return. ✓ However, when trade discount allowed by M/s. Moon Ltd. is not in the ordinary course of business, M/s. Moon Ltd. should record the sales at gross value of ₹ 6,50,000. Discount of ₹ 53,000 in price and return of goods worth ₹ 67,000 are to be adjusted by suitable provisions. ✓ M/s Moon Ltd. might have sent the credit note of ₹ 1,20,000 to Mr. Star to account for these adjustments. In both the cases, the contention of the accountant to book the sales for ₹ 5,30,000 is not correct.

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.X1	Raw material	1,00,000	80,000
20.1.X1	Pulp (WIP 1)	1,20,000	1,20,000
27.1.X1	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.X1	Fine Paper Rolls	1,80,000	3,50,000
20..2.X1	Ready for sale	1,80,000	3,50,000
15.3.X1	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.X1	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state are how much would be net profit for year ending 31-3-X1 on this product according to AS-9.

(Nov 2016)

Sol. **Provision: -** As per AS-9, "Revenue Recognition", Revenue is recognized in case of sale of goods only When the following conditions are fulfilled:

i) Significant risks and rewards of ownership on goods transferred to the buyer. and the seller retains no effective control of the goods transferred.

ii) No significant uncertainty in ultimate collection at the time of sales.

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.

Analysis and conclusion: - In the given situation, company has sold goods and raised' invoice on 15.3.X1 and goods are ready for delivery. In that case company is entitled to recognize sale for the year ended 31.3.20X1, provided delay in delivery is due to buyer's request.

Calculation of Net Profit is as under:

Sale price	₹ 3,50,000
Less: Cost	₹ (2,00,000)
Thus, Net profit	₹ 1,50,000

17. Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

1) Trade discount and volume rebate received.
2) Where goods are sold to distributors or others for resale.
3) Where seller concurrently agrees to repurchase the same goods at a later date.
4) Insurance agency commission for rendering services.
5) On 11-03-20X1 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request, clothes were delivered on 12-04-20X1. **(Nov 2019)**

Sol.

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 11.03.20X1, 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, 20X1 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.

Assignment
AS-10
Property, Plant and Equipment

Q. No.	Question and Solutions
1.	**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 remodeling 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 super market. 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)? **(May 2021 RTP/ ICAI SM/Nov. 2018/March 2021 MTP)**
Sol.	**a)** **Provision:** -As per AS-10, Any cost directly attributable to bringing the asset to the 'location and condition' necessary for it to be capable of operating in the manner intended by the management should be included in the carrying amount of an item of PPE. **Analysis and conclusion: -** Trozen Ltd. should capitalize the costs of construction and remodeling 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 remodeling expenditure. ✓ Therefore, this construction and remodeling 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)** **Provision:** -As per 10 the cost of an item of property, Plant and equipment shall be recognized as an asset if, and only if; **1)** It is probable that future economic benefits associated with the item will flow to the entity; and **2)** The cost of the item can be measured reliably. ✓Further, the standard provides that 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.

Analysis and conclusion: - 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 so the cost incurred should be capitalized of the said expenditure even though the company cannot restrict the access of others for using the assets individually. but the 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.

2. 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".

(ICAI SM/ April 2021 MTP/July 2021)

Sol. **Provision**-: As per AS-10 (REVISED) 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.

Analysis and conclusion-: The costs to be incurred by the Mohan Ltd. 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 (REVISED) and therefore, cannot be capitalized.

3. **ABC Ltd. is installing a new plant at its production facility. It has incurred these costs;**

Particulars	(₹)
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 capitalized in accordance with AS-10 (Revised).

(ICAI SM/ Nov. 2015 RTP/Nov.2017)

Sol.

Provision: - As per AS-10 (REVISED) Cost of an item of PPE includes purchase price, any directly attributable cost to bringing the asset to the 'location and condition' necessary for it to be capable of operating in the manner intended by the management. And decommissioning, restoration and other similar liabilities.

Analysis and conclusion: - These costs can be capitalized:

Particulars	(₹)
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 capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

4.

a) Entity A has a policy of not providing for depreciation of 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 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.

The following items are given to you;

Items;

1) Costs of testing whether the asset is functioning property, 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

1) Purchase Price of PPE.
2) Directly attributable cost of PPE or
3) Cost not included in determining the carrying amount of an item of PPE.

(ICAI SM/ May 2020 RTP)

Sol.

Provision- As per AS-10, The depreciable amount of an 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.

Analysis and conclusion- Entity A policy is not acceptable because depreciable amount is not allocated on a systematic basis over its useful life and full depreciation is provided in the year of disposal of an asset.

a) The entity has charged depreciation using the straight-line method at ₹10,000 per annum i.e. (1,00,000 /10 years).

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).

Note: 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.

b)

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 cost 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 purchases price of PPE.

5.

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. **(ICAI SM/ Nov. 2020 RTP)**

Sol.

Provision-: As per AS-10 (REVISED) Cost of an item of PPE includes purchase price, any directly attributable cost to bringing the asset to the 'location and condition' necessary for it to be capable of operating in the manner intended by the management. And decommissioning, restoration and other similar liabilities.

Analysis and conclusion-:

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 (45,000×3)	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

6.

Srishti 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 d 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 Srishti 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 Srishti Limited. Internally booked profits should be eliminated in arriving at the cost of machine. **(Nov. 2019 RTP/ Nov. 2013)**

Sol.

Provision-: As per AS-10 (REVISED) Cost of an item of PPE includes purchase price, purchase price includes import duties and non-refundable purchase taxes and deduction of trade discounts and rebates. Any directly attributable cost to bringing the asset to the 'location and condition' necessary for it to be capable of operating in the manner intended by the management. And decommissioning, restoration and other similar liabilities.

Analysis and conclusion-:

Calculation of Cost of Fixed Asset (i.e., Machinery);

Particulars		**(₹)**
✓ Purchase Price	– Given (₹ 158,34,000×100/112)	1,41,37,500
✓ ***Add:*** Site Preparation Cost	– Given	1,41,870
✓ Technician's Salary	– Specific/Attributable overheads for 3 months (See Note) (45,000×3)	1,35,000
✓ Initial Delivery Cost	– Transportation	55,770
✓ Professional Fees for Installation	– Architect Fees	30,000
✓ **Total Cost of Asset**		**1,45,00,140**

In the given case Srishti Ltd. Purchase a PPE at 1,58,34,000 on which IGST is paid but input tax credit can be availed so IGST is to be excluded from the purchase price so purchase price is 1,58,34,000*100/112=1,41,37,500.

7. During the current year 20X0 – X1 M/s L & C Ltd. made the following expenditure relating to its plant and machinery:

Particulars	**(₹)**
✓ General repairs	4,00,000
✓ Repairing of Electric Motors	1,00,000
✓ Partial Replacement of parts of Machinery	50,000
✓ Substantial improvements to the electrical wiring system Which will increase efficiency of the plant and machinery	10,00,000

What amount should be capitalized according to AS-10?

(May 2010/ Nov. 2014)

Sol. **<u>Provision</u>-:** As per AS-10 (REVISED)**-** The cost of an item of PPE shall be recognized as an asset if and only if

1. It is probable that <u>future economic benefits associated with the item will inflow to the firm</u>.
2. The <u>cost can be measured reliably</u>.

Analysis and Conclusion: -

Therefore, in the given case, repairs amounting ₹5 lakhs and partial replacement of parts of machinery worth ₹50,000 should be charged to statement of profit & loss. <u>₹ 10 lakhs incurred for substantial improvement to the electrical wiring system which will increase efficiency should be capitalized.</u>

8. A company acquired a machine on 01-04-20X0 for ₹5,00,000. The company charged straight line depreciation based on 10 year working life estimate and residual value ₹50,000 up to 20X2-X3. From 20X3-X4, the company decided to change to 20% reducing balance method (WDV method) of depreciation. Show adjustment required in the books of the company as per revised AS 10.

(May 2010/May 2012)

Sol. **<u>Provision</u>**-: As per AS 10 (REVISED), <u>change in depreciation method is treated as change in estimate</u> and it should be <u>accounted prospectively i</u>.e., the remaining WDV should be depreciated over the remaining useful life.

<u>Analysis and conclusion</u>-: Annual depreciation charged up to 20X2-X3 = (₹5,00,000 – ₹50,000)/10 = ₹45,000

WDV of machine at the end of 20X2-X3 ₹5,00,000 – (₹45,000 × 3) ₹3,65,000

Depreciation to be charged in 20X3-X4 in WDV method = ₹3,65,000* 20% = ₹73,000

9. 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.

(ICAI SM/November 2021 RTP)

Sol.

Case a)

Provision: - As per AS-10 (REVISED) Depreciable amount is the cost of an asset (or other amount substituted for cost i.e., revalued amount) – Residual value. The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Analysis and conclusion: - In the given case 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)

Provision: - As per AS-10 (REVISED) Depreciable amount is the cost of an asset (or other amount substituted for cost i.e., revalued amount) – Residual value. The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Analysis and conclusion: - In the given case the company considers that the residual value, based on prices prevailing at thebalance 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].

10.

In the books of Optic Fiber Ltd., plant and machinery stood at ₹6,32,000 on 01-04-20X0. However, on scrutiny it was found that machinery worth ₹1,20,000 was included in the purchases on 01-06-20X0. On 30-06-20X0 the company disposed a machine having book value of ₹1,89,000 on 01-04-20X0 at ₹1,75,000 in part exchange of a new machine costing ₹2,56,000. The company charges depreciation @ 20% WDV on plant and machinery.

You are required to calculate:

- **i)** Depreciation to be charged to Profit and Loss.
- **ii)** Book value of Plant and Machinery A/c as on 31-03-20X1
- **iii)** Loss on exchange of machinery.

(Nov. 2014)

Sol.

i) Depreciation to be charged in the Profit and Loss Account

	₹
Depreciation on old Machinery	31,600
[20% on ₹6,32,000 for 3 months (01.4.X0 to 30.6.X0)] Add: Depreciation machinery acquired on 01.06.20X0 (₹1,20,000×20%×10/12)	20,000
Depreciation on Machinery after adjustment of Exchange [20% of ₹(6,32,000 – 1,89,000 + 2,56,000) for 9 months]	1,04,850
Total Depreciation to be charged in Profit and Loss A/c	**1,56,450**

ii) Book Value of Plant and Machinery as on 31-03-20X1

	₹	₹
Balance as per books on 01-04-20X0		6,32,000
Add: Included in purchases on 01-06-20X0	1,20,000	
Add: Purchase on 30-06-20X0	2,56,000	3,76,000
		10,08,000
Less: Book value of Machine sold on 30-06-20X0		(1,89,000)
		8,19,000
Less: Depreciation on machinery in use (**1,56,450 – 9,450)**		(1,47,000)
Book Value as on 31-03-20X1		6,72,000

iii) Loss on exchange of Machinery

	₹
Book value of machinery as on 01-04-20X0	1,89,000
Less: Depreciation for 3 months	9,450
WDV as on 30-06-20X0	1,79,550
Less: Exchange value	1,75,000
Loss on Exchange of machinery	4,550

11. 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 remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodeling cost will be capitalized or not. **(ICAI SM)**

Sol. **Provision-:** As per AS-10 (REVISED)- The cost of an item of PPE should be recognized as an asset if, and only if:

a) Probable future economic benefits inflow to the entity.

b) The cost of an item can be measured reliably.

Analysis and conclusion: -

In the given case the expenditure in remodeling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodeling can be measured reliably, therefore, it should be capitalized.

12. 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 capitalized. Comment.

(ICAI SM)

Sol. **Provision-:** As per AS-10 (REVISED) Cost incurred while an item capable of operating in the manner intended by management has yet to be bought into use or is operated at less than full capacity, initial operating losses, such as those incurred while demand for the output of an item builds up are not included in the carrying amount of an item of PPE.

	Analysis and conclusion The net operating costs should not be capitalized, but should be recognized 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
13.	Carrying amount of a machine is ₹1,00,000. (Historical cost less depreciation.) The machine is expected to generate ₹25,000 net cash flow for 5 years. The net realizable value (or net selling price) of the machine on current date is ₹85,000. The enterprises required rate of earning is 10% p.a. State the value at which the enterprise should carry its machine. The present value factors at 10% are 0.909, 0.826, 0.751, 0.683 and 0.621 at the end of first, second, third, fourth and fifth year respectively. **(May 2011)**
Sol.	Value in use is the present value of estimated future cash flow expected to arise from the continuing use of an asset. Therefore, ✓ Value in use* = ₹ 25,000 × (0.909 + 0.826 + 0.751 + 0.683 + 0.621) ₹ 94,750 Net Selling price = ₹ 85,000 Recoverable amount is the higher of an asset's value in use and its net selling price i.e., 94,750. Carrying value of a machine = ₹1,00,000 (recorded in the books) ✓ Carrying amount is the amount at which an asset is recognized in the balance sheet after deduction any accumulated depreciation (amortization) and accumulated impairment losses thereon. In the given case, carrying amount of machine will be lower of its recoverable amount ₹94,750 and its book value i.e., ₹1,00,000. Therefore, the enterprise should carry its machine at value of ₹ 94,750.
14.	M/s. Tiger Ltd. allotted 7,500 equity shares of ₹100 each fully paid up to Lion Ltd. in consideration for supply of special machinery. The shares exchanged for machinery are quoted at National Stock Exchange (NSE) at ₹95 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, show how the value of the machinery would be recorded in the books of Tiger Ltd.? **(Nov. 2011)**
Sol.	**Provision**: -As per AS-10 (REVISED) If PPE is acquired in exchange of assets and transaction has commercial substance then PPE is recorded at fair value of the asset given or the face value of the asset acquired whichever is more clearly evident. **Analysis and conclusion**: - In the given case, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at ₹7,12,500 (i.e., 7,500 shares × ₹95 per share) being the market price of the shares issued in exchange.
15.	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)? **(ICAI SM)**
Sol.	**Provision**: -As per AS-10 (REVISED) If PPE is acquired in exchange of assets and transaction has commercial substance then PPE is recorded at fair value of the asset given or the face value of the asset acquired whichever is more clearly evident. **Analysis and conclusion**: -In the given case the transaction has commercial substance the plant and machinery would be recorded at ₹ 25,00,000, which is equivalent to the fair value of the land of ₹ 45,00,000 less the cash received of ₹20,00,000.

16. 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 y'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?

(ICAI SM)

Sol. **Provision: -** As per AS-10 (REVISED) If PPE is acquired in exchange of assets and transaction did not have commercial substance or have F.V then PPE is value at carrying amount of asset given up less settle up paid or received often referred as boot.

Analysis and conclusion: - In the given case the entity recognizes the assets received at the book value of car X. Therefore, it recognizes cash of ₹15,000 and car Y as PPE with a carrying value of ₹12,85,000.

17. **With reference to S-10 Revised, classify the items under the following heads;**

Heads;

1) Purchase Price of Property, Plant and Equipment (PPE)
2) Directly attributable cost of PPE or
3) 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 to 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.

(ICAI SM)

Sol. **Heads;**

1) Purchase Price of PPE
2) Directly attributable cost of PPE.
3) 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	–	**(1)**
2) Initial delivery and handling costs	–	**(2)**
3) Initial operating losses, such as those incurred while demand for the output of an item builds up	–	**(3)**
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.	–	**(3)**
5) Trade discounts and rebates (deducted for computing purchase price)	–	**(1)**
6) Costs of relocating or reorganizing part or all of the operations of an enterprise.	–	**(3)**
7) Installation and assembly costs	–	**(2)**
8) Administration and other general overhead costs	–	**(3)**

18.	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 building 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? **(ICAI SM)**
Sol.	**Provision: -** As per AS-10 (REVISED) An enterprise should choose either cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of PPE. A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise. **Analysis and conclusion: -** In the given case 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.
19.	Narmada Ltd. purchased an existing bottling unit from Kaveri Ltd. Kaveri Ltd. followed SLM of charging depreciation on machinery of the sold unit whereas Narmada Ltd. followed WDV method in its other units. The directors of Narmada Ltd. want to continue to charge deprecation for the acquired unit in SLM which is not consistent with the WDV method followed in other units. Discuss the contention of the directors with reference to the AS 10. Further during the year, Narmada Ltd. set up a new plant on coastal land. In view of the corrosive climate, the company felt that its machine life is reducing faster. Can the Company charge a higher rate of depreciation? **(May 2009 RTP)**
Sol.	**Provision: -** As per AS 10 (REVISED) there are several methods of allocating deprecation over the useful life of the assets. If there has been significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the change pattern. A combination of more than once method is sometimes used even for each part of significant assets if it is justified. **Analysis and conclusion:** - In the given case Narmada Ltd. can continue to charge depreciation for the acquired unit as per SLM because directors of Narmada Ltd. Wanted to charge depreciation for the acquired unit in SLM which is not consistent with the WDV method followed in other units. The enterprise should consider related statutes for computation of the depreciation. For example, the Companies Act lays down the useful lives of various assets. Where the management's estimate of the useful life of an asset of the enterprise is shorter than that envisages under the provisions of the relevant statute, the depreciation provision is appropriately computed by applying higher rate. Therefore, in the given case, the Company can charge higher rated of depreciation based on its estimate of the useful life of machinery, provided that such estimate is no less than the rate prescribed by the Companies Act, for that class of assets. However, such higher depreciation rates and/or the reduced lives of the assets should be disclosed by way of Notes to accounts in the Financial Statements.

20 **PQR Ltd. constructed a PPE and incurred the following expenses on its construction:**

Materials (including of GST ₹50,000, GST credit is available for 50% of the 16,00,000-duty paid)	
Direct Expenses	3,00,000
Total Labor charges (200 out of the total of 600 men hours worked, on 6,00,000 installation work)	
Spare parts and tools consumed in installation 60,000 Total salary of supervisor (time spent for installation was 25% of the total 24,000 time worked).	
Test run and experimental production expenses	23,000
Consultancy changes to architect for plant set up	9,000
Total Office & Administrative Expenses (4% is chargeable to the 9,00,000 construction)	
Depreciation on other assets used for the construction of this asset	15,000

The machine was ready for use on 15-01-20X0 but was used from 01-02-20X0. Due to this delay, further expenses of ₹19,000 were incurred. Calculate the value at which the plant should be capitalized.

(Nov. 2012)

Sol. **Provision-:** As per AS-10 (REVISED) Cost of an item of PPE includes purchase price, purchase price includes import duties and non-refundable purchase taxes and deduction of trade discounts and rebates. Any directly attributable cost to bringing the asset to the 'location and condition' necessary for it to be capable of operating in the manner intended by the management. And decommissioning, restoration and other similar liabilities.

Analysis and conclusion-:

Calculation of cost of PPEs	**₹**
Materials [16,00,000 – (50,000 * 50%)]	15,75,000
Direct Expenses	3,00,000
Labour changes (6,00,000/600*200)	2,00,000
Spare parts and tools consumed in installation	60,000
Supervisor salary (₹24,000*25%)	6,000
Test run and experimental production expenses	23,000
Consultancy charges	9,000
Office and administrative expenses (4% ₹9,00,000)	36,000
Depreciation on assets	15,000
Cost of PPE	**22,24,000**

Expenses of ₹19,000 from 15-01-20X0 to 01-02-20X0 to be charged to Profit and Loss as plant were ready for production on 15-01-20X0

21. Jadu Ltd. purchased certain Plant & Machinery for ₹40 lakh. 20% of cost, net of GST Credit the subsidy component to be realized from a State Government for establishing industry in a backward district. Cost of ₹40 lakh includes GST of ₹5 lakh against which GST credit can be claimed. Compute depreciable amount.

(Nov. 2017)

Sol. **Provision: -** As per AS-10 (REVISED) cost of an item of PPE includes purchase price, any directly attributable costs and decommissioning, restoration and similar liabilities. Purchase price includes import duties and non-refundable purchase taxes. And deduction of trade discounts and rebates.

Analysis and conclusion: -

Computation of Depreciable amount:

Particulars	**₹ in Lakhs**
Purchase Price	40
Less: Specified duty against which GST Credit is available	-5
Cost of Plant & Machinery	35
Less: Subsidy provided by state Government (35*20%)	-7
Depreciable amount	28

22. 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.

(ICAI SM)

Sol. **Provision: -** As per AS-10 (REVISED) a depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate.

Analysis and conclusion: - In the given case 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.

23. Entity A carried plant and machinery in its books at ₹2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost ₹20,00,000. The machines were acquired by the insurance company and the company did not receive ₹20,00,000 as cash compensation. State, how Entity A should accounted for the same.

(ICAI SM)

Sol. **Provision: -** As per AS-10 (REVISED) the cost of PPE may undergo changes subsequent to its acquisitions or construction on account of: changes in liabilities, price adjustments, changes in duties, changes in initial estimates of amounts for dismantling, removing restoration and similar factors.

Analysis and conclusion: - Entity A should account for a loss in the Statement of Profit and Loss on de- recognition of the carrying value of plant and machinery in accordance with AS 10 (Revised).

Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds under AS 29 (Revised)* once receipt is virtually certain. The receivable should be measured at the fair value of assets that will be provided by the insurer.

24. On 01.04.20X0 a machine was acquired at ₹4,00,000. The machine was expected to have a useful life of 10 years. The residual value was estimated at 10% of the original cost. At the end of the 3rd year, an attachment was made to the machine at a cost of ₹1,80,000 to enhance its capacity. The attachment was expected to have a useful life of 10 years and zero terminal value. During the same time the original machine was revalued upwards by ₹90,000 and remaining useful life was reassessed at 9 years and residual value was reassessed at NIL.

Find depreciation for the year, if

i) Attachment retains its separate identity

ii) Attachment becomes integral part of the machine.

(May 2014)

Sol.

i) <u>Provision:</u> - As per AS-10 (REVISED) Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if <u>expectations differ from previous estimates, the changes should be accounted for as a change in accounting estimate</u>. <u>Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.</u>

<u>Analysis and conclusion: -</u>

if attachment retains its Separate Identify

Cost of Machine on 1.4.20X0	=	4,00,000		
Less: Residual Value 10%	=	40,000		
Depreciation Value	=	3,60,000		
Estimated Useful life	=	10 years		
Depreciation p.a.	=	3,60,000 ÷ 10	=	₹36,000
Total Depreciation in 3 years	=	36,000 × 3	=	₹1,08,000
WDV for 4th year	=	4,00,000 – 1,08,000	=	2,92,000
Upward Revaluation of Original Machine = 90,000				
WDV for 4th year after revaluation	=	2,92,000 + 90,000	=	3,82,000
Remaining useful	=	9 years		
Depreciation in 4th year	=	3,82,000 ÷ 9	=	₹42,444
Depreciation on attachment	=	1,80,000 ÷ 10	=	₹18,000
Total Depreciation	=	42,444 + 18,000	=	₹60,444

Note:

1) Since, upward revaluation of the machine and reassessment of remaining useful life had been made at the end of the 3rd year, it is implied that depreciation for the 3rd year has been charged on the basis of old calculation & remaining useful life of 9 years is to be calculated from the beginning of the 4th year onwards.

2) Depreciation for the 4th year i.e. 20X3-X4 has been given in the solution.

<u>Provision:</u> - As per AS-10 (REVISED) Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if <u>expectations differ from previous estimates, the changes should be accounted for as a change in accounting estimate</u>.

<u>Analysis and conclusion:</u> - If attachment becomes integral part of Machine In this case it will be added to the value of machine and depreciated along with machine over the life of machine.

Value of Machine after Revaluation = 3,82,000
Add: Cost of Attachment = 1,80,000
Total Value = 5,62,000
Life = 9 years
Depreciation = 5,62,000 ÷ 9 = ₹62,444

25. In the Trial Balance of M/s Sun Ltd. as on 31-03-20X1, balance of machinery appears ₹5,60,000. The company follows rate of depreciation on machinery @ 10% p.a. On scrutiny it was found that a machine appearing in the books on 1-4-20X0 at ₹1,60,000 was disposed on 30-9-20X0 at ₹1,35,000 in part exchange of a new machine costing ₹1,50,000.

You are required to Calculate: -

1) Total depreciation to be charged in the Profit and Loss Account.
2) Loss on exchange of machine.
3) Book value of machinery in the Balance Sheet as on 31-3-20X1.

(Nov. 2011)

Sol. **Assumption: -** The question has been solved on the basis of written down value method due to absence of related information regarding straight line method.

1) Total Depreciation to be charged in the statement of Profit and Loss.

Particulars	(₹)
✓ Depreciation on old machinery in use [10% of (5,60,000 – 1,60,000)]	40,000
✓ ***Add:*** Depreciation on new machine @ 10% for six months $\left(1{,}50{,}000 \times 10\% \times \frac{6}{12}\right)$	7,500
✓ Total depreciation on machinery in use	47,500
✓ ***Add:*** Depreciation on machine disposed of (10% for 6 months) $\left(1{,}60{,}000 \times 10\% \times \frac{6}{12}\right)$	8,000
✓ So, total depreciation to be charged in statement of profit and loss	**55,500**

2) Loss on Exchange of Machine;

Particulars	(₹)
✓ Book value of machine as on 1.4.20X0	1,60,000
✓ ***Less:*** Depreciation for 6 months @ 10%	(8,000)
✓ Written Down Value as on 30.9.20X0	1,52,000
✓ ***Less:*** Exchange value	(1,35,000)
✓ Loss on exchange of machine	17,000

3) Book Value of Machinery in the Balance Sheet as on 31.03.20X1

Particulars	(₹)
✓ Balance as per trial balance	5,60,000
✓ ***Less:*** Book value of machine sold	(1,60,000)
	4,00,000
✓ ***Add:*** Purchase of new machine	1,50,000
	5,50,000
✓ ***Less:*** Depreciation on machinery in use	(47,500)
	5,02,500

26.	M/s Progressive Company Limited has not charged depreciation for the year ended on 31st March, 20X1, in respect of a spare bus purchase during the financial year 20X0-X1 and kept ready by the company for use as a stand-by, on the ground that, it was not actually used during the year. State your views with reference to Accounting Standard 10 “Property, Plant and Equipment”. Further during the year company made additions to its factory by using its own workforce, at a cost of ₹4,50,000 as wages and materials. The lowest estimate from an outside contractor to carry out the same work was ₹6,00,000. The directors contend that, since they are fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with ₹6,00,000. Comment whether the directors’ Contention is right in view of the provisions of Accounting Standard 10? **(May.2012)**
Sol.	**Provisions: -** As per AS-10 (REVISED), Depreciation is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. As per AS-10 (REVISED) The gross book value of the self-constructed fixed asset includes the costs of construction that relate directly to the specific asset and the costs that are attributable to the construction activity in general can be allocated to the specific asset. If any internal profit on any items used from its stores or abnormal loss of material should not be the part of self-constructed asset. **Analysis and Conclusion: -** ✓ The need for using the stand by bus may not have arisen during the year but that does not imply that the useful life of the bus has not been affected. Therefore, non-provision of depreciation on the ground that the bus was not used during the year is not tenable. ✓ Saving of ₹1,50,000 on account of using its own workforce is an unrealized/internal profit, which should not be capitalized/recorded as per the standard. Therefore only ₹4,50,000 should be debited to the factory building account and not ₹6,00,000. Hence, the contention of the directors of the company to capitalize ₹6,00,000. As cost of factory building, on the ground that the company is fully entitled to employ an outside contractor is not justifiable.
27.	Hema Ltd. purchased a machinery on 1.04.20X0 tor ₹15,00,000. The company charged straight line depreciation based on 15 years working life estimate and residual value ₹3,00,000. At the beginning of the 4th year, the company by way of systematic evaluation revalued the machinery upward by 20% of net book value as on date and also re-estimated the useful life as 7 years and scrap value as nil. The increase in net book value was credited directly to revaluation reserves. Depreciation (on SLM basis) later on was charged to Profit & Loss Account. At the beginning of 8 year the company decided to dispose off the machinery and estimated the realizable value to ₹2,00,000. You are required to ascertain the amount to be charged to Profit & Loss Account at the beginning of 8th year with reference to AS-10. **(November 2016)**

Sol.

Provision: - As per AS-10 (REVISED) Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the changes should be accounted for as a change in accounting estimate.

Analysis and conclusion: -

Calculation of Depreciation:

Cost of Machinery as on 1.4.20X0 = ₹15,00,000

Depreciation p.a. = ₹ $\frac{15,00,000-3,00,000}{15}$

= ₹80,000

∴ Depreciation for 3 years (1.4.20X0 to 31.3.20X3) = ₹80,000×3

= ₹2,40,000

∴ Net Book Value of Machinery as on 1.4.20X3:

Cost of Machinery (1.4.20X0)	₹ 15,00,000
Less: Depreciation for 3 years	₹ (2,40,000)
	₹ 12,60,000

Revised Net Book Value as on 1.4.20X3:

Book Value (Less: Depreciation)	₹ 12,60,000
Add: Increase in book value 20%	₹ 2,52,000
	₹ 15,12,000

Thus:

Increase in Revaluation to be taken to Revaluation Reserve

= ₹ 12,60,000 – ₹15,12,000 = **₹ 2,52,000**

Revised Depreciation (p.a.) = $\frac{₹\,15,12,000-Nil}{7}$ = ₹ 2,16,000

(Assumption: Useful life = 7 years)

∴ Depreciation for 4 years (1.04.20X3 to 31.03.20X7)

= ₹2,16,000 × 4 = ₹8,64,000

Thus:

Net Book Value of Machinery as on 1.4.20X7:

Revised Book Value as on 1.4.20X3=	₹ 15,12,000
Less: Depreciation for 4 years	₹ (8,64,000)
	₹ 6,48,000

Deemed Book Value of Machinery on 1.4.20X7

If Revaluation had not taken place	₹ 15,00,000
Less: Depreciation for first 3 years	₹ 2,40,000
	₹ 12,60,000
Less: Depreciation for next 4 years = $\frac{₹\,(12,60,000)-Nil}{7} \times 4 =$	₹ 7,20,000

	₹ 5,40,000
Loss on Disposal Book Value (1.4.20X7)	₹ 6,48,000
Less: Realizable Value on Disposal	₹ 2,00,000
	₹ 4,48,000
Deemed Book Value	₹ 5,40,000
Less: Realizable Value on Disposal	₹ 2,00,000
	₹ 3,40,000

Thus:

Loss to be debited (Adjusted in Revaluation Reserve)

= ₹ 4,48,000 – ₹ 3,40,000 = ₹ 1,08,000

Amount to be debited (Adjusted in Profit and Loss A/c)

= ₹ 4,48,000 – ₹ 1,08,000= ₹ 3,40,000

Balance in Revaluation Reserve transferred to general Reserve

= ₹ 2,52,000 – ₹ 1,08,000= ₹ 1,44,000.

28. A machinery with a useful life of 6 years was purchased on 1st April, 20X0 for ₹1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost.

In the beginning of fourth year the company reassessed the remaining useful life of machinery at 4 years and residual value was estimated at 5% of original cost.

The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year.

(Nov.2015)

Sol. <u>**Provision:**</u> -As per AS-10 (REVISED) <u>if the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets.</u> In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

<u>**Analysis and conclusion:**</u> -

As per the standard, when there is a revision of the estimated useful life of an asset, the unamortized depreciable amount should be charged over the revised remaining useful life. Accordingly revised depreciation shall be calculated prospectively. Thus, the treatment done by the accountant regarding recalculating the revised depreciation historically i.e. retrospectively is incorrect.

Calculation of Depreciation

Depreciation per year charged for first three years	=	₹ 1,35,000/6 = ₹ 22,500
WDV of the machine at the beginning of the fourth year	=	₹ 1,50,000 – (₹ 22,500×3)
	=	₹ 82,500
Depreciable amount after reassessment of residual vale	=	₹ 82,500 – 7,500
	=	₹ 75,000
Remaining useful life as per revised estimate	=	4 years
Depreciation from the fourth year onwards	=	₹ 75,000/4
		₹ 18,750

29. Versatile Limited purchased Machinery for ₹4,80,000 (inclusive of GST of ₹40,000). Input Tax credit is available for the GST paid. The Company incurred the following other expenses for installation.

Particulars	**₹**
Cost of preparation of site for installation	21,000
Total labour charges (200 out of the total 600-man hours worked, were spent for installation of the Machinery)	66,000
Spare parts and tools consumed in installation	6,000
Total salary of supervisor (time spent for installation was 25% of the total time worked)	24,000
Total administrative expenses (1/10 relates to the plant installation)	32,000
Test run and experimental production expenses	23,000
Consultancy charges to architect for plant set up	9,000
Depreciation on assets used for the installation	12000

The Machine was ready for use on 15th January but was used from 1st February. Due to this delay further costs ₹19,000 were incurred. Calculate the value at which the plant should be capitalized.

(May 2015)

Sol. **Provision:** - As per AS-10 (REVISED), Cost of an item of PPE includes purchase price, purchase price includes import duties and non-refundable purchase taxes and deduction of trade discounts and rebates. Any directly attributable cost to bringing the asset to the 'location and condition' necessary for it to be capable of operating in the manner intended by the management. And decommissioning, restoration and other similar liabilities. General administration and other overhead expenses usually excluded from the cost.

Analysis and conclusion: -

Cost of PPE (i.e. Machine) is calculated as under

Particulars	**₹**
Purchase Price (₹ 4,80,000 less GST for which Credit is available 40,000)	4,40,000
Add: Site Preparation Cost	21,000
Labour Charges ₹ 66,000 × $\frac{200}{600}$	22,000
Spares and Tools in Installation	6,000
Salary of Supervisor (24,000 × 25%)	6,000
Admin Expense attributable to Installation (Attributable Costs are included) 1/10th of 32,000	3,200
Test Run & Experimental Production (Indirect Element)	23,000
Consultancy Charges to Architect for Plant setup	9,000
Depreciation on Asset used for Installation	12,000
Expenses due to delay in use (Excluded as it is abnormal)	Nil
Total Capitalized Cost of Asset	**5,42,200**

30. A publishing Company undertook repair and overhauling of its Machinery at a cost of ₹250 lakh to maintain them in good condition & capitalized the amount as it is more than the earlier. The company performance this overhauling every three years. Comment.

Sol. **Provision:** - As per AS-10 (REVISED) the cost of an item of PPE should be recognized as an asset if, and only if:

1) Probable future economic benefits inflow to the entity.
2) Cost should be measured reliable.

	Analysis and conclusion: - In the given case subsequent expenditure should be capitalized as it increases the future economic benefits i.e. the additional expenditure satisfies the definition of asset expenditure on repairs and overhauling is not of general and it is significant in amount, as the economic benefits are available over a period of 3 years. Hence it the expenditure should be capitalized as a separate significant part and it should be amortized over a period of 3 years. If there is any carrying amount of earlier overhaul expense in balance sheet, the entity should transfer that balance to Profit and Loss and make it nil.
31.	Fire Ltd. purchase equipment for its power plant from U Ltd. during the year 20X0 -X1 at a cost of ₹100 lakh. Out of this they paid only 90% and Balance 10% was to be paid after 1 year on satisfactory performance of the equipment. During the financial year 20X1-X2, U Ltd. waived off the balance 10% amount. Fire Ltd. credited it to Profit and Loss discount received. Comment.
Sol.	**Provision:** - As per AS-10 (REVISED) Change in liability should be adjusted with the PPE and the remaining carrying amount should be depreciated over the remaining life of the asset prospectively. **Analysis and conclusion: -** In the given case the treatment made by Fire Ltd. is not correct so reduction in the amount of Liability should be reduced from the cost of the Asset

Assignment
AS 11
The Effects of Changes in Foreign Exchange Rates

<table>
<tr><th>Q. No.</th><th>Question and Answers</th></tr>
<tr><td>1.</td><td>M/s Power Track Ltd. purchased a plant for US $ 50,000 on 31st October, 20X1 payable after 6 months. The company entered into a forward contract for 6 months @ 64.25 per Dollar. On 31st October, 20X1 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, 20X2.
(Nov. 2019 RTP/May 2016/May 2020 RTP/November 2018/ICAI SM/May 2012 RTP/November 2021 RTP/November 2009/November 2014)</td></tr>
<tr><td>Sol.</td><td><u>Provision:</u> - As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates' An enterprise may enter into a forward exchange contract, which is not intended for trading or speculation purposes, then the <u>premium or discount arising at the inception of such forward contract should be amortised as expense or income over the life of the contract.</u>
<u>Exchange difference</u> on such a contract <u>should be recognised in the statement of profit and loss in the reporting period in which the exchange rate change</u>. Any <u>profit or loss arising on cancellation or renewal of such forward exchange contract</u> should be <u>recognised as income or expense</u> of the period.

<u>Analysis and conclusion:</u> - In the given case:
Calculation of profit or loss to be charged or recognised in the books of M/s Power Track Ltd.
<table>
<tr><th>Particulars</th><th>(₹)</th></tr>
<tr><td>Forward Contract Rate</td><td>64.25</td></tr>
<tr><td>(-) Spot rate</td><td>(61.50)</td></tr>
<tr><td>Loss</td><td>2.75</td></tr>
<tr><td>Forward Contract Amount</td><td>$ 50,000</td></tr>
<tr><td>Total loss on entering into forward contract ($ 50,000 × 2.75)</td><td>₹ 1,37,500</td></tr>
<tr><td>Contract Period</td><td>6 Months</td></tr>
<tr><td>Loss for the period 1st Nov. 20X1 to 31st March, 20X2</td><td>5 Months</td></tr>
<tr><td>i.e. 5 months falling in year 20X1-X2 (137500 × 5/6)</td><td>₹ 1,14,583.33</td></tr>
</table>
Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 20X1.</td></tr>
<tr><td>2.</td><td>Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.20X1.
Trade receivables include amount receivables 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.
(ICAI SM/ Nov. 2019 RTP /January 2021 (modified)/Nov. 2018/ March 2021(modified) MTP/November 2015)</td></tr>
</table>

Sol.

Provision: - 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.

According to the standard, the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, if they relate to acquisition of depreciable capital assets, can be added to or deducted from the cost of the assets and should be depreciated over the balance life of the assets, 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 assets or liability, by recognition as income or expense in each of such periods.

Analysis and conclusion: - In the given case the transactions are recognised as:

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 × (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 × (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 charged to Profit and Loss A/c so exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

3.

Particulars	**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.

(ICAI SM/Nov. 2008/Nov. 2020 RTP/May 2015 RTP/may 2010)

Sol.

Provision: - 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.

As per AS 11 at the balance sheet date all monetary transactions should be reported using the closing rate.

Further according to the standard, exchange difference arising on the settlement of the monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period should be recognised as income or as expenses in the period in which they arise.

	Analysis and conclusion: - In the given case the, goods purchased on 1.1.20X1 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e., $ 15,000 × ₹ 75) because all foreign currency transactions should be recorded by applying the exchange rate on the date of transaction. The, 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 because at the balance sheet date all monetary transactions should be reported using the closing rate. On 7.7.20X1 creditors of $ 15,000 is paid the rate of ₹73. 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 because exchange difference arising on the settlement of the monetary items should be recognised as income in the period in which they arise.
4.	**Classify the following items as monetary or non-monetary item;** ✓ Inventories ✓ Trade Receivables ✓ Investment in Equity shares ✓ Property, Plant and Equipment. ✓ Share Capital; ✓ Trade Payables; ✓ Cash balance; **(ICAI SM/May 2013/may 2020 RTP/November 2020 RTP/May 2021 RTP)**
Sol.	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. Non-monetary items are assets and liabilities other than monetary items. ✓ Inventories – Non-monetary ✓ Trade Receivables – Monetary ✓ Investment in equity shares – Non-monetary ✓ Property, Plant and Equipment – Non-monetary ✓ Share Capital – Non-Monetary ✓ Trade Payables – Monetary ✓ Cash balance – Monetary
5.	Explain "Monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognised at each Balance Sheet date? **(ICAI SM, May 2013, RTP)**
Sol.	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.
6.	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 You are required to pass necessary journal entries in the books of Kalim Ltd. **(ICAI SM/ May 2018 (modified))**

Sol. **Provision: -** As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates' the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, if they relate to acquisition of depreciable capital assets, can be added to or deducted from the cost of the assets and should be depreciated over the balance life of the assets, 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 assets or liability, by recognition as income or expense in each of such periods.

Analysis and conclusion: -

Journal Entries in the Books of Kalim Ltd.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
20X1 Jan.01	Bank A/c (4,50,000 × 48) Dr.		2,16,00,000	
	To Foreign Loan A/c			2,16,00,000
March 31	Foreign Exchange Difference A/c Dr.		4,50,000	
	To Foreign Loan A/c [4,50,000 × (49- 48)]			4,50,000
July 01	Foreign Exchange Difference A/c Dr. [4,50,000× (49.5-49)]		2,25,000	
	Foreign Loan A/c Dr.		220,50,000	
	To Bank A/;c			2,22,75,000

7. 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.

(ICAI SM/ May 2020 RTP)

Sol. **Provision: -** As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates' 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 reason, A rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period.

The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date,

Non-monetary items (for example, fixed assets, inventories, investments in equity shares.) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.

The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operations should be charged to profit and loss account.

Analysis and conclusion: - In the given case, 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.

8. 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.
✓ Property, Plant and Equipment (Purchased on 01.04.20X1)	5,000	
✓ Debtors	1,600	
✓ Opening Stock	400	
✓ Goods Received from Head Office Account (Recorded in HO books as ₹ 4,02,000)	6,100	
✓ Sales		20,000
✓ Purchases	10,000	
✓ Wages	1,000	
✓ Salaries	1,200	
✓ Cash	3,200	
✓ Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	2,900	
✓ Head Office Account (Recorded in HO books as ₹ 4,90,000)		7,400
✓ Creditors		4,000

- ✓ Closing Stock at branch is £ 700 on 31.03.20X4.
- ✓ Depreciation @ 10% p.a. is to be charged on Property, Plant and equipment.
- ✓ Prepare the trial balance after been converted in Indian Rupees.
- ✓ Exchange rates of Pounds on different dates are as follows;
  01-04.20X1-₹ 61; 01.04.20X3-₹ 63 & 31.3.20X4 - ₹ 67

(ICAI SM/Nov. 2019)

Sol. **Provision: -** As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates' 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 reason, A rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period.

The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date,

Non-monetary items (for example, fixed assets, inventories, investments in equity shares.) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.

The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operations 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'.

Analysis and conclusion: -

Trial Balance of the Foreign Branch Converted into Indian Rupees as on March 31, 20X4;

Particulars	Dr. (₹)	Cr. (₹)	Conversion Basis	Dr. (₹)	Cr. (₹)
Property, Plant and Equipment	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	

9. Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹47.10 when exchange rate was US$ 1 = ₹47.02.

On 31st December when he closed his books exchange rate was US$ 1 = ₹47.15. On 31st January, he decided to sell the contract at ₹47.18 per dollar. Show how the profits from contract will be recognised in the books.

(ICAI SM/Nov. 2013 RTP)

Sol. **Provision: -** As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates' 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.

Analysis and conclusion: - In the given case of Mr. A, the forward contract was for **speculation purpose** (AS FOREIGN EXCHANGE CONTRACT HAS BEEN ENTERED WITHOUT ANY LIABILITY TO PAY IN FOREIGN EXCHANGE) so 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 × 0.08)** – ₹ 8,000

10. 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.

(ICAI SM/Nov.2013)

Sol.	**Provision: -** 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 expenses. **Analysis and conclusion: -** In the given case of A Ltd. The following treatment has been: ✓ Calculating of Exchange Difference; ✓ Foreign currency loan = $\frac{₹\,3{,}000\text{ lakhs}}{₹\,40}$ = 75 lakhs US Dollars ✓ Exchange difference = 75 lakhs US Dollars × (42.50− 40.00) = ₹ 187.50 lakhs (including exchange loss on payment of first instalment) ✓ Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.
11.	Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11. **(ICAI SM)**
Sol.	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.
12.	With reference to AS 11, define the following: i) Integral Foreign Operation. ii) Non-integral Foreign Operation. iii) **(November. 2016)**
Sol.	**i) Integral Foreign Operation:** It 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 operation. **ii) Non-Integral Foreign Operation** It is a foreign operation that is not an integral foreign operation when there is a change between in the exchange rate between the reporting currency and the local currency. There is a little or no direct impact of the present and future cash flow from operations of either the non - integral foreign operation or the reporting enterprise the change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non-monetary items held by the non-integral foreign operation.
13.	Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 20X1, when the exchange rate was ₹44 per US Dollar. The transaction was recorded in the books at the above-mentioned rate. The payment for the transaction was made on 10" April, 20X1, when the exchange rate was ₹48 per US Dollar. At the year-end 31st March, 20X1, the rate of exchange was ₹49 per US Dollar. The Chief Accountant of company passed an entry on 31st March, 20X1 adjusting the cost of raw material consumed for the difference between ₹48 and ₹44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised). **(Nov. 2011)**

Sol.

Provision: - As per AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction, and at the balance sheet date all monetary transactions should be reported using the closing rate.

Further according to this exchange difference arising on the settlement of the monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period should be recognised as income or as expenses in the period in which they arise.

Analysis and Conclusion: -

Accordingly, on 25th February 20X1, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹44 = ₹3,96,000.

Further as on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 × ₹49=₹ 4,41,000) at 31st March, 20X1, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of ₹5 (49-44) per US dollar i.e. ₹45,000 (USD 9,000 × ₹5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 20X1 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss Account an exchange gains of ₹1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹49 and ₹48 per US dollar i.e. ₹ 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS-11.

14.

The following items appear in the Trial Balance of a Foreign Branch (IFO)-

a)	Head Office Account	e)	Closing Stock	i)	Equity Share Capital
b)	Salaries and Wages	f)	Purchases	j)	Loans and Borrowings
c)	Creditors	h)	Fixed Assets	k)	Sundry Debtors
d)	Opening Stock	h)	Sales	l)	Provision for Taxes

Give the exchange rates to be applied for translation into Rupee. How would you treat the exchange difference?

(May 2010 RTP)

Sol.

The above items will be translated at the following exchange rates-

Exchange Rate of Opening Date	Exchange Rate of Closing Date	Average Exchange Rate	Specific Exchange Rate
Opening Stock	Creditors	Salaries and Wages	Fixed Assets
	Closing Stock	Purchases	Equity Share Capital
	Loans and Barrowings	Sales	
	Sundry Debtors		
	Provision for Tax		

The Head Office A/c will be taken at the value appearing in the Branch A/c of the Indian Parent Company. The difference due to translation will be shown in P & L A/c of the current year as Exchange Difference. The foreign exchange gain should be credited to P&L a/c of the business

Assignment
AS-12
Government Grant

Q. No.	Questions and Answers
1.	How would you treat the following in the account in accordance with AS 12 government grants? a) ₹35 lakhs received from the local authority for providing medical facilities to the employees. b) ₹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 promoter's contribution. c) ₹10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment **(ICAI SM/Nov. 2020 RTP/May 2020 RTP/July 2021(modified)**
Sol.	**a)** **Provision-:** As per AS-12 "Accounting for Government Grant" grants related to revenue are either deducted from the related expense or credited in profit and loss statement either separately or under a general heading such as other income. **Analysis and conclusion: -** In the given case ₹35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in nature of revenue grant. So, this grant is 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 benefits expense. **b)** **Provision: -** As per AS-12 "Accounting for Government Grant" where the government grants are in the nature of promoter's 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 thereof. The grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. **Analysis and conclusion-:** 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 assets nor in relation to revenue. Thus, amount of ₹100 lakhs should be credited to capital reserve. **c)** **Provision-:** As per AS-12 "Accounting for Government Grant" provides option to treat the grant related to depreciable assets either as a deduction from the cost of the asset concerned in arriving at its book value. The grant is thus recognised in profit and loss statement over the useful life of a depreciable asset by way of reduced depreciation charge or 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. **Analysis and conclusion: -** In the given case ₹10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed 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.
2.	On 1.4.20X1 ABC ltd. Received government grant of ₹300 lakhs for acquisition of machinery costing ₹1,500 lakhs. The grants was credited to the cost of the assets. 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-fulfilment 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? **(ICAI SM/November 2020/May 2018)**

Sol.

<u>Provision</u>: -As per AS 12 “Accounting for Government Grants”, the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of government grant it is deducted from the cost of the asset then at the time of refund of grant <u>Increase in the book value of the asset and depreciation on revised book value charged prospectively over the residual useful life of assets.</u>

<u>Analysis and conclusion: -</u>

Date	Particulars	Amount
1st April 20X1	Acquisition cost of machinery (1,500-300)	1,200
31st march 20X2	Less: depreciation @20%	(240)
		960
31st march 20X3	Less: depreciation @20%	(192)
		768
31st march 20X4	Less: depreciation @20%	(153.60)
1st April 20X4	Book value	614.40
May 20X4	Add: refund of grant	300
	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 assets.

3.

Ram Ltd. purchased machinery for ₹40 lakhs (useful life 4 years and residual value ₹8 lakhs). Government grant received was ₹16 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,

a) if the grant had been credited to fixed asset A/c

b) if the grant had been credited to Deferred Grant A/c.

(April 2021 MTP/ICAI SM(modified)/May 2017 (modified)

Sol.

In the books of A ltd.

1) If the grant is credited to fixed assets account:

<u>Provision</u>: - As per AS-12 “Accounting for Government Grant” the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of government grant it is deducted from the cost of the asset then at the time of refund of grant <u>Increase in the book value of the asset and depreciation on revised book value charged prospectively over the residual useful life of assets.</u>

Journal entries (at the time of refund of grant)

Particulars	L.F	Debit	Credit
Fixed assets a/c Dr. To bank a/c (being grant refunded)		16,00,000	 16,00,000

The balance of fixed assets after two years depreciation will be ₹16 lakhs (WN.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 lakh p.a. will be charged for next two years.

2) If the grant is credited to deferred grant a/c:

Provision: - As per AS 12 “Accounting for government grants” the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of grant treated as deferred income then at the time of refund of grant it is adjusted against unamortized deferred income and balance from statement of profit and loss account.

Analysis and conclusion: - In the given case income from deferred grant a/c is allocated to profit and loss a/c usually over the periods and in the proportion in which depreciation on related assets is charged. Accordingly in the first two years (₹16 lakhs/4 years) = ₹4 lakhs p.a.*2 years = ₹8 lakhs were credited to profit and loss a/c and ₹8 lakhs was the balance of deferred grant a/c after t wo years.

Therefore, on refund in the 3rd year following entry will be passed:

Particulars	L.F.	Debit	Credit
Deferred grant a/c Dr.		8 lakhs	
Profit and loss a/c Dr.		8 lakhs	
To bank a/c			16 lakhs
(being government grant refunded)			

Deferred grant will become nil. The fixed assets will continue to be shown in the books at ₹24 lakhs (WN2) 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. = (24-8)/4 = ₹4 lakhs per year
Value of fixed assets after two years but before refund of grant = 24 lakhs – (4*2) = ₹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 – (8*2) = 24 lakhs

Note: it is assumed that the question requires the value of fixed assets is to be given after refund of government grant.

4. 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 crore from the government in February 20X1. 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?

(Nov. 2019 RTP/May 2015 [modified]/ICAI SM)

Sol. **Provision: -** As per AS 12 “accounting for government grants” where the government grants are in the nature of promoter’s 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 ordinary expected in respect thereof. The grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Analysis and conclusion: - The subsidy received by samrat ltd. for setting up its business in a designated backward area will be treated as grant by the govt. in the nature of promoters 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 is respected 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 statement in the given case. It should be recognised as capital reserve which can be neither distributed as dividend nor considered as deferred income.
5.	Hygiene Ltd. had received a grant of ₹50 lakh in 20X0 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 20X8. The Company debited the said amount to its machinery account in 20X8 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 20X8 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not. **(May 2021 RTP/May 1999 (modified))**
Sol.	**Provision:** - As per AS 12 "Accounting for Government Grant" the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of government grant if it is deducted from the cost of the asset then at the time of refund of grant Increase in the book value of the asset and depreciation on revised book value charged prospectively over the residual useful life of assets. **Analysis and conclusion: -** As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 20X0 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. The Standard further makes it clear that 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.
6.	Z ltd. Purchased a fixed assets 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. **(ICAI SM/May 2012 (modified)**

Sol. **Provision: -** As per AS 12 “Accounting for government grants” 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.

Journal in the books of Z ltd.

Year	Particulars	L.F.	Debit	Credit
1st	Fixed assets A/c To bank A/c (Being fixed assets purchased)	Dr.	50,00,000	 50,00,000
	Bank A/c To Deferred Government. grant A/c (Being grant received from the government)	Dr.	10,00,000	 10,00,000
	Depreciation A/c To fixed assets A/c (Being depreciation charged on SLM)	Dr.	9,00,000	 9,00,000
	Profit & loss A/c To depreciation A/c (Being depreciation transferred to Profit and loss account)	Dr.	9,00,000	 9,00,000
	Deferred Government grants A/c To profit and loss A/c (Being proportionate govt. grant taken to Profit and loss account)	Dr.	2,00,000	 2,00,000
2nd	Depreciation A/c To fixed assets A/c (Being depreciation charged on SLM)	Dr.	9,00,000	 9,00,000
	Profit and loss A/c To depreciation A/c (Being depreciation transferred to p/l a/c)	Dr.	9,00,000	 9,00,000
	Deferred Government grant A/c To profit and loss A/c (Being proportionate govt. grant taken to p/l a/c)	Dr.	2,00,000	 2,00,000

7. 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 crore 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.

(ICAI SM/May 2010)

Sol. **Provision: -** As per 12 “Accounting for Government grants” when government grant is received for a specific purpose, it should be utilised for the same.

Analysis and conclusion: - In the case of Santosh Ltd. the grant received for setting up a factory is not available for distribution of dividend. So the treatment done by Santosh Ltd. Is incorrect.

Provision: - As per AS-12 “Accounting for Government grant” when non-monetary assets received from government then asset is recorded at acquisition cost but when non-monetary assets received at free of cost then they are recorded at nominal value.

Analysis and conclusion; -In the given 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 done by Santosh Ltd. of the grant is incorrect as per AS 12.

8. A fixed assets is purchased for ₹20 lakhs. Government grant received towards it is ₹8 lakh. Residual value is ₹4 lakhs and useful life is 4 years. Assume depreciation on the basis of straight-line method. Assets is shown in the balance sheet net of grant. After 1 year grant becomes refundable to the extent of ₹5 lakh due to non-compliance with certain condition. Pass journal entries for first two years.

(ICAI SM/ May 2016)

Sol. **Provision: -** As per AS-12 "Accounting for Government grant" the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of government grant if it is deducted from the cost of the asset then at the time of refund of grant <u>Increase in the book value of the asset and depreciation on revised book value charged prospectively over the residual useful life of assets.</u>

Journal entries

Year	Particulars	L.F.	Debit	Credit
1st	Fixed assets a/c	Dr.	20	
	To bank a/c			20
	(Being fixed assets purchased)			
	Bank a/c	Dr.	8	
	To fixed assets a/c			8
	(Being grant received from the government reduced the cost of fixed assets)			
	Depreciation a/c (WN1)	Dr.	2	
	To fixed assets a/c			2
	(Being depreciation charged on SLM)			
	Profit and loss a/c	Dr.	2	
	To depreciation a/c			2
	(Being depreciation transferred to profit and loss a/c at the end of year 1st)			
2nd	Fixed assets a/c	Dr.	5	
	To bank a/c			5
	(Being government grant on assets partly refunded which increased the cost of fixed assets)			
	Depreciation a/c (WN1)	Dr.	3.67	
	To fixed assets a/c			3.67
	(Being depreciation charged on SLM on revised value of fixed assets prospectively)			
	Profit and loss a/c	Dr.	3.67	
	To depreciation a/c			3.67
	(Being depreciation transferred to profit and loss a/c at the end of year 2)			

<u>**Working notes**</u>:

1) **Depreciation for year 1**

Particulars	Amount
Cost of the assets	20
Less: government grant received	(8)
	12
Depreciation (12-4)/4	2

2) Depreciation for year 2

Particulars	Amount
Cost of the assets	20
Less: government grant received	(8)
	12
Less: depreciation for the first year	(2)
	10
Add: government grant refundable	5
	15
Depreciation for the second year (15-4)/3	3.67

9. X ltd. Received a revenue grant of ₹10 crores during 20X1-X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed the condition for utilisation.

However, during the year 20X3-X4, it was found that the prescribed conditions were not fulfilled and the grant should be refunded to the government.

State how this matter will have to be dealt with in the financial statement of X ltd. For the year ended 20X3-X4.

(Nov. 2009/May 2011)

Sol. **Provision: -** As per AS 12 "Accounting for Government grants" that become refundable should be treated as an extra-ordinary item as per accounting standard 5 "net profit or loss for the period, prior period items and changes in accounting policies". 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 exits, the amount is charged immediately to profit and loss statement.

Analysis and conclusion: - In the Case of X ltd. refund of grant of ₹10 crore should be shown in the profit and loss account of the company as an extra-ordinary item during the financial year 20X3-X4.

10. Z ltd. Purchased a fixed assets 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 lakh (this amount was reduced from the cost of fixed assets). 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.

(ICAI SM)

Sol. **Provision: -** As per AS-12 "Accounting for Government grant" the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of government grant if it is deducted from the cost of the asset then at the time of refund of grant Increase in the book value of the asset and depreciation on revised book value charged prospectively over the residual useful life of assets.

Journal Entry

Particulars	L.F.	Debit	Credit
Fixed assets a/c To bank a/c (Being government grant on assets refunded)	Dr.	7,00,000	7,00,000

11. 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 employee. 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 provision of AS 12. **(ICAI SM)**

Sol.	**Provision:** - As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5. The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. **Analysis and conclusion:** - 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.
12.	ABC ltd. Received two acres of land received for set up of plant. It also received ₹2lakhs 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? **(May 21 RTP)**
Sol.	**Provision:** - As per AS -12 "Accounting for Government grant" when non-monetary assets received from government then asset is recorded at acquisition cost but when non-monetary assets received at free of cost then they are recorded at nominal value. The standard provides option to treat the grant related to depreciable assets either as a deduction from the cost of the asset concerned in arriving at its book value. The grant is thus recognised in profit and loss statement over the useful life of a depreciable asset by way of reduced depreciation charge or 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. **Analysis and conclusion:** - In the case 1 of ABC Ltd. Received the land at free of cost so land should be recognised at nominal value in the balance sheet of ABC Ltd. In the case 2 of ABC ltd. Received a grant of ₹2 lakh to purchase a machinery under method 1 Accordingly the grant of ₹2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the book at ₹10 lakhs – ₹2 lakhs = ₹8 lakhs and depreciation will be charged on it as follows: ₹8 lakh/₹5 lakhs = ₹1.60 lakhs per years. Under method 2 accordingly grant of ₹2 lakh received treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of assets. Such allocations to income is usually made over the periods and in the proportionate 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 assets. In this case, ₹40,000 (2 lakhs/5 years) should be credited to profit and loss each year over the periods of 5 years.
13.	Darshan ltd. purchased a machinery on 1st April 20X1 for ₹130 lakhs (useful life is 4 years). Government grant received is ₹40 lakhs for the purchase of above machinery. Salvage value at the end of useful life is estimated at ₹60 lakhs. Darshan ltd. decides to treat the grant as deferred income. You are required to calculate the amount of depreciation and grant to be recognised in profit and loss account for the year ending 31st march 20X2, 31st March 20X3, 31st march 20X4 and 31st march 20X5. Darshan ltd. follows straight line method for charging depreciation. **(January 2021)**

Sol.

Provision: - As per AS-12 “Accounting for Government grant” related to depreciable assets, if treated as deferred income are recognised in the profit and loss statement on a systematic and rational basis over the useful life of the assets.

Analysis and conclusion: - In the given case of Darshan ltd. Amount of depreciation and grant to be recognised in the profit and loss account each year.
Depreciation per year:

Particulars	**Amount**
Cost of the assets	130
Less: salvage value	(60)
	70
Depreciation per year (70/4)	17.50

₹17.50 lakhs depreciation will be recognised for the year ending 31 march 20X2, 31st March 20X3, 31st march 20X4 and 31st march 20X5

Amount of grant recognised in profit and loss account each year:
40 lakhs/4 years = ₹10 lakhs for the year ending 31st march 20X2, 31st march 20X3, 31st march 20X4 and 31st march 20X5.

14.

State whether the following statements are true and false. Also give reason for your answer:
As per AS 12, government grants in the nature of promoter’s contribution which becomes refundable should be reduced from the capital reserve.

(May 2019)

Sol.

True
Reason: When grants are in the nature of promoter’s contribution becomes refundable in part or in full to the government on non- fulfilment of some specified conditions. The relevant amount refundable to the government is reduced from the capital reserve.

15.

Viva ltd. received a specific grant of ₹30 lakhs for acquiring the plant of ₹150 lakhs during 20X1-X2 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 20X4-X5, due to non-compliance of condition 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 ₹21lakhs and written down value of plant was ₹105 lakhs. What should be treatment of the refund of the grant and the effect on cost of the fixed assets and the amount of depreciation to be charged during the year 20X4-X5 in Profit and loss a/c?

(March 2021 MTP)

Sol.

Provision: - As per AS-12 “Accounting for Government grants” the amount refundable in respect of a grant related to specific fixed assets 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.

Analysis and conclusion: - In this case the grant refunded is ₹30 lakhs and balance in deferred income ₹21 lakhs, ₹9 lakhs shall be charged to the profit and loss account for the year 20X4-X5. There will be no effect on the cost of the fixed assets and depreciation charged will be on the same basis as charged in the earlier years.

16.

How Government grant relating to specific fixed asset is treated in the books as per AS-12?

(May 2007)

Sol.	As per AS-12 'Accounting for Government Grants'**,** Government grant relating to specific fixed asset is treated as follows; **1)** Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as deduction from the cost of the fixed assets concerned in arriving at their book value. **2)** When the grant related to a specific fixed asset equal to the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. **3)** Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., Such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. **4)** Grant 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. **5)** But, when 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 certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations to charge to income. **6)** Any differed income is suitably disclosed in the balance sheet pending its apportionment to profit & Loss account.
17.	How would you record a non- monetary grant received from the government as per AS 12? **(May 2008)**
Sol.	**Provision: -** As per AS 12 "Accounting for Government grant" when non-monetary assets received from government then asset is recorded at acquisition cost but when non-monetary assets received at free of cost then they are recorded at nominal value.
18.	Explain the treatment of Refund of Government Grants as per Accounting Standard-12. **Or** Explain in brief the treatment of Refund of Government Grants in line with AS 12 in the following three situations: **1)** When Government Grant is related to revenue. **2)** When Government Grant is related to specific fixed assets. **3)** When Government Grant is in the nature of Promoter's Contribution. **(2014 May)**
Sol.	**Provision-:** As per AS 12, "Accounting for Government Grants"**,** treatment of government grants in following situations. **1) When government grant is related to revenue;** **a) When deferred credit account has a balance;** The amount of government grant refundable will be adjusted against unamortized deferred credit balance remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, the amount is immediately charged to profit and loss account. **b) Where no deferred credit account balance exists;** The amount of Government grant refundable will be charged to profit and loss account. **2) When government grant is related to specific fixed assets;** **a) Where at the time of receipt the amount of Government grant reduced the cost of asset;** The amount of Government grant refundable will increase the book value of the asset and depreciation is charged on revised book value prospectively. **b) Where at the time of receipt the amount of government grant was credited to "Deferred income":** The amount of Government grant refundable will reduce the unamortized balance of deferred income account and balance from statement of profit and loss.

c) **Where at the time of receipt the amount of government grant was credited to capital reserve-**: The amount of government grants refundable will adjusted from capital reserve and balance from statement of profit and loss.

3) When Government grant is in the nature of Promoter's Contribution;
The amount of government grant refundable in part or in full on non-fulfilment of specific conditions, the relevant amount recoverable by the Government will be reduced from Capital reserve.

A Government grant that becomes refundable is treated as an extra-ordinary item.

19. D Ltd. acquired a machine on 01-04-20X1 for ₹20,00,000. The useful life is 5 years. The company had applied on 01-04-20X1, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 20X4. The Company's Fixed Assets Account for the financial year 20X4-X5 shows a credit balance as under:

Particulars	**₹**
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 20X1-X2- to 20X3-X4 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 20X4-X5? **(November 2021 RTP)**

Sol. **1) Provision-:** As per AS 12 "Accounting for Government grant" Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as deduction from the cost of the fixed assets concerned in arriving at their book value.

Analysis and conclusion: - In the given case 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 20X4-X5 or 20X5-X6 as the depreciable amount is now Nil.

20. A specified government grant ₹15 lakhs received by USB Ltd. for acquiring the Hi-Tech Dairy plant of ₹95 lakhs during the year 20X1-X2. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 20X4-X5, 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 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 20X4-X5 in profit and loss account?
- **ii)** What should be the treatment of the refund, if grant was deducted from that cost of the plant during 20X1-X2 assuming plant account showed the balance of ₹56 lakhs as on 1.4.20X4?

You are required to explain in the line with provision of AS 12.

(May 2010 RTP)

Sol.	**i) Provision-:** 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. **Analysis and conclusion: -** 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 20X4-X5. 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) Provision: -** As per AS-12 "Accounting for Government grant" the amount refundable in respect of a grant related to a specific fixed assets when at the time of receipt of government grant if it is deducted from the cost of the asset then at the time of refund of grant Increase in the book value of the asset and depreciation on revised book value charged prospectively over the residual useful life of assets. **Analysis and conclusion: -** In the given case the book value of the plant shall be increased by ₹15 lakhs. The increased cost of ₹15 lakhs of the plant should be amortised over 7 years (residual life). Depreciation charged during the year 20X4-X5 shall be (56+15)/7 years = ₹10.14 lakhs presuming the depreciation is charged on SLM.
21.	The Company purchased on 1st April, 20X1 special purpose machinery for ₹25 lakhs. It received a central Government subsidy for 20% of the price. Effective life of the machinery is ₹10 years. Advise on the accounting treatment. **(May 2012 RTP)**
Sol.	**Provision-:** As per AS-12 "Accounting for Government grant", Grants Related to specific Depreciable Fixed Assets either Deduct the amount of grant from the cost of the asset and Depreciate the Asset on net value. Or it is treated as deferred income which be shown in Profit and loss account over the useful life of the asset. **Analysis and conclusion: -** In the given case ₹5 lakhs grant should be deducted from the cost of the assets, alternatively it could be treated as deferred income and recognized in the P & L account on a systematic and rational basis over the useful life of the assets (10 years in this case), such grants should be allocated to income over the periods and in the proportion in which depreciation on those assets is charged.
22.	X Limited received a grant of ₹2 crores from the Central Government for the purpose of special Machinery during 20X1 – X2; The cost of Machinery was ₹20 crores and had a useful life of 9 years. During 20X4 – X5, the grant has become refundable due to non – fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. State with reasons, the accounting treatment to be followed in the year. **(November 2011 RTP)**

Sol.

Provision-: As per AS 12 “Accounting for Government Grants” 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. Depreciation on the revised book value is provided prospectively over the residual useful life of the assets.

Analysis and conclusion: - In the given case, book value of machinery will be increased by ₹2 crores in the year 20X5-20X6. The computations for the depreciation on machinery can be given as:

Cost of Machinery	₹20Crores
Less: Grant received	₹2 Crores
Cost of machinery	₹18Crores
Useful life of machinery	9Years
Depreciation per year as per straight line method	₹18 crores/9
(Assuming residual value to be zero)	= ₹2 Crores
Total depreciation for 4 years (20X1 – X2 to 20X4–20X5)	₹8 Crores
Book value (in year 20X5-X6)	₹10crores
Add: Grant refunded	₹2crores
Revised book value	₹12 crores
Remaining use full life	5 years
Revised annual depreciation	₹12crores/5 = 2.4 crores

Thus, book value of machinery will be ₹12 crores in the year 20X5 –20X6 and the depreciation amounting ₹2.4 crores will be charged on machinery. Annual depreciation of ₹2.4 Crores will be charged in the next five years.

AS-13
Accounting for Investments

Q. No.	Questions and Answers
1.	On 15th June, 20X1, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decide and state the amount of transfer, based on the following information; **1)** A portion of long-term investments purchased on 1st March, 20X0 are to be re-classified as current investments. The original cost of these investments was ₹ 14 lakhs but had been written down by ₹ 2 lakhs (to recognise 'other than temporary' decline in value.) The market value of these investments on 15th June, 20X1 was ₹ 11 lakhs. **2)** Another portion of long-term investments purchased on 15th January, 20X0 are to be re-classified as current investments. The original cost of these investments was ₹ 7 lakhs but had been written down to ₹ 5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 20X1 was ₹ 4.5 lakhs. **3)** A portion of current investments purchased on 15th March, 20X1 for ₹ 7 lakhs are to be re-classified as long-term investments, as the company has decided to retain them. The market value of these investments on 31st March, 20X1 was ₹ 6 lakhs and fair value on 15th June 20X1 was ₹ 8.5 lakhs. **4)** Another portion of current investments purchased on 7th December, 20X0 for ₹ 4 lakhs are to be re-classified as long-term investments. The market value of these investments was; ✓ On 31st March, 20X1 ₹ 3.5 lakhs ✓ On 15th June, 20X1 ₹ 3.8 lakhs **(May 2020 RTP/January 2021(modified)/May 2019/November 2014 (modified)/ICAI SM)**
Ans.	**Provision: -** As per AS 13 (Revised) "accounting for investment" where long term investments are reclassified as current investments, transfer are made at the lower of cost and carrying amount at the date of transfer, and where investments are reclassified from current to long term investments, transfer are made at lower of cost and fair value at the date of transfer. **Analysis and conclusion: -** In the given case of Y Ltd. The re-classification will be done on the following basis: **1)** In the first case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 12 lakhs in the books. **2)** In the second case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 5 lakhs in the books. **3)** In the third case, reclassification of current investment into long-term investments will be made at ₹ 7 lakhs as cost is less than its fair value of ₹ 8.5 lakhs on the date of transfer. **4)** In the fourth case, market value (considered as fair value) is ₹ 3.8 lakhs on the date of transfer which is lower than the cost of ₹ 4 lakhs. The reclassification of current investment into long-term investments will be made at ₹ 3.8 lakhs.
2.	A limited invested in the shares of XYZ ltd. On 1st December 20X1 at a cost of ₹50,000. Out of these shares ₹25,000 shares were purchased with an intention to hold for 6 months and ₹25,000 shares were purchased with an intention to hold as long-term investment. A ltd. Also earlier purchased gold of ₹1,00,000 and silver of ₹30,00,000 on 1st april 20X1. Market value as on 31st march 20X2 of above investment are as follows: Shares ₹47,500 (decline in the value of shares is temporary) Gold ₹1,80,000 Silver ₹30,55,000 How above investments will be shown in the books of accounts of M/s A ltd. For the year ending 31st march 20X2 as per the provision of AS 13(revised)? **(November 2020/May 2016(modified)/May 2012 (modified)/ICAI SM)**

Ans.	**Provision: -** As per AS 13 (revised) "accounting for investment, for investment in shares- if the investment is purchased with an intention to hold for short term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value. Long-term investments are usually carried at cost but if, there is a decline, other than temporary, in the carrying amounts of long term valued investments the resultant reduction in carrying amount is charged to the profit and loss statement. **Analysis and conclusion: -** In the given case ₹25,000 shares held as current investment will be carried in the books at ₹23,750 (₹47,500/2) because current investments are carried at lower of cost and the fair value. And balance of equity shares are acquired with an intention to hold for long term period (more than one year) then should be considered as long term investment to be shown at cost in the balance sheet of the company. But, there is a decline, other than temporary, in the carrying amounts of long term valued investments hence ₹25,000 shares held as long term investment will be carried in the books at ₹25,000. Gold and silver are generally purchased with an intention to hold them for long term period (more than one year) until and unless given otherwise. Hence the investment in gold and silver (purchased on 1st march 20X1) should continue to be shown at cost (since there is no other than temporary decline) as on 31st march 20X2. Thus, gold at ₹1,00,000 and silver at ₹ 30,00,000 respectively will be shown in the books.
3.	Paridhi electronics ltd. Invested in the share of Dhansukh ltd. On 1st may 20X1 at a cost of ₹10,00,000. Three fourth of these investments were current investments and the remaining investment were intended to be held for more than a year. The published accounts of Dhansukh ltd. Received in January 20X2 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi electronics ltd. May not fetch more than 7,50,000. The reduction in value is apparent to be non-temporary. You are required to explain how you will the above in the financial statements of the Paridhi electronics ltd. As on 31-3-X1 with reference to AS 13. **(May 2021 RTP/November 2016/ICAI SM/November 2020 RTP)**
Ans.	**Provision: -** As per AS 13 (Revised) "accounting for investments" carrying amount for current investment is the lower of cost and fair value. In respect of current investment for which an active market exits market value generally provides the best evidence of fair value. Long-term investments are usually carried at cost but if, there is a decline, other than temporary, in the carrying amounts of long term valued investments the resultant reduction in carrying amount is charged to the profit and loss statement. such reduction being determined and made for each investment individually. The standard also states that indicators of the value of investments are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. **Analysis and conclusion: -** In the given case Paridhi ltd. Made three fourth of ₹10,00,000 i.e. ₹7,50,000 as current investments and remaining ₹2,50,000 as long term. The facts of the case given in the question clearly suggest that if, there is a decline, other than temporary, in the carrying amounts of long term valued investments Therefore, reduce the carrying amount of shares for both categories of share to bring them to market value. Hence the carrying value of investment will be shown at amount of ₹7,50,000 in the financial statement for the year ended 31st march 20X2 and charge the difference of loss of ₹2,50,000 to profit and loss account.
4.	Z bank has classified its total investment on 31-3-20X1 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI guidelines. Held to maturity investments are carried at acquisition cost less amortized amount "available for sale" investments are carried at market to market. Held for trading investments are valued at weekly intervals at market rates. Net depreciations if any is charged to revenue and net appreciation if any is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13? **(November 2019 RTP/ November 2021 RTP)**

Ans.	As per AS 13 (Revised) "accounting for investment" the accounting standard is not applicable to bank, insurance company, mutual funds. In this case Z bank is a bank therefore AS 13 does not apply to it. For banks the RBI has issued separate guidelines for classification and valuation of its. Investment and Z bank should comply with those RBI guidelines/norms. therefore, through Z bank has not followed the provision of AS 13 yet it would not be said s non-compliance since its complying with the norms stipulated by the RBI.
5.	Mention two categories of investment defined by AS 13 and also state their valuation principle**.** **(November 2008)**
Ans.	As per AS 13 "accounting for investment" there are two categories of investments viz. current investment and long-term investments. According to the standard the carrying amount for current investment is the lower of cost and fair value. Long-term investments are usually carried at cost but if, there is a decline, other than temporary, in the carrying amounts of long term valued investments the resultant reduction in carrying amount is charged to the profit and loss statement. Such reduction being determined and made for each investment individually. For current investment account to this standard any reduction to fair value and any reversals of such reduction are included in the profit and loss statement.
6.	An unquoted long-term investment is carried in the books at a cost of ₹2 lakh. The published accounts of the unlisted company received in may 20X1 showed that the company was incurring cash losses with declining market share and the long-term investment may not fetch more than ₹20,000. How will you deal with this in preparing the financial statement of R ltd. For the year ended 31st march 20X1? **(ICAI SM)**
Ans.	**Provision: -** As per AS-13 (Revised) "accounting for investments" Long-term investments are usually carried at cost but if, there is a decline, other than temporary, in the carrying amounts of long term valued investments the resultant reduction in carrying amount is charged to the profit and loss statement. **Analysis and conclusion: -** On the basis of these facts of the given case clearly suggest that there is a decline, other than temporary, in the carrying amounts of long term valued investments so reduce the carrying amount of long-term investment to ₹20,000 in the financial statements for the year ended 31st march 20X1.
7.	Briefly explain disclosure requirements for investment as per AS 13**.** **(ICAI SM)**
Ans.	The disclosure requirements as per AS 13 (revised) are as follows: 1) Accounting policies followed for valuation of investment. 2) Classification of investment into current and long term. 3) The amount includes in profit and loss statement for- a) Interest, dividend and rentals for long term and current investment disclosing therein gross income and tax deducted at source thereon, b) Profits and loss on disposal of current investment and changes in carrying amount of such investment. c) Profits and loss on disposal of long-term investment and changes in carrying amount of such investment. 4) Aggregate amount of quoted and unquoted investment giving the aggregate market value of quoted investment. 5) Any significant restriction on investment like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India. 6) Other disclosure required by the relevant statute governing the enterprise.
8.	A Government company, on the direction of the Central Government, had made investment in the shares of certain other companies from long term purpose, During the year, some of these investments were sold at profit of ₹4 crores and the same was treated as revenue profit for the year. The value of remaining investments on the balance sheet date had fallen by ₹6.30 crores for which no provision had been made in the accounts**.** **(May 2015 RTP)**

Ans.	**Provision: -** As per AS-13(Revised)"accounting for investments" Long term Investments are valued at cost**.** If there is a decline in value of investment, but such decline is not temporary then carrying amount of investment is reduced by the amount of such decline. **Analysis and conclusion: -** In the given case The Government company should show the long term Investments at cost if decline in the value of Investments is temporary. If the decline in the value of investments is not temporary then Provision should be made for ₹6.3 crores, if there is permanent decline in value of investment.
9.	Srikrishna Ltd. purchased 10,000 shares of Gopal Ltd. and issued its 5000 shares. Nominal value of shares of both Srikrishna Ltd. and Gopal Ltd. is ₹10. The fair values of shares of Srikrishna Ltd. and Gopal Ltd. are ₹11.50 and ₹12 respectively. Calculate the cost of acquisition of investment. **(May 2002)**
Ans.	**Provision: -** As per AS-13(Revised) "accounting for investments", if shares or other securities are issued to acquire investment then Purchase price of investment is the fair value of the securities issued **Analysis and conclusion: -** As Sri Krishna Ltd has issued its own 5,000 shares and fair value of one share is ₹11.50 so Investments should be valued at ₹ 57,500
10.	Venkat Ltd. acquired 10,000 shares of ₹10 each of Gopal Ltd. @ ₹12 per share in 20X1. In 20X1, Venkat Ltd acquired another 5000 shares of ₹10 each of Gopal Ltd. @ ₹21 each on right basis on 1:2. Calculate the cost of acquisition of 15,000 shares; if the right shares were not subscribed but were sold in the market at the rate of ₹15 each, then calculate the cost of acquisition of shares and give the treatment of proceeds received against sale of right. **(Past exam Question)**
Ans.	**Provision: -** As per AS-13(Revised) "accounting for investments", Cost of investment comprises of purchase price and acquisition charges such as brokerage, fees and duties, etc. **Analysis and conclusion: -** ✓ If Rights shares are purchased then cost of Investments is: ✓ 10,000×12+5,000×21=2,25,000 ✓ If Rights options of 5,000 shares are sold then value of Investments is: 10,000×12=1,20,000 and 5,000×15=₹75,000 will be credited to P/L A/c.
11.	A company has invested a substantial amount in the shares of another company under the same management. The market price of the shares of the aforesaid company is about half of that at which these shares were acquired by the company. The management is not prepared to provide for the fall in the value of shares on the ground that the loss is only notional till the time the shares are actually sold? **(Past exam Question)**
Ans.	**Provision: -** As per AS – 13 (Revised) "accounting for investments" for the purpose of determining carrying amount of shares, the investment has to be classified into long – term and current. **Analysis and conclusion: -** **Long-term investment** is usually **carried/ valued at cost;** ✓ If there is a decline in value of investment, but such decline is not temporary then carrying amount of investment is reduced by the amount of such decline. ✓ In the instant case it appears that the investment is long – term, hence it should be carried at cost, unless there is permanent diminution in value of investment. As the market price investment is half of its cost, the reduction appears to be heavy and permanent, hence the provision for permanent diminution (decrease) in value of investment should be made. The contention of management is not as per AS – 13.

12 D Ltd. acquired 1,000 shares of X Ltd. at a cost of ₹30,000. In the current year, K Ltd. offered Rights Share @ ₹50 per share in the ratio of 1:2. The cum – Rights Price of the share was ₹60 and D Ltd. purchased 1,000 shares at this price from the market. Thereafter, it sold 25% of Rights entitlement @ ₹10 per share. The remaining entitlement was duly subscribed by D Ltd. Find out the carrying amount of investment at the end of the year if MP falls to ₹45 per share after Rights.

(Past exam Question)

Ans. **Provision: -** As per AS-13 (Revised) "accounting for investments"**,** Carrying amount of each current investment is the lower of cost and fair value.

AS -13 provides that if the investments are acquired at cum – Rights basis and the market value of the investment after becoming ex – Rights is less than the cost of acquisition then the sale proceeds, if any, from the rate of Rights entitlement should be deducted from the cost of investment to the extent of fall in the value of Investments.

Analysis and conclusion: -

In the above case, D Ltd. had acquired the shares at cum – Rights basis. So, the sale proceeds of Rights entitlement should be adjusted in the cost of investment as Market price falls below cost after the Rights offer as follows:

Particulars	(₹)
✓ Cost of existing investment (1,000 shares)	30,000
✓ Cost of new investment at cum – Rights Price (1,000 ₹60)	60,000
✓ **Total cost (2,000 shares)**	**90,000**
✓ Total Rights entitlement (1:2 ratio)	1,000 shares
✓ Sale of Rights of 250 shares @ ₹10	2,500
✓ Subscription to Rights Shares (750 '₹50)	37,500
Calculation of carrying cost;	
✓ Cost of 2,000 shares	90,000
✓ Cost of Rights shares (750)	37,500
✓ Total cost of 2,750 shares (1,27,500/2,750=46.3636	1,27,500
✓ ***Less:*** Sale proceeds of Rights entitlement	(2,500)
✓ ***Less:* Fall in value to be charged to P/L A/c**	**(1,250)**
✓ Carrying cost of investments (45X2,750)	1,23,750

13 ANISCHIT Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investments held by it for trading as on 31.3.20X1.

Figures in (INR Lakhs)

Scripts:	Cost	Market Price
Equity Shares;		
A	60.00	61.20
B	31.50	24.00
C	36.00	60.00
D	60.00	120.00
E	90.00	105.00
F	75.00	90.00
G	30.00	6.00
Mutual fund;		
MF-1	39.00	24.00
MF-2	30.00	21.00
MF-3	6.00	9.00
Government Securities;		
GV-1	60.00	66.00
GV-2	75.00	72.00

1) Can the company adjust depreciation of a particular item of investments within a category?
2) What should be the value of investments as on 31.3.20X1?

[Nov. 2008]

Ans. **Provision: -** As per AS 13 (Revised) "Accounting for investments", the carrying amount for current investments is the lower of cost and market price. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investments, and accordingly, the investments may be computed at the lower of cost and market value computed category wise.

Analysis and conclusion: -

1) Quoted current investments for each category shall be valued at cost of market value, whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in **each category**, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Therefore, depreciation of a particular item of investments can be adjusted within the same category in investments.

2) Value of investments as on 31.3.20X1;

Type of investment	Valuation Principle	Value (₹) in lakhs
✓Equity Shares (Aggregated)	✓ Lower of cost or market value	308.50
✓Mutual Fund	✓ NAV (market value, assumed)	54.00
✓Government securities	✓ Cost	135.00
Total		497.50

Assignment
AS-16 Borrowing Cost

Q. No. | **Questions and Answers**

1.

Govind Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.04.20X1. to be utilized as under:

Particulars	**(₹) in Lakhs**
✓ Construction of factory building	40
✓ Purchase of Machinery	35
✓ Working Capital	25

In March 20X2, 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 31.03.20X2 was ₹ 12,00,000. During the year 20X1-20X2, 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.

(May 2020 RTP/ November 2010 (modified)/ November 2011 (modified)/ May 2014 (modified)/ICAI SM)

Ans.

Provision: - 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.

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.

Analysis and conclusion: - In the given case of Govind Ltd. Received ₹ 3,00,000 as an interest which is an income from temporary investment.

Thus, eligible borrowing cost

- = ₹ 12,00,000– ₹ 3,00,000
- = ₹ 9,00,000

Particulars	**Nature of Assets**	**Interest to be Capitalised (₹)**	**Interest to be charged to Profit & Loss Account (₹)**
1) Construction of factory building	Qualifying Asset	9,00,000 × 40/100 = ₹ 3,60,000	NIL
2) Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000 × 35/100 = ₹ 3,15,000
3) Working Capital	Not a Qualifying Asset	NIL	9,00,000 × 25/100 = ₹ 2,25,000
Total		**₹ 3,60,000**	**₹ 5,40,000**

2. M/s. First Ltd. began construction of a new factory building on 1st April, 20X1. It obtained ₹ 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 20X1 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 :

Rate of Interest per annum	Amount (₹)
9%	4,00,000
12%	5,00,000
14%	3,00,000

The expenditures that were made on the factory building construction were as follows;

Date	Amount (₹)
✓ 1st April, 20X1	3,00,000
✓ 31st May, 20X1	2,40,000
✓ 1st August, 20X1	4,00,000
✓ 31st December, 20X1	3,60,000

The Construction of factory building was completed by 31st March, 20X2. 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/May 2015/November 2009/ICAI SM)

Ans. **Provision: -** As per 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 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.

Analysis and conclusion: - In the Given case following treatment as under:

1) Computation of average accumulated expenses;

Particulars	(₹)
✓ ₹ 3,00,000 × 12/12 =	3,00,000
✓ ₹ 2,40,000 × 10/12 =	2,00,000
✓ ₹ 4,00,000 × 8/12=	2,66,667
✓ ₹ 3,60,000 × 3/12=	90,000
	8,56,667

2) 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
Total		**1,38,000**
✓ Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000} \times 100\right)$		11.5 %

3) Interest on average accumulated expenses:

Particulars	(₹)
Interest on average accumulated expenses;	
✓ Specific borrowings (₹ 2,00,000 × 8%) ✓ Non-specific borrowings (₹ 6,56,667* × 11.5%)	16,000 75,517
✓ Amount of interest to be capitalised	**91,517**

4) Total expenses to be capitalised for building;

Particulars	(₹)
✓ Cost of building ₹ (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000) ✓ ***Add:*** Amount of interest to be capitalized	13,00,000 91,517
	13,91,517

5) **Journal Entry**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
31.03.2018	Building A/c Dr. To Building WIP ** A/c To Borrowing Costs A/c (Being amount of cost of building and borrowing cost thereon capitalised)		13,91,517	 13,00,000 91,517

3. When capitalisation of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

(May 2021 RTP/May 2016 (modified)/ICAI SM/May 2020 RTP)

Ans.

✓ 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.

4. 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.

(ICAI SM/May 2010 (modified)/November 2016)

Ans. **Provision: -** As per AS-16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time to get ready for its intended use or sale.

Analysis and conclusion: - In the given case of company the treatment for total interest amount of ₹ 52.20 lakhs can be given as;

Purpose	Nature	Interest to be capitalised (₹ in lakhs)	Interest to be charged to profit and loss account (₹ 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 expenses in the profit and loss account for year ended 31st March, 20X2.

5. A Company incorporated in June 20X1, 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/April 2021 MTP)

Ans. **Provision: -** 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.

Accounting standard further clarifies that 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 should be considered. It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time. **Analysis and conclusion: -** In the given case 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.
6.	Omega limited has borrowed a sum of US $10,00,000 at the beginning of financial year 20X1-X2 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 31^{st} march 20X2 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 computed borrowing cost and exchange difference for the year ending 31^{st} march 20X2 as per applicable accounting standards. **(March 2021 MTP/ICAI SM)**
Ans.	**Provision: -** As per AS-16 "Borrowing costs" exchange differences arising from foreign currency borrowing and considered as borrowing costs are those exchange differences which arises on the amount of principal of the foreign currency borrowing to the extent of the difference between interest on local currency borrowing and interest on foreign currency borrowing. The amount of exchange difference not exceeding the difference between interest on local currency borrowing and interest on foreign currency borrowing is considered as borrowing costs to be accounted for under this standard and the remaining exchange difference if any is accounted under AS-11. **Analysis and conclusion: -** In the given case 1) Interest for the period 20X1-X2 = US $10 lakhs *4%*₹62 per US$ = ₹24.80 lakhs 2) Increase in the liability towards the principal amount = US$10 lakhs *(62-56) = ₹60 lakhs 3) Interest that would have resulted if the loan was taken in Indian currency = US $ 10 lakhs×₹56×10.5%= ₹58.80 lakhs 4) 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 lakh 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 borrowing 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
7.	In May, 20X1, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January. 20X2 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 31^{st} March, 20X2 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.

(November 2019 RTP/November 2021 RTP)

Ans. **Provision: -** As per AS 16 "Borrowing costs" 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.

Analysis and conclusion: - In the case of Capacity Ltd. construction of the factory building is completed in January 20X2 so interest Up to January 20X2 should be capitalised because capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying assets for its intended use are completed. interest on the amount that has been used for the construction of the building up to the date of completion (January, 20X1) i.e., ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

8. On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under;

Particulars	**(₹)**
1) Construction of Sea link across two cities; (Work was help up totally for a month during the year due to high water levels)	25 Crores
2) Purchase of equipment and machineries	3 Crores
3) Working capital	2 Crores
4)	
5) Purchase of vehicles	50,00,000
6) Advance for tools/cranes etc.	50,00,000
7) Purchase of technical know-how	1 Crores
8) 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. **(ICAI SM/November 2020)**

Ans. **Provision: -** 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.

Analysis and conclusion: - The treatment of interest by Amazing Construction Ltd. can be shown as;

Particulars	**Qualifying Asset**	**Interest to be capitalised (₹)**	**Interest to be charged to Profit & Loss A/c (₹)**	
✓Construction of sea-link	Yes	62,50,000		[80,00,000 × (25/32)]
✓Purchase of equipment and Machines	No		7,50,000	[80,00,000 × (3/32)]
✓Working capital	No		5,00,000	[80,00,000 × (2/32)]
✓Purchase of vehicles	No		1,25,000	[80,00,000 × (0.5/32)]

✓Advance for tools, cranes etc.	No		1,25,000	[80,00,000 × (0.5/32)]
✓Purchase of technical know-how	No		2,50,000	[80,00,000 × (1/32)]
Total		**62,50,000**	**17,50,000**	

9. Sital Limited borrowed an amount of ₹ 150 crores on 1.4.20X1 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 31.3.20X2. 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.

(November 2020 RTP)

Ans. **Provision: -** As per 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 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.

Analysis and conclusion: - In the case of Vital Limited, treatment of accountant is incorrect. The amount of borrowing costs capitalized in the financial year 20X1-X2 should be calculated as follows:

Particulars	(₹)
✓ Actual interest for 20X1-X2 (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 20X1-X2	₹ 13.50 Crores

10. Enumerate two points which the financial statement should disclose in respect of borrowing cost as per AS 16. **(May 2009)**

Ans. As per AS 16 the financial statement should disclose the following:

1) The accounting policy adopted for borrowing cost and
2) The amount of borrowing cost capitalised during the period.

11. Briefly indicates the items which are included in the expressions borrowing cost as per AS 16.

(November 2009)

Ans. Borrowing cost are interest and other cost incurred by an enterprise in connection with the borrowing funds:

Borrowing cost generally includes:

1) Interest and commitment charges on bank borrowing and other short term and long-term borrowings.
2) Amortisation of discount or premiums relating to borrowing.
3) Amortisation of ancillary costs incurred in connection with the arrangement of borrowings.
4) Finance charges in respect of assets required under finance leases or under other similar arrangements and
5) Exchange difference arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

12. An industry borrowed ₹40,00,000 for purchase of machinery on 1-6-20X1. Interest on loan is 9% per annum. The machinery was put to use from 1-1-20X2. Pass journal entry for the year ended 31-3-20X2 to record the borrowing cost of loan as per AS16.

(May 2008)

Aans. **Provision: -** As per AS 16 "Borrowing costs" a Qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use or sale.

Accounting standard further clarifies that 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 should be considered.

Analysis and conclusion: - In the given case, it is assumed that the asset in question is a Qualifying asset. Hence the borrowing cost incurred till the date of assets coming into use will be capitalised.

Particulars	Amount	Rate			Interest
9% loan	40,00,000	9%	7 months	Capitalised (i.e. for operative period)	2,10,000
			3 months	Charged to P&L (i.e. for post operation period)	90,000
			10 months		3,00,000

Particulars	L.F.	Debit	Credit
Machinery a/c To loan a/c (Being interest on loan for pre-operative period capitalised)	Dr.	2,10,000	2,10,000
Interest on loan a/c To loan a/c (Being the interest on loan for the post operative period)	Dr.	90,000	90,000
Profit and loss a/c To interest on loan a/c (Being interest on loan transferred to P&l a/c)	Dr.	90,000	90,000

13. Raj & co. has taken a loan of US$20,000 at the beginning of the financial year for a specific project at an interest rate of 6% per annum, payable annually. On the day of taking loan the exchange rate between currencies was ₹48 per 1 US$. The exchange rate at the closing of the financial year was ₹50 per 1 US$. The corresponding amount could have been borrowed by the company in Indian rupee at an interest rate of 11% per annum. Determine the treatment of borrowing cost in the books of accounts. **(November 2013)**

Ans. **Provision: -** As per AS-16 "Borrowing costs" exchange differences arising from foreign currency borrowing and considered as borrowing costs are those exchange differences which arises on the amount of principal of the foreign currency borrowing to the extent of the difference between interest on local currency borrowing and interest on foreign currency borrowing. The amount of exchange difference not exceeding the difference between interest on local currency borrowing and interest on foreign currency borrowing is considered as borrowing costs to be accounted for under this standard and the remaining exchange difference if any is accounted under AS-11.

	Analysis and conclusion: - In the given case the following computations would be made to determine the amount of borrowing cost for the purpose of AS 16 borrowing cost. Interest for the period = US$20,000 ×₹50 per US$×6% = ₹60,000 Increase in the liability towards the principle amount = US$20,000*₹(50-48) = ₹40,000(A) Interest that would have resulted if the loan was taken in Indian currency = US$20,000*48*11% = ₹1,05,600 Difference between interest on local currency borrowing and foreign currency borrowing = ₹1,05,600-₹60,000 = ₹45,600 (B) In the above cases, ₹40,000(A) is less than ₹45,600 (B) therefore the entire exchange difference of ₹40,000 would be considered as borrowing costs. The total borrowing cost would be ₹1,00,000 (₹60,000+₹40,000).
14.	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. **(ICAI SM)**
Ans.	**Provision: -** As per AS-13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. Further, as per AS-16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. **Analysis and conclusion: -** 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, 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.
15.	ABC Limited has started construction of an asset on 1st December, 20X0, which continues till 31st March, 20X1 (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 20X0 and ₹4 lakh in each of the months of January to March 20X1. 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, 20X1. Interest was paid on the overdraft at 10% until 1st January, 20X1 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'. **(November 2021 MTP)**
Ans.	**Provision: -** As per 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 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.

Analysis and conclusion:-

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×c) × (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 × (12/12)} + (4,00,000 × (11/12)} + {8,00,000 × (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest / Weighted average of general borrowings) × 100] = [(2,26,000 / 24,33,334) × 100] = 9.29% p.a.

16. 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. **(Nov. 2022 RTP)**

Ans. **Provision: -** As per AS 16 "Borrowing costs" 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.

Analysis and conclusion: -

	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 = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	13,30,317 (approx.)
7)	Interest on loan used for Phases III & IV, based on proportionate Loan amount 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 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** The 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.
17.	**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?
Ans.	**a)** **Provision: -** 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 the equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. **Analysis and conclusion: -** 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) is 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 still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that is 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.

AS-17 Segment Reporting
Assignment

<table>
<tr><th>Q. No.</th><th>Question & Answers</th></tr>
<tr><td>1.</td><td>The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:
₹ in lakhs
<table>
<tr><th>Particulars</th><th>M</th><th>N</th><th>O</th><th>P</th><th>Q</th><th>R</th><th>Total</th></tr>
<tr><td>Segment Assets</td><td>40</td><td>80</td><td>30</td><td>20</td><td>20</td><td>10</td><td>200</td></tr>
<tr><td>Segment Results</td><td>50</td><td>(190)</td><td>10</td><td>10</td><td>(10)</td><td>30</td><td>(100)</td></tr>
<tr><td>Segment Revenue</td><td>300</td><td>620</td><td>80</td><td>60</td><td>80</td><td>60</td><td>1,200</td></tr>
</table>
The Chief accountant is of the opinion that segments “M” and “N” alone should be reported. Is he justified in his view? Discuss.
(ICAI SM/ May 2020 RTP /January 2021/November 2020)</td></tr>
<tr><td>Ans.</td><td>Provision: - 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 at least 75% of total enterprise revenue is included in reportable segments.
Analysis and conclusion: - In the given case,
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 upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of chief accountant is wrong.</td></tr>
<tr><td>2.</td><td>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?
(ICAI SM / May 2021 RTP / November 2020 RTP/November 2021 MTP)</td></tr>
<tr><td>Ans.</td><td>Provision: - As per 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.
Analysis and conclusion: -In the given case, 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.</td></tr>
<tr><td>3.</td><td>SRI SAI Limited has three segments viz. A, B and C. The total assets of the company is ₹ 15 Crores. The assets of Segment a is 1.85 crores, Segment B is 6.15 Crores and Segment C is ₹ 7.00 Crores. Assets of each segment include deferred tax assets of ₹ 0.50 Crores in A, ₹ 0.40 Crores in B and ₹ 0.30 Crores in C. The accountant of SRI SAI Limited contends that all segments are reportable segments. Based on segment assets criteria, determine the veracity of the contention of the accountant.
(ICAI SM /November 2008/May 2018/Nov. 2014)</td></tr>
</table>

Ans.

<u>Provision: -</u> As per AS 17 "Segment Reporting', one of the basis of segment asset criteria for identification of a business segment or geographical segment as a reportable segment is when its segment assets are 10% or more of the total assets of all segments and <u>segment assets do not include income tax assets</u>

<u>Analysis and conclusion: -</u>

Statement showing percentage of Segment net assets to Total assets of the company

				₹ in crores
Particulars		**Segments**		**Total**
	A	**B**	**C**	
Segment assets	1.85	6.15	7.00	15.00
Less: Deferred tax assets	(0.50)	(0.40)	(0.30)	(1.20)
Net segment assets	1.35	5.75	6.70	13.80
Percentage to total net segment assets	9.78%	41.67%	48.55%	100%

Accordingly, <u>the reportable segments will be segments B and C only.</u> Therefore, the contention of the accountant that all the segments are reportable segments is not tenable.

4.

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

Particulars	**₹ ('000)**
Forging Shop Division	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	6,135
	10,800
Bright Bar Division	
Sales to Fitting Division	45
Export Sales to Rwanda	300
	345
Fitting Division	
Export Sales to Maldives	270

Particulars	**Head Office ₹ ('000)**	**Forging Shop Division ₹ ('000)**	**Bright Bar Division ₹ ('000)**	**Fitting Division ₹ ('000)**
Pre-tax operating result		240	30	(12)
Head office cost reallocated		72	36	36
Interest costs		6	8	2
Fixed assets	75	300	60	180
Net current assets	72	180	60	135
Long-term liabilities	57	30	15	180

(ICAI SM)

Ans.

Diversifiers Ltd. Segmental Report

(₹ ’000)

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging shop	Bright Bar	Fitting		
Segment Revenue					
Sales:					
Domestic	90	-	-	-	90
Export	6,135	300	270	-	6,705
External Sales	6,225	300	270	-	6,795
Inter-Segment Sales	4,575	45	-	4,620	-
Total Revenue	10,800	345	270	4,620	6,795
Segment Result (Given)	240	30	(12)		258
Head Office Expenses					(144)
Operating Profit					114
Interest Expense					(16)
Profit Before Tax					98
Information in Relation to Assets and Liabilities:					
Fixed Assets	300	60	180	-	540
Net Current Assets	180	60	135	-	375
Segment assets	480	120	315	-	915
Unallocated Corporate Assets (75 + 72)	-	-	-	-	147
Total assets					1,062
Segment liabilities	30	15	180	-	225
Unallocated corporate liabilities					57
Total liabilities					282

Sales Revenue by Geographical Market

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	(₹ ’000) Consolidated Total
External sales	90	6,135	300	270	6,795

5. Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for inverters and UPS. How many segments should it have and why? **(ICAI SM)**

Ans. **Provision: -** As per As-17, “Segment reporting” 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 or services and that is subject to risks and return that are different from those of other business segment. 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.”

Analysis and conclusion: - In the 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 inverters and UPS are affected by a different set of factors. In the 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 inverters and UPS, the risks and returns are affected by power condition, the 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'.

6. 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. **(Nov 2021 RTP)**

Sol. **Provision: -** 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."

Analysis and conclusion: - 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.

7. Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain. **(Nov 2021 RTP)**

Sol. 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 the 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.

AS-18 Related Party Disclosure
Assignment

Q. No.	Question & Answers
1.	R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 10% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd. You are required to assess the situation from the view point of AS 18 on Related Party Disclosures. **(May 2021 RTP /November 2007/November 2012)**
Ans.	**Provision: -** As per AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Further, Standard provides that associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture is a related party. **Significant Influence** is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies. **Analysis and conclusion: -** In the given case, R Ltd. has direct economic interest in T Ltd. to the extent of 10%, and through S Ltd. in which it is the majority shareholders, it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%). These two taken together (10% + 9%) make the total control of 19%. So, control of R Ltd. in T Ltd. directly and through S Ltd., is only 19%. Significant influence may also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries only 19% of the voting power of the T Ltd. Accordingly, R Ltd. and T Ltd. are not related parties. Hence related party disclosure, as per AS 18, is not required.
2.	Arohi Ltd. sold goods for ₹ 90 lakhs to Anya Ltd. during financial year ended 31-3-20X1. The Managing Director of Arohi Ltd. own 100% of Anya Ltd. The sales were made to Anya Ltd. at normal selling prices followed by Arohi Ltd. The Chief accountant of Arohi Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct? Comment in accordance with AS 18. **(May 2020 RTP /ICAI SM/ November 2020 RTP)**
Ans.	**Provision: -** As per AS-18, "Related Party Disclosures", Key management personnel and relative of such personnel are related parties. Key management personnel mean a person having the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. It includes MD, CEO etc. Further Standard provides disclosure should be made even if the transactions are arm length transactions or transactions are not influenced by relationship. **Analysis and conclusion: -** In the given case, Arohi Ltd. and Anya Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Arohi Ltd. is wrong.
3.	Identify the related parties in the following cases as per AS-18 **1)** Maya Ltd. holds 61% shares of Sheetal Ltd. Sheetal Ltd. holds 51% shares of Fair Ltd. Care Ltd. holds 49% shares of Fair Ltd. (Given your answer Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.) **2)** Mr. Subhash Kumar is Managing Director of A Ltd. and also holds 72% capital of B Ltd. (B Ltd. is subsidiary of A Ltd.) **(November 2020 RTP /May 2019)**
Sol.	**As per As-18, "Related Party Disclosures"** **i)** Enterprise that is directly or indirectly through or more intermediaries under control or controlled by reporting enterprise or enterprise under common control. (Includes Holding and subsidiaries)

	ii) Associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is and associate or a joint venture. **iii)** Key management personnel and relative of such personnel are covered under related parties. **1) Reporting entity-Maya Ltd.** ✓ Sheetal Ltd. (Subsidiary) is a related party. ✓ Fair Ltd. (Subsidiary) is a related party. **Reporting Entity- Sheetal Ltd.** ✓ Maya Ltd. (holding company) is a related party. ✓ Fair Ltd. (subsidiary) is a related party. **Reporting Entity-Fair Ltd.** ✓ Maya Ltd. (holding company) is a related party. ✓ Sheetal Ltd. (holding company) is a related party. ✓ Care Ltd. (investor/investing party) is a related party. **Reporting Entity-Care Ltd.** ✓ Fair Ltd. (associate) is a related party. **2) Reporting Entity-A Ltd.** ✓ Mr. Subhash Kumar (Managing Director) is a related party. ✓ B Ltd. (subsidiary) is a related party.
4	Following transactions are disclosed as on 31st March, 20X2: **1)** Mr Keshav, relative of Managing Director, received remuneration of ₹ 2,10,000 for his services in the company for the period from 1st April, 20X1 to 30th June, 20X1. He left the service on 1st July, 20X1. Should the relative be identified as on closing date i.e. on 31-3-20X2 for the purpose of AS-18. **2)** Goods sold amounting to ₹ 50 lakhs to associate company during the 1st quarter ended on 30th June, 20X1. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transactions. **(November 2018/ICAI SM)**
Sol.	**1) Provision: -** As per AS-18, "Related Party Disclosures", parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Key management personnel mean a person having the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. It includes MD, CEO etc **Analysis and conclusion: -** Hence, Mr. Keshav, a relative of key management personnel should be identified as relative as at the closing date i.e. on 31.3.20X2. **2) Provision: -** As per AS-18, "Related Party Disclosures", parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. **Analysis and conclusion: -** In the given case, transactions of the company with its associate company for the first quarter ending on 30.06.20X1 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.
5.	A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would B Limited be considered a related party for the purpose of financial statements of C Limited? **(Nov 2021 RTP)**

Sol.	**Provision: -** As per AS-18,” Related Party Disclosures” states that “enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise” are related parties. Further, it is given that “associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture” are also related parties. **Analysis and conclusion: -** In the given case, both B Limited and C Limited are ‘associates’ of A Limited. Fellow-associates cannot be regarded as a related parties only by virtue of the relationship. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.
6.	Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (reporting enterprise)? **(Nov 2021 RTP)**
Sol.	**Provision: -** As per AS-18, “Related Party Disclosures” associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venture” are related party relationship. Further, an associate has been defined as “an enterprise in which an investing reporting party has significant influence. Significant influence has been defined to be “participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies”. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. **Analysis and conclusion: -** In the given case, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power. Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be treated as a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.
7.	**i)** Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited. **ii)** Shri Bhanu a relative of key management personnel received remuneration of ₹ 3,50,000 for his services in the company for the period from 1st April, 20X0 to 30th June, 20X0. On 1st July, 20X0, he left the service. You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 20X1 for the purposes of AS 18- Related Party Disclosures. **(July 2021)**
Sol.	**i)** **Provision: -** As per AS-18, Related Party Disclosures” which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties.

	Analysis and conclusion: - In the given case, in the absence of share ownership, Mr. Happy would not be considered to exercise significant influence on Khushi Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. Happy does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel. **ii) Provision: -** As per AS-18, “Related Party Disclosures”, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. **Analysis and conclusion: -** In the given case of Shri Bhanu, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.20X1 as he received remuneration for his services in the company for the period from 1st April,20X0 to 30th June,20X0.

AS 19 Accounting for Lease
Assignment

Q. No.	Question and Answers
1.	A Ltd. sold JCB having WDV of ₹ 20 lakhs to B Ltd. for ₹ 24 lakhs and the same JCB was leased back by B Ltd. to A Ltd. The lease is operating lease. In context of Accounting Standard 19 “Leases” explain the accounting treatment of profit or loss in the books of A Ltd. if I) Sale price of ₹ 24 lakhs is equal to fair value. II) Fair value is ₹ 20 lakhs and sale price is ₹ 24 lakhs. III) Fair value is ₹ 22 lakhs and sale price is ₹ 25 lakhs. IV) Fair value is ₹ 25 lakhs and sale price is ₹ 18 lakhs. V) Fair value is ₹ 18 lakhs and sale price is ₹ 19 lakhs. **(ICAI SM ills3/ November 2020 RTP (M)/January 2021/May 2018/May 2012/October 2021 MTP)**
Sol.	**Provision: -** As per AS-19 “leases”, where sale and leaseback results in an operating lease, then the accounting treatment in different situations is as follows: **Case 1: Sale Price = Fair value** Profit or loss should be recognized immediately. **Case 2: Sale Price < Fair Value** Profit or loss should be recognized immediately. However, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. **Case 3: Sale Price > Fair value** The excess of fair value should be deferred and amortized over the period for which the asset is expected to be used. **Analysis and conclusion: -** **Following will be the treatment in the given cases:** I) When sales price of ₹ 24 lakhs is equal to fair value. A Ltd. should immediately recognize the profit of ₹ 4 lakhs (i.e., 24-20) in its books. II) When the fair value is ₹ 20 lakhs and sales price is ₹ 24 lakhs then, the profit of ₹ 4 lakhs is to be deferred and amortized over the lease period. III) When the fair value is ₹ 22 lakhs and sales price is ₹25 lakhs, profit of ₹ 2 lakhs (22-20) to be immediately recognized in its books and balance profit of ₹ 3 lakhs (25-22) is to be amortized/deferred over the lease period. IV) When the fair value of leased machinery is ₹ 25 lakhs and Sales price is ₹ 18 lakhs, the loss of ₹ 2 lakhs (20-18) to be immediately recognized by A Ltd. in its book’s provided loss is not compensated by future lease payment. v) When the fair value is ₹ 18 lakhs and sales and sales price is ₹ 19 lakhs, then the loss of ₹ 2 lakhs (20-18) to be immediately recognized by A Ltd. in its books and profit of ₹ 1 lakh (19-18) should be amortized/deferred over the lease period.
2.	Sri Shyam Ltd. took a machine on lease from Sri Krishna Ltd., the fair value being ₹ 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, Sri Shyam Ltd. pays ₹ 3,50,000. The lessee has guaranteed a residual value of ₹ 40,000 on expiry of the lease to the lessor. However, Sri Krishna Ltd. estimates that the residual value of the machinery will be ₹ 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.74432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by Sri Shyam Ltd. and the finance charges for each year. **(May 2020 RTP /May 2011/May 2019/ICAI SM ills1/November 2021 MTP)**

Sol.

Provision: - As per AS-19 “Lease”, the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the least of fair value of the leased asset at the inception of the Finance lease or the present value of minimum lease payment from the standpoint of the lessee.

Analysis and conclusion-: In the given case, fair value of the machinery is ₹ 10,00,000 and the net present value of minimum lease payments is ₹ 10,01,497 (Refer working Note). As the present value of the machine is more than the Fair value of the machine, the machine and the corresponding liability will be recorded at fair value of ₹10,00,000.

Calculation of finance charges for each year

Year	Finance charge (₹)	Payment (₹)	Reduction in outstanding liability (₹)	Outstanding liability (₹)
1st year beginning	-	-	-	**10,00,000**
End of 1st year	**1,60,000**	**3,50,000**	**1,90,000**	**8,10,000**
End of 2nd year	**1,29,600**	**3,50,000**	**2,20,400**	**5,89,600**
End of 3rd year	**94,336**	**3,50,000**	**2,55,664**	**3,33,936**
End of 4th year	**53,430**	**3,50,000**	**2,96,570**	**37,336***

Working Note:

Present value of minimum lease payments

Annual lease rental × PV factor	
₹ 3,50,000 × (0.8621 + 0.7432 + 0.6407 + 0.5523)	**₹9,79,405**
Present value of guaranteed residual value	
₹40,000 × (0.5523)	**₹22,092**
	₹ 10,01,497

3.

Answer the following:

Classify the following into either operating lease or finance lease with reason:

1) Economic life of an asset is 10 years, the lease term is 9 years, but the asset is not acquired at the end of the lease term.
2) Lessee has the option to purchase the asset at lower than fair value at the end of lease term.
3) Lease payments should be recognized as an expense in the statement of Profit and Loss of a lessee.
4) Present Value (PV) of Minimum Lease Payment (MLP) = ‘X’. Fair value of the asset is ‘Y’. and X = Y.
5) Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.

(ICAI SM/ November 2020 RTP /November 2019/November 2013)

Sol.

Provision: - As per AS-19 “leases” Situations which would normally lead to a lease being classified as a finance lease. **(EVEN IF ANY 1 CONDITION IS SATISFIED)**

- **a)** The lessor transfers ownership of the asset to the lessee by the end of the lease term (these situations may commonly arise in hire purchases)
- **b)** The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable.
- **c)** The lease term is for a major part of the economic life of the asset (i.e., **usually 75% of the life**)
- **d)** At the inception (starting) of lease present value of the minimum lease payments amounts to at least all of the fair value of the leased asset (**usually 90% of value**)
- **e)** The Leased asset is of **specialized nature** such that only the lessee can use it without any modification being made.

1) **Finance lease**: The lease term is for a major part of the economic life of the asset.
2) **Finance Lease:** The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable.
3) **Operating Lease:** As Lease payments are recognized as an expense in the statement of Profit and Loss of a lessee.
4) **Finance lease:** At the inception (starting) of the lease present value of the minimum lease payments amounts to at least all of the fair value of the leased asset **(usually 90% of value)**
5) **Finance Lease:** The Leased asset is of **specialized nature** such that only the lessee can use it without any modification being made.

4. **Answer the following:**

Aksat International Limited has given a machinery on lease for 36 months and its useful life is 60 months. Cost and fair market value of the machinery is ₹ 5,00,000. The amount will be paid in 3 equal annual instalments and the lessee will return the machinery to the lessor at the termination of lease. The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and the present value of annuity factor of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and the present value of ₹ 1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitutes a finance lease or an operating lease. If it is a finance lease, calculate unearned finance income.

(November 2015/November 2011/November 2014/May 2010)

Sol. **Determination of Nature of Lease**

Present value of unguaranteed residual value at the end of 3rd year
= ₹ 50,000 × 0.7513
= ₹ 37,565
Present value of lease payments= ₹ 5,00,000 – ₹ 37,565
= ₹ 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (₹ 4,62,435 / ₹ 5,00,000) × 100 = 92.487%

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435/2.4868 = ₹ 1,85,956 (approx.)

Gross investment in the lease	= Total minimum lease payments + unguaranteed residual value = (₹ 1,85,956 × 3) + ₹ 50,000 = ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868

Unearned finance income = Gross investment – Present value of minimum lease payments and unguaranteed residual value = ₹ 6,07,868 – ₹ 5,00,000 = ₹ 1,07,868

5. **Answer the following:**

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

Calculate the interest rate implicit on lease from the following details:

Annual Lease Rent	: ₹ 80,000 at the end of each year
Lease Period	: 5 Years
Guaranteed Residual Value	: ₹ 40,000
Unguaranteed Residual Value	: ₹ 24,000

Fair Value at the inception of the lease: 3,20,000

Discounted rates for the first 5 years are as below:

At 10%	0.909	0.826	0.751	0.683	0.621
At 14%	0.877	0.769	0.675	0.592	0.519

(November 2012/May 2014/ICAI SM)

Sol. **Provision: -**As per AS–19 “Leases” the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

a) The minimum lease payments under a finance lease from the standpoint of the lessor; and

b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Analysis and conclusion: - In the given case

The present value at a discount rate of 10%

Year	Lease Payments (₹)	Disc. Factor (10%)	Present Value (₹)
1	80,000	0.909	72,720
2	80,000	0.826	66,080
3	80,000	0.751	60,080
4	80,000	0.683	54,640
5	80,000	0.621	49,680
5	40,000	0.621	24,840
5	24,000	0.621	14,904
	Total		**3,42,944**

Present value at discount rate of 14%

Year	Lease Payments (₹)	Disc. Factor (14%)	Present Value (₹)
1	80,000	0.877	70,160
2	80,000	0.769	61,520
3	80,000	0.675	54,000
4	80,000	0.592	47,360
5	80,000	0.519	41,520
5	40,000	0.519	20,760
5	24,000	0.519	12,456
	Total		**3,07,776**

Interest Rate Implicit on Lease = 10% + $\frac{14\% - 10\%}{3,42,944 - 3,07,776} \times (3,42,944 - 3,20,000) = 10\% + 2.609\% = 12.609\%\ or\ \ say\ 12.61\%$

6. Stateany four situations when a lease would be classified as Finance Lease.

(November 2012/May 2015)

Sol. **Situation when a lease would be classified as finance lease:**

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

As per AS-19, in following situations, the lease transactions would be classified as Finance lease:

1) When there is transfer of ownership in finance lease of the asset to the lessee by the end of the lease term.
2) When option to purchase the asset is available to the lessee, at a price which is sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised.
3) When lease term is for the major part of the economic life of the asset even if title

is not transferred.

4) When present value of minimum lease payment at the inception of the lease amounts is equal to all of fair value of leased asset (i.e., PV of MLP = Fair value approx.)
5) Where Asset is given on lease is of specified nature and can be used by lessee without any major modification.

7. Sri Govind Ltd. has taken an asset on lease from Sri Gopal Ltd. for a period of 3 years. Annual Lease Rentals are ₹ 6 Lakhs payable at the end of every year. The Residual Value guaranteed by Sri Govind is ₹ 2 Lakhs whereas Sri Gopal expects the estimated salvage value to be ₹ 5 Lakhs at the end of the lease term. If the Fair Value of the asset at the lease inception is ₹ 15 Lakhs and the interest rate implicit in the lease is 12%, compute the Net Investment in the Lease from the viewpoint of Sri Gopal Ltd. and the annual Finance Income.

(RTP)

Sol.

1.	Minimum Lease Payments = ₹ 6 Lakhs × 3 years (MLP)	₹18,00,000
2..	Guaranteed Residual Value (GRV)	₹ 2,00,000
3.	MLP from the viewpoint of Lessor= MLP as above + GRV the Lessee	= 20,00,000
4.	Unguaranteed Residual = Total Residual Value – GRV Value (URV)	= ₹ 3,00,000
5.	**Gross Investment in the MLP for Lessor + URV Lease**	= 23,00,000
6.	PV of MLP, GRV and URV As per computation below	₹ 17,97,040
7.	**Unearned Finance Income (5) – (6)**	₹ 5,02,960
8.	**Net Investment in the Lease (5) – (7)**	₹ 17,97,040

Note: PV of Gross Investment in the Lease is computed as under:

PV of MLP = ₹ 6,00,000 × PVF at 12% for 3 years = ₹ 6,00,000 × (0.8929 + 0.7972 + 0.7118) =	₹ 14,41,140
PV of (GRV + URV) = ₹ 5,00,000 × PVF at 12% for year 3 = ₹ 5,00,000 × 0.7118 =	₹ 3,55,900
Total of the above	₹ 17,97,040

Recognition of Finance Income by Lessor

Year	**Net Investment in the Lease = Receivable**	**Finance Income at 12% on NI**	**Total Lease Payments received from Lessee**	**Balance Reduction in Receivable (i.e. principal)**
(1)	**(2)**	**(3) = (2) × 12%**	**(4)**	**(5) = (4) – (3)**
1	₹ 17,97,040	₹ 17,97,040 × 12% = ₹ 2,15,645	₹ 6,00,000	₹ 6,00,000 – ₹ 2,15,645 = ₹ 3,84,355
2	₹17,97,040 – ₹ 3,84,355 = ₹ 14,12,685	₹ 14,12,685 × 12% = ₹ 1,69,522	₹ 6,00,000	₹ 6,00,000 – ₹ 1,69,522 = ₹ 4,30,478
3	₹ 14,12,685 – ₹ 4,30,478 = ₹ 9,82,207	₹ 9,82,207 × 12% = ₹ 1,17,865	₹ 6,00,000	₹ 6,00,000 – ₹ 1,17,865 = ₹ 4,82,135
3 (end)	₹ 9,82,207 – ₹ 4,82,135 = ₹ 5,00,072	Nil	(GRV + URV) ₹ 5,00,000	Nil (difference ₹ 72 due to R/Off)

8. SRI HARI Silk Mills leased its looms to SRI HARHRISHANJI Looms Ltd. for a period of five years from 1st April, 20X1, for a lumpsum lease of ₹ 10,50,000 payable in full in advance. The Lessor agreed to incur the expenditure for Repairs and Maintenance of the looms which were as under: Financial Year 20X1 – 20X2 ₹ 4,700, Financial Year 20X2-20X3 ₹ 5,200.

WDV of the Looms on 01.04.20X1 was ₹ 4,60,000 and depreciation at 33 1/3% was to be charged.

Pass Journal Entries in the books of the Lessor. Show relevant entries in the P & L A/c and the Balance Sheet for the year 20X1-20X2, if the Lessor closes its account on 31st March every year.

(RTP)

Sol.

1. Journal Entries in the Books of the Lessor

Date	Particulars		Dr. (₹)	Cr. (₹)
1st April 20X1	Bank A/c To Lease Rent Advance A/c (Being Lease Rent for 5 years received in advance.)	Dr.	10,50,000	 10,50,000
31st March 20X2	Repairs and Maintenance A/c To Bank A/c (Being Maintenance Expenses Incurred for the year)	Dr.	4,700	 4,700
31st March 20X2	Lease Rent Advance A/c To Lease Rental Income A/c (Being Lease Rental Income recognized for year 1)	Dr.	2,10,000	 2,10,000
31st March 20X2	Depreciation A/c To Plant and Machinery A/c (Being Depreciation at 33.33% on WDV of Asset) (4,60,000 × 33.33% for Year 1)	Dr.	1,53,333	 1,53,333
31st March 20X2	Profit and Loss A/c To depreciation A/c To Repairs and Maintenance A/c (Being Depreciation and R & M Expense for the year transferred to P & L Account)	Dr.	1,58,033	 1,53,333 4,700
31st March 20X2	Lease Rent Income A/c To Profit and Loss A/c (Being Lease Rental Income for the year transferred to P & L Account)	Dr.	2,10,000	 2,10,000

2) Profit and Loss A/c (extract)

Particulars	Amount (₹)	Particulars	Amount (₹)
To Depreciation A/c	1,53,333	By Lease Rental Income	2,10,000
To Repairs and Maintenance A/c	4,700		

3) Balance Sheet (extract)

Liabilities	Amount (₹)	Assets		Amount(₹)
Lease Rent in Advance (10,50,000 – 2,10,000)	8,40,000	Loom: WDV at beginning	4,60,000	
Repairs and maintenance A/c	4,700	Less: Depreciation	1,53,333	3,06,667

9.

Sooraj ltd. wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹ 3 lakh p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sooraj limited is not sure about the treatment of these lease rentals and seeks your advice. [use annuity factor@ 15 % for 3 years as 3.36]

(May 2021 RTP)

Sol.

Provision: - As per AS 19 "leases", a lease will be classified as finance leases if at the inception of the leases the present value of minimum lease payment amount to at least substantially all of the fair value of leased assets.

Analysis and conclusion: - In the given case the implicit rate of interest is given at 15%. The present value of minimum lease payment at 15% using PV annuity factor can be computed as:

Annuity factor (year 1 to year 3	3.36
Present value of minimum lease payments (₹3 lakh each year)	₹10.08 lakhs

Thus, the present value of minimum lease payment is ₹10.08 lakhs and the fair value of the machine is ₹30 lakh. In finance, the lease term should be for the major part of the economic life assets even if the title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, a lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight-line basis over the lease term unless another systematic basis is more representative of the of the time pattern of the users benefit.

10.

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

i)	Fair value of the machine	48.00
ii)	Lease term	5 Years
iii)	Lease rental per annum	8.00
vi)	Guaranteed residual value	1.60
v)	Expected residual value	3.00
vi)	Internal rate of return	15%

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

Ascertain Unearned Finance Income.

(ICAI SM ills2)

Sol.

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

Where:

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

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

= [(₹8,00,000 x 5 years) + ₹1,60,000] + ₹1,40,000 =43,00,000 (a)

b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	8,00,000	0.8696	6.95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	1,60,000 (GRV)	0.4972	79,552
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	69,608(ii)
	43,00,000	(i) + (ii)	28,30,920(b)

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

Manufacturer or dealer lessor

The manufacturer or dealer lessor should recognise the transaction of sale in the statement of profit and loss for the period, in accordance with the policy followed by the enterprise for outright sales. If artificially low rates of interest are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged. Initial direct costs should be recognized as an expense in the statement of profit and loss at the inception of the lease.

11. A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate.

Compute the following:

i) Annual Lease Rent
ii) Lease Rent income to be recognized in each operating year and
iii) Depreciation for 3 years of lease.

(ICAI SM)

Sol.

i) Annual lease rent

Total lease rent

$= 130\%$ of ₹1,50,000 × $\frac{\text{Output during lease period}}{Total\ output}$

= 130% of ₹1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 + 70,000)

= 1,95,000 × 1,50,000 units/3,00,000 units = ₹97,500

Annual lease rent = ₹97,500 / 3 = ₹32,500

ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognised in years 1, 2 and 3 will be as: Year 1 ₹ 26,000,

Year 2 ₹32,500 and

	Year 3 ₹39,000. **iii) Depreciation for three years of lease** Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70. Depreciation for year 1 is ₹20,000, year 2 = 25,000 and year 3 = 30,000.

AS-20 Earnings Per Share
Assignment

Q. No. — **Questions and Answers**

1. Answer the following question:

"While calculating diluted EPS, the 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 Debenture is compulsorily & fully convertible into 10 equity shares)	
Debenture interest expense for the current year	₹ 5,00,000
Assume applicable Income Tax rate @ 30%	

(ICAI SM/ May 2020 RTP /MTP November 2021(M)/November 2018/May 2009/November 2016/December 2021)

Sol. **<u>Provision: -</u>** 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."

Calculation of Diluted Earnings per Share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Particulars	**Net profit for the period attributable to Equity Shareholders**	**Weighted Average no. of Equity Shareholders**
For Basic EPS	1,00,00,000	10,00,000
Add: Adjustment for Dilution	3,50,000 (W.N.1)	5,00,000 (W.N.1)
Adjusted EPS	1,03,50,000	15,00,000

Basic EPS $= \frac{1,00,00,000}{10,00,000} =$ ₹ 10

Diluted EPS $= \frac{1,03,50,000}{15,00,000} =$ ₹ 6.90 per share

Working Note:

1.) Tax adjusted interest on 10% Convertible Debentures

= Interest × (100% − Tax Rate)

= 5,00,000 × (100% − 30%)

= 3,50,000

2.) $1,00,000 \times 10 \times \frac{6}{12} = 5,00,000$ **Assumption**:

Annual Interest on Debentures

= 10% × ₹ 100 × 1,00,000 Debentures

= ₹ 10,00,000

But interest expense for the current year is given as ₹ 5,00,000 **Hence:** It can be implied that debentures are issued during the year. Period = 6 months (By comparing Annual Interest Rate @ 10% on ₹ 10,00,000 with given interest expense of ₹ 5,00,000)

2. **Answer the following:**

The following information is available for Sri Gopal Ltd. for the accounting year 20X1-X2 and 20X2-X3.

Net Profit:	Year 20X1-X2	₹ 25,00,000
	Year 20X2-X3	₹ 40,00,000

No. of shares outstanding prior to right issue 12,00,000 shares.
Right issue: One new share for each three outstanding i.e. 4,00,000 shares
: Right issue Price ₹ 22
: Last date of exercise rights 30-6-20X2
Fair rate of one equity share immediately prior to exercise of rights on 30-6-20X2 = ₹ 28
You are required to compute the basic earnings per share for the years 20X1-X2 and 20X2-X3
(ICAI SM/November 2020 RTP /November 2019/May 2011/May 2014)

Sol. **Calculation of basic earnings per share (EPS)**

Particulars	**Year 20X1-X2 (₹)**	**Year 20X2-X3 (₹)**
EPS for the year 20X1-X2 as (original)		
$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ $= \frac{₹\ 25,00,000}{12,00,000\ shares}$	2.08	
EPS for the year 20X1-X2 restated for rights issue $= \frac{₹\ 25,00,000}{12,00,000\ shares \times 1.06}$ (Ref. Note)	1.97 (approx.)	
EPS for the year 20X2-X3 including effects of right issue $= \frac{40,00,000}{\left(12,00,000 \times 1.06 \times \frac{3}{12}\right) + \left(16,00,000 \times \frac{9}{12}\right)}$		2.64 (approx.)

Note: The number of equity shares to be used in calculating basic earnings per share for periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the adjustment factor. The adjustment factor has been calculated as in Working Note 2.

Working Notes:

1. **Calculation of theoretical ex-rights fair value per share**

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$= \frac{(₹\ 28 \times 12,00,000\ \text{shares}) + (₹\ 22 \times 4,00,000\ \text{shares})}{12,00,000\ \text{shares} + 4,00,000\ \text{shares}} = ₹\ 26.50$$

2. **Calculation of adjustment factor**

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex−right value per share}} = \frac{₹\ 28}{₹\ 26.5} = 1.06\ (\text{approx.})$$

3. Ram Ltd. has 12,00,000 equity shares on April, 1,20X1. The company earned a profit of ₹ 30,00,000 during the year 20X1-X2. The average fair value per share during 20X1-X2 was ₹ 25. The company has given share option to its employees of 2,00,000 equity shares at option price of ₹ 15 Calculate basic E.P.S. and diluted E.P.S.

(November 2010/May 2015/ICAI SM ills6/May 2013)

Sol.

Computation of Earnings Per Share

Particulars	Earnings	Share	Earnings Per Share
Net Profit for the year 20X1-X2	30,00,000		
Weighted average number of shares outstanding during the year 20X1-X2		12,00,000	
Basic Earnings Per Share = $\frac{30,00,000}{12,00,000}$			2.50
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value (As indicated in Working Note) $2,00,000 \times \frac{15}{25}$		(1,20,000)	
Diluted Earnings Per Share $\left[\frac{30,00,000}{12,80,000}\right]$	30,00,000	12,80,000	2.34

<u>Working Note:</u> -

The earnings have not increased as the total number of shares has been increased only by the number of shares (80,000) deemed for the purpose of the computation to have been issued for no consideration.

4. As at 1st April, 20X1 a Sri Krishna Ltd 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 60,000equity shares. The net profit for the year ended 31st March, 20X2 was ₹ 21,96,000 after considering dividend on preference shares ₹3,40,000.

Compute Basic EPS for the year ended 31st March, 20X2 as per Accounting Standard 20 "Earnings Per Share".

(ICAI SM/MTP October 2021/May 2018)

Sol.

Basic Earnings Per Share (EPS)

$$= \frac{\textbf{Net Profit attributable to equity shareholders}}{\textbf{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{₹\ 21,96,000}{4,57,500\ shares\ (as\ per\ Working\ note)} = ₹ 4.80\ per\ share$$

Working Note:

Calculation of weighted average number of equity shares.

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity share ₹	Amount paid per share ₹	Weighted average no. of equity shares ₹
01.04.20X1	6,00,000	5	6,00,000 × 5/10 × 5/12 = 1,25,000
01.09.20X1	5,40,000	10	5,40,000 × 7/12 = 3,15,000
01.09.20X1	60,000	5	60,000 × 5/10 × 7/12 = 17,500
Total Shares			**4,57,500**

5. **Answer the following:**

Compute Basic earnings per share from the following information:

Date	Particulars	No. of Shares
1st April, X1	Balance at the beginning of the year	1,500
1st August, X1	Issue of shares for cash	600
31st March, X2	Buy back of shares	500
Net profit for the year ended 31st March, 20X2 was ₹ 2,75,000.		

(ICAI SM/November 2009)

Sol. **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) × (4)
1st April, 20X1	1,500 (Opening)	12 months	12/12	1,500
1st August, 20X1	600 (Additional issue)	8 months	8/12	400
31st March, 20X2	500 (Buy back)	0 months	0/12	—
Total				1900

$$\textbf{Basic Earnings Per Share} = \frac{\text{Net Profit or Loss for the period attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding during the period}}$$

$$= \frac{₹\ 2,75,000}{1,900\ shares} = ₹\ \mathbf{144.74}$$

6. **Answer the following:**

Explain the concept of 'Weighted average number of equity shares outstanding during the period'. State how would you compute, based on AS-20, the weighted average number of equity shares in the following case:

		No. of Shares
1st April, 20X1	Balance of Equity Shares	4,80,000
31st August, 20X1	Equity shares issued for cash	3,60,000
1st February, 20X2	Equity shares bought back	1,80,000
31st March, 20X2	Balance of equity shares	6,60,000

(May 2012/November 2015)

Sol. **Provision: -** As per AS-20,'Earning per share' the weighted average number of equity shares outstanding during the period reflects the fact that the amount at any time. Hence, for the purpose of calculating basic or diluted earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Analysis and conclusion: -

Weighted average number of equity shares

Period		Weighted shares
1st April, 20X1 to 31st August, 20X1	4,80,000 shares × 5/12	2,00,000 shares
1st September, 20X1 to 31st January, 20X2	8,40,000 shares × 5/12	3,50,000 shares
1st February, 20X2 to 31st March, 20X2	6,60,000 shares × 2/12	1,10,000 shares
		6,60,000 shares

7. **Answer the following:**

(a) From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

Particulars	**₹ in Crores**
Profit before VRS Payments but after depreciation	75.00
Depreciation	10.00
VRS payments	32.10
Provision for taxation	15.00
Paid up Share Capital (Shares of ₹ 10 each fully Paid)	93.00

(November 2007/ RTP)

Sol.

Particulars	**Amount**
Profit before tax	75,00,00,000
Less: VRS payment	32,10,00,000
Provision for tax	15,00,00,000
Earnings available to shareholders	27,90,00,000
No. of shares	9,30,00,000

$$\textbf{Earnings per share} = \frac{\text{Profits attribuatble to equity shareholders}}{\text{Weighted average no. of shares}} = \frac{27,90,00,000}{9,30,00,000} = \textbf{₹ 3 per share}$$

8. XYZ Ltd. is engaged in manufacturing Industrial Packaging Equipment. As per the terms of an agreement entered into with its Debenture holders, the Company is required to appropriate an 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. Kashyapa Ltd. Has excluded this from the Numerator, in the Computation of Basic EPS. Is this treatment correct?

(November 2021 RTP)

Sol. **Provision: –** As per AS-20 "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".

Analysis and conclusion: - With an emphasis on the phrase "attributable to Equity Shareholder", it may be construed that amounts appropriated to Mandatory Reserves as described in this case, though not available for distribution as dividend, are still attributable to Equity Shareholders. So, the appropriation made to 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. The treatment given by the Company is not correct.

9. **Sri Gopal Ltd. has the following different classes of Equity Shares of ₹ 10 each, outstanding as at 31st March, having disproportionate rights with respect to voting and dividends:**

Number of Shares	**Rights as to Share in Net Profit to the extent of Capital**
1,00,000 "A" Class Equity Shares	Proportionate to Capital
30,000 "B" Class Equity Shares	In the proportion of 3:2 with respect to "A" Class Shares
30,000 "C" Class Equity Shares	In the proportion of 5:2 with respect to "A" Class Shares
40,000 "D" Class Equity Shares	In the proportion of 3:1 with respect to "A" Class Shares

Profit for the year ended 31st March was ₹ 8,00,000. The Company believes that Net Profit is to be allocated to the Shares in the ratio or 2:3:5:6 as derived from their rights to Share Net Profit. The Company has calculated the Basic EPS in the following manner. You are required to confirm whether this calculation is correct.

Class	**Apportionment of Net Profit**	**No. of Shares**	**Basic EPS**
Class A	₹ 8,00,000 × 2/16 = ₹ 1,00,000	1,00,000	₹ 1.00
Class B	₹ 8,00,000 × 3/16 = ₹ 1,50,000	30,000	₹ 5.00
Class C	₹8,00,000 × 5/16 = ₹ 2,50,000	30,000	₹ 8.33
Class D	₹ 8,00,000 × 6/16 = ₹ 3,00,000	40,000	₹ 7.50

(RTP)

Sol. **<u>Provision:</u> -**As per AS-20, "<u>If an Enterprise has more than one class of Equity Shares, Net Profit or Loss for the period is apportioned over the different classes of Shares in accordance with their dividend rights</u>". In the instant case, Net Profit should first be apportioned to various classes of **Equity Shares in accordance with their Dividend Rights in the following manner:**

Class (1)	No. of Shares (2)	Ratio of rights in Profit (3)	Adjusted Number of Shares (4)	Apportioned Profit (in the ratio of adjusted number of Shares) (5)	Basic EPS (6) = (5) ÷ (2)
A	1,00,000	1:1	1,00,000 × $\frac{1}{1}$ = 1,00,000	8,00,000 × $\frac{100}{340}$ = ₹ 2,35,294	₹ 2.35
B	30,000	3:2	30,000 × $\frac{3}{2}$ = 45,000	8,00,000 × $\frac{45}{340}$ = ₹ 1,05,882	₹ 3.53
C	30,000	5:2	30,000 × $\frac{5}{2}$ = 75,000	8,00,000 × $\frac{75}{340}$ = ₹ 1,76,471	₹ 5.88
D	40,000	3:1	40,000 × $\frac{3}{1}$ = 1,20,000	8,00,000 × $\frac{120}{340}$ = ₹ 2,82,353	₹ 7.06
		Total	**3,40,000**	**₹8,00,000**	

<u>Conclusion:</u> - The Company's EPS computation is not correct. The amounts presented above should be considered.

10. **In the following list of shares issued, for the purpose of calculations of weighted average number of shares, from which date, weight is to be considered:**

1) Equity shares issued in exchange of cash,
2) Equity shares issued as a result of conversion of a debt instrument,
3) Equity shares issued in exchange for the settlement of a liability of the enterprise,
4) Equity shares issued for rendering of services to the enterprise,
5) Equity shares issued in lieu of interest and/or principal of another financial instrument,
6) Equity shares issued as consideration for the acquisition of an asset other than in cash.

(May 2021 RTP)

Sol.

The following dates should be considered for consideration of weights for the purpose of calculations of weighted average number of shares in the given situations:

1) Date of <u>cash receivable</u>
2) Date of <u>conversion</u>
3) Date on which <u>settlement becomes effective</u>
4) When the <u>services are rendered</u>
5) Date when <u>interest ceases to accrue</u>
6) Date on which the <u>acquisition is recognised</u>.

11.

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. **(ICAI SM)**

Sol.

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:

$(1{,}800 \times \frac{12}{12}) + (300 \times \frac{2}{12}) = 1{,}850$ shares.

12.

Calculate Basic Earnings Per Share.

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

(ICAI SM)

Sol.

<u>**Provision:**</u> **–** As per AS-20 "For the <u>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".</u>

<u>**Analysis and conclusion: -**</u>

No. of Bonus Issue 20,00,000 × 2 = 40,00,000 shares

Earnings per share for the year 20X2 $\frac{₹\ 60{,}00{,}000}{(20{,}00{,}000+40{,}00{,}000)} = ₹\ 1.00$

Adjusted earnings per share for the year 20X1 $\frac{₹\ 18{,}00{,}000}{(20{,}00{,}000+40{,}00{,}000)} = ₹\ 0.30$

<u>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.</u>

AS-22

Accounting for Taxes on Income

Q. No. Question and Answers

1. Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	6,00,000
Depreciation as per income tax records	10,00,000
Unamortized preliminary expenses as per tax record	60,000

There is adequate evidence of future profit sufficiency. You are required to calculate the amount of deferred tax asset/liability to be recognized as transition adjustment assuming Tax rate as 30%.

(Nov 2020 RTP /ICAI SM/May 2011/May 2018)

Sol. **Table showing calculation of deferred tax asset / liability**

Particulars	**Amount**	**Timing differences**	**Deferred tax**	**Amount @ 30%**
	₹			₹
Excess depreciation as per tax records (₹ 10,00,000 – ₹ 6,00,000)	4,00,000	Timing	Deferred tax liability	1,20,000
Unamortized preliminary expenses as per tax records	60,000	Timing	Deferred tax asset	(18,000)
Net deferred tax liability				1,02,000

2. The following particulars are stated in the Balance Sheet of PQR Ltd. as on 31.03.20X1:

	(₹ in lakh)
Deferred Tax Liability (Cr.)	30.00
Deferred Tax Assets (Dr.)	15.00

The following transactions were reported during the year 20X1-20X2:

i)	Tax Rate	30%
		(₹ in lakh)
ii)	Depreciation as per books	80.00
	Depreciation for tax purposes	70.00
iii)	Items disallowed in 20X0-20X1 and allowed for tax purposes in 20X1-20X2.	10.00
iv)	Donations to Private Trust made in 20X1-20X2.	10.00

There were no additions to Fixed Assets during the year.

You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31.03.20X2.

(May 2020 RTP /January 2021)

Sol. **Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset**

Transactions	Analysis	Nature of difference	Effect	Amount
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	₹ (80−70) lakh × 30% = ₹ 3 lakh
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakh × 30% = ₹ 3 lakh
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

3. From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	**₹**
Accounting Profit	6,00,000
Book Profit as per MAT	3,50,000
Profit as per Income Tax Act	60,000
Tax rate	20%
MAT rate	7.50%

(ICAI SM/November 2020)

Sol. Tax as per accounting profit 6,00,000×20% = ₹ 1,20,000
Tax as per Income-tax Profit 60,000×20% =₹ 12,000
Tax as per MAT 3,50,000×7.50%= ₹ 26,250
Tax expense= Current Tax +Deferred Tax
₹ 1,20,000 = ₹ 12,000+ Deferred tax
Therefore, Deferred Tax liability as on 31-03-20X1
= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000
Amount of tax to be debited in Profit and Loss account for the year 31-03-20X1 Current Tax + Deferred Tax liability + Excess of MAT over current tax
= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000)
= ₹ 1,34,250

4. Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

(ICAI SM/May 2009)

Sol.

Calculation of Deferred Tax Asset/Liability in Omega Limited

Year	Accounting Income	Taxable Income	Timing Difference	Timing Difference (balance)	Deferred Tax	Deferred Tax Liability (balance)
20X0-20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1-20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2-20X3	21,00,000	23,00,000	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

5. Write short note on the following:

What are Timing differences and Permanent differences?

What are Timing Differences and Permanent Differences as per Accounting Standard – 22? Explain with example.

(November 2008/May 2014/November 2020 RTP)

Sol.

1) **Timing difference** is the difference between the accounting income and taxable income that originated in the same period and are capable of reversal in one or more subsequent periods. Examples of timing differences are as follows:
   - **i)** Expenditure of nature mentioned in Section 43 (B), like taxes, duty, cess, fees etc. if are accrued in the P/L A/c on accrual basis; but are allowed only on actual payment for tax purpose.
   - **ii)** Provision made in P/L A/c, but the relevant liability is allowed in the year in which it actualize.
   - **iii)** Depreciation
2) **Permanent difference** is the difference between the accounting income and taxable income that originated in the same period; but are not capable of reversal. Examples of permanent differences are as follows: -

   Personal expenditure

   Contribution to National Laboratory.

   Donations, etc.

6. Write short notes on the following:

Provision for taxation and advance payment of tax.

(Dec 2011/Dec 2009)

Sol.

Provision for Taxation: Provision for Income Tax to be created for current year is shown in the debit side of profit and loss account as well as under provision in liabilities side in the balance sheet. If rate of Income Tax is given it will be applied on net profit. Surcharge if any, will be calculated on Income Tax, while calculating income tax provision as a percentage of net profit. Some adjustment may be required. Net profit as shown by profit and loss account may be different from the taxable profit.

Advance Tax: Any advance tax paid by company will be shown on the assets side of the balance sheet under short term 'Loans and Advances'. Alternatively, it may be shown as a deduction from provision for Income Tax. If amount of advance tax is more than the amount of tax assessed, the excess is refundable by income. Tax department. This excess will be shown in the assets side under short terms 'Loans and Advances' until refund is received.

7. Sri Guruji Limited is a full tax-free enterprise for the 1st 12 years of its existence and is in third year of operations. Depreciation timing difference resulting in a deferred tax liability in 1st, 2nd and 3rd year is ₹ 200 lakhs. ₹ 300 lakhs and ₹ 400 lakhs respectively. From the 4th year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of 3rd year and any charge to the Profit and Loss Account.

(November 2012/ICAI SM)

Sol. **<u>Provision:</u> -** As per AS-22, "Accounting for Taxes on Income**",** <u>in the case of tax-free enterprises, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period</u>. <u>Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period For this purpose, adjustments are done in accordance with the FIFO method.</u>

<u>Analysis and conclusion:</u> - Accordingly, depreciation timing difference of ₹ 90 lakhs (₹ 10 lakhs × 9 years) will reverse in the tax holiday period i.e. from 4th year to 12th year. Therefore, no deferred liability on ₹ 90 lakhs out of ₹ 200 lakhs. Will be created. In the 1st year, deferred tax liability of ₹ 38.5 lakhs will be created @ 35% on ₹ 110 lakhs (₹ 200 lakhs – ₹ 90 lakhs) only.

However, the entire depreciation timing difference of 2nd and 3rd year i.e. ₹ 300 lakhs and ₹ 400 lakhs will reverse only after the tax holiday period. So, deferred tax liability will be created in the 2ndyear for ₹ 105 lakhs (₹ 300 × 35%) and in the 3rd year for ₹ 140 lakhs (₹ 400 × 35%).

Therefore, total deferred tax liability in the Balance Sheet at the end of 3rd year will be ₹ (38.5 + 105 + 140) lakhs = ₹ 283.5 lakhs and charge to Profit and Loss account in the 3rd year will be ₹ 140 lakhs (₹ 400 × 35%)

8. The following information is furnished in respect of Slate Ltd. for the year ending 31-3-20X1:

i) Depreciation as per books ₹ 2,80,000
Depreciation for tax purpose ₹ 1,90,000
The above depreciation does not include depreciation on new additions.

ii) A new machinery purchased on 1.4.X0 costing ₹ 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.

iii) The company has made a profit of ₹ 6,40,000 before depreciation and taxes.

iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-20X1 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(May 2021 RTP)

Sol. **Statement of Profit and Loss for the year ended 31st March, 20X1 (Extract)**

		₹
Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000)
Profit before taxes (A)		3,30,000
Less: Tax expense (B)	1,32,000	
Current tax (W.N.1) (3,30,000 × 40%) Deferred tax (W.N.2)	NIL	(1,32,000)
Profit after tax (A−B)		1,98,000

Working Notes:

1) Computation of taxable income

	Amount (₹)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2) Impact of various items in terms of deferred tax liability / deferred tax asset

S. No.	Transactions	Analysis	Nature of difference	Effect	Amount (₹)
i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 – 1,90,000) × 40% = (36,000)
ii)	Depreciation on new machinery	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) × 40% = 36,000
	Net impact				NIL

9. What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22? **(May 2021 RTP)**

Sol. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

10. PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

(ICAI SM)

Sol. **Statement of Profit and Loss**

	31.3.20X1	**31.3.20X2**	**31.3.20X3**
	₹	**₹**	**₹**
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year (2,00,000 × 40%)	80,000		
Tax effect of timing differences reversed/adjusted during the year (1,00,000 × 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

11. Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22.

(Nov 2021 RTP)

Sol. Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

- **i)** the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and
- **ii)** the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

12. The following particulars are stated in the balances sheet of Deep Limited as on 31st March, 20X1.

	₹in Lakhs
Deferred Tax liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the Year 20X1-20X2.

- (i) Depreciation as per books was ₹70 Lakhs whereas Depreciation for Tax purposes was ₹42 Lakhs. There were to additions to Fixed Assets during the Year.
- (ii) Expenses disallowed in 20X0-20X1 and allowed for tax purposes in 20X1-20X2 were ₹14 Lakhs.
- (iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the Year 2020-2021 (1/10th of ₹70.00 Lakhs insured on 20X0-20X1.
- (iv) Repairs to Plant and Machinery were made during the year for ₹14.00 Lakhs and was spread over the period 20X1-20X2 and 20X2-20X3 equally in the books. However, the entire expenditure was allowed for income tax purposes in the year 20X1-20X2.

Tax Rate to be taken at 40%.

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 20X2.

Sol. Impact of various items in items of deferred tax liability/ deferred tax assets on 31.3.X2.

Transactions	Analysis	Nature of Difference	Effect	Amount ₹
Difference in Depreciation	Generally, written down value method of depreciation is under IT Act, which leads to higher depreciation in earlier years of useful life of the assets in comparison to later years.	Responding time difference	Reversal of DTL	28 Lakhs*40%=₹11.20 Lakhs
Disallowances as per IT Act, of earlier Years.	Tax Payable for the earlier year was higher on this account.	Responding time difference	Reversal of DTL	14 Lakhs*40%= 5.6Lakhs

	Share Issue expenses.	Due to allowances of full expenditure under IT Act, tax payable in the earlier Years was higher.	Responding time difference	Reversal of DTL	7 Lakhs*40% = ₹2.8 Lakhs.
	Repairs to Plant and Machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Responding time difference	Reversal of DTL	70Lakhs*40%=28 Lakhs.

AS-24 Discontinuing Operations
Assignment

Q. No.	Question & Answers
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. **(May 2020 RTP /November 2009/November 2018/ November 2020 RTP)**
Ans.	**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)** As per AS- 24 “Discontinuing Operations” explains the criteria for determination of discontinuing operations. examples of activities that do not necessarily satisfy criterion , but that might do so in combination with other circumstances, include: a) Gradual or evolutionary phasing out of a product line or class of service; b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business; c) Shifting of some production or marketing activities for a particular line of business from one location to another; and d) Closing of a facility to achieve productivity improvements or other cost savings. An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.
2.	Sri Maruti 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 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 will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. i) 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. 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? **(May 2021 RTP /November 2013)**

Ans.	**Provision: -** Mere gradual phasing is not considered as discontinuing operation as defined under AS-24, 'Discontinuing operation'. Examples or 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. A Reportable business segment or geographical segment as defined in AS-17, would normally satisfy criteria (b) of the definition. **In view of the above the answers are:** **No.** The company's strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has started.. Hence, AS-24 will not be applicable **No**. The resolution is salient about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory , closure road map and new segment starting road map is missing. Hence, AS-24 will not be applicable. **Yes.** Phased and time bound programmed resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map. Hence, this action will attract AS-24 compliance.
3.	What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements? **(November 2021 RTP)**
Sol.	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.

AS 26 Intangible Assets
Assignment

<table>
<tr><th>Q. No.</th><th>Questions & Answers</th></tr>
<tr><td>1.</td><td>
<p>A company had deferred research and development cost of ₹150 lakhs Sales expected in the subsequent years are as under.</p>
<table>
<tr><th>Years</th><th>Sales</th></tr>
<tr><td>I</td><td>400</td></tr>
<tr><td>II</td><td>300</td></tr>
<tr><td>III</td><td>200</td></tr>
<tr><td>IV</td><td>100</td></tr>
</table>
<p>You are asked to suggest how should Research and development cost is to be charged to the Profit and loss account.
If at the end of the III year, it was felt that no further benefit will accrue in the IV year, how the unamortizedamount would be dealt with in the accounts of the company?</p>
<p>[May 2005/ May 2020 RTP /May 2012/May 2013(M)]</p>
</td></tr>
<tr><td>Sol.</td><td>
<p><u>Provision: -</u> As per AS 26, expenditure on research should be recognized as an expense when it is incurred. <u>An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use.</u>
<u>Analysis and conclusion:</u> - In the given case
Based on sales, research and development cost to be allocated as follows</p>
<table>
<tr><th>Year</th><th>Research and development cost allocation</th><th>(INR in lakhs)</th></tr>
<tr><td>I</td><td>400 × 150 ÷ 1000 =</td><td>60</td></tr>
<tr><td>II</td><td>300 × 150 ÷ 1000 =</td><td>45</td></tr>
<tr><td>III</td><td>200 ×150 ÷ 1000 =</td><td>30</td></tr>
<tr><td>IV</td><td>10 × 150 ÷ 1000 =</td><td>15</td></tr>
</table>
<p>If the end of the III year, the circumstances do not justify that further benefit will accrue in IV year,then <u>company has to charge the unamortized amount i.e. remaining ₹45 lakhs [150 – (60 + 45)] as an expense immediately.</u></p>
</td></tr>
<tr><td>2.</td><td>
<p>NDA Corporation is engaged in research on a new process design for its product. It had incurred an expenditure of ₹ 530 lakhs on research up to 31st March, 20X2.The development of the process began on 1stApril, 20X2 and Development phase expenditure was ₹ 360 lakhs up to 31st March, 20X3 which meets assets recognition criteria.
From 1st April, 20X3, the company will implement the new process design which will result in an after-tax saving of ₹ 80 lakhs per annum for the next five yea₹
The cost of capital of the company is 10% Explain: -
1) Accounting treatment for research expenses.
2) The cost of internally generated intangible asset as per AS 26.
3) The amount of amortization of the asset. (The present value of annuity factor of ₹ 1 for 5 years @ 10% =3.7908)</p>
<p>[May 2009/November 2013/December 2021(M)/May 2015(M)]</p>
</td></tr>
</table>

Sol.

1) Provision: - As per AS-26, "Intangible assets" Expenditure on research or on the research phase should be recognized as expense when it is incurred.

Analysis and conclusion: - In the given case expenditure on research of new process design for its product 530 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 20X0-X1. Hence, it should be written off as an expense in that year itself.

2) Provision: - As per AS-26, "Intangible assets" Cost of an internally generated intangible assets is all directly attributable expenses (like material consumed and salaries paid) excluding cost of staff training, initial operating losses before the assets meet the recognition criteria and selling, administrative expenses. Or the present value of future cash flows whichever is lower.

Analysis and conclusion: - In the given case the development phase expenditure amounting ₹ 360 lakhs incurred up to 31st March, 20X3 meets asset recognition criteria for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

	₹
Saving (after tax) from implementation of new design For next 5 years	80 lakhs p.a
Company's cost of capital	10%
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flow (₹ 80 lakhs × 3.7908)	303.26 lakhs

The cost of an internally generated intangible asset would be lower of cost value 360 lakhs or present value off future net cash flows ₹ 303.26 lakhs.

Hence, cost of an internally generated intangible asset will be ₹ 303.26 lakhs.

The difference of ₹ 56.74 lakhs (i.e. ₹ 360 lakhs – ₹ 303.26 lakhs) will be amortized by the enterprise forthe financial year 20X2-X3.

3) **Amortization** – The company can Amortize ₹ 303.26 lakhs over a period of five years by charging ₹ 60.65lakhs per annum from the financial year 20X2-X3 onwards.

3.

A company acquired a patent at a cost of ₹ 160 lakhs for a period of 5 years and the product life cycle is also 5 yea₹ The company capitalized the cost and started amortising the asset at ₹ 16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹ 50 lakhs, ₹ 30 lakhs, ₹ 60 lakhs, ₹ 70 lakhs and ₹ 40 lakhs. Find out the amortization cost of the patent for each of the yea₹ **(May 2018/May 2006/May 2017/ICAI SM)**

Sol.

Provision: - As per AS-26, An intangible asset is to be amortized over the best estimate of its useful life, if the expected useful life of the asset is significantly different from previous estimates, the amortization period should be changed accordingly. AS-5 provides that in case of change in estimate, the effect should be given prospectively over the remaining useful life of the intangible asset.

Analysis and conclusion: - In the given case the company amortised ₹ 16,00,000 per annum for the first two years i.e. ₹ 32,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net Cash flows (₹)	Amortisation Ratio	Amortisation Amount (₹)
1	-	0.10	16,00,000
2	-	0.10	16,00,000
3	50,00,000	0.20	25,60,000
4	30,00,000	0.12	15,36,000
5	60,00,000	0.24	30,72,000
6	70,00,000	0.28	35,84,000
7	40,00,000	0.16	20,48,000
	2,50,00,000	**1.00**	**1,60,00,000**

It may be seen from above that from third year onwards, the balance of carrying amount i.e. ₹ 1,28,00,000 has been amortised in the ratio of net cash flows arising from the product of the company.

4. M Ltd. launched a project for producing product A in November 20X0. The company incurred ₹ 30 lakhs demonstrate towards Research and Development expenses up to 31st March, 20X2. Due to unfavorable market conditions, the management feels that it is not possible to manufacture and sell the product in the market for the next so many yea₹ The management hence wants to defer the expenditure write off to future yea₹ Required: Advise the company as per the applicable Accounting Standard. **[Nov. 2003/November 2010/ICAI SM]**

Sol. **Provision: -** As per AS 26, expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can fulfill all of the conditions specified in this accounting standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use.

Analysis and conclusion: - In the given case of M Ltd. the management cannot defer the expenditure write off to future years because expenses incurred by M LTD. treated as an expense on research and research expenses should be recognized when it is incurred so the company is required to expense the entire amount of ₹ 30 lakhs in the Profit and Loss account of the year ended 31st March, 20X2.

5. A company with a turnover of 250 crores an annual advertising budget of 2 crores had taken up to the marketing of a new product. It was estimated that the company would have a turnover of 25 crores from the product. The company had debited to its profit and loss account the total expenditure 2 crores incurred of an extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company, correct?

(ICAI SM/November 2016/November 2019(M))

Sol. **Provision: -** As per AS 26,” intangible assets” expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms the part of the cost of an intangible asset Further, standard provides that expenditure on advertising and promotional activities should be recognized as an expense when incurred.

Analysis and conclusion: -

In the given case, an advertisement of expenditure of 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of 25 crores. Here, no intangible assets is acquired or created that can be recognized. Therefore, the accounting treatment by the company of debiting the entire advertising of expenditure of 2 crores to the profit and loss account of the year is correct.

6. Mahesh Ltd. is developing a new production process. During the financial year 31st March, 20X2,the total expenditure incurred on this process was ₹60 lakhs. The production process met the criteria for recognition as an intangible asset on 1st December, 20X1. Expenditure incurred till this date was ₹ 32 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March 20X3, was ₹ 90 lakhs. As at 31 -3-20X3, the recoverable amount of know-how embodied in the process is estimated to be ₹82 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to work out:

a) What is the expenditure to be charged to the profit and loss account for the financial year ended 31stMarch 20X2? (Ignore depreciation for this purpose)

b) What is the carrying amount of the intangible asset as at 31st March 20X2?

d) What is the expenditure to be charged to the profit and loss account for the year ended 31st March 20X3?

What is the carrying amount of the intangible asset as at 31st March 20X3?

(December 2021/May 2015/Nov. 2020)

Sol. As per AS 26, the amount charged and recognized are as follows:

1) **The expenditure to be charged to profit and loss a/c for year ended 31st march 20X2:**

   ₹32 lakh will be recognized as an expenses because the recognition criteria were not met until 1st December 20X1.

   This expenditure will not from part of the cost of the production process recognized in the balance sheet

2) **The carrying amount of the assets as on 3st march 20X2:**

   The production process will be recognized (i/r/ carrying amount) as intangible assets at a cost of ₹28 lakhs (i.e. expenditure incurred since the date the recognition criteria were met i.e. total during 20X1-20X2 ₹60 lakhs. Expenses incurred upto 1st December 20X1 ₹32 lakh.

3) **The expenditure to be charged to profit and loss a/c for the year ended 31st march 20X3:**

Book value on 31 march 20X3	Amount
Carrying amount on 31 march 20X3 + expenses in 20X2-X3	28+90 = 118
Less: recoverable amount	82 lakhs
Impairment loss to be charged to p&l a/c	36 lakh

4) **The carrying amount of assets as on 31st march 20X3:**

The production process will be shown at book value ₹118 lakh or, recoverable amount ₹82 lakh, whichever is less, hence carrying amount is ₹ 82 lakh.

7. A company acquired patent right for ₹ 1200 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year	**1**	**2**	**3**	**4**	**5**
Estimated future cash flows (₹ in lakhs)	600	600	600	300	300

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹ 150 lakhs. You are required to determine the amortization pattern under Accounting Standard 26.

(May 2020 RTP /November 2020/May 2013)

Sol. **Provision: -** As per AS-26, An intangible asset is to be amortized over the best estimate of its useful life, if the expected useful life of the asset is significantly different from previous estimates, the amortization period should be changed accordingly. AS-5 provides that in case of change in estimate, the effect should be given prospectively over the remaining useful life of the intangible asset.

Analysis and conclusion: - In the given case the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be ₹ 300 lakh (1,200−900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Year	**Estimated future cash flow (₹ In lakhs)**	**Amortization Ratio**	**Amortized Amount (₹ In lakhs)**
1	600	.25(600/2,400)	300
2	600	.25(600/2,400)	300
3	600	.25(600/2,400)	300
4	300	.40 (Revised)(300/750)	120
5	300	.40 (Revised)(300/750)	120
6	150	.20 (Revised)(150/750)	60
			1,200

8. The company has spent ₹45 lakhs for publicity and research expenses on one of its new consumer products, which was marketed in the accounting year 20X1-20X2 but proved to be a failure. State how you will deal with the following matters in the accounts of U ltd. for the year ended 31st march 20X2 **(ICAI SM /November 2019(M))**

Sol. **Provision: -** As per AS-26, expenditure on research should be recognized as an expense when it is incurred. Further, the standard provides that expenditure on advertising and promotional activities should be recognized as an expense when incurred.

Analysis and conclusion: - In the given case, the company spent ₹45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefits because of the failure of the product. Thus, the company should charge the total amount of ₹45 lakhs as an expense in the profit and loss account.

9. During 20X0-X1, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particulars	**₹**
Completion of detailed program and design (Phase1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above cost to be recognized in the books of accounts as per AS 26.

(ICAI SM/ October 2021 MTP)

Sol. **Provision: -** As per AS-26 "Intangible Assets" Expenditure on development should be treated as an expense unless they meet the recognition criteria. For treating as an asset following conditions needs to be fulfilled:

1) Technically feasibility of project
2) Identification of cost incurred
3) Probability of external market

	4) Realistic expectation that there will be sufficient future revenues to cover the cost. **Analysis and conclusion: -** In the given case, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model. ₹ 90,000 would be recorded as an expense (₹ 50,000 for completion of detailed program design and ₹ 40,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000 + 18,000 + 19,500) = ₹ 1,00,500. Packing cost ₹ 16,500 should be recognized as expenses and charged to P & L A/c.
10.	Himalaya Ltd. in the past three years spent ₹ 75,00,000 to develop a drug to treat cancer, which was charged to Profit and Loss Account since they did not meet AS – 26 criteria for capitalisation. In the current year approval of the concerned Government Authority has been received. The company wishes to Capitalise ₹ 75,00,000 and disclose it as a prior period item. Is it correct? Give reasons for your view. **[November,2005/November 2019]**
Sol.	**Provision: -** As per AS 26,” intangible assets” expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms the part of the cost of an intangible asset. **Analysis and conclusion: -** In the given case Himalaya Ltd. cannot capitalise ₹ 75,00,000 because it has already been charged to Profit and Loss Account in the previous accounting yea₹ AS – 26 prohibits reinstatement of expenditure recognized as an expenses in previous annual financial statements of interim reports.
11.	A company is showing an intangible asset at ₹ 88 lakhs as on 01.04.20X4. This asset was acquired for ₹ 120 lakhs on 01.04.20X0 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard. **(Nov 2014/Nov. 2021 RTP)**
Sol.	**Provision:** - As per AS-26 standard, the depreciable amount of an intangible asset should be allocated on a Systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of the intangible asset will not exceed ten years from the date when the assets is available for use. **Analysis and conclusion: -** In the given case the Company has been following the policy of amortisation of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS-26. According to the above, the company would be required to restate the carrying amount of intangible asset as on 01.04.20X4 at ₹ 72 lakhs i.e. cost ₹ 120 lakhs less 48 lakhs $\left(\frac{₹120 \text{ Lakhs}}{10 \text{ Years}} \times 4 \text{ years} = 48 \text{ Lakhs}\right)$ Difference of ₹ 16 Lakhs (i.e. ₹ 88 lakhs − ₹ 72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 72 lakhs will be amortised over remaining 6 years by amortising ₹ 12 lakhs per year.
12.	ABC Ltd. developed a know-how by incurring expenditure of ₹ 20 lakhs. The know-how was used by the company from 1.4.20X0. The useful life of the assets is 10 years from the year of commencement of its use. The company has not amortized the asset till 31.3.20X7. Pass journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X7. **(ICAI SM)**

Sol.

Particulars		L.F.	Debit	Credit
Profit and loss a/c (prior period item)	Dr.		12,00,000	
Amortization a/c	Dr.		2,00,000	
To know how a/c				14,00,000
(Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)				

13. Decide when research and development cost of a project can be deferred (postpone) to future periods as per AS – 26. **[May 2003]**

Sol. Development costs of a project may be deferred to future periods, if the following criteria are satisfied.

1) The product or process is clearly defined and the costs attributable to the product or process can be separately identified:
2) The technical feasibility of the product or process has been demonstrated.
3) The management of the enterprise has indicated its intention to complete the intangible asset and use or sell it.
4) There is a reasonable indication that current and future research and development costs to be incurred. On the project together with expected production, selling and administration costs are likely to be more than covered by related future revenues / benefits; and
5) Adequate resources exist, or are reasonably expected to be available to complete title project and market the product or process.

14. An intangible asset appears in Balance Sheet of A co. Ltd. at ₹ 16 lakhs as on 31.3.20X14. The asset was acquired for **₹.**40 lakhs in April, 20X1. The Company has been amortising the assets value on straight line basis. The policy is to amortize for 20 years?

Do you advise the company to amortize the entire asset value in the books of the company as on 31.3.20X14? **[Nov. 2005]**

Sol. **Provision: -** As per AS-26 standard, the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of the intangible asset will not exceed ten years from the date when the assets is available for use. But if there is persuasive evidence that the useful life of an intangible assets is more than ten years than an intangible asset has to be amortized over the best estimate of its useful life

Analysis and conclusion: - In the given case the amortization period of ten years has already expired on 31.3.20X14, therefore, the carrying amount of ₹16 lakhs has to be eliminated with a corresponding adjustment to the balance of revenue reserves of 31.03.20X14. However, if there is persuasive evidence that the useful life of an intangible assets is more than ten years thenan intangible asset has to be amortized over the best estimate of its useful life and therefore, assuming that the best estimate of its, useful life is 20 years as given in the question, depreciation amounting ₹ 2 lakhs i.e. (₹ 40 lakhs – Nil) ÷ 20 years] as per straight line basis should be charged by A Co. Ltd. and no other adjustments is required as on 31.3.20X144.

15. SAD Enterprises, a partnership firm, had purchased business of SWAD enterprises on 01.04.20X0 and paid ₹ 50,000 towards goodwill. On 01.04.20X1, SAD enterprises decided to admit W as partner and the goodwill was valued at ₹ 1,00,000 for the purpose. Please explain with reasons, at what price goodwill can be shown in the books of account.

[Nov. 2009]

Sol. **Provision: -** As per AS 26," Intangible assets" goodwill can be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, only purchased goodwill should be recorded in the books.

Analysis and conclusion: - In the given case Payment of ₹ 50,000 was made towards purchase of goodwill, hence to this extent goodwill can be recorded in the books. Additional goodwill of ₹ 50,000 is self-generated goodwill, which should not be recorded. On admission, death or retirement of a partner, goodwill adjustments can be carried out through capital accounts.

16. Naresh ltd. had the following transaction during the financial year 20X0-20X1:

1) Naresh ltd. acquired running business of Sunil ltd. for ₹10,80,000 on 15th may 20X0. The fair value of Sunil ltd net assets was ₹5,16,000. Naresh ltd. is of the view that due to popularity of Sunil ltd. product in the market, its goodwill exists.
2) Naresh ltd. had taken a franchise on July 20X0 to operate a restaurant from Sankalp ltd. for ₹1,80,000 and at an annual fee of 10% of net revenue (after deducting expenditure). The franchise expires after 6 yea₹ Net revenue was ₹60,000 during the financial year 20X0-20X1
3) On 20th august 20X0, Naresh ltd. incurred costs of ₹2,40,000 to register the patent for its product. Naresh ltd. expects the patents economic life to be 8 years

Naresh ltd. follows an accounting policy to amortize all intangible on straight line basis over the maximum period permitted by accounting standard taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14

Prepare a schedule showing the intangible assets section in Naresh ltd. balance sheet at 31st march 20X1.

(May 2021 RTP)

Sol.

Naresh ltd.

Balance sheet (extract relating to intangible assets) as on 31st march 20X1

	Note no.	Amount
Assets		
1) Non-current assets		
Intangible assets	1	8,11,200

Note to account (extract)

	Amount	Amount
Intangible assets		
Goodwill (refer note 1)	4,51,200	
Franchise (refer note 2)	1,50,000	
Patents (refer note 3)	2,10,000	8,11,200

Working notes:

		Amt.
1	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: amortization as per AS 14 over 5 years (AS per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
2	Franchise	1,80,000
	Less: amortization (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
3	Patent	2,40,000
	Less: amortization (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

17.	X ltd. carried on the business of manufacturing of bakery products. The company has two trademarks sun and Surya. One month before, the company comes to know through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation legal department of the company informed that it had a weak case on trademark sun and a strong case in regards to trademark Surya. X ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 yea₹ How should X ltd. account for these legal costs incurred relating to the two trademarks? **(November 2020 RTP)**
Sol.	**Provision:** - As per AS 26, "Intangible assets" subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expenses. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the assets reliably, then such subsequent expenditure should be added to the cost of intangible assets. **Analysis and conclusion: -** In the given case the legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the cases is decided in favor of the company. Therefore, such legal costs incurred for both trademarks must be recognized as an expenses.
18.	An intangible item is appearing in the Balance Sheet of A Ltd. ₹ 15 lakhs on 1-4-20X1. The item was acquired for ₹ 25 lakhs on 1-4-20X0. The enterprise has been following a policy of amortizing the intangible item over a period of 5 years on a straight-line basis. Applying paragraph 63 of AS 26 the enterprise determines the amortization period to be 8 years, being the best estimate of its useful life, from the date when the item was amiable for use i.e., April 1, 20X0. Comment. **(RTP)**
Sol.	**Provision: -** As per AS-26, An intangible asset is to be amortized over the best estimate of its useful life, if the expected useful life of the asset is significantly different from previous estimates, the amortization period should be changed accordingly. AS-5 provides that in case of change in estimate, the effect should be given prospectively over the remaining useful life of the intangible asset i.e. 6 yea₹ **Analysis and conclusion-:** In the given case the intangible asset was Acquired i.e. 1st April 20X0, the revision of the amortization period from 5 years to 8 years is a change in Accounting estimate. Note: It is assumed that since the date of purchase of intangible item, the enterprise has been following a policy of amortizing the intangible asset over a period of 5 years on straight-line basis by applying AS 26 i.e.being the best estimate of its useful life. On 1.4.20X2, the company again reviewed the useful life of the intangible asset.

AS-29 Provisions, Contingent Liability and Contingent Assets Assignment

<table>
<tr><th>Q. No.</th><th>Question & Answers</th></tr>
<tr><td>1.</td><td>A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?
(November 2012/November 2014/November 2016)</td></tr>
<tr><td>Sol.</td><td><u>Provision: -</u> As per AS-29, (Revised) ‘Provisions, Contingent Liabilities and Contingent Assets’, a provision should be recognized when;
A) An enterprise has <u>a present obligation</u> as a result of a past event:
B) It is probable that an <u>outflow of resources</u> embodying economic benefits will be required to settle the obligation; and
C) a <u>reliable estimate can be made of the amount of the obligation</u>.
If these conditions are not met, no provision should be recognised.
<u>Analysis and Conclusion: -</u> In the given situation, since, the directors of the <u>company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources.</u> The company will disclose the same as contingent liability by way of the following note;
“Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company.”</td></tr>
<tr><td>2.</td><td>At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:
<table>
<tr><th></th><th>Probability</th><th>Loss (₹)</th></tr>
<tr><td>In respect of five cases (Win)</td><td>100%</td><td>-</td></tr>
<tr><td>Next ten cases (Win)</td><td>50%</td><td>-</td></tr>
<tr><td>Lose (Low damages)</td><td>40%</td><td>1,20,000</td></tr>
<tr><td>Lose (High damages)</td><td>10%</td><td>2,00,000</td></tr>
<tr><td>Remaining five cases</td><td></td><td></td></tr>
<tr><td>Win</td><td>50%</td><td>-</td></tr>
<tr><td>Lose (Low damages)</td><td>30%</td><td>1,00,000</td></tr>
<tr><td>Lose (High damages)</td><td>20%</td><td>2,10,000</td></tr>
</table>
Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.
(ICA SM/November 2017)</td></tr>
<tr><td>Sol.</td><td><u>Provision: -</u> As per AS-29 (Revised) ‘Provisions, Contingent Liabilities and Contingent Assets’, <u>contingent liability should be disclosed in the financial statements if following conditions are satisfied:</u>
i) There is a present obligation arising out of past events but not recognised as provision.
ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
iii) The possibility of an outflow of resources embodying economic benefits is not remote.
iv) The amount of the obligation cannot be measured with sufficient reliability to be recognised as provision.</td></tr>
</table>

<u>Analysis and conclusion: -</u> In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the <u>loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made.</u> For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 48,000 + ₹ 20,000 = ₹ 68,000
Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to <u>disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 × 10 + ₹ 72,000 × 5) as contingent liability.</u>

3. Answer the following:

Sri JMD company provides after sales warranty for 2 years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount; on the remaining balance warranty period:

Less than 1 year: 2% provision
More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 20X1	40,000
29th January, 20X2	25,000
15th October, 20X2	90,000

Calculate the provision to be made for warranty under accounting Standard 29 as at 31st March, 20X2 and 31st March, 20X3. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 20X3.

(May 2014/ November 2019/May 2013)

Sol. **<u>Provision: -</u>** As per AS-29 (Revised) "Provisions, Contingent Liabilities and Contingent Assets" a provision should be recognized when;

A) An enterprise has <u>a present obligation</u> as a result of a past event:
B) It is probable that an <u>outflow of resources</u> embodying economic benefits will be required to settle the obligation; and
C) a <u>reliable estimate can be made of the amount of the obligation</u>.

If these conditions are not met, no provision should be recognised

<u>Analysis and conclusion: -</u> <u>'Provision</u> to be made for warranty as under

As at 31st March, 20X2	= ₹ 40,000 × .02 + ₹ 25,000 × .03
	= ₹ 800 + ₹ 750
	= ₹ 1,550
As at 31st March, 20X3	= ₹ 25,000 × .02 + ₹ 90,000 × .03
	= ₹ 500 + ₹ 2,700 = ₹ 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 20X3

Particulars	**₹**
Balance of provision required as on 31.03.20X3	3,200
Less: **Opening Balance as on 1.4.20X2**	(1,550)
Amount debited to profit and loss account in year ending 31-03-X3	1,650

Note: <u>No provision will be computed on 31st March, 20X3 in respect of sales amounting ₹ 40,000 made on 19th January, 20X1 as the warranty period of 2 years has already expired.</u>

4.	With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates: **i)** An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted. **ii)** During 20X1-X2 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 20X2-X3, the financial condition of Brew Ltd. deteriorates and on 31st Dec. 20X2, it goes into liquidation. (Balance Sheet date 31-3-X2). **(May 2020 RTP /November 2020/ICAI SM)**
Sol.	**i)** **Provision: -** As per AS-29 (Revised) "Provisions, Contingent Liabilities and Contingent Assets" a provision should be recognized when; A) An enterprise has a present obligation as a result of a past event: B) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and C) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised **Analysis and conclusion: -** In the given case, all conditions are met which are required for the provision recognition, the construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event or a present obligation result of past event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted. **ii) Provision: -** As per AS-29 (Revised), "Provisions, Contingent Liabilities and Contingent Assets" for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation and a reliable estimate can be made of the amount of the obligation. **Analysis and conclusion: -** In the given case, the obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 20X2.Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote. During 20X2-X3, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31st March 20X3, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.
5.	Answer the following: An airline is required by law to overhaul its aircraft once in every five years. The Pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29. **(May 2012/ November 2021 MTP)**
Sol.	**Provision: -** As per AS-29 (Revised), "Provisions, Contingent Liabilities and Contingent Assets" Provision should be recognised only when an enterprise has a present obligation as a result of past event. Further Standard provides that there is no realistic alternative settlement of that obligating event.

	Analysis and conclusion: - In the given case, there is no present obligation, The cost of overhauling aircraft is not recognized as a provision because it is future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircraft therefore no provision is recognised. ✓ Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. ✓ However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.
6.	A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company. The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated. The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts. You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29. **(Nov 2021 RTP)**
Ans.	**Provision: -** As per AS-29, (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when; A) An enterprise has a present obligation as a result of a past event: B) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and C) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised. **Analysis and conclusion: -** In the given case, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts and circumstances of the case.
7.	An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29? **(Nov 2021 RTP)**
Ans.	**Provision: -** As per AS-29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

	Analysis and conclusion: -In the given case, when environmental damage is caused, there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.
8.	The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. You are required to examine in line with the provisions of AS 29. **(May 2021 RTP)**
Ans.	**Provision: -** As per provisions of AS-29 (Revised) "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision. **Analysis and conclusion: -** In the given situation, it is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.
9.	Explain whether provision is required in the following situations in line with AS 29: **i)** There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation; **ii)** There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources. **iii)** There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote. **(May 2021 RTP)**
Ans.	**i)** There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognised. Disclosures are required for the provision. **ii)** There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability. **iii)** There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.
10.	How will you distinguish contingent assets with Contingent Liabilities? Explain in brief. **(Nov 2020 RTP)**
Ans.	A Contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or A present obligation that arises from past events but is not recognized because: **i)** It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or **ii)** A reliable estimate of the amount of the obligation cannot be made. An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

	Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.
11.	Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 20X1-X2 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 20X2-X3 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 20X1-X2 financial year. As on balance sheet date (31.3.20X2), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement of provision for contingency in the financial statements for the year ended 31st March, 20X2, in line with provisions of AS 29? **(Nov 2020 RTP)**
Ans.	**Provision: -** As per AS-29, (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when; A) An enterprise has a present obligation as a result of a past event: B) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and C) a reliable estimate can be made of the amount of the obligation. If these conditions are met, provision should be recognised **Analysis and conclusion: -** In the given case, Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting ₹ 2 crores as per AS 29.
12.	EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following: **i)** The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore. **ii)** The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 20X2. **(ICAI SM)**
Sol.	**i)** Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and also disclosed as a contingent liability of ₹ 2.10 crore. **ii)** The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

13. Answer the following:

With reference to AS 29 “Provisions, Contingent Liabilities and Contingent Assets”, define:

i) A Provision
ii) A Liability
iii) A Contingent Asset
iv) Present Obligation **(May 2016)**

Sol.

i) A Provision:

A Provision is a liability, which can be measured only by using a substantial degree of estimation.

ii) A Liability:

A liability is an obligation which the enterprise has to pay to some parties based on some contractual or any other trading arrangements within some specified or reasonable time period, So that it is considered as amount payable.

iii) A Contingent Asset:

A Contingent Asset is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

iv) Present Obligation:

Present Obligation is an obligation of outflow of resources that is probabic and reliable. It is estimated that amount is payable in present situation.

14. Saharsh Ltd. Is engaged in manufacturing of electric appliances. The company is in the process of finalizing its accounts for the year ended 31.3.20X1 and needs your expert advice on the following issue in line with the provisions of AS-29.

I. A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹20 Lakh has been received. The company has appointed a lawyer to defend the case for a fee of ₹2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalization of the case. There are 75% chances that the penalty may not be levied.

II. The company has committed to supply a consignment worth ₹1 Crore to one of its dealers by the year end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth ₹30 lakh met with an accident. It was however covered by insurance. According to the surveyor’s report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth ₹30 Lakhs which was in transit.

Sol.

1) Provision: - As per AS-29, (Revised) ‘Provisions, Contingent Liabilities and Contingent Assets’**,** a provision should be recognized when;

A) An enterprise has a present obligation as a result of a past event:

B) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

C) a reliable estimate can be made of the amount of the obligation.

Analysis and conclusion: - In the given case, there are 75% chances that the penalty may not be levied so it is probable that there is no outflow of resources. Accordingly, Saharsh Ltd. Should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

Provision: - As per provisions of AS-29 (Revised) “Provisions, Contingent Liabilities and Contingent Assets”, where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision**.**

Analysis and conclusion: -

Loss due to accident = ₹30,00,000
Insurance claim received by company = 3,00,000*90% = ₹27,00,000
Loss to be recognized in the books for 20X0-X1 = ₹3,00,000
Insurance claim receivable to be recorded in the books = = ₹27,00,000
Compensation claim by dealer against company to be provided for in the books
= 30,00,000*15% = ₹4,50,000.

15. Answer the following:

M/s. Sri Hari Ltd., a public Sector Company, provides consultancy and engineering services to its clients. In the year 20X3-20X4, the Government set up a commission to decide about the pay revision. The pay will be revised with respect from 1–1–20X1 based on the recommendations of the commission. The company makes the provision of ₹ 1,250 lakhs for pay revision in the financial year 20X3 – 20X4 on the estimated basis as the report of the commission is yet to come. As per the contracts with client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

“Salaries and benefits include the provision of ₹ 1,250 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made.”

The Accountant feels that the company should also book/recognize the income by ₹ 1,250 lakhs in Profit & Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept and understatement of profit.

Comment on the opinion of the accountant with reference to relevant Accounting Standards.

(May 2015)

Sol. **Provision: -** As per AS-29(Revised), ‘Provisions, Contingent Liabilities and Contingent Assets’, where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

Thus, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

Analysis and conclusion: - In the given case, the provision of salary to employees of ₹ 1,250 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 1,250 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of ₹ 1,250 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of ₹ 1,250 lakhs is not as per AS-29 and also the concept of prudence will not be followed if ₹ 1,250 lakhs is simultaneously recognized as income. ₹ 1,250 lakhs are not the revenue at present but only reimbursement of claim for which an asset is created. However, the accountant is correct to the extent as that non-recognition of ₹ 1,250 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Buy-Back of Securities and Equity Shares with Differential Rights Assignment

Q. No.	Questions and Answers
1	Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March, 20X1:

(in lakhs ₹)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	120
B) Reserves and Surplus	2	118
2.) Non-current liabilities		
Long term borrowings	3	4
3.) Current liabilities		
A) Trade Payables		70
Total		**312**
Assets		
1.) Non-current assets		
A) Property, plant and Equipment		50
B) Non-current Investments		120
2.) Current assets		
A) Cash and Cash equivalents		142
Total		**312**

Notes to accounts

No.	**Particulars**		**₹**
1.)	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity shares of ₹ 10 each fully paid		100
	9% Redeemable preference shares of ₹ 100 each fully paid		20
	Total		120
2.)	**Reserves and Surplus**		
	Capital reserves		8
	Revenue reserves		50

	Securities premium		60
	Total		118
3.)	**Long term borrowings**		
	10% Debentures		4

i) The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.

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

iii) Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.

iv) The company had 1,00,000 equity stock options outstanding on the above-mentioned date, to the employees at ₹ 20 when the market price was ₹30 (This was included under current liabilities). On 1.04.20X1 employees exercised their options for 50,000 shares.

v) Pass the journal entries to record the above.

vi) Prepare Balance Sheet as at 01.04.20X1.

(ICAI SM/November 2010/November 2012/December 2021(M)/ October 2021 MTP)

Sol.

(₹ in lakhs)

Date	Particulars	Debit	Credit
20X1 1st April	9% Redeemable preference share capital A/c Dr. Premium on redemption of preference shares A/c Dr. To Preference shareholders A/c (Being preference share capital transferred to shareholders account)	20.00 2.00	 22.00
	Preference shareholders A/c Dr. To Bank A/c (Being payment made to shareholders)	22.00	 22.00
	Equity shares buy-back A/c Dr. To Bank A/c (Being 3 lakhs equity shares of ₹ 10 each bought back @ ₹ 30 per share)	90.00	 90.00
	Equity share capital A/c Dr. Securities premium A/c Dr. To Equity Shares buy-back A/c (Being cancellation of shares bought back)	30.00 60.00	 90.00
	Revenue reserve A/c Dr. To Capital redemption reserve A/c (Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)	50.00	 50.00

	10% Debentures A/c Dr. To Investment (own debentures) A/c To Profit on cancellation of own debentures A/c (Being cancellation of own debentures costing ₹ 2 lakhs, face value being ₹ 2.20 lakhs and the balance being profit on cancellation of debentures)	2.20	 2.00 0.20
	Bank A/c Dr. Employees stock option outstanding (Current liabilities) A/c Dr. To Equity share capital A/c To Securities premium A/c (Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)	10.00 5.00	 5.00 10.00
	Securities premium A/c Dr. To Premium on redemption of preference shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	2.00	 2.00

Balance Sheet of Extra Ltd. as at 01.04.20X1

(in lakhs ₹)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	75.00
B) Reserves and Surplus	2	66.20
2.) Non-current liabilities		
Long term borrowings	3	1.80
3.) Current liabilities		
A) Other Current Liabilities	4	65.00
Total		208
Assets		
1.) Non-current assets		
A) Property, plant and Equipment		50.00
B) Non-current Investments	5	118.00
2.) Current assets		
A) Cash and Cash equivalents	6	40.00
Total		208

Notes to accounts

No.	Particulars		₹
1.)	**Share Capital**		
	Equity shares of ₹ 10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2.)	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-
	Securities Premium		
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
	Total		66.20
3.)	**Long term borrowings**		
	10% Debentures		4.00
	Less: Cancellation of own debentures		(2.20)
	Total		1.80
4.)	**Other Current liabilities**		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		(5.00)
	Total		65.00
5.)	**Non-current investments**		
	Opening balance		120.00
	Less: Investment in own debentures		(2.00)
	Total		118.00

6.)	**Cash and Cash Equivalents**		
	Opening balance		142.00
	Less: Payment to preference shareholders		(22.00)
	Less: Payment to equity shareholders		(90.00)
	Add: Share price received against ESOP		10.00
	Total		40.00

2. KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	1,200
B) Reserves and Surplus	2	810
2.) Non-current liabilities		
Long term borrowings	3	750
3.) Current liabilities		
A) Trade Payables		745
B) Other Current Liabilities		195
Total		3,700
Assets		
1.) Non-current assets		
A) Property, plant and equipment	4	2,026
B) Non-current Investments		74
2.) Current assets		
A) Inventories		600
B) Trade receivables		260
C) Cash and Cash equivalents		740
Total		3,700

Notes to accounts

No.	**Particulars**		**₹**
1.)	**Share Capital**		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid-up shares of ₹ 10 each)		1,200

2.)	**Reserves and Surplus**		
	Securities premium		175
	General reserve		265
	Capital redemption reserve		200
	Profit & loss A/c		170
	Total		810
3.)	**Long term borrowings**		
	12% Debentures		750
4.)	**Property, plant and equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

On 1st April, 20X1, the company announced the buy-back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 75 lakhs.

On 5th April, 20X1, the company achieved the target of buy-back. On 30th April, 20X1 the company issued one fully paid up equity share of ₹ 10 by way of bonus for every four equity shares held by the equity shareholders.

You are required to:

i) Pass necessary journal entries for the above transactions.

ii) Prepare Balance Sheet of KG Limited after bonus issue of the shares.

(ICAI SM/ May 2021 RTP /November 2016/May 2018)

Sol.

In the books of KG Limited Journal Entries

Date 20X1	Particulars		(₹ in lakhs)	
			Dr.	Cr.
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	300	
	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450
	(Being the amount due to equity shareholders on buy-back)			
	Equity shares buy-back A/c	Dr.	450	
	To Bank A/c			450
	(Being the payment made on account of buy-back of 30 Lakh Equity Shares)			
April 5	General reserve A/c	Dr.	265	
	Profit and Loss A/c	Dr.	35	
	To Capital redemption reserve A/c			300
	(Being amount equal to nominal value of buy-back shares from free reserves transferred to capital redemption reserve account as per the law)			

April 30	Capital redemption reserve A/c Dr.	225	
	To Bonus shares A/c (W.N.1)		225
	(Being the utilization of capital redemption reserve to issue bonus shares)		
	Bonus shares A/c Dr.	225	
	To Equity share capital A/c		225
	(Being issue of one bonus equity share for every four equity shares held)		

Balance Sheet (After buy-back and issue of bonus shares)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	1,125
B) Reserves and Surplus	2	436
2.) Non-current liabilities		
Long term borrowings	3	750
3.) Current liabilities		
A) Trade Payables		745
B) Other Current Liabilities		195
Total		3,251
Assets		
1.) Non-current assets		
A) Property, plant and equipment	4	2,026
2.) Current assets		
A) Inventories		600
B) Trade receivables		260
C) Cash and Cash equivalents		365
Total		3,251

Notes to accounts

No.	Particulars		₹
1.)	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		1,125
2.)	**Reserves and Surplus**		
	General Reserve	265	
	Less: Transfer to CR	(265)	-
	Capital Redemption Reserve	200	
	Add: Transfer due to buy-back of shares from P/L	35	
	Add; Transfer due to buy-back of shares from General Reserve	265	
	Less: Utilisation for issue of bonus shares	(225)	275
	Securities premium	175	
	Less: Adjustment for premium paid on buy-back	(150)	25
	Profit & Loss A/c	170	
	Add: Profit on sale of investment	1	
	Less: Transfer to CRR	(35)	136
	Total		436
3.)	**Long term borrowings**		
	12% Debentures		750
4.)	**Property, Plant and Equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working Notes:

1) Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹ 225 lakhs

2) Cash at bank after issue of bonus shares

Particulars	**₹ in lakhs**
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

Note: In the given solution, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

3.

Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	12,50,000
B) Reserves and Surplus	2	18,75,000
2.) Non-current liabilities		
Long term borrowings	3	28,75,000
3.) Current liabilities		
A) Other Current Liabilities		16,50,000
Total		76,50,000
Assets		
1.) Non-current assets		
A) Property, plant and Equipment	4	46,50,000
2.) Current assets		
A) Other Current Assets		30,00,000
Total		76,50,000

Notes to accounts

No.	**Particulars**		**₹**
1.)	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		12,50,000
2.)	**Reserves and Surplus**		
	Securities premium		2,50,000
	Profit and loss account		1,25.000
	Revenue reserve		15,00,000
	Total		18,75,000
3.)	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000

4.)	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

The company wants to buy-back 25,000 equity shares of ₹ 10 each, on 1st April, 20X1 at ₹ 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy-back of shares by company is within the provisions of the Companies Act, 2013. If yes, pass necessary journal entries towards buy-back of shares and prepare the Balance Sheet after buy-back of shares.

(ICAI SM/May 2012/May 2016/May 2019)

Sol. **Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013**

1) Shares Outstanding Test

Particulars	**(Shares)**
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2) Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000
25% of Shareholders fund (₹)	7,81,250
Buy-back price per share	₹ 20
Number of shares that can be bought back (shares)	39,062
Actual Number of shares for buy-back	25,000

3) Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	**₹**
a)	Loan funds (₹) (18,75,000 + 10,00,000 +16,50,000)	45,25,000
b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	22,62,500
c)	Present equity/shareholders fund (₹)	31,25,000
d)	Future equity/shareholders fund (₹) (see W.N.) (31,25,000 – 2,87,500)	28,37,500 *
e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	5,75,000
f)	Maximum number of shares that can be bought back @ ₹ 20 per share	28,750 shares
g)	Actual Buy-Back Proposed	25,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	31,250
Resources Test	39,062
Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

	Particulars	Debit (₹)	Credit (₹)
a)	Equity shares buy-back A/c Dr.	5,00,000	
	To Bank A/c		5,00,000
	(Being buy-back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)		
b)	Equity share capital A/c Dr.	2,50,000	
	Securities premium A/c Dr.	2,50,000	
	To Equity shares buy-back A/c		5,00,000
	(Being cancellation of shares bought back)		
c)	Revenue reserve A/c Dr.	2,50,000	
	To Capital redemption reserve A/c		2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)		

Balance Sheet of M/s. Competent Ltd. as at 31st March, 20X1

Particulars	Notes	₹
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	10,00,000
B) Reserves and Surplus	2	16,25,000
2.) Non-current liabilities		
Long term borrowings	3	28,75,000
3.) Current liabilities		
A) Other Current Liabilities		16,50,000

Total		71,50,000
Assets		
1.) Non-current assets		
A) Property, plant and equipment	4	46,50,000
2.) Current assets		
A) Other Current Assets (30,00,000 – 5,00,000)		25,00,000
Total		71,50,000

Notes to accounts

No.	Particulars		₹
1.)	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		10,00,000
2.)	**Reserves and Surplus**		
	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	(2,50,000)	12,50,000
	Securities premium	2, 0,000	
	Less: Utilization for share buy-back	(2,50,000)	-
	Capital Redemption Reserves		2,50,000
	Total		16,25,000
3.)	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4.)	Property, plant and equipment		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

Working Note

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

Suppose amount transferred to CRR account is ‘x’ and maximum permitted buy- back of equity is ‘y’.

Then

$$(31{,}25{,}000 - x) - 22{,}62{,}500 = y \qquad \textbf{(1)}$$

$$\left(\frac{y}{20} \times 10\right) = x \quad \text{or} \quad 2\,x = y \qquad \textbf{(2)}$$

by solving the above equation, we get

x = ₹ 2,87,500

y = ₹ 5,75,000

4 W, X, Y and Z hold Equity capital is held by in the proportion of 40:30:10:20. A, B, C and D hold preference share capital in the proportion of 30:40:20:10. If the paid-up capital of the company is ₹ 40 Lakh and Preference share capital is ₹ 20 Lakh, find their voting rights in case of resolution of winding up of the company.

(ICAI SM/January 2021/November 2020/November 2018)

Sol W, X, Y and Z hold Equity capital is held by in the proportion of 40:30:10:20 and A, B, C and D hold preference share capital in the proportion of 30:40:20:10. As the paid up equity share capital of the company is ₹ 40 Lakhs and Preference share capital is ₹ 20 Lakh (2:1), then relative weights in the voting right of equity shareholders and preference shareholders will be 2/3 and 1/3. The respective voting right of various shareholders will be

W=	2/3×40/100	= 4/15
X =	2/3×30/100	= 3/15
Y =	2/3×10/100	= 1/15
Z =	2/3×20/100	= 2/15
A =	1/3×30/100	= 1/10
B =	1/3×40/100	= 2/15
C =	1/3×20/100	= 1/15
D =	1/3×10/100	= 1/30

5. Rohan Ltd. furnishes the following information as at 31-03-20X1.

	(in ₹)	**(in ₹)**
Share Capital:		
Equity Share Capital of ₹ 20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹ 100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus:		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	25,50,000	43,50,000
12% Debentures		12,50,000
Current Liabilities and Provisions		5,50,000
Property, Plant and Equipment		1,00,75,000
Current Assets:		
Investment	3,00,000	

Inventory	2,00,000	
Cash and Bank	15,75,000	20,75,000

The shareholders adopted the following resolution on 31st March, 20X1:

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

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

  a) Issues 3,000, 14% debentures of ₹ 100 each at a premium of 20%.

  b) Issues 2,500, 10% preference shares of ₹ 100 each.

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

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

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

You are required to pass the necessary journal entries to record the above transactions.

(Nov 2021 RTP /November 2019/ November 2021 MTP(M))

Sol.

In the books of Rohan Limited

Journal Entries

	Particulars	**Dr.**	**Cr.**
		₹	**₹**
1)	Bank A/c Dr.	3,60,000	
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
	(Being 14 % debentures issued to finance buy back)		
2)	Bank A/c Dr.	2,50,000	
	To 10% preference share capital A/c		2,50,000
	(Being 10% preference share issued to finance buy back)		
3)	Bank A/c Dr.	1,50,000	
	To Investment A/c		1,00,000
	To Profit on sale of investment		50,000
	(Being investment sold on profit)		
4)	Equity share capital A/c (62,500 × ₹20) Dr.	12,50,000	
	Premium on buyback or Securities premium A/c Dr. (62,500 × ₹16)	10,00,000	
	To Equity shares buy back A/c (62,500 × ₹36)		22,50,000
	(Being the amount due to equity shareholders on buy back)		
5)	Equity shares buy back A/c Dr.	22,50,000	
	To Bank A/c		22,50,000

	(Being the payment made on account of bu back of 62,500 Equity Shares as per the Companies Act)		
6)	Revenue reserve Dr. Securities premium Dr. Profit and Loss A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law) [12,50,000 less 2,50,000]	3,00,000 2,60,000 4,40,000	 10,00,000
7)	Capital redemption reserve A/c Dr. To Bonus shares A/c (Being the utilization of capital redemption reserve to issue 37,500 bonus shares)	7,50,000	 7,50,000
8)	Bonus shares A/c Dr. To Equity share capital A/c (Being issue of 3 bonus equity share for every 15equity shares held)	7,50,000	 7,50,000

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

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

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

(ICAI SM/May 2017/July 2021)

Sol.

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	**Whe loan fund is**	
	₹ 3,200 crores	**₹ 6,000 crores**
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil
Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy-Back
(applicable only when loan fund is ₹ 3,200 crores)

₹ in crores

	Particulars	**Debit**	**Credit**
a)	Equity shares buy-back A/c Dr.	720	
	To Bank A/c		720
	(Being payment for buy-back of 24 crores equity shares of ₹ 10 each @ ₹ 30 per share)		
b)	Equity share capital A/c Dr.	240	
	Premium Payable on buy-back A/c Dr.	480	
	To Equity share buy-back A/c		720
	(Being cancellation of shares bought back)		
	Securities Premium A/c Dr.	400	
	General Reserve / Profit & Loss A/c Dr.	80	
	To Premium Payable on buy-back A/c		480
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)		
c)	General Reserve / Profit & Loss A/c Dr.	240	
	To Capital redemption reserve A/c		240
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)		

Working Notes:

1) Shares Outstanding Test

Particulars	**(Shares in crores)**
Number of shares outstanding	120
25% of the shares outstanding	30

2) Resources Test

Particulars	
Paid up capital (₹ in crores)	1,200
Free reserves (₹ in crores) (1,080 + 400 + 200)	1,680
Shareholders' funds (₹ in crores)	2,880
25% of Shareholders fund (₹ in crores)	₹ 720 crores
Buy-back price per share	₹ 30
Number of shares that can be bought ba k	24 crores shares

3) Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	**When loan fund is**	
		₹ 3,200 crores	**₹ 6,000 crores**
a)	Loan funds (₹)	3,200	6,000
b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	1,600	3,000
c)	Present equity shareholders fund (₹)	2,880	2,880
d)	Future equity shareholders fund (₹) (see W.N.4)	2,560	N.A.
e)	Maximum permitted buy – back of Equity (₹) [(d) – (b)]	960	Nil
f)	Maximum number of shares that can be bought back @ ₹ 30 per share	32 crore shares	Nil
	As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

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

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

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

$= (2{,}880 - x) - 1{,}600 = y$

$= 1280 - x = y$ **(1)**

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

$y/30 \times 10 = x$ or

$3\,x = y$ **(2)**

by solving the above two equations we get

x = ₹ 320

y = ₹ 960

7. Dee Limited (a non-listed company) furnishes the following Balance Sheet as at 31st March, 20X1:

(in thousand ₹)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	2,700
B) Reserves a d Surplus	2	9,700
2.) Current liabilities		
A) Trade Payables		1,400
Total		13,800
Assets		
1.) Non-current assets		
A) Property, plant and Equipment		9,300
B) Non-Current Investments		3,000
2.) Current assets		
A) Inventories		500
B) Trade receivables		200
C) Cash and Cash equivalents		800
Total		13,800

Notes to accounts

No.	**Particulars**		**(in thousand ₹)**
1)	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,500
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy-back)		_____
	Total		2,700

2)	**Reserves and Surplus**		
	Capital reserve		1,000
	Revenue reserve		3,000
	Securities premium		2,200
	Profit and loss account		3,500
	Total		9,700

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

You are required to pass necessary journal entries and prepare the Balance Sheet.

(ICAI SM/Nov. 2009/ May 2020 RTP)

Sol.

Journal Entries in the books of Dee Limited

(in thousand ₹)

	Particulars	**Dr.**	**Cr.**
i)	Bank A/c Dr. Profit and Loss A/c Dr. To Investment A/c (Being the investments sold at loss for the purpose of buy-back)	2,200 800	3,000
ii)	Equity Share buy-back A/c Dr. To Bank A/c (Being the payment made on buy-back)	2,500	2,500
iii)	Equity Share Capital A/c Dr. Premium Payable on Buy-Back A/c Dr. To Equity Shares Buy-Back A/c (Being the buy-back amount allocated to equity share capital)	500 2,000	2,500
iv)	Securities premium A/c Dr. To Premium payable on buy-back A/c (Being the premium payable on buy-back adjusted against securities premium account)	2,000	2,000
v)	Revenue reserve A/c Dr. To Capital Redemption Reserve A/c (Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)	300	300

Balance Sheet of Dee Limited as at 1st April, 20X1
(After buy-back of shares)

(in thousand ₹)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	2,200
B) Reserves and Surplus	2	6,900
2.) Current liabilities		
A) Trade Payables		1,400
Total		10,500
Assets		
1.) Non-current assets		
A) Property, plant and Equipment		9,300
2.) Current assets		
A) Inventories		500
B) Trade receivables		200
C) Cash and Cash equivalents		500
Total		10,500

Notes to accounts

No.	**Particulars**		**₹**
1.)	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,000
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy- back)		
	Total		2,200

2.)	**Reserves and Surplus**		
	Capital reserve		1,000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	
	Less: Loss on investment	(800)	2,700
	Total		6,900

8.

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 20X1:

Particulars	**₹**	**₹**
Equity Share Capital (shares of ₹ 10 each fully paid		30,00,000
Reserves & Surplus		
General Reserve	32,50,000	
Security Premium Account	6,00,000	
Profit & Loss Account	4,30,000	
Revaluation Reserve	6,20,000	49,00,000
Loan Funds		42,00,000

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy-back is ₹ 30 per share.

(ICAI SM/RTP November 2020)

Sol.

Debt Equity Ratio Test

	Particulars	**₹**
a)	Loan funds	42,00,000
b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	21,00,000
c)	Present equity shareholders fund (₹ in crores)	72,80,000
d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000 – 12,95,000)
e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)

f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1) Shareholders' funds

Particulars	**₹**
Paid up capital	30,00,000
Free reserves (32,50,000 + 6,00,000 + 4,30,000)	42,80,000
	72,80,000

2) As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Equation 1 : (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity

$(72{,}80{,}000 - x) - 21{,}00{,}000 = y \qquad (1)$

Since $51{,}80{,}000 - x = y$

Equation 2: $\left(\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \times \text{Nominal Value}\right)$

= Nominal value of the shares bought – back to be transferred to CRR

$= \left(\frac{y}{30} \times 10\right) = x$

$3x = y \qquad (2)$

x = ₹ 12,95,000 crores and y = ₹ 38,85,000 crores

9. M Ltd. furnishes the following Balance Sheet as at 31st March, 20X1:

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

B) Trade receivables		2,000
C) Cash and Cash equivalents		1,000
Total		**11,750**

Notes to accounts

No.	Particulars		₹ (in 000)
1.)	**Share Capital**		
	Authorized, Issued and Subscribed Capital:		
	3,00,000 Equity shares of ₹ 10 each fully paid up		3,000
	20,000 9% Preference Shares of 100 each		2,000
	Total		5,000
2.)	**Reserves and Surplus**		
	Capital reserve		10
	Revenue reserve		4,000
	Securities premium		500
	Profit and Loss account		1,800
	Total		6,310
3.)	**Long term borrowings**		
	10% Debentures		400
4.)	**Property, Plant and Equipment (PPE)**		
	PPE: Cost		3,000
	Less: Provision for depreciation		(250)
	Net carrying value		2,750

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

You are required to pass necessary Journal entries. **(ICAI SM)**

Sol.

Journal Entries in the books of M Ltd.

₹ in '000

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

10. Anu Ltd. (a non-listed company) furnishes you with the following balance sheet as at 31st March, 20X1:

(in crores ₹)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	100
B) Reserves and Surplus	2	300
2.) Current liabilities		
A) Trade Payables		40
Total		440

Assets		
1.) Non-current assets		
A) Property, plant and equipment	3	-
B) Non-Current Investments	4	100
2.) Current assets		
A) Trade receivables		140
B) Cash and Cash equivalents		200
Total		440

Notes to accounts

No.	**Particulars**		**₹**
1.)	**Share Capital**		
	Authorized, issued and subscribed share capital:		
	12% Redeemable preference shares of ₹ 100 each, fully paid up		75
	Equity shares of ₹ 10 each, fully paid up		25
	Total		100
2.)	**Reserves and Surplus**		
	Capital reserve		15
	Securities premium		25
	Revenue reserves		260
	Total		300
3.)	**Property, Plant and Equipment**		
	PPE Cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		NIL
4.)	**Non-Current Investments**		
	Non-current investments at cost (Market value ₹ 400 Cr.)		100

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

i) Pass journal entries to record the above.
ii) Prepare balance sheet as at 1.4.20X1.

(ICAI SM)

Sol.

i)

Journal entries in the books of Anu Ltd.

₹ in crores

	Particulars	**Dr.**	**Cr.**
1st April, 20X1	12% Preference share capital A/c Dr.	75	
	To Preference shareholders A/c		75
	(Being preference share capital account transferred to shareholders account)		
	Preference shareholders A/c Dr.	75	
	To Bank A/c		75
	(Being payment made to shareholders)		
	Shares buy-back A/c Dr.	25	
	To Bank A/c		25
	(Being 50 lakhs equity shares bought back @ ₹ 50 per share)		
	Equity share capital A/c (50 lakhs × ₹ 10) Dr.	5	
	Securities premium A/c (50 lakhs × ₹ 40) Dr.	20	
	To Shares buy-back A/c		25
	(Being cancellation of shares bought back)		
	Revenue Reserve A/c Dr.	80	
	To Capital Redemption Reserve A/c (75 + 5)		80
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)		

ii) **Balance Sheet of Anu Ltd as at 1.4.20X1**

(in crores ₹)

Particulars	**Notes**	**₹**
Equity and Liabilities		
1.) Shareholders' funds		
A) Share capital	1	20
B) Reserves and Surplus	2	280
2.) Current liabilities		
A) Trade Payables		40

Total		340
Assets		
1.) Non-current assets		
A) Property, plant and equipment	3	-
B) Non-Current Investments	4	100
2.) Current assets		
A) Trade receivables		140
B) Cash and Cash equivalents	5	100
Total		340

Notes to accounts

No.	**Particulars**		**₹**
1.)	**Share Capital**		
	Authorized, issued and subscribed share capital 200 lakhs Equity shares of ₹ 10 each fully paid		20
	Total		20
2.)	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3.)	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4.)	**Non-Current Investments**		
	Non-current investments at cost (Market value ₹ 400 Crores)		100
5.)	**Cash and Cash Equivalents**		
	Cash and Cash Equivalents as on 31.3.20X1		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

11.

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.20X1:

	Particulars	**(₹ in crores)**	
1)	Equity Share Capital (Shares of ₹ 10 each fully paid)	-	330
2)	Reserves and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-
	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
3)	Loan Funds		1,800

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.20X1 a proposal to buy-back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is ₹ 25 per share and in order

to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Development Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,200 crores or ₹ 1,500 crores.

Assuming that the entire buy-back is completed by 09.12.20X1, show the accounting entries in the company's books in each situation.

(ICAI SM)

Sol.

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	**When loan fund is**		
	₹ 1,800 crores	**₹ 1,200 crores**	**₹ 1,500 crores**
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy-Back
(applicable only when loan fund is ₹ 1,200 crores)

₹ in crores

	Particulars	**Debit**	**Credit**
a)	Equity share buy-back account Dr. To Bank account (Being buy-back of 3.75 crores equity shares of ₹ 10 each @ ₹ 30 per share)	112.5	 112.5
b)	Equity share capital account Dr. Securities premium account Dr. To Equity share buy-back account (Being cancellation of shares bought back)	37.5 75	 112.5
c)	General reserve account Dr. To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)	37.5	 37.5

Working Notes:

1) Shares Outstanding Test

Particulars	**(Shares in crores)**
Number of shares outstanding	33
25% of the shares outstanding	8.25

2) Resources Test

Particulars	
Paid up capital (₹ in crores)	330
Free reserves (₹ in crores)	420
Shareholders' funds (₹ in crores)	750
25% of Shareholders fund (₹ in crores)	₹ 187.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3) Debt Equity Ratio Test

	Particulars	When loan fund is		
		₹ 1,800 crores	**₹ 1,200 Crores**	**₹ 1,500 Crores**
a)	Loan funds (₹ in crores)	1,800	1,200	1,500
b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	900	600	750
c)	Present equity shareholders fund (₹ in crores)	750	750	750
d)	Future equity shareholder fund (₹ in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) **(See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note:

1) Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.

2) As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. In the question, it is stated that the company has surplus funds to dispose of therefore, it is presumed that buy- back is out of free reserves or securities premium and hence a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from present equity.
Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is ‘x’ and maximum permitted buy-back of equity is ‘y’.
Then
Equation 1 : (Present equity − Nominal value of buy − back transfer to CRR) − Minimum equity to be maintained = Maximum permissible buy-back of equity

$$(750 - x) - 600 = y \qquad \textbf{(1)}$$

Since $150 - x = y$

Equation 2: $\left(\frac{\text{Maximum buy−back}}{\text{Offer price for buy−bck}} \times \text{Nominal Value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10\right) = x$$

[here (30 = 25% × 120]

Or $3x = y$ **(2)**

by solving the above two equations we get

x = ₹ 37.5 crores

y = ₹ 112.5 crores

12. The Directors of Umang Ltd. passed a resolution to buyback 5,00,000 of its fully paid equity shares of ₹ 10 each at ₹ 15 per share. This buyback is in compliance with the provisions of the Companies Act, 2013.

For this purpose, the company

- **i)** Sold its investments of ₹ 30,00,000 for ₹ 25,00,000.
- **ii)** Issued 20,000, 12% preference shares of ₹ 100 each at par, the entire amount being payable with application.
- **iii)** Used ₹ 15,00,000 of its Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back.
- **iv)** The company has necessary cash balance for the payment to shareholders.

You are required to pass necessary Journal Entries (including narration) regarding buy-back of shares in the books of Umang Ltd.

(Jan 2021)

Sol.

Journal Entries in the books of Umang Ltd.

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

Amalgamation
Assignment

Q. No.	Question / Answers
1.	The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹P Ltd	₹Q Ltd
		Equity and Liabilities			
1.		**Shareholder's funds**			
	a.	Share Capital	1	8,00,000	4,00,000
	b.	Reserves and Surplus		3,00,000	2,00,000
2.		**Non-current liabilities**			
	a.	Long-term borrowings	2	2,00,000	1,50,000
3.		**Current liabilities**			
	a.	Trade Payables		2,50,000	1,50,000
		Total		**15,50,000**	**9,00,000**
		Assets			
1.		**Non-current assets**			
	a.	Property, Plant and Equipment		7,00,000	2,50,000
	b.	Non-current investments		80,000	80,000
2.		**Current assets**			
	a.	Inventories		2,40,000	3,20,000
	b.	Trade receivables		4,20,000	2,10,000
	C.	Cash and Cash equivalents		1,10,000	40,000
		Total		**15,50,000**	**9,00,000**

Notes to accounts

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

Details of Trade receivables and trade payables are as under:

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

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

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

i) 8 Equity Shares of ₹10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.
ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by the issue of 10% Preference Shares of ₹100 each at par in P Ltd.
iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.
iv) ₹30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include ₹10,000 due to P Ltd.
v) Inventory in Trade and Debtors are taken over at 5% lesser than their book value by P Ltd.

Prepare:

a) Journal entries in the books of P Ltd.
b) Statement of consideration payable by P Ltd.

(ICAI SM /May 2019/November 2010/November 2009/May 2017)

Ans.

Journal Entries in the Books of P Ltd.

		Dr.	Cr.
		₹	₹
Property, Plant and Equipment	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of PPE at 15% above book value)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @10%)			
Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	4,90,000	
To Liquidator of Q Ltd.			4,90,000
(Consideration payable for the business taken over from Q Ltd.)			
Property, Plant and Equipment (115% of ₹2,50,000)	Dr.	2,87,500	
Inventory (95% of ₹3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(₹40,000 –₹30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (₹1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders of Q Ltd. at a discount of 10%)			

Sundry Creditors of Q Ltd. Dr. To Sundry Debtors of P Ltd. (Cancellation of mutual owing)	10,000	 10,000
Goodwill Dr. To Bank (Being liquidation expenses reimbursed to Q Ltd.)	30,000	 30,000
Capital Reserve Dr. To Goodwill (Being goodwill set off)	30,000	 30,000

b) Statement of Consideration payable by P Ltd. for 30,000 shares (payment method)

Shares to be allotted $\frac{30,000}{6} \times 8$ = 40,000 shares of P Ltd.

Issued 40,000 shares of ₹10 each i.e. ₹4,00,000 (i)

For 10% preference shares, to be paid at 10% discount

₹ $\frac{1,00,000 \times 90}{100}$ ₹90,000 (ii)

Consideration amount [(i) + (ii)] ₹4,90,000

2. K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies as at the date of amalgamation was as under:

		Particulars	Notes	₹ K Ltd.	₹ L Ltd.
		Equity and Liabilities			
1.		**Shareholders' funds**			
	A.	Share capital	1	12,00,000	6,00,000
	B.	Reserves and Surplus	2	3,71,375	1,97,175
2.		**Non-current liabilities**			
	A.	Long-term borrowings	3	2,00,000	2,00,000
3.		**Current liabilities**			
	A.	Trade Payables		1,00,000	2,10,000
		Total		18,71,375	12,07,175
		Assets			
1.		**Non-current assets**			
	A.	Property, Plant and Equipment	4	11,30,000	8,20,000
	B.	Intangible assets	5	80,000	-
2.		**Current assets**			
	A.	Inventories		2,25,000	1,40,000
	B.	Trade receivables		2,75,000	1,75,000
	C.	Cash and Cash equivalents	6	1,61,375	72,175
		Total		18,71,375	12,07,175

Notes to accounts

1	**Share Capital**	**K Ltd.**	**L Ltd.**
	Equity shares of ₹100 each	8,00,000	3,00,000
	7% Preference Shares of ₹100 each	4,00,000	3,00,000
		12,00,000	6,00,000
2	**Reserves and Surplus**		
	General reserve	—	1,00,000
	Profit and loss account	3,71,175	97,175
		3,71,175	1,97,175
3	**Long-term borrowings**		
	5% Debentures	2,00,000	—
	Secured loan	—	2,00,000
		2,00,000	2,00,000
4	**Property, Plant and Equipment**		
	Land and Building	4,50,000	3,00,000
	Plant and machinery	6,20,000	5,00,000

	Furniture and fittings	60,000	20,000
		11,30,000	8,20,000
5	**Intangible assets**		
	Goodwill	80,000	—
		80,000	—
6	**Cash and Cash Equivalents**		
	Cash at Bank	1,20,000	55,000
	Cash in hand	41,375	17,175
		1,61,375	**72,175**

The terms of amalgamation are as under:

A) 1) The assumption of liabilities of both the Companies.

2) Issue of 5 Preference shares of ₹20 each in LK Ltd. @₹18 paid up at a premium of ₹4 per share for each preference share held in both the Companies.

3) Issue of 6 Equity shares of ₹20 each in LK Ltd. @₹18 paid up at a premium of ₹4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both Companies in accordance with the intrinsic value of the shares of both Companies.

4) Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.

B) 1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2½% respectively to be raised.

2) The trade receivables of K Ltd. include ₹20,000 due from L Ltd.

C) The LK Ltd. is to issue 15,000 new equity shares of ₹20 each, ₹18 paid up at premium of ₹4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

(ICAI SM ills8/May 2013(M)/RTP May 2020/May 2017/December 2021)

Ans.

Books of K Ltd.
Realization Account

	₹		₹
To Goodwill	80,000	By 5% Debentures	2,00,000
To Land & Building	4,50,000	By Trade payables	1,00,000
To Plant & Machinery	6,20,000	By LK Ltd.	15,60,000
To Furniture & Fitting	60,000	(Purchase consideration)	
To Trade receivables	2,75,000	By Equity shareholders A/c	
To Stores & inventory	2,25,000	(loss)	
To Cash at Bank	1,20,000		
To Cash in hand	41,375		
To Preference shareholders			
(Excess payment)	40,000		
	19,11,375		**19,11,375**

Equity Shareholders Account

	₹		₹
To Realization A/c (loss)	51,375	By Share capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit & Loss A/c	3,71,375
To Cash	64,000		–
	11,71,375		11,71,375

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	4,40,000	By Share capital	4,00,000
		By Realization A/c	40,000
	4,40,000		4,40,000

LK Ltd. Account

	₹		₹
To Realization A/c	15,60,000	By Equity Shares in LK Ltd.	
		For Equity 10,56,000	
		Pref. 4,40,000	14,96,000
		By Cash	64,000
	15,60,000		**15,60,000**

Books of L Ltd.
Realization Account

	₹		₹
To Land & Building	3,00,000	By Trade payables	2,10,000
To Plant & Machinery	5,00,000	By Secured loan	2,00,000
To Furniture & Fittings	20,000	By LK Ltd. (Purchase	
To Trade receivables	1,75,000	consideration)	7,90,000
To Inventory of stores	1,40,000	By Equity shareholders A/c-	
To Cash at bank	55,000	Loss	37,175
To Cash in hand	17,175		
To Pref. shareholders	30,000		–
	12,37,175		**12,37,175**

Equity Shareholders Account

	₹		₹
To Equity shares in LK Ltd.	3,96,000	By Share Capital	3,00,000
To Realization	37,175	By Profit & Loss A/c	97,175
To Cash	64,000	By Reserve	1,00,000
	4,97,175		**4,97,175**

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	3,30,000	By Share capital	3,00,000
		By Realization A/c	30,000
	3,30,000		3,30,000

LK Ltd. Account

	₹		₹
To Realization A/c	7,90,000	By Equity shares in LK Ltd.	
		For Equity 3,96,000	
		Preference 3,30,000	7,26,000
		By Cash	64,000
	7,90,000		**7,90,000**

Working Notes:

i) Purchase consideration

	K Ltd. ₹	L Ltd. ₹
Payable to preference shareholders:		
Preference shares at ₹22 per share	4,40,000	3,30,000
Equity Shares at ₹22 per share	10,56,000	3,96,000
Cash [See W.N. (ii)]	64,000	64,000
	15,60,000	7,90,000

ii) Value of Net Assets

	K Ltd.		L Ltd.
	₹		₹
Goodwill	80,000		
Land & Building	4,50,000		3,00,000
Plant & Machinery	6,20,000		5,00,000
Furniture & Fittings	60,000		20,000
Trade receivables less 2.5%	2,68,125		1,70,625
Inventory less 2%	2,20,500		1,37,200
Cash at Bank	1,20,000		55,000
Cash in hand	41,375		17,175
	18,60,000		
Less : Debentures 2,00,000		–	12,00,000
Trade payables 1,00,000		2,10,000	
Secured Loans –	(3,00,000)	2,00,000	(4,10,000)
	15,60,000		7,90,000
Payable in shares	14,96,000		7,26,000
Payable in cash	64,000		64,000

3. Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04. 20X1. Following is the Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3. 20X1:

		Particulars	Notes	Neel	Gagan
		Equity and Liabilities			
1.		**Shareholders' funds**			
	a.	Share capital		7,75,000	8,55,000
2.		**Current liabilities**		6,23,500	5,57,600
		Total		13,98,500	14,12,600
		Assets			
1.		**Non-current assets**			
	a.	Property, Plant and Equipment	1	12,35,000	12,54,000
2.		**Current assets**		1,63,500	1,58,600
		Total		**13,98,500**	**14,12,600**

Notes to accounts:

1.	**Property, plant and Equipment**		
	Land and Building	7,50,000	6,40,000
	Plant and machinery	4,85,000	6,14,000
		12,35,000	12,54,000

Following is the additional information:

i) The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:

	Neel	Gagan
	₹	₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

ii) The purchase consideration is to be discharged as under:

a) Issue 24,000 equity shares of ₹25 each fully paid up in the proportion of their profitability in the preceding 2 years.

b) Profits for the preceding 2 years are given below:

	Neel	Gagan
	₹	₹
1st year	2,62,800	2,75,125
2nd year	2,12,200	2,49,875
Total	4,75,000	5,25,000

c) Issue 12% preference shares of ₹10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as of 31.3.20X1 after revaluation of assets of Neel Ltd. and Gagan Ltd. respectively.

You are required to compute the

i) Equity and preference shares issued to Neel Ltd. and Gagan Ltd.,
ii) Purchase consideration.

(ICAI SM/May 2011/MTP October 2021)

Ans.

i) Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.

Profits of	**Neel**	**Gagan**
	₹	**₹**
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	**4,75,000**	**5,25,000**

The total profits- ₹4,75,000+ ₹5,25,000= ₹10,00,000
No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profits.

	Neel	**Gagan**
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. and Gagan Ltd.

	Neel	**Gagan**
	₹	**₹**
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued $\left[67,200 \times \frac{100}{}\right]$ = 5,60,000@ ₹10 each	56,000 shares	
$\left[73,920 \times \frac{100}{}\right]$= 6,16,000@ ₹10 each		61,600 shares

ii) Total Purchase Consideration

	Neel	**Gagan**
	₹	**₹**
Equity shares @ of ₹25 each	2,85,000	3,15,000
12% Preference shares @ of ₹10 each	5,60,000	6,16,000
Total	**8,45,000**	**9,31,000**

Working Note:
Calculation of Net assets as on 31.3.20X1

	Neel	**Gagan**
	₹	**₹**
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	(6,23,500)	(5,57,600)
	8,40,000	9,24,000

Note- Since the income from the preference shares shall be equal to the 8% return on assets, the shares are computed in such way that 12% dividend on them shall be equal to 8% of the return on Net assets.

4. X Ltd. and Y Ltd. give the following information of assets, equity and liabilities as on 31st March, 20X5:

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

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

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

ii) Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of the preceding three financial years (20X3-X4: ₹ 90,000; 20X2-X3: ₹ 78,000 and 20X1-X2: ₹ 72,000). The profits of 20X1 -X2 included a credit of an insurance claim of ₹ 25,000 (fire occurred in 20X0-X1 and loss by fire ₹ 30,000 was booked in Profit and Loss Account of that year). In the year 20X2-X3, there was embezzlement of cash by an employee amounting to ₹ 10,000.

iii) Land & Buildings are valued at ₹ 5,00,000 and the Plant & Machinery at ₹ 4,00,000. Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.

iv) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to ₹ 15,000 and such asset was also taken over by X Ltd.

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

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

You are required to:

i) Prepare Realization A/c in the books of Y Ltd.

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

iii) Prepare the Balance Sheet of X Ltd. after absorption as at 31st March,20X5.

(RTP November 2020/May 2018/ICAI SM)

Ans.

In the Books of Y Ltd.

Realization Account

Particulars	**₹**	**₹**	**Particulars**	**₹**
To Sundry Assets:			By Retirement Gratuity Fund	60,000
Goodwill	75,000			
Land & Building	3,00,000		By Trade payables	2,40,000
Plant & Machinery	4,50,000		By X Ltd. (Purchase Consideration)	15,90,000
Inventory	5,25,000			
Trade receivables	3,00,000			
Bank	60,000	17,10,000		
To Preference Shareholders (Premium on Redemption)		30,000		
To Equity Shareholders (Profit on Realization)		1,50,000		
		18,90,000		**18,90,000**

In the Books of X Ltd.
Journal Entries

		Dr.	Cr.
		₹	₹
Business Purchase A/c	Dr.	15,90,000	
To Liquidators of Y Ltd. Account			15,90,000
(Being business of Y Ltd. taken over)			
Goodwill Account	Dr.	1,50,000	
Land & Building Account	Dr.	5,00,000	
Plant & Machinery Account	Dr.	4,00,000	
Inventory Account	Dr.	4,72,500	
Trade receivables Account	Dr.	3,00,000	
Bank Account	Dr.	60,000	
Unrecorded assets Account	Dr.	15,000	
To Retirement Gratuity Fund Account			60,000
To Trade payables Account			2,40,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			15,90,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Y Ltd. A/c	Dr.	15,90,000	
To 9% Preference Share Capital A/c			3,30,000
To Equity Share Capital A/c			12,00,000
To Securities Premium A/c			60,000
(Being Purchase Consideration satisfied as above)			

Balance Sheet of X Ltd. (after absorption)
as at 31st March, 2018

Particulars		Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
	A) Share capital	1	48,30,000
	B) Reserves and Surplus	2	2,70,000
2	Non-current liabilities		
	A) Long-term provisions	3	2,10,000
3	Current liabilities		
	A) Trade Payables	4	6,10,000
	B) Short term provision	5	7,500
	Total		59,27,500
	Assets		
1	Non-current assets		
	Property, Plant and Equipment	6	33,00,000
	Intangible assets	7	3,00,000
2	Current assets		
	A) Inventories	8	12,22,500
	B) Trade receivables	9	8,80,000
	C) Other current Assets	10	15,000
	D) Cash and cash equivalents	11	2,10,000
	Total		**59,27,500**

Notes to accounts

Particulars		₹
1	Share Capital	
	Equity share capital	
	4,20,000 Equity Shares of ₹ 10 each fully paid (Out of above 1,20,000 Equity Shares were issued at 5% premium in consideration other than for cash)	42,00,000
	Preference share capital	
	6,300 9% Preference Shares of ₹ 100 each (Out of above 3,300 Preference Shares were issued in consideration other than for cash)	6,30,000
	Total	48,30,000
2	Reserves and Surplus	
	Securities Premium	60,000
	General Reserve	2,10,000
	Total	2,70,000
3	Long-term provisions	
	Retirement Gratuity fund	2,10,000
4	Trade payables (3,90,000 + 2,40,000 - 20,000*) * Mutual Owings eliminated.	6,10,000
5	Short term Provisions	
	Provision for Doubtful Debts	7,500
6	Property, Plant and Equipment	
	Land & Buildings	14,00,000
	Plant & Machinery	19,00,000
	Total	33,00,000
7	Intangible assets	
	Goodwill (1,50,000 +1,50,000)	3,00,000
8	Inventories (7,50,000 + 4,72,500)	12,22,500
9	Trade receivables (6,00,000 + 3,00,000 – 20,000)	8,80,000
10	Other current Assets	15,000
11	Cash and cash equivalents (1,50,000 +60,000)	2,10,000

Working Notes:

1.) Computation of goodwill

Profit of 20X3-X4	90,000
Profit of 20X2-X3 adjusted (₹ 78,000 + 10,000)	88,000
Profit of 20X1-X2 adjusted (₹ 72,000 – 25,000)	47,000
	2,25,000
Average profit	75,000

Goodwill to be valued at 2 times of average profits = ₹ 75,000 × 2 = ₹ 1,50,000

Purchase Consideration:		₹
Goodwill		1,50,000
Land & Building		5,00,000
Plant & Machinery		4,00,000
Inventory		4, 2,500
Trade receivables		3,00,000
Unrecorded assets		15,000
Cash at Bank		60,000
Less: Liabilities:		18,97,500
Retirement Gratuity	60,000	
Trade payables	2,40,000	
Provision for doubtful debts	7,500	(3,07,500)

Net Assets/ Purchase Consideration	15,90,000
To be satisfied as under:	
10% Preference Shareholders of Y Ltd.	3,00,000
Add: 10% Premium	30,000
9% Preference Shares of X Ltd.	3,30,000
Equity Shareholders of Y Ltd. to be satisfied by issue of 1,20,000 equity Shares of X Ltd. at 5% Premium	12,60,000
Total	**15,90,000**

5.

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigate competition, a new company Glorious Ltd, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. The summarized Balance Sheet of Galaxy Ltd. and Glory Ltd. as at 31st March,20X0 are as follows:

		Galaxy Ltd. **₹**	**Glory Ltd.** **₹**
(I)	**Equity & Liabilities**		
	(1) Shareholders' fund Share Capital		
	Equity shares of ₹10 each	8,40,000	4,55,000
	Reserves & Surplus		
	General Reserve	4,48,000	40,000
	Profit & Loss A/c.	1,12,000	72,000
	(2) Non-current Liabilities		
	Secured Loan 6% Debenture	-	3,30,000
	(3) Current Liabilities		
	Trade Payables	4,20,000	1,83,000
	Total	**18,20,000**	**10,80,000**
(II)	**Assets**		
	(1) Non-current assets Property, Plant & Equipment		
	Freehold Property, at cost	5,88,000	3,36,000
	Plant & Machinery, at cost less depreciation	1,40,000	84,000
	Moto vehicles, at cost less depreciation	56,000	-
	(2)Current Assets		
	Inventories	3,36,000	4,38,000
	Trade Receivables	4,62,000	1,18,000
	Cash at Bank	2,38,000	1,04,000
	Total	**18,20,000**	**10,80,000**

Assets and Liabilities are to be taken book value, with the following exceptions:

i) The Debentures of Glory Ltd. are to be discharged by the issue of 8% Debentures of
Of Glorious Ltd. at a premium of 10%.

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

iii) Goodwill is to be valued at:
Galaxy Ltd. ₹4,48,000
Glory Ltd. ₹1,68,000

iv) Liquidator of Glory Ltd., is appointed for collection from trade debtors and payment to trade creditors. He retained the cash balance and collected ₹1,10,000 from debtors and paid ₹1,80,000 to trade creditors. Liquidator is entitled to receive 5% commission for collection and 2.5% for payments. The balance cash will be taken over by new company.

You are required to:

1) Compute the number of shares to be issued to the shareholders of Galaxy Ltd. assuming the nominal value of each share in Glorious Ltd. is ₹10.
2) Prepare Balance Sheet of Glorious Ltd., as on 1st April,20X0 and also prepare notes to the accounts as per Schedule III of the Companies Act, 2013

(January 2021/May 2015(M)/May 2014(M))

Ans. **Calculation of Purchase Consideration (or basis for issue of shares of Glorious Ltd.)**

Particulars	**Galaxy Ltd**	**Glory Ltd.**
Purchase Consideration	₹	₹
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36, 00
Plant and Machinery	2.52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000
Less: Liabilities		
6% Debentures (3,00,000 × 110%)		(3,30,000)
Trade payables	(4,20,000)	___
Net Assets taken over	19,60,000	7,20,000
To be satisfied by the issue of shares of Glorious Ltd. @ ₹10each	1,96,000	72,000

ii) Balance Sheet of Glorious Ltd. as at 1st April, 20X0

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

Notes Accounts:

		₹	₹
1.	Share Capital		
	Equity share capital 2,68,000 shares of ₹10 each		26,80,000
	(All the above shares are issued for consideration other than cash)		

2.	Reserves and surplus		
	Securities Premium		
	10% premium on debentures of ₹3,00,000)		30,000
3.	Long-term borrowings Secured		
	8%3,000 Debentures of ₹100 each		3,00,000
4.	Property Plant and Equipment Freehold property		
	Galaxy Ltd.	5,88,000	
	Glory Ltd.	3,36,000	9,24,000
	Plant and Machinery		
	Galaxy Ltd.	2.52,000	
	Glory Lt .	84,000	3,36,000
	Motor vehicles – Galaxy Ltd.		56,000 13,16,000
5	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	4,38,000	7,74,000
7	Cash and cash equivalents Galaxy Ltd.	2,38,000	
	Glory Ltd. (As per working note)	24,000	2,62,000

Working Note:

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

	₹
Cash balance as at 31st March,20X0	1,04,000
Add: Received from debtors	1,10,000
	2,14,000
Less: paid to creditors	(1,80,000)
	34,000
Less: Commission to liquidators	
On Debtors @ 5% 5,500	
On Creditors @ 2.5% 4,500	
	(10,000)
	24,000

6.

S. Ltd. is absorbed by P. Ltd. S ltd. gives the following information on the date of absorption:

	₹
Sundry Assets	13,00,000
Share capital:	
2,000 7% Preference shares of ₹100 each (fully paid-up)	2,00,000
5,000 Equity shares of ₹100 each (fully paid-up)	5,00,000
Reserves	3,00,000
6% Debentures	2,00,000
Trade payables	1,00,000

Additional information:

P. Ltd. has agreed:

i) to issue 9% Preference shares of ₹100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.

ii) to issue to the debenture-holders in S Ltd. 8% Mortgage Debentures at ₹96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%;

iii) to pay ₹20 per share in cash and to issue six equity shares of ₹100 each issued at the market value ₹125 in lieu of every five shares held in S. Ltd.; and

iv) to assume the liability to trade payables.

You are required to calculate the purchase consideration.

(ICAI SM ills2/May 2011(m))

Ans. **The purchase consideration will be**

		₹	Form
Preference shareholders:	2,000 × 3/4 × 100	1,50,000	9% Pref. shares
Equity shareholders:	5,000 × 20	1,00,000	Cash
5,000 × 6/5 × 125		7,50,000	Equity shares
		10,00,000	

Note-

1) According to AS 14, 'consideration' excludes any amount payable to debenture-holders. The liability in respect of debentures of S Ltd. will be taken by P Ltd., which will then be settled by issuing new 8% debentures.
2) The issue of the equity shares is done at ₹125 (market value) as has been mentioned in the question. The face value shall not be considered for this purpose.

7. Super Express Ltd. and Fast Express Ltd. were in competing business. They decided to form a new company named Super-Fast Express Ltd. The balance sheets of both the companies were as under:

		Particulars	Notes	Super Express Ltd. ₹	Fast Express Ltd. ₹
		Equity and Liabilities			
1.		**Shareholders' funds**			
	a.	Share capital	1	20,00,000	10,00,000
	b.	Reserves and Surplus	2	1,00,000	2,60,000
2.		**Non-current liabilities**			
	a.	Long term provisions	3	1,00,000	--
3.		**Current liabilities**			
	a.	Trade Payables		60,000	40,000
		Total		**22,60,000**	**13,00,000**
		Assets			
1.		**Non-current assets**			
	a.	Property, Plant and Equipment	4	14,00,000	11,00,000
	b.	Intangible assets	5	--	1,00,000
2.		**Current assets**			
	a.	Inventories		3,00,000	40,000
	b.	Trade receivables		2,40,000	40,000
	c.	Cash and Cash equivalents	6	3,20,000	20,000
		Total		**22,60,000**	**13,00,000**

Notes to accounts

		Super Express Ltd.₹	Fast Express Ltd.₹
1.	**Share Capital**		
	Equity shares of ₹100 each	20,00,000	10,00,000
2.	**Reserves and Surplus**		
	Insurance reserve	1,00,000	--
	Employee profit-sharing reserve	--	60,000
	Reserve account	--	1,00,000
	Surplus	--	1,00,000
		1,00,000	2,60,000
3.	**Long term provisions**		
	Provident fund	1,00,000	--
	Total	1,00,000	--
4.	**Property, Plant and Equipment**		
	Land and Building	10,00,000	6,00,000
	Plant and machinery	4,00,000	5,00,000
		14,00,000	11,00,000
5.	**Intangible assets**		
	Goodwill	--	1,00,000
		--	1,00,000
6.	**Cash and Cash Equivalents**		
	Cash at Bank	2,20,000	10,000
	Cash in hand	1,00,000	10,000
		3,20,000	20,000

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of ₹100 each in lieu of purchase consideration amounting to ₹30,00,000 (20,00,000 for Super- Fast Express Ltd and 10,00,000 for Fast Express Ltd.).

Prepare an opening balance sheet of Superfast Express Ltd. considering pooling method.

(ICAI SM /May 2012)

Ans.

Balance Sheet of Super Fast Express Ltd

	Particulars	Notes	₹
	Equity and Liabilities		
1.	**Shareholders' funds**		
	a. Share capital	1	30,00,000
	b. Reserves and Surplus	2	3,60,000
2.	**Non-current liabilities**		
	a. Long-term provisions	3	1,00,000
3.	**Current liabilities**		
	a. Trade Payables		1,00,000
	Total		**35,60,000**
	Assets		
1.	**Non-current assets**		
	a. Property, Plant and Equipment	4	25,00,000
	b. Intangible assets	5	1,00,000
2.	**Current assets**		
	Inventories		3,40,000
	Trade receivables		2,80,000
	Cash and cash equivalents	6	3,40,000
	Total		**35,60,000**

Notes to Accounts

	Particulars	₹
1.	**Share Capital**	
	Equity share capital	
	Issued, subscribed and paid up	
	30,000 Equity shares of ₹100 each	30,00,000
	Total	30,00,000
2.	**Reserves and Surplus**	
	Reserve account	1,00,000
	Surplus	1,00,000
	Insurance reserve	1,00,000
	Employees profit sharing Reserve	60,000
	Total	3,60,000
3.	**Long-term provisions**	
	Provident fund	1,00,000
	Total	1,00,000
4.	**Property, Plant and Equipment**	
	Buildings	16,00,000
	Machinery	9,00,000
	Total	25,00,000
5.	**Intangible assets**	
	Goodwill	1,00,000
	Total	1,00,000
6.	**Cash and cash equivalents**	
	Balances with banks	2,30,000
	Cash on hand	1,10,000
	Total	**3,40,000**

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

Heera Ltd. and Rita Ltd. make available the following information as on 31st March, 20X3 (the date of amalgamation):

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

The consideration was to be based on the net assets of the companies as shown above but subject to an additional payment to Heera Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March 20X3. The weights for this purpose for the years 20X0-X1, 20X1-X2 and 20X2-X3 were agreed as 1, 2 and 3 respectively.

The profit had been:

20X0-X1 ₹ 3,00,000; 20X1-X2 ₹ 5,25,000 and 20X2-X3 ₹ 6,30,000.

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

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

You are required to calculate the number of shares issued to Heera Ltd. and Rita Ltd. and prepare necessary journal entries in the books of HR Ltd.

(November 2021 RTP /May 2017)

Sol.

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

Amount of Share Capital as per balance sheet	**₹**
Heera Ltd.	6,00,000
Rita Ltd.	8,40,000
	14,40,000
Share of Heera Ltd. = ₹ 14,40,000 × [21,60,000/ (21,60,000 + 14,40,000)] = ₹ 8,64,000 or 86,400 shares	
Securities premium = ₹ 21,60,000 – ₹ 8,64,000 = ₹ 12,96,000	
Premium per share = ₹ 12,96,000 / ₹ 86,400 = ₹ 15	
Issued 86,400 shares @ ₹ 10 each at a premium of ₹ 15 per share	
Share of Rita Ltd. = ₹ 14,40,000 x [14,40,000/ (21,60,000 + 14,40,000)] = ₹ 5,76,000 or 57,600 shares	
Securities premium = ₹ 14,40,000 – ₹ 5,76,000 = ₹ 8,64,000	
Premium per share = ₹ 8,64,000 / ₹ 57,600 = ₹ 15	
Issued 57,600 shares @ ₹ 10 each at a premium of ₹ 15 per share	

Journal Entries in the books of HR Ltd.

		Dr.	**Cr.**
Particulars		**Amount (₹)**	**Amount (₹)**
Business purchase account	Dr.	36,00,000	
To Liquidator of Heera Ltd. account			21,60,000
To Liquidator of Rita Ltd. account			14,40,000
(Being the amount of purchase consideration payable to liquidator of Heera Ltd. and Rita ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	
PPE account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	
Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of Heera Ltd. taken over)			
PPE account	Dr.	10,80,000	
Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Rita Ltd. taken over)			

Working Notes:

1) Calculation of goodwill of Heera Ltd.

Particulars	**Amount** ₹	**Weight**	**Weighted amount** ₹
20X0-X1	3,00,000	1	3,00,000
20X1-X2	5,25,000	2	10,50,000
20X2-X3	6,30,000	3	18,90,000
Total (a+b+c)	14,55,000	6	32,40,000
Weighted Average = [Total weighted amount/Total of weight] [₹ 32,40,000/6] Goodwill			5,40,000

2) Calculation of Net assets

	Heera Ltd. ₹	Rita Ltd. ₹
Assets		10,80,000
Goodwill	5,40,000	
PPE	7,20,000	
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft		5,40,000
Trade payable	2,40,000	5,40,000
Net assets or Purchase consideration	21,60,000	14,40,000

9. A Sun Ltd. and Moon Ltd. were amalgamated on and from 1st April, 20X1. A new company Star Ltd. was formed to take over the business of the existing companies. The Balance Sheets of Sun Ltd. and Moon Ltd. as at 31st March, 20X1 are given below:

Liabilities	**Sun**	**Moon**	**Assets**	**Sun**	**Moon**
	Ltd.	**Ltd.**		**Ltd.**	**Ltd.**
Share-Capital:			**PPE**		
Equity Shares of ₹100 each	400	375	Land and Building	275	200
12% Preference Shares of ₹100 each	150	100	Plant and Machinery	175	125
Reserves and Surplus			Investments	75	25
Revaluation reserve	75	50			
General reserve	85	75			
Investment allowance reserve	25	25			
P & L Account	25	15			
Secured Loan			**Current Assets,**		
			Loans and Advances		
10% Debentures			Stock	175	125
(₹ 100 each)	30	15	Sundry Debtors	125	150
Current Liabilities and			Bills Receivables	25	25
Provisions			Cash and Bank balances	150	100
Sundry creditors	135	60			
Acceptance	75	35			
Total	**1,000**	**750**	**Total**	**1,000**	**750**

Additional information:

a) Star Ltd. will issue 5 equity shares for each equity share of Sun Ltd. and 4 equity shares for each equity share of Moon Ltd. The shares are to be issued @₹30 each, having a face value of ₹10 per share.

b) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of Star Ltd. at a price of ₹150 per share (face value ₹100).

c) 10% Debenture holders of Sun Ltd. and Moon Ltd. are discharge by Star Ltd., issuing such number of its 15% Debentures of ₹100 each so as to maintain the same amount of interest.

d) Investment allowance reserve is to be maintained for 4 more years.

e) Liquidation expenses are:
Sun Ltd. ₹2,00,000
Moon Ltd. ₹1,00,000
It was decided that these expenses would be borne by Star Ltd.

f) All the assets and liabilities of Sun Ltd. and Moon Ltd. are taken over at book value.

g) Authorised equity share capital of Star Ltd. is ₹5,00,00,000, divide into equity shares of ₹10 each. After issuing the required number of shares to the Liquidators of Sun Ltd. and Moon Ltd., Star Ltd. issued balance shares to Public. The issue was fully subscribed.

Required:

Prepare the Balance Sheet of Star Ltd. as at 1st April, 20X1 after amalgamation has been carried out on the basis of Amalgamation in the nature of Purchase.

(November 2009/November 2020)

Sol.

Balance Sheet of Star Ltd. as at 1st April, 20X1

Particulars	**Notes No**	**₹ in Lakhs**
1. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share capital	1	750
(b) Reserves and Surplus	2	875
(2) Non - current Liabilities		
(a) 15% Debentures (20 + 10)		30
(3) Current Liabilities		
(a) Trade payables (Acceptance 75 + 3)		110
(b) Trade Creditors (135 + 60)		195
Total		**1,960**
2. Assets		
(1) Non - Current Assets		
(a) Property Plant and Equipment		
(i) Tangible Assets	3	775
(ii) Intangible Assets	4	13
(b) Non - current investment	5	100
(c) Other Non - Current Asset	6	50
(2) Current Assets		
(a) Inventories		
Stock ₹ (175 + 125)		300
(b) Trade Receivables	7	325
(c) Cash and Cash equivalents	8	397
Total		**1,960**

Notes to Accounts:

	Particulars	**in Lakhs**	
1.	**Share Capital**		
	Equity Share Capital Authorised, Issued and Subscribed 50,00,000 equity share @₹10 each 15% Pref. Share Capital	500	
	2,50,000 @15% pref share issued @ ₹100 each	250	750
	(**Notes:** 35,00,000 equity shares and all preference shares are allotted as full paid up for consideration other than each)		
2.	Reserve & Surplus		
	Security Premium (75 + 50 + 400 + 300) Lakhs	825	
	Investment Allowance Reserve ₹ (25 + 25) Lakhs	50	875
3.	**Tangible Assets**		
	Land and Building (275 + 200) Lakhs	475	
	Plant and Machinery (175 + 125)	300	

4.	**Intangible Assets**		775
	Goodwill ₹(10+2+1) Lakhs		13
5.	**Investment (75 + 25) Lakhs**		100
6.	**Other Non - Current Asset**		
	Amalgamation Adjustment A/c	50	50
7.	**Trade Receivables**		
	Sundry Debtors (125 + 15)	275	
	Bills Receivable (25 + 25)	50	325
8.	**Cash & Cash equivalent &**		
	Cash & Bank balance ₹(250 + 150 - 3) Lakhs		397

Working Notes:

1.	**Computation of Purchase Consideration**		**₹ in lakhs**	
			Sun Ltd.	**Moon Ltd.**
(a)	**Preference shareholders:**			
	1,50,00,000/100 = 1,50,000 shares			
	Share capital = 1,50,000 shares x ₹100 each	150		
	Securities premium = 1,50,000 shares x ₹50 each	75	225	
	1,00,00,000/100 = 1,00,000 shares			
	Share capital = 1,00,000 shares x ₹100 each	100		
	Securities premium = 1,00,000 shares x ₹50 each	50		150
(b)	**Equity Shareholders:**			
	4,00,0 ,000/100 x 5 = 20,00,000 shares			
	Share capital = 20,00,000 shares x ₹10 each	200		
	Securities premium = 20,00,000 shares x ₹20 each	400	600	
	3,75,00,000/100 × 4 = 15,00,000 shares			
	Share capital = 15,00,000 shares x ₹10 each	150		
	Securities premium = 15,00,000 shares x ₹20 each	300		450
Amount of purchase Consideration			825	600
2.	**Calculation of number of Debentures issued**		**₹ in Lakhs**	
			Sun Ltd.	**Moon Ltd.**
	10% Debentures of ₹100 each		30	15
	15% Debentures to be issued to maintain same amount of interest:			
	Interest = ₹30,00,000 × 10% = ₹3,00,000			
	Number of 15% Debentures = $\frac{₹3,00,000}{} \times 100$		20	
	Interest = ₹15,00,000 × 10%			
	Number of 15% Debentures = $\frac{₹1,50,000}{} \times 100$			10
3.	**Net assets taken over**		**₹ in lakhs**	
			Sun Ltd.	**Moon Ltd.**
	Assets taken over			
	Land and building		275	300
	Plant and machinery		175	125
	Investments		75	25
	Inventories		1 5	125
	Trade Receivable		125	150
	Bills receivable		25	25
	Cash and bank		150	100
			1,000	**750**

L ss: Liabilities taken over		
Debentures	20	10
Trade Payables	135	60
Bills payable	75	35
	230	**105**
Net assets taken over	770	645
Purchase consideration	825	600
(Goodwill)/Capital Reserve	(55)	45
Net goodwill		(10)

4. Liquidation expenses of Sun Ltd. and Moon Ltd., ₹2 lakhs and ₹1 lakhs respectively will be debited to Goodwill account in the books of Star Ltd.

10. Following are the summarised Balance Sheets of A Ltd. and B Ltd. as at 31.3.20X1:

Particulars	**A Ltd.**	**B Ltd.**
Share Capital: quity shares 10 each (fully paid up)	10,00,000	6,00,000
Share premium	2,00,000	__
General reserve	3,000,000	2,50,000
Profit and Loss account	1,80,000	1,60,000
10% debentures	5,00,000	__
Secured loan	__	3,00,000
Sundry creditors	2,60,000	1,70,000
	24,40,000	**14,80,000**
Land and Building	9,00,000	4,50,000
Plant and Machinery	5,00,000	3,80,000
Investment (5,000 shares of B Ltd.)	80,000	__
Stock	5,20,000	3,50,000
Debtors	4,10,000	2,60,000
Cash at bank	30,000	40,000
	24,40,000	**14,80,000**

The companies agree on a scheme of amalgamation on the following terms:

- **i)** A new company is to be formed by name AB Ltd.
- **ii)** AB Ltd. to take over all the assets and liabilities of the existing companies.
- **iii)** For the purpose of amalgamation, the shares of the existing companies are to be valued as under:
  - A Ltd. = ₹ 18 per share
  - B Ltd. = ₹ 20 per share
- **iv) A contingent liability of A Ltd. of ₹ 60,000 is to be treated as actual existing liability.**
- **v)** The shareholders of A Ltd. and B Ltd. are to be paid by issuing sufficient number of shares of AB Ltd. at a premium of ₹ 6 per share.
- **vi)** The face value of shares of AB Ltd. are to be of ₹ 10 each.

You are required to:

- **i)** Calculate the purchase consideration (i.e., number of shares to be issued to A Ltd. and B Ltd.)
- **ii)** Pass journal entries in the books of A Ltd. for the transfer of assets and liabilities.
- **iii)** Pass journal entries in the books of AB Ltd. for acquisition of A Ltd. and B Ltd.
- **iv)** Prepare the Balance Sheet of AB Ltd.

(May 2008/November 2011)

Sol.

i) **Calculation of Purchase Consideration**

No. of Equity shares	Agreed Value of share	Purchase Consideration	Value of Share in AB Ltd.	No. of Shares to be issued
(a)	**(b)**	**(c = a × b)**	**(d)**	**(c ÷ d)**
A Ltd. 1,00,000	₹ 18	₹ 18,00,000	₹ 16	1,12,500
B Ltd.				
(For 55,000 shares held by outsiders) 55,000	₹ 20	₹ 11,00,000		68,750
For 5,000 shares held by A Ltd to be set off 5,000	₹ 20	₹ 1,00,000		
Total Purchase Consideration		₹ 30,00,000		
Total No. of shares to be issued				**1,81,250**

	₹	₹
Share capital	11,25,000	6,87,500
Add: Securities premium	6,75,000	4,12,500
	18,00,000	**11,00,000**

ii) **Journal Entries in the Books of A Ltd.**

Particulars	L.F.	Dr. (₹)	Cr. (₹)
Equity shareholders A/c Dr.		60,000	
To Other's liabilities A/c			60,000
(Being liability created for contingent liability which is treated now as actual liability)			
Realisation A/c Dr.		24,40,000	
To Land and Building			9,00,000
To Plant and Machinery			5,00,000
To Investment (5,000 shares of B Ltd.)			80,000
To Inventories			5,20,000
To Trade Receivables			4,10,000
To Cash at Bank			30,000
(Being all assets transferred to Realisation A/c on sale of the business to AB Ltd)			
Trade Payables A/c Dr.		2,60,000	
10% Debentures A/c Dr.		5,00,000	
Contingent liabilities A/c Dr.		60,000	
To Realisation A/c			8,20,000
(Being recognizing contingent liability and transferred to Realisation A/c along with other liability on sale of business to AB Ltd.)			
AB Ltd. A/c Dr.		18,00,000	
To Realisation A/c			18,00,000
(Being purchase consideration due)			
Shares in AB Ltd. A/c Dr.		18,00,000	
To AB Ltd. A/c			18,00,000
(Being purchase consideration received from AB Ltd.)			
Realisation A/c Dr.		1,80,000	
To Equity shareholders' A/c			1,80,000
(Being Profit on realisation transferred to Equity shareholders A/c)			
Share Capital A/c Dr.		10,00,000	
Share Premium A/c Dr.		2,00,000	
General Reserve A/c Dr.		3,00,000	

Profit and Loss A/c Dr.		1,80,000	
To Equity shareholders A/c			16,80,000
(Being share capital and accumulated profits transferred to Equity share holder's A/c)			
Equity Shareholders A/c Dr.		18,00,000	
To Shares in AB Ltd.			18,00,000
(Being shares in AB Ltd. distributed amongst equity shareholders)			

iii) **Journal Entries in the Books of AB Ltd.**

Particulars	Dr. (₹)	Cr. (₹)
Land and Building A/c Dr.	9,00,000	
Plant and Machinery A/c Dr.	5,00,000	
Investment A/c Dr.	80,000	
Stock A/c Dr.	5,20,000	
Debtors A/c Dr.	4,10,000	
Goodwill A/c Dr.	1,80,000	
Cash at Bank A/c Dr.	30,000	
To 10% Debenture A/c		5,00,000
To Trade Payable A/c		2,60,000
To Other Liabilities A/c		60,000
To Liquidator of A Ltd.		18,00,000
(Being all assets and liabilities taken over from A Ltd.)		
Land and Building A/c Dr	4,50,000	
Plant and Machinery A/c Dr.	3,80,000	
Inventories A/c Dr.	3,50,000	
Trade Receivable A/c Dr.	2,60,000	
Goodwill A/c Dr.	1,90,000	
Cash at Bank A/c Dr.	40,000	
To Secured loan A/c		3,00,000
To Trade Payables		1,70,000
To Liquidator of B A/c		12,00,000
(Being all assets and liabilities taken over from B Ltd.)		
Liquidator of A A/c Dr.	18,00,000	
Liquidator of B A/c Dr.	12,00,000	
To Equity share Capital A/c		18,12,500
To Security Premium A/c		10,87,500
To Investment A/c		1,00,000
(5000 shares of B Ltd. held by A Ltd.)		
(Being 1,81,250 Equity shares issued of Z 10 each issued at a premium of Z 6 per share in discharge of purchase consideration and cancellation of investment in share of B Ltd held by A Ltd.)		
Investment A/c Dr.	20,000	
To Goodwill A/c		20,000
(Being profit on cancellation applied to write down the value of Goodwill)		

Balance Sheet of AB Ltd.
as on 31.3.20X1

	Particulars	Notes No.	Amount (₹)
I.)	**Equity and Liabilities**		
	1.) Shareholders' Funds		
	a) Share capital	1	18,12,500
	b) Reserves and Surplus	2	10,87,500
	2.) Non - Current Liabilities		

	a) Long - term borrowings	3	8,00,000
	3.) Current Liabilities		
	a) Trade payables (Sundry Creditors)		4,30,000
	b) Other current liabilities		60,000
	Total		**41,90,000**
II.)	**Assets**		
	1.) Non - Current Assets		
	a) Properly Plant and Equipment		
	i) Tangible Assets	4	22,30,000
	ii) Intangible Assets	5	3,50,000
	2.) Current Assets		
	a) Inventories - (stock)		8,70,000
	b) Trade receivable - (Debtors)		6,70,000
	c) Cash and Cash Equivalents		70,000
	Total		**41,90,000**

Notes to Accounts:

1.) Share Capital		
1,81,250 equity share issued @ ₹ 10 each, fully paid - up		18,12,500
2.) Reserve and Surplus		
Security Premium		10,87,500
3.) Long - term borrowings		
10% Debenture	5,00,000	
Other Secured Loans	3,00,000	8,00,000
4.) Tangible Assets		
Land and Building	13,50,000	
Plant and Machinery	8,80,000	22,30,000
5.) Intangible Asset		
Goodwill		3,50,000

Alternate Solution:

Journal Entries in the Books of A Ltd.

Particulars	L/F	Dr. (₹)	Cr. (₹)
Realisation A/c Dr.		24,40,000	
To Land and building A/c			9,00,000
To Plant and machinery A/c			5,00,000
To Inventories A/c			5,20,000
To Trade Receivables A/c			4,10,000
To Investments A/c			80,000
To Bank A/c			30,000
(Being assets transferred to Realisation A/c)			
Profit and Loss A/c Dr.		60,000	
To Trade Payables A/c			60,000
(Being contingent liability treated as real liability)			
10% Debentures A/c Dr.		5,00,000	
Trade Payables A/c Dr.		3,20,000	
To Realisation A/c			8,20,000
(Being transfer of liabilities to Realisation A/c)			
Ab Ltd. Dr.		18,00,000	
To Realisation A/c			18,00,000
(Being the purchase consideration accounted for)			
Share in AB Ltd. A/c Dr.		18,00,000	
To AB Ltd.			18,00,000
(Being purchase consideration received)			

Share Capital A/c Dr.		10,00,000	
Securities premium A/c Dr.		2,00,000	
General Reserve A/c Dr.		3,00,000	
Profit and Loss A/c Dr.		1,20,000	
Realisation A/c Dr.		1,80,000	
To Shareholders A/c			18,00,000
(Being transfer of balances to shareholders A/c)			
Shareholders A/c Dr.		18,00,000	
To Shares in AB Ltd.			18,00,000
(Being closure of shareholders A/c)			

Journal Entries in the Books of AB Ltd.

Particulars	**L/F**	**Dr. (₹)**	**Cr. (₹)**
Land and building A/c Dr.		9,00,000	
Plant and machinery A/c Dr.		5,00,000	
Inventories A/c Dr.		5,20,000	
Trade Receivables A/c Dr.		4,10,000	
Bank A/c Dr.		30,000	
Goodwill A/c Dr.		2,60,000	
To 10% Debentures A/c			5,00,000
To Trade Payables A/c			3,20,000
To Liquidator of A Ltd. A/c			18,,00,000
(Being the purchase consideration of A Ltd. accounted for)			
Land and building A/c Dr.		4,50,000	
Plant and machinery A/c Dr.		3,80,000	
Inventories A/c Dr.		3,50,000	
Trade Receivables A/c Dr.		2,60,000	
Bank A/c Dr.		40,000	
Goodwill A/c Dr.		90,000	
To Secured loan A/c			3,00,000
To Trade Payables A/c			1,70,000
To Liquidator of B Ltd. A/c			11,00,000
(Being purchase consideration of B Ltd. accounted for)			
Liquidator of A Ltd. A/c Dr.		18,00,000	
To Equity share capital A/c			11,25,000
To Securities premium A/c			6,75,000
(Being shares issued.to Liquidator of A Ltd.)			
Liquidator of B Ltd. A/c Dr.		11,00,000	
To Equity share capital A/c			6,87,500
To Securities premium A/c			4,12,500
(Being shares issued to Liquidator of B Ltd.)			

Balance Sheet of AB Ltd.
as on 31.3.20X1

	Particulars	**Note No.**	**Amount (₹)**
I.)	**Equity and Liabilities**		
	1.) Shareholders' Funds		
	a) Share capital	1	18,12,500
	b) Reserves and Surplus	2	10,87,500
	2.) Non - Current Liabilities		
	a) Long - term borrowings	3	8,00,000
	3.) Current Liabilities		
	a) Trade payables (Sundry Creditors)		4,30,000
	b) Other current liabilities		60,000
	Total		**41,90,000**

II.)	**Assets**		
	1.) Non - Current Assets		
	a) Property Plant and Equipment		
	i) Tangible Assets	4	22,30,000
	ii) Intangible Assets	5	3,50,000
	2.) Current Assets		
	a) Inventories - (stock)		8,70,000
	b) Trade receivable - (Debtors)		6,70,000
	c) Cash and Cash Equivalents		70,000
	Total		**41,90,000**

Notes No. Accounts:

1)	**Share Capital**		
	1,81,250 equity shares issued ₹ 10 each, fully paid - up		18,12,500
2)	**Reserve and Surplus**		
	Security Premium		10,87,500
3)	**Long - term borrowings**		
	10% Debenture	5,00,000	
	Other Secured Loans	3,00,000	8,00,000
4)	**Tangible Assets**		
	Land and Building	13,50,000	
	Plant and Machinery	8,80,000	22,30,000
5)	**Intangible Asset**		
	Goodwill		3,50,000

11. Consider the following balance sheets of X Ltd. and Y Ltd. as at 31st March, 20X1:

		Particulars	Notes	X Ltd. ('000)	Y Ltd. ('000)
		Equity and Liabilities			
1.		**Shareholders' funds**			
	a.	Share capital	1	72,00	47,00
	b.	Reserves and Surplus	2	15,50	10,50
2.		**Non-current liabilities**			
	a.	Long-term borrowings	3	5,00	3,50
3.		**Current liabilities**			
	a.	Trade Payables		4,50	3,50
	b.	Other current liabilities		2,00	1,50
		Total		**99,00**	**66,00**
		Assets			
1.		**Non-current assets**			
	a.	Property, Plant and Equipment	4	63,25	36,00
	b.	Non-current investments	5	7,00	5,00
2.		**Current assets**			
	a.	Inventories		12,50	9,50
	b.	Trade receivables		9,00	10,30
	c.	Cash and Cash equivalents		7,25	5,20
		Total		**99,00**	**66,00**

Notes to accounts

		X Ltd ('000)	Y Ltd ('000)
1.	**Share Capital**		
	Equity share capital (₹10 each)	50,00	30,00
	14% Preference Shares capital ₹100 each	22,00	17,00
		72,00	**47,00**
2.	**Reserves and Surplus**		
	General reserve	5,00	2,50

	Export profit reserve	3,00	2,00
	Investment allowance reserve	-	1,00
	Profit and loss account	7,50	5,00
		15,50	**10,50**
3.	**Long-term borrowings**		
	13% Debentures of ₹100 each	5,00	3,50
		5,00	**3,50**
4.	**Property, Plant and Equipment**		
	Land and Building	25,00	15,50
	Plant and machinery	32,50	17,00
	Furniture	5,75	3,50
		63,25	**36,00**
5.	**Non-current investments**		
	Investments at cost	7,00	5,00
		7,00	**5,00**

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

i) Issued 3,50,000 equity shares of ₹10 each at par to the equity shareholders of Y Ltd.

ii) Issued 15% preference shares of ₹100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into an equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

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

a) the amalgamation is in the nature of a merger.

b) the amalgamation is in the nature of the purchase.

(ICAI SM)

Ans.

a) Amalgamation in the nature of merger:

Balance Sheet of X Ltd.

		Particulars	**Notes**	**₹in '000**
		Equity and Liabilities		
1.		**Shareholders' funds**		
	a.	Share capital	1	12,570
	b.	Reserves and Surplus	2	1,930
2.		**Non-current liabilities**		
	a.	Long-term borrowings	3	850
3.		**Current liabilities**		
	a.	Trade Payables		800
	b.	Other current liabilities		350
		Total		16,500
		Assets		
1.		**Non-current assets**		
	a.	Property, Plant and Equipment	4	9,925
	b.	Non-current investments		1,200
2.		**Current assets**		
	a.	Inventories		2,200
	b.	Trade receivables		1,930
	c.	Cash and cash equivalents		1,245
		Total		**16,500**

Notes to accounts

			₹ in '000
1.	**Share Capital**		
	Equity share capital		
	8,50,000 Equity Shares of ₹10 each		8,500
	Preference share capital		
	18,700, 15% Preference Shares of ₹100 each		1,870
	22,000, 14% Preference Shares of ₹100 each		2,200
	Total		**12,570**
2.	**Reserves and Surplus**		
	General Reserve of X Ltd. 500		
	Add: General reserve of Y Ltd. 250	750	
	Less: Adjustment for amalgamation*	(670)	80
	Export Profit Reserve of X Ltd.	300	
	Add: Export Profit Reserve of Y Ltd.	200	500
	Investment Allowance Reserve		100
	Profit & Loss A/c of X Ltd.	750	
	Add: Profit & Loss A/c of Y Ltd.	500	1,250
	Total		**1,930**
3.	**Long-term borrowings**		
	Secured		
	8,500 13% Debentures of ₹100 each		850
	Total		**850**
4.	**Property, Plant and Equipment**		
	Land & Buildings		4,050
	Plant & Machinery		4,950
	Furniture & Fittings		925
	Total		**9,925**

*The difference between the amount recorded as share capital issued and the amount of share capital of transferor-company should be adjusted in reserves. Thus, Adjustment for amalgamation = ₹'000 (53,70 – 47,00) = ₹('000) 670

b) Amalgamation in the nature of purchase:

Balance Sheet of X Ltd.

		Particulars	Notes	₹in'000
		Equity and Liabilities		
1.		**Shareholders' funds**		
	a.	Share capital	1	12,570
	b.	Reserves and Surplus	2	1,930
2.		**Non-current liabilities**		
	a.	Long-term borrowings	3	850
3.		**Current liabilities**		
	a.	Trade Payables		800
	b.	Other current liabilities		350
		Total		**16,500**
		Assets		
1.		**Non-current assets**		
	a.	Property, Plant and Equipment	4	9,925
	b.	Non-current investments		1,200
2.		**Current assets**		
	a.	Inventories		2,200
	b.	Trade receivables		1,930
	c.	Cash and cash equivalents		1,245
		Total		**16,500**

Notes to accounts

		₹in'000
1.	**Share Capital**	
	Equity share capital	
	8,50,000 Equity Shares of ₹10 each	8,500
	Preference share capital	
	18,700, 15% Preference Shares of ₹100 each	1,870
	22,000, 14% Preference Shares of ₹100 each	2,200
	Total	**12,570**
2.	**Reserves and Surplus**	
	Capital Reserve	380
	General Reserve	500
	Amalgamation adjustment reserve	(300)
	Export Profit Reserve	500
	Investment Allowance Reserve	100
	Surplus (Profit & Loss A/c)	750
	Total	**1,930**
3.	**Long-term borrowings**	**850**
	Secured	
	8,500 13% Debentures of ₹100 each	
	Total	**850**
4.	**Property, Plant and Equipment**	
	Land & Buildings	4,050
	Plant & Machinery	4,950
	Furniture & Fittings	925
	Total	**9,925**

Workings Notes: Capital Reserve arising on Amalgamation:

A)	**Net Assets taken over:**	**₹('000)**	**₹('000)**
	Sundry Assets		66,00
	Less: 13% Debentures	3,50	
	Trade payables	3,50	
	Other current liabilities	1,50	(8,50)
			57,50
B)	**Purchase consideration:**		
	To Equity Shareholders of Y Ltd.		35,00
	To Preference Shareholders of Y Ltd.		18,70
			53,70
C)	**Capital Reserve (A – B)**		3,80

12. Wye Ltd. acquires the business of Zed Ltd. whose balance sheet as at 31st March, 20X1 is as under:

		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1.		**Shareholders' funds**		
	a.	Share capital	1	12,00,000
	b.	Reserves and Surplus	2	1,58,000
2.		**Non-current liabilities**		
	a.	Long-term borrowings	3	2,00,000
3.		**Current liabilities**		
	a.	Trade Payables		1,20,000
	b.	Other current liabilities		12,000
		(Interest payable on debentures)		
		Total		**16,90,000**
		Assets		
1.		**Non-current assets**		

	a.	Property, Plant and Equipment	4	10,00,000
	b.	Intangible assets	5	2,90,000
2.		**Current assets**		
	a.	Inventories		1,50,000
	b.	Trade receivables		1,80,000
	c.	Cash and Cash equivalents		70,000
		Total		**16,90,000**

Notes to accounts:

	Particulars	**₹**
1.	**Share Capital**	
	Equity Share capital (₹100 each)	8,00,000
	6% Preference Share capital (₹100 each)	4,00,000
		12,00,000
2.	**Reserves and Surplus**	
	Capital reserve	1,00,000
	Profit and loss A/c	50,000
	Workmen compensation reserve	8,000
	(Expected liability ₹5,000)	
		1,58,000
3.	**Long-term borrowings**	
	6% Debentures	2,00,000
		2,00,000
4.	**Property, Plant and Equipment**	
	Land and Building	4,00,000
	Plant and machinery	6,00,0 0
		10,00,000
5.	**Intangible assets**	
	Goodwill	2,40,000
	Patents	50,000
		2,90,000

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay the following amounts:

i) ₹2,00,000 7% Debentures (₹100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth ₹105.

ii) For each preference share in Zed Ltd. ₹10 in cash and one 9% preference share of ₹100 each in Wye Ltd.

iii) For each equity share in Zed Ltd. ₹20 in cash and one equity share in Wye Ltd. of ₹100 each having the market value of ₹ 140.

iv) Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of ₹10,000. Actual expenses amounted to ₹12,500.

Wye Ltd. valued Land and building at ₹5,50,000 Plant and Machinery at ₹6,50,000 and patents at ₹20,000 of Zed Ltd for the purpose of amalgamation.

(ICAI SM)

Ans. **Purchase Consideration:**

Particulars		**₹**	**Form**
i) Preference Shares: ₹10 per share	40,000		Cash
Preference shares	4,00,000	4,40,000	Preference shares
ii) Equity shares: ₹20 per share	1,60,000		Cash
8,000 equity shares in			
Wye Ltd. @₹140	11,20,000	12,80,000	Equity shares
		17,20,000	

Steps to close the books of the vendor company

1. Open Realisation account and transfer all assets at book value

The journal entry in the above case is:	**L.F.**	**₹**	**₹**
Realization A/c	Dr.	16,20,000	
To Goodwill			2,40,000
To Land & Building			4,00,000
To Plant & Machinery			6,00 000
To Patents			50,000
To Inventory			1,50,000
To Trade receivables			1,80,000
(transfer of assets to realization a/c on sale of business of wye ltd.)			
6% debenture in wye ltd.	Dr.	2,00,000	
Workmen compensation reserve	Dr.	5,000	
Trade payable	Dr.	1,20,000	
To realization a/c			3,25,000
(transfer of liabilities taken over by wye ltd. to realization a/c)			
Wye ltd.	Dr.	17,20,000	
To realization a/c			17,20,000
(amount receivable from wye ltd. for sale of business)			
Cash a/c	Dr.	2,00,000	
9% preference share in wye ltd.	Dr.	4,00,000	
Equity share in wye ltd.	Dr.	11,20,000	
To wye ltd.			17,20,000
(receipt of payment consideration from the purchase of company)			
Wye ltd.	Dr.	10,000	
Realization a/c	Dr.	2,500	
To cash a/c			12,500
(liquidation of expenses out of which ₹10,000 is payable by wye ltd.)			
Cash a/c	Dr.	10,000	
To wye ltd.			10,000
(Amount reimbursed by wye ltd. for expenses)			
Interest outstanding	Dr.	12,000	
To debenture holder			12,000
(Amount due to debenture holder for debenture interest)			
Debenture holder a/c	Dr.	12,000	
To cash a/c			12,000
(Debenture holder paid cash ₹12,000 for outstanding interest)			
6% preference share capital a/c	Dr.	4,00,000	
Realization a/c	Dr.	40,000	
To preference hare holder			4,40,000
(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)			
Preference shareholder a/c	Dr.	4,40,000	
To cash a/c			40,000
To 9% preference shareholder in wye ltd.			4,00,000
(cash and preference share in wye ltd. given to preference shareholder)			

Equity share capital a/c	Dr.	8,00,000	
Capital reserve a/c	Dr.	1,00,000	
Profit and loss a/c	Dr.	50,000	
Workmen compensation reserve	Dr.	3,000	
Realization a/c	Dr.	4,22,500	
To sundry equity shareholder a/c			13,75,500
(Various accounts representing capital and profit transferred to Equity Shareholders Account)			

Working Notes

1. Realization Account

	₹		₹
To Sundry Assets	16,20,000	By Sundry iabilities	3,25,000
To Cash (excess expenses of liquidation)	2,500	By Wye Ltd.	17,20,000
To Preference Shareholders	40,000		
To Equity Shareholders A/c -			
profit transferred	3,82,500		
	20,45,000		**20,45,000**

2. Cash Account

	₹		₹
To Balance b d	70,000	By Realization	2,500
To Wye Ltd.	2,00,000	By Wye Ltd.	10,000
(consideration for amalgamation)			
To Wye Ltd.	10,000	By Debenture-holders	12000
(liquidation expenses reimbursed)		By Preference shareholder	40000
		By Equity Shareholder (B/F)	215500
	280000		**280000**

13. **The following Balance Sheets are given as at 31st March, 20X1:**

		Particulars	₹Best Ltd. (in lakhs)	₹Better Ltd. (in lakhs)
		Equity and Liabilities		
1.		**Shareholders' funds**		
	a.	Share capital	20	10
		(Shares of ₹100 each, fully paid)		
	b.	Reserves and Surplus	10	8
2.		**Current liabilities**	20	2
	a.	**Total**	**50**	**20**
		Assets		
3.		**Non-current assets**		
	a.	Property, Plant and Equipment	25	15
	b.	Non-current investments	5	-
		Current assets	20	5
		Total	**50**	**20**

The following further information is given –

a) Better Limited issued bonus shares on 1st April, 20X1, in the ratio of one share for every two held, out of Reserves and Surplus.

b) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.

c) The value of shares in Best Ltd. was considered to be ₹150 and the shares in Better Ltd. were valued at ₹100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.

d) Liabilities of Better Ltd., included ₹1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made a profit of 25% of the cost. The goods of ₹50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 20X1 after the takeover.

(ICAI SM)

Ans.

LEDGER OF BETTER LIMITED

Property, Plant and Equipment (PPE) Account

Particulars	₹	Particulars	₹
To Balance b/d	15,00,000	By Realization A/c (transfer)	15,00,000

Current Assets Account

Particulars	₹	Particulars	₹
To Balance b/d	5,00,000	By Realization A/c (transfer)	5,00,000

Liabilities Account

Particulars	₹	Particulars	₹
To Realization A/c	2,00,000	By Balance b/d	2,00,000

Realization Account

Particulars	₹	Particulars	₹
To PPE A/c	15,00,000	By Liabilities A/c	2,00,000
To Current Assets A/c	5,00,000	By Best Limited	15,00,000
		(Purchase Consideration)	
		By Shareholders' A/c	3,00,000
		(Loss on Realization)	
	20,00,000		**20,00,000**

Share Capital Account

Particulars	₹	Particulars	₹
To Sundry shareholders		By Balance b/d	10,00,000
A/c - (transfer)	15,00,000	By Reserves & Surplus A/c	5,00,000
	_	(Bonus issue)	
	15,00,000		15,00,000

Reserves & Surplus A/c

Particulars	₹	Particulars	₹
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
To Sundry Shareholders	3,00,000		–
	8,00,000		8,00,000

Best Ltd.

Particulars	₹	Particulars	₹
To Realization A/c – Purchase Consideration	15,00,000	By Shares in Best Ltd	15,00,000
	15,00,000		15,00,000

Share in Best Ltd.

Particulars	₹	Particulars	₹
To Best Ltd.	15,00,000	By Sundry Shareholders A/c	15,00,000

Sundry Shareholders Account

Particulars	₹	Particulars	₹
To Realization A/c	3,00,000	B Share Capital A/c	15,00,000
(Loss)		By Reserves & Surplus A/c	3,00,000
To Share in Best Ltd.	15,00,000		–
	18,00,000		18,00,000

Journal of Best Ltd.

	Dr.	Cr.
20X1 Apr. 1	₹	₹
Property, Plant and Equipment A/c Dr. Current Assets A/c Dr . To Liabilities A/c To Liquidator of Better Ltd. To Capital Reserve A/c (Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of ₹15,00,000 as per agreement dated)	15,00,000 5,00,000	 2,00,000 15,00,000 3,00,000
Liquidator of Better Ltd. Dr. To Share Capital A/c To Securities Premium A/c (Discharge of Purchase consideration by the issue of equity shares of ₹10,00,000 at a premium of ₹50 per share as per agreement)	15,00,000	 10,00,000 5,00,000
Trade payables A/c Dr. To Trade receivables A/c (Amount due from Better Ltd., and included in its creditors taken over, cancelled against own Trade receivables)	1,00,000	 1,00,000
Capital Reserve A/c Dr. To Current Asset (Stock) A/c (Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account. 20% on sale value of ₹50,000 shall be eliminated as unrealized profit)	10,000	 10,000

Working Note :

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at ₹100 per share ₹15,00,000 Purchase consideration has been discharged by Best Ltd. by the issue of shares for ₹10,00,000 at a premium of ₹5,00,000. This gives the value of ₹150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	Notes	₹
		Equity and Liabilities		
1.		**Shareholders' funds**		
	a.	Share capital	1	30,00,000
	b.	Reserves and Surplus	2	17,90,000
2.		**Current liabilities**		21,00,000
		Tota		68,90,000
		Assets		
1.		**Non-current assets**		
	a.	Property, Plant and Equipment	3	40,00,000
	b.	Non-current investments		5,00,000
2.		**Current assets**		23,90,000
		Total		68,90,000

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued & Subscribed		
	30,000 shares of ₹100 (of the above 10,000 shares have been issued for consideration other than cash)		30,00,000
	Total		**30,00,000**
2.	**Reserves and Surplus**		
	Capital Reserve (3,00,000 – 10,000)		2,90,000
	Securities Premium		5,00,000
	Other reserves and surplus		10,00,000
	Total		**17,90,000**
3.	**Property, Plant and Equipment**		
	PPE	25,00,000	
	Acquired during the year	15,00,000	40,00,000
	Total		**40,00,000**

14. The following are the Balance Sheets of A Ltd. and B Ltd. as at 31.3.20X1:

		Particulars	**Notes**	**₹A Ltd (in'000)**	**₹B Ltd (in'000)**
		Equity and Liabilities			
1.		**Shareholders' funds**			
	a.	Share capital	1	2,000	1,000
	b.	Reserves and Surplus	2	1,000	(800)
2.		**Non-current liabilities**			
	a.	Long-term borrowings	3	750	450
3.		**Current liabilities**			
	a.	Trade Payables		300	300
	b.	Short term Borrowings –			
		Bank overdraft			50
		Total		**4,050**	**1,000**
		Assets			
1.		**Non-current assets**			
	a.	Property, Plant and Equipment		2,700	850
	b.	Non-current investments		700	--
2.		**Current assets**			
	a.	Trade receivables		400	150
	b.	Cash and Cash equivalents (cash at bank)		250	
		Total		**4050**	**1000**

Notes to accounts

1.	**Share capital**	**A Ltd. ('000)**	**B Ltd. ('000)**
	Equity shares of ₹100 each	2000	1000
		2000	1000
2.	**Reserves and Surplus**		
	General reserve	1000	--
	Profit and loss A/c (debit balance)	--	(800)
		1000	(800)
3.	**Long term borrowings**		
	10% debentures	500	--
	Loan from banks	250	450
		750	450

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

i) Banks agreed to waive off the loan of ₹60 thousands of B Ltd.

ii) B Ltd. will reduce its shares to ₹10 per share and then consolidate 10 such shares into one share of ₹100 each (new share).

iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.

iv) Trade payables of B Ltd. includes ₹100 thousand payable to A Ltd.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger.

(ICAI SM)

Ans. **Calculation of purchase consideration**

One share of B Ltd. will be issued in exchange of every share of A Ltd. (i.e.20,000 equity shares of B Ltd. will be issued against 20,000 equity shares of A Ltd.)	20,000 shares

Journal Entries in the books of B Ltd.

Date			**(₹ in thousands)**	
20X1			**Dr.**	**Cr.**
March,31	Loan from bank A/c	Dr.	60	
	To Capital reduction A/c			60
	(Being loan from bank waived off to the extent of ₹60 thousand)			
	Equity share capital A/c (₹100)	Dr.	1,000	
	To Equity share capital A/c (₹10)			100
	To Capital reduction A/c			900
	(Being equity shares of ₹100 each reduced to ₹10 each)			
	Equity share capital A/c (₹10)	Dr.	100	
	To Equity share capital A/c (₹100 each)			100
	(Being 10 equity shares of ₹10 each consolidated to one share of ₹100 each)			
	Capital reduction A/c	Dr.	960	
	To Profit and loss A/c			800
	To Capital reserve A/c			160
	(Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)			
	Property, plant and equipment A/c	Dr.	2,700	
	Investment A/c	Dr.	700	
	Trade receivables A/c	Dr.	400	
	Cash at bank A/c	Dr.	250	
	To Trade payables A/c			300
	To Loans from bank A/c			250
	To 10% Debentures A/c			500
	To Liquidator of A Ltd. A/c			2,000
	To Reserves A/c			1,000
	(Being assets, liabilities and reserves taken over under pooling of interest method and amount due to Liquidator)			
	Liquidator of A Ltd. A/c	Dr.	2,000	
	To Equity share capital A/c			2,000
	(Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)			
	Trade payables A/c	Dr.	100	
	To Trade receivables A/c			100
	(Being mutual owing cancelled)			

Balance Sheet of B Ltd. after merger
as at 31.3.20X1

		Particulars	Notes	₹in '000
		Equity and Liabilities		
1.		**Shareholders' funds**		
	a.	Share capital	1	2,100
	b.	Reserves and Surplus	2	1,160
2.		**Non-current liabilities**		
	a.	Long term borrowings	3	1,140
3.		Current liabilities		
	a.	Trade payables		500
	b.	Short term borrowings	4	50
		Total		**4,950**
		Assets		
1.		**Non-current assets**		
	a.	Property, Plant and Equipment		3,550
	b.	Non-current investments		700
2.		**Current assets**		
	a.	Trade receivables		450
	b.	Cash and cash equivalents		250
		Total		**4,950**

Notes to accounts

			₹ in '000
1.	**Share Capital**		
	21,000, Equity shares of ₹100 each fully paid		2,100
	(Out of the above, 20,000 shares have been issued for consideration other than cash)		
2.	**Reserves and Surplus**		
	Capital reserve	160	
	General reserve	1,000	
	Total		1,160
3.	**Long Term Borrowings**		
	10% Debentures	500	
	Loan from Bank (250+450-60)	640	1,140
4.	**Short term borrowings**		
	Bank overdraft		50

15. The following are the Balance Sheets of Yes Ltd. and No Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹Yes Ltd (in crores)	₹No Ltd (in crores)
		Equity and Liabilities			
1.		**Shareholders' funds**			
	a.	Share capital	1	12	5
	b.	Reserves and Surplus		88	10
2.		**Non-current liabilities**			
	a.	Long term borrowings	2	-	10
3.		**Current liabilities**		**33**	**15**
		Total		**133**	**40**
		Assets			
4.		**Non-current assets**			
	a.	Property, Plant and Equipment	3	20	6
	b.	Non-current investments	4	13	-
5.		**Current assets**		100	34
		Total		**133**	**40**

Notes of accounts

		Yes Ltd.	No Ltd.
1.	**Share Capital**		
	Equity share capital		
	Authorized share capital	25	5
	Issued and subscribed:		
	Equity shares of ₹10 each fully paid	12	5
		12	5
2.	**Long term borrowings**		
	Unsecured loan from Yes Ltd.	-	10
		-	10
3.	**Property, Plant and Equipment**		
	Gross value	70	30
	Depreciation	(50)	(24)
		20	6
4.	**Non-current investments**		
	30 lakhs equity shares of ₹10 each	3	-
	Long term loan to No Ltd.	10	-
		13	-

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity share of Yes Ltd. issued at a premium of ₹2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.

You are asked to pass journal entries in the books of the two companies to give effect to the above.

(ICAI SM)

Ans.

Journal Entries in the books of No Ltd.

			(Rupees in crores)
		Dr.	**Cr.**
Realization Account To Property, plant and equipment Account To Current Assets Account (Being the assets taken over by Yes Ltd. transferred to Realization Account)	Dr.	64.00	 30.00 34.00
Provision for depreciation Account Current Liabilities Account Unsecured Loan from Yes Ltd. Account To Realization Account (Being the transfer of liabilities and provision to Realization Account)	Dr. Dr. Dr.	24.00 15.00 10.00	 49.00
Yes Ltd. To Realization Account (Being the amount of consideration due from Yes Ltd. credited to Realization Account)	Dr.	1.2	 1.2
Equity Shareholders Account To Realization Account (Being the loss on Realization transferred to equity shareholders account)	Dr.	13.80	 13.80
Equity Share Capital Account Reserves and Surplus Account To Equity Shareholders Account (Being the amount of share capital, reserves and surplus credited to equity shareholders account)	Dr. Dr.	5.00 10.00	 15.00

Equity shares of Yes Ltd. To Yes Ltd. (Being the receipt of 10 lakhs equity shares of ₹10 each at ₹12 per share for allotment to shareholders)	Dr.	1.20	 1.20
Equity shareholders Account To Equity shares of Yes Ltd. (Being the distribution of equity shares received from Yes Ltd. to shareholders)	Dr.	1.20	 1.20

Journal Entries in the books of Yes Ltd.

			(Rupees in crores)
		Dr.	**Cr.**
Business Purchase Account To Liquidator of No Ltd. Account (Being the amount of purchase consideration agreed under approved scheme of amalgamation-W.N. 1)	Dr.	1.2	 1.2
Property, plant and equipment Current Assets To Current Liabilities To Unsecured Loan (from Yes Ltd.) To Business Purchase Account To Reserve & Surplus A/c To Profit & loss A/c (Being the assets and liabilities taken over and the surplus transferred to Profit and loss account)	Dr. Dr.	6.00 34.00	 15.00 10.00 1.20 10.00 3.80
Liquidator of No Ltd. To Equity Share Capital Account To Securities Premium Account (Being the allotment to shareholders of No Ltd. 10 lakhs equity shares of ₹10 each at a premium of ₹2 per share)	Dr.	1.20	 1.00 0.20
Unsecured Loan (from Yes Ltd.) To Loan to No. Ltd. (Being the cancellation of unsecured loan given to No Ltd.)	Dr.	10.00	 10.00

* As amalgamation in the nature of merger so balancing figure will be transferred to Profit & Loss account.

Working Note:

Purchase Consideration	₹in crores
$\frac{50\ lakhs}{5} \times 12$ i.e., 10 lakhs equity shares at ₹12 per share	1.20

Number of equity shares of ₹10 each to be issued $\left[\left[\underline{1.20\ crores}\right]\right]$ = 10 lakhs

16. **Mohan Ltd. gives you the following information as on 31st March, 20X1:**

Particulars	**₹**
Share capital: Equity shares of ₹ 10 each	 3,00,000
6,000, 9% cumulative preference shares of ₹ 10 each	60,000
Profit and Loss Account (Dr. balance)	1,70,000
10% Debentures of ₹ 100 each	2,00,000
Interest payable on Debentures	20,000
Trade Payables	1,50,000
Property, Plant and Equipment	3,40,000

Goodwill	10,000
Inventory	80,000
Trade Receivables	1,10,000
Bank Balance	20,000

A new company Ravi Ltd. is formed with an authorized share capital of ₹ 4,00,000 divided into 40,000 Equity Shares of ₹ 10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following terms:

i) a) Mohan Ltd.'s debentures are paid by similar debentures in new company and for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.

b) The trade payables are paid by the issue of 12,000 equity shares at par in full and final settlement of their claims.

c) Preference shareholders are to get an equal number of equity shares issued at par. Dividend on preference shares is in arrears for three years. Preference shareholders to forgo dividend for two years. For balance dividend, equity shares of equal amount are issued at par.

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

ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%). Goodwill is to be eliminated. The Property, plant and equipment is taken over at ₹ 3,08,400.

iii) Remaining equity shares of the new company are issued to public at par fully paid up.

iv) Expenses of ₹ 5,000 to be met from bank balance of Mohan Ltd. This is to be adjusted from the bank balance of Mohan Ltd. before acquisition by Ravi Ltd.

You are required to prepare:

a) Realization account and Equity Shareholders' account in the books of Mohan Ltd.

b) Bank Account and Balance Sheet with notes to accounts in the books of Ravi Ltd.

(RTP May 2021)

Ans.

In the books of Mohan Ltd.

Realization Account

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

ii) Equity shareholders' Account

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

*Alternatively, expenses may be routed through the Realization account.

In the books of Ravi Ltd.

i) Bank Account

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

ii) Balance Sheet as at 31st March, 20X0

Particulars	**Note No.**	**₹**
I. Equity and Liabilities		
1) Shareholder's Funds		
Share Capital		
2) Non-Current Liabilities	1	4,00,000
Long-term borrowings	2	2,00,000
Total		**6,00,000**
II. Assets		
1) Non-current assets		
a) Property, plant and equipment		3,08,400
2) Current assets		
a) Inventories		72,000
b) Trade receivables		1,10,000
c) Cash and cash equivalents		1,09,600
Total		**6,00,000**

Notes to Accounts

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

Working Notes:

1) Calculation of Purchase consideration

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

2) Preference shareholders' Account in books of Mohan Ltd.

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

3) Calculation of number of Equity shares issued to the public

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

17. A Ltd. gives the following information on 31st March, 20X1:

	₹
8,000 Equity shares of ₹ 100 each	8,00,000
10% Debentures	4,00,000
Loans	1,60,000
Trade payables	3,20,000
General Reserve	80,000
Building	3,40,000
Machinery	6,40,000
Inventory	2,20,000
Trade receivables	2,60,000
Bank	1,36,000
Patent	1,30,000
Profit & Loss account (Dr. balance)	34,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

1) B Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.
2) B Ltd. is to take over trade payables at book value.
3) The purchase consideration is to be paid in cash to the extent of ₹ 6,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 1,24,400. The liquidation expenses amounted to ₹ 16,000. B Ltd. sold prior to 31st March, 20X1 goods costing ₹ 1,20,000 to A Ltd. for ₹ 1,60,000. ₹ 1,00,000 worth of goods are still in Inventory of A Ltd. on 31st March, 20X1. Trade payables of A Ltd. include ₹ 40,000 still due to B Ltd.

Show the Realisation A/c, Bank A/c, B Ltd. A/c and Equity shareholders A/c to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 20X1 after the takeover from the available information.

(MTP November 2021)

Ans.

Books of A Limited
Realization Account

Particulars	₹		₹
To Building	3,40,000	By Trade payables	3,20,000
To Machinery	6,40,000	By B Ltd.	12,10,000
To Inventory	2,20,000	By Equity Shareholders (Loss)	76,000
To Trade receivables	2,60,000		
To Patent	1,30,000		
To Bank (Exp.)	16,000		
	16,06,000		16,06,000

Bank Account

To Balance b/d	1,36,000	By Realization (Exp.)	16,000
To B Ltd.	6,00,000	By 10% Debentures	4,00,000
		By Loans	1,60,000
		By Equity shareholders	1,60,000
	7,36,000		7,36,000

B Ltd. Account

To Realisation A/c	12,10,000	By Bank	6,00,000
		By Equity share in B Ltd. (4,880 shares at ₹ 125 each)	6,10,000
	12,10,000		12,10,000

Equity Share Holders Account

To Realization Account	76,000	By Equity share capital	8,00,000
To Profit & Loss A/c (Dr.)	34,000	By General reserve	80,000
To Equity shares in B Ltd.	6,10,000		
To Bank	1,60,000		
	8,80,000		8,80,000

B Ltd

Balance Sheet as on 1st April, 20X1 (An extract)[1]

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	4,88,000
b	Reserves and Surplus	2	1,07,000
2	Current liabilities		
a	Trade Payables	3	2,80,000
b	Bank overdraft		6,00,000
	Total		14,75,000
	Assets		
1	Non-current assets		
	Property, Plant and Equipment	4	8,82,000
	Intangible assets	5	2,16,000
2	Current assets		
a	Inventories	6	1,83,000
b	Trade receivables	7	1,94,000
			14,75,000

[1] In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the complete BalanceSheet of B Ltd. after takeover cannot be prepared.

Notes to Accounts

			₹
1	Share Capital		
	Equity share capital		
	4,880 Equity shares of ₹ 100 each (Shares have been issued for consideration other than cash)		4,88,000
	Total		4,88,000
2	Reserves and Surplus (an extract)		
	Securities Premium		1,22,000
	Profit and loss account	.....	
	Less: Unrealized profit	(15,000)	(15,000)
	Total		1,07,000

3	Trade payables		
	Opening balance	3,20,000	
	Less: Inter-company transaction cancelled upon amalgamation	(40,000)	2,80,000
4	Property, Plant and Equipment		
	Buildings		3,06,000
	Machinery		5,76,000
	Total		8,82,000
5	Intangible assets		
	Goodwill		2,16,000
6	Inventories		
	Opening balance	1,98,000	
	Less: Cancellation of profit upon amalgamation	(15,000)	1,83,000
7	Trade receivables		
	Opening balance	2,34,000	
	Less: Intercompanytransaction cancelled upon amalgamation	(40,000)	1,94,000

Working Notes:

1.	Valuation of Goodwill	₹
	Average profit	1,24,400
	Less: 8% of ₹ 8,80,000	(70,400)
	Super profit	54,000
	Value of Goodwill = 54,000 x 4	2,16,000
2.	Net Assets for purchase consideration	
	Goodwill as valued in W.N.1	2,16,000
	Building	3,06,000
	Machinery	5,76,000
	Inventory	1,98,000
	Trade receivables	2,34,000
	Total Assets	15,30,000
	Less: Trade payables	(3,20,000)
	Net Assets	12,10,000

Out of this ₹ 6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) ₹ 6,10,000 in shares of ₹ 125. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3.	Unrealized Profit on Inventory	₹
	The Inventory of A Ltd. includes goods worth ₹ 1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this Inventory will be $\frac{40,000}{1,60,000} \times 1,00,000$	25,000
	As B Ltd. purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 1,00,000.	(10,000)
	Amount of unrealized profit	15,000

18. The following was the Balance Sheet of V Ltd. as on 31st March, 20X1:

Particulars	Note No.	Amount ₹ (in lakhs)
Equity and Liabilities		
1.) Shareholders' Funds		
a) Share Capital	1	1,150
b) Reserves and Surplus	2	(87)
2.) Non-current Liabilities		
a) Long-term Borrowings	3	630
3.) Current Liabilities		
Trade Payables		170

Total		**1,863**
Assets		
1.) Non-current Assets		
a) Property Plant and Equipment		
i) Tangible Assets	4	1,152
2.) Current Assets		
Inventories		380
Trade Receivables		256
Cash and Cash equivalents	5	75
Total		**1,863**

Notes:

1.)	**Share Capital**	
	Authorised:	?
	Issued, Subscribed and Paid up:	
	80 lakh Equity Shares of ₹ 10 each, fully paid up	800
	35 lakh 12% Cumulative Preference Shares of ₹ 10 each, fully paid up	350
	Total	**1,150**
2.)	**Reserves and Surplus**	
	Debit Balance of Profit & Loss Account	87
	Total	**87**
3.)	**Long-Term Borrowings**	
	10% Secured Cumulative Debentures of ₹ 100 each, fully paid up	600
	Outstanding Debenture Interest	30
	Total	**630**
4.)	Tangible Assets	
	Land and Buildings	445
	Plant and Machinery	593
	Furniture, Fixtures and Fittings	114
	Total	**1,152**
5.)	**Cash and Cash Equivalents**	
	Balance at Bank	69
	Cash in hand	6
	Total	**75**

On 1st April, 20X1 P Ltd. took over the entire business of V Ltd. on the following terms:
V Ltd.'s equity shareholders would receive 4 fully paid equity shares of P Ltd. of ₹ 10 each issued at a premium of ₹ 2.50 each for every five shares held by them in V Ltd. Preference shareholders of V Ltd. would get 35 lakh 13% Cumulative Preference Shares of ₹ 10 each fully paid up in P Ltd., in lieu of their present holding.
All the debentures of V Ltd. would be converted into equal number of 10.5% Secured Cumulative Debentures of ₹ 100 each, fully paid up after the takeover by P Ltd., which would also pay outstanding debenture interest in cash.
Expenses of amalgamation would be borne by P Ltd. Expenses came to be ₹ 2 lakh. P Ltd. discovered that its creditors included ₹ 7 lakh due to V Ltd. for goods purchased. Also, P Ltd.'s stock included goods of the invoice price of ₹ 5 lakh earlier purchased from V Ltd., which had charged profit @ 20% of the invoice price.
You are required to:

i) Prepare Realization A/c in the books of V Ltd.
ii) Pass journal entries in the books of P Ltd. assuming it to be an amalgamation in the nature of merger.

(November 2012)

Ans.

i) **In the books of V Ltd.**

Realisation Account

Dr. **Cr.**

Particulars	**₹ in lakhs**	**Particulars**	**₹ in lakhs**
To Land and Buildings A/c	445	By 10% Secured Cumulative Debentures A/c	600
To Plant and Machinery A/c	593	By Outstanding Debenture interest, A/c	30
To Furniture, Fixtures and Fittings A/c	114	By Trade payables A/c	170
To Inventories A/c	380	By P Ltd. A/c (Purchase consideration - Refer working note)	1,150
To Trade Receivables A/c	256		
To Bank A/c	69		
To Cash in Hand A/c	6		
To Equity Shareholder's A/c (Profit on Realisation)	87		
	1,950		**1,950**

ii) **In the books of P Ltd.**

Journal Entries

	Particulars	**LF**	**Dr.** ₹ in lakhs	**Cr.** ₹ in lakhs
1.)	Business Purchase A/c Dr. To Liquidator of V Ltd. A/c (Being purchase consideration due)		1,150	 1,150
2.)	Land and Buildings A/c Dr. Plant and Machinery A/c Dr. Furniture, Fixtures & Fittings A/c Dr. Inventories A/c Dr. Trade Receivables A/c Dr. Bank Ac Dr. Cash in Hand A/c Dr. Profit and Loss A/c Dr. To 10% Debentures A/c To Outstanding Debenture interest A/c To Trade Payables A/c To Business Purchase A/c (WN) (Being assets and liabilities taken over from V Ltd. under the scheme of amalgamation in the nature of merger)		445 593 114 380 256 69 6 87	 600 30 170 1,150
3.)	Liquidators of V Ltd. A/c Dr. To Equity Share Capital A/c To 13% Cumulative Preference Shares A/c To Securities Premium A/c (Being discharge of consideration, by allotment of 64 lakhs equity shares of ₹ 10 each at a premium of ₹ 2.50 per share and 35 lakhs 13% cumulative preference shares of ₹ 10 each at par)		1,150	 640 350 160
4.)	10% Secured Cumulative Debentures A/c Dr. To 10.5% Secured Cumulative Debentures A/c (Being 10% Secured Cumulative Debentures of V Ltd. converted into 10. 5% Secured Cumulative Debentures of P Ltd.)		600	 600

5.)	Outstanding Debenture Interest A/c Dr To Bank A/c (Being outstanding debenture interest paid in cash by P Ltd.)		30	 30
6.)	Profit & Loss A/c Dr. To Bank A/c (Being amalgamation expenses met by P Ltd.)		2	 2
7.)	Trade Payables A/c Dr. To Trade Receivables A/c (Being settlement of mutual liability)		7	 7
8.)	Profit and Loss A/c Dr. To Inventories A/c (5 × 20%) (Being unrealized profit on stock eliminated from the inventories of P Ltd.)		1	 1

Working Note:

Calculation of Purchase Consideration payable by P Ltd.

Particulars	₹ in lakhs
Payment to preference shareholders:	
13% Cumulative Preference Shares of ₹ 10 each (35 lakhs shares × ₹ 10)	350
Payment to equity shareholders	
(80 lakhs shares $\times \frac{4}{}$) = 64 lakhs equity shares @ ₹ 10	640
Securities Premium (64 lakhs equity shares @ ₹ 2.5)	160
Total	**1,150**

19. Given below are the Balance Sheet of two companies as on 31st December, 20X1.

A Limited

Liabilities	₹	Assets	₹
Share Capital:		Patent	1,00,000
Issued and fully paid up	5,00,0000	Building	5,40,000
50,000 8% Cumulative		Plant and Machinery	15,10,000
Preference Shares of ₹10		Furniture	75,000
each 1,50,000 Equity shares		Investment	1,55,000
of ₹10 each	15,00,000	Stock	3,58,000
General Reserve	7,65,000	Sundry Debtors	72,000
Profit and Loss account	1,25,000	Cash and Bank	1,40,000
Sundry Creditors	60,000		
	29,50,000		**29,50,000**

B Limited

Liabilities	₹	Assets	₹
Share Capital:		Goodwill	62,000
Issued and fully, paid		Motor Car	1,26,000
50,000 Shares of ₹10 each	5,00,000	Furniture Stock	58,000
Profit and Loss Account	45,000	Stock	2,40,000
Sundry Creditors	31,000	Sundry Debtors	70,000
		Cash and Bank	20,000
	5,76,000		**5,76,000**

It has been agreed that both these companies should be wound up and a new company AB Ltd. should be formed to acquire the assets of both the companies on the following terms and conditions:

i) AB Ltd. is to have an authorized capital of ₹36,00,000 divided into 60,000, 8% cumulative preference shares of ₹10 each and 3,00,000 equity shares of ₹10 each.

ii) AB Ltd. is to purchase the whole of the assets of A Ltd. (except cash and Bank balances) for ₹28,25,000 to be settled as to ₹5,75,000 in cash and as to the balance by issue of 1,80,000 equity shares. credited as fully paid, to be treated as valued at ₹12.50 each.

iii) AB Ltd. is to purchase the whole of the assets of B Ltd. (except cash and Bank balances) for ₹4,91,000 to be settled as to ₹16,000 in cash and as to the balance by issue of 38,000 equity shares, credited as fully paid, to be treated as valued at ₹12.50 each.

iv) A Ltd. and B Ltd. both are to be wound up, the two liquidators distributing the shares in AB Ltd. in kind among the equity shareholders of the respective companies.

v) The liquidator of A Ltd. is to pay the preference shareholders ₹12 in cash for every share held in full satisfaction of their claims.

vi) AB Ltd. is to make a public issue of 60,000, 5% cumulative preference shares at a premium of 10% and 30,000 equity shares at the issue price of ₹12.50 per share, all amount payable in full on application.

It is estimated that the cost of liquidation (including the liquidators' remuneration) will be ₹ 10,000 in case of A Ltd. and ₹5,000 in case of B Ltd. and that the preliminary expenses of AB Ltd. will amount to ₹24,000 exclusive of the underwriting commission of ₹38,900 payable on the public issue.

You are required to prepare the initial Balance Sheet of AB Ltd. on the basis that all assets other than goodwill are taken over at the book value.

(may 2016)

Ans.

Balance Sheet of AB Limited

Particulars	**Notes**	**Amount (₹)**
Equity and Liabilities		
1. Shareholders' funds		
a. Share Capital	1	30,80,000
b. Reserves and Surplus	2	6,17,100
2. Current liabilities		
a. Other liabilities		38,900
Total		37,36,000
Assets		
1. Non-current assets		
a. Property Plant and Equipment		
(i) Tangible assets	3	23,09,000
(ii) Intangible assets	4	1,12,000
b. Non-current investments		1,55,000
2. Current assets		
a. Inventories (3,58,000 + 2,40,000)		5,98,000
b. Trade receivables (72,000 + 70,000)		1,42,000
c. Cash and cash equivalents		4,20,000
Total		37,36,000

Notes to Accounts:

	Particulars	**₹**	**₹**
1.	Share Capital		
	Authorized Share Capital		
	3,00,000 equity shares of ₹10 each	30,00,000	
	60,000, 8% Cumulative Preference		
	Shares of ₹10 each	60,00,000	36,00,000
	Equity Share Capital		
	2,48,000 equity shares of ₹10 each (of the above shares, 2,18,000 shares have been issued for consideration other than cash)		
	Preference Share Capital		24,80,000

	60,000, 8% Cumulative Preference		
	Shares of ₹ 10 each		6,00,000
	Total		30,80,000
2.	Reserves and Surplus		
	Debit balance of Profit and Loss Account		
	Underwriting commission	38,900	
	Preliminary expenses	24,000	(62,900)
	Securities Premium A/c		
	(2,48,000 equity shares × 2.50)	6,20,000	
	(60,000 Preference shares × ₹1)	60,000	6,80,000
			(6,17,100)
3.	Tangible assets		
	Building	5,40,000	
	Motor Car	1,26,000	
	Plant & Machinery	15,10,000	
	Furniture	1,33,000	23,09,000
4	Intangible assets		
	Goodwill (W.N. 4)		
	(15,000 + 62,000 - 65,000)	12,000	
	Patents	1,00,000	1,12,000

Working Notes:

1) Mode of discharge of Purchase Consideration of A Ltd.

	₹
Cash payment	5,75,000
Equity shares (1,80,000 shares × ₹12.5)	22,50,000
Total Purchase consideration	28,25,000

2) Mode of discharge of Purchase Consideration of B Ltd.

	₹
Cash payment	16,000
Equity shares (38,000 shares × ₹12.5)	4,75,000
Total Purchase consideration	4,91,000

3) Cash at bank balance in the initial balance sheet of AB Ltd.

Cash and Bank Account

Particulars	₹	Particulars	₹
To Issue of preference	6,60,000	By Payment to A Ltd.	5,75,000
shares (60.000 × 11)		By Payment to B Ltd.	16,000
To Equity shares	3,75,000	By Preliminary expenses	24,000
(30,000 × 12.50)		By Balance c/d	4,20,000
	10,35,000		10,35,000

4) Calculation of goodwill/capital reserve of A Ltd. & B Ltd.

Particulars	**A Ltd.**		**B Ltd.**	
Business Purchase A/c		28,25,000		4,91,000
Less: Goodwill			62,000	
Patent A/c	1,00,000		—	
Building A/c	5,40,000		—	
Plant and Mach. A/c	15,10,000		—	
Motor Car A/c	—		1,26,000	
Furniture A/c	75,000		58,000	
Investment A/c	1,55,000		—	
Stock A/c	3,58,000		2,40,000	

Debtors A/c	72,000	(28,10,000)	70000	(5,56,000)
Goodwill/Capital reserve (Bal. fig.)		15,000		(65,000)

Net goodwill (15,000 + 62,000— 65,000) = 12,000

Note:

1) As per the information given in the question, only the assets of A Ltd and B Ltd. are taken over by AB Ltd. Thus the creditors are considered to be paid by the liquidators of the respective companies and hence being not taken over by AB Ltd.

2) As per the information given in the second last para of the question, it is stated that the preliminary expenses of AB Ltd. will amount to ₹24,000 exclusive of the underwriting commission of ₹38,900 payable on the public issue. It has been assumed that ₹24,000 has been paid and underwriting commission is still payable in the balance sheet of the amalgamated company. Alternatively, any other reasonable assumption about this may be considered.

Preliminary expenses and underwriting commission have been written off as per the provisions of Accounting Standards.

20. A and B decide to amalgamate themselves into Sharp Limited. The following are their Balance Sheets as on 31st December, 20X1.

Liabilities	**A Ltd.**	**B Ltd.**	**Assets**	**A Ltd.**	**B Ltd.**
Face value and paid up capital			Investments		
Share capital (₹ 100 each)	5,00,000	4,00,000	1,000 shares in B Ltd.	1,30,000	_
General Reserves	2,00,000	1,00,000	2,000 shares in A Ltd	_	2,10,000
10% Debentures	2,00,000	1,50,000	Sundry Assets	7,70,000	4,40,000
	9,00,000	**6,50,000**		**9,00,000**	**6,50,000**

Compute the amount of purchase consideration each of these companies under purchase method as per AS-14.

Nov 2010

Ans. Let the net assets of A Ltd. be a and net assets of B Ltd. be b.

Then $a = 7,70,000 - 2,00,000 + \frac{1}{4} b$

$a = 5,70,000 + \frac{1}{4} b$

$4a - b = 22,80,000$ (i)

Similarly

$b = 4,40,000 - 1,50,000 + 2/5\, a$

$b = 2,90,000 + 2/5\, a$

$-2a + 5b = 14,50,000$ (ii)

By multiplying equation (ii) by 2, we get

$-4a + 10b = 29,00,000$ (iii)

By adding equation (i) with equation (iii), we get

$4a - b = 22,80,000$

$\underline{-4a + 10b = 29,00,000}$

$9b = 51,80,000$ i.e. $b = \frac{51,80,000}{9} = 5,75,556$

Putting the value of b in equation (i) we get

$4a - 5,75,556 = 22,80,000$

$4a = 22,80,000 + 5,75,556 = 28,55,556$

$a = \frac{28,55,556}{4} = 7,13,889$

Computation of Purchase Consideration

Particulars	**A Ltd.**	**B Ltd.**
Total value of net assets	7,13,889	5,75,556
Less: 1/4 for shares held by A Ltd.	_	1,43,889
Less: 2/5 for shares held by B Ltd.	2,85,556	_
Purchase consideration	4,28,33	4,31,667

Assuming that the shares in Sharp Ltd. consist of ₹ 100 each Sharp Ltd. may satisfy the purchase consideration as follows:

	A Ltd.	B. Ltd.
Shares in Sharp Ltd. (@ ₹ 100)	4,28,300	4,31,600
Cash	33	67
	4,28,333	**4,31,667**

21. Let us consider the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ (000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	a.	Share capital	1	100,00
	b.	Reserves and Surplus	2	12,50
2		**Non-current liabilities**		
	a.	Long-term borrowings	3	40,00
3		**Current liabilities**		
	a.	Trade Payables		20,00
		Total		172,50
		Assets		
1		**Non-current assets**		
	a.	Property, Plant and Equipment	4	105,50
	b.	Non-current investments	5	5,00
2		**Current assets**		
	a.	Inventories		23,00
	b.	Trade receivables		24,00
	c.	Cash and Cash equivalents		15,00
		Total		172,50

Notes to accounts

1	**Share Capital**	**₹ in ('000)**
	Equity share capital	
	7,50,000 Equity Shares of ₹10 each	75,00
	25,000 14% Preference Shares of ₹100 each	25,00
		100,00
2	**Reserves and Surplus**	
	General reserve	12,50
		12,50
3	**Long-term borrowings**	
	Secured	
	14% Debentures	40,00
		40,00
4	**Property, plant and Equipment**	
	Land and Building	50,00
	Plant and machinery	45,00
	Furniture	10,50
		105,50
5	**Non-current investments**	
	Investments at cost	5,00
		5,00

Other Information:

i) Y Ltd. takes over X Ltd. on 10th April, 20X1.

ii) Debenture holders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.

iii) 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value ₹100 each).

iv) Intrinsic value per share of X Ltd. is ₹20 and that of Y Ltd. ₹30. Y Ltd. will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, the entry should be made at par value only. The nominal value of each equity share of Y Ltd. is ₹10.

Compute the purchase consideration

(ICAI SM ill1)

Sol.

Computation of Purchase consideration	(₹in '000)	Form
For Preference Shareholders of X Ltd.	3,000	30,000
		15% Preference
		shares in Y Ltd.
For equity shareholders of X Ltd.	5,000	5,00,000 Equity
(20/30 × 7,50,000) × ₹10		shares of Y Ltd.
of ₹10 each		
Total Purchase consideration	8,000	

Note: According to AS 14, amount paid to the debenture holders should not be included in the purchase consideration calculation. Such debentures will be taken over by Y Ltd. and then discharged by them later.

22. The following are the Balance Sheets of X Ltd. and Y Ltd :

		Particulars	**Notes**	**₹X Ltd.**	**₹Y Ltd.**
		Equity and Liabilities			
1.		**Shareholders' funds**			
	a.	Share capital	1	1,00,000	50,000
	b.	Reserves and Surplus	2	10,000	(10,000)
2.		**Non-current liabilities**			
	a.	Long term borrowings	3	--	15,000
3.		**Current liabilities**			
	a.	Trade Payables		25,000	5,000
		Total		135,000	60,000
		Assets			
1.		**Non-current assets**			
	a.	Property, Plant and Equipment	4	1,20,000	60,000
	c.	Non-current investments		15,000	--
		Total		135,000	60,000

Notes to accounts

1.	**Share Capital**	**X Ltd.**	**Y Ltd.**
	Equity share capital	1,00,000	50,000
		1,00,000	50,000
2.	**Reserves and Surplus**		
	Profit and loss A/c	10,000	--
	Profit and loss A/c (debit balance)	--	(10,000)
		10,000	(10,000)
3.	**Long term borrowings**		
	Loan from X Ltd.	--	15,000
4.	**Non-current investments**	--	--
	Loan to Y Ltd.	15,000	--
		15,000	--

A new company XY Ltd. is formed to acquire the sundry assets and trade payables of X Ltd. and Y Ltd. and for this purpose, the sundry assets of X Ltd. are revalued at ₹1,00,000. The debt due to X Ltd. is also to be discharged in shares of XY Ltd. Show the Ledger Accounts to close the books of X Ltd.

(ICAI SM pq2)

Sol.

Books of X Ltd.
Realization Account

	₹		₹
To Sundry Assets	1,20,000	By Trade payables	25,000
		By XY Ltd. (Purchase consideration)	75,000
		By Shareholders (Loss on realization)	20,000
	1,20,000		**1,20,000**

Shareholders Account

	₹		₹
To Realization Account (Loss)	20,000	By Equity Share Capital	1,00,000
To Shares in XY Ltd.	90,000	By Profit and Loss Account	10,000
	1,10,000		1,10,000

Loan Y Ltd.

	₹		₹
To Balance b/d	15,000	By Shares in XY Ltd.	15,000

Shares in XY Ltd.

	₹		₹
To XY Ltd.	75,000	By Shareholders	90,000
To Loan Y Ltd.	15,000		
	90,000		90,000

XY Ltd.

	₹		₹
To Realization Account	75,000	By Shares in XY Ltd.	75,000

23. Sun and Neptune had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of ₹4,00,000 divided into 80,000 equity shares of ₹5 each. On 31st March, 20X3 the respective information of Sun and Neptune were as follows:

	Sun (₹)	**Neptune (₹)**
Share capital	3,65,000	3,52,500
Current liabilities	5,97,000	1,80,250
Property, Plant and Equipment	6,35,000	3,65,000
Current assets	3,27,000	1,67,750

Additional Information:

a) Revalued figures of non-current and Current assets were as follows:

	Sun (₹)	**Neptune (₹)**
Property, Plant and Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

b) The debtors and creditors include ₹43,350 owed by Sun to Neptune.
The purchase consideration is satisfied by issue of the following shares and debentures.

i) 60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

	Sun (₹)	**Neptune (₹)**
20X1 Profit	4,49,576	2,73,900
20X2 (Loss)/Profit	(2,500)	3,42,100
20X3 Profit	3,77,924	3,59,000

ii) 15% debenture in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31st March, 20X3 after revaluation of assets.

You are required to:

i) Compute the amount of debentures and shares to be issued to Sun and Neptune.

ii) A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.

(ICAI SM pq5)

Sol.

1) Computation of Amount of Debentures and Shares to be issued:

		Sun	**Neptune**
i)	Average Net Profit		
	₹(4,49,576-2,500+3,77,924)/3	= 2,75,000	
	₹(2,73,900+,3,42,100+3,59,000)/3		= 3,25,000

ii) Equity Shares Issued

a) Ratio of distribution

Sun: Neptune

275 325

b) Number

Sun: 27,500

Neptune: 32,500

60,000

c) Amount

27,500 shares of ₹5 each = 1,37,500

32,500 shares of ₹5 each = 1,62,500

		₹	₹
iii)	**Capital Employed (after revaluation of assets)**		
	Property, plant and equipment	7,10,000	3,90,000
	Current Assets	2,99,500	1,57,750
		10,09,500	5,47,750
	Less: Current Liabilities	(5,97,000)	(1,80,250)
		4,12,500	3,67,500
iv)	**Debentures Issued**		
	8% Return on capital employed	33,000	29,400
	15% Debentures to be issued to provide equivalent income:		
	Sun: $33,000 \times \frac{100}{}$ =	2,20,000	
	Neptune: $29,400 \times \frac{100}{}$ =		1,96,000

2)

Balance Sheet of Jupiter Ltd.
As at 31st March 20X3 (after amalgamation)

Particulars	**Note No**	**₹**
I. Equity and Liabilities		3,00,000
(1) Shareholders' Funds	1	
(a) Share Capital		
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		
(a) Other current liabilities		7,33,900
Total		**15,13,900**
II. Assets		
(1) Non-current assets		
(a) PPE		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		**15,13,900**

Notes to Accounts

		₹
1.	**Share Capital**	
	Authorized	
	80,000 Equity Shares of ₹5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of ₹5 each	3,00,000
	(all the above shares are allotted as fully paid-up	
	pursuant to a contract without payment being received in cash)	
2.	**Reserve and Surplus**	
	Capital Reserve	64,000
3.	**Long-term borrowings**	
	Secured Loans	
	15% Debentures	4,16,000

Working Notes:

		Sun	**Neptune**	**Total**
		₹	**₹**	**₹**
(1)	**Purchase Consideration**			
	Equity Shares Issued	1,37,500	1,62,500	3,00,000
	15% Debentures Issued	2,20,000	1,96,000	4,16,000
		3,57,500	3,58,500	7,16,000
(2)	**Capital Reserve**			
	(a) Net Assets taken over			
	Property, plant & equipment	7,10,000	3,90,000	11,00,000
	Current Assets	2,99,500	1,14,400*	4,13,900
		10,09,500	5,04,400	15,13,900
	Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
		4,55,850	3,24,150	7,80,000
	a) Purchase Consideration	3,57,500	3,58,500	7,16,000
	c) Capital Reserve [(a) - (b)]	98,350		
	d) Goodwill [(b) - (a)]		34,350	
	e) Capital Reserve [Final Figure(c) - (d)]			64,000

* 1,57,750–43,350= 1,14,400

** 5,97,000–43,350= 5,53,650

Accounting for Reconstruction of Companies

Q. No.	Question & Answers	Marks
	Following two types of Questions are asked **1.Direct Reconstruction of companies** **2.Surrender of shares**	
1.	The Summarised Extract Balance Sheet of Sri Ram Ltd. At 31st March, 20X1 was as follows:	**16**

	₹		₹
Share capital Authorised	14,00,000	Intangibles	68,000
Issued: 64,000 8% cumulative preference shares of		Freehold premises at cost Plant and equipment at	1,40,000
₹ 10 each, fully paid	6,40,000	Cost less depreciation	2,40,000
64,000 Equity share of		Investments in shares in	
₹ 10 each, ₹ 7.5 paid	4,80,000	Q Ltd. at cost	3,24,000
Loans from Directors	60,000	Stocks	2,48,000
Sundry creditors	4,40,000	Debtors	3,20,000
Bank overdraft	2,08,000	Deferred Revenue expenditure Profit & Loss account	48,000 4,40,000
	18,28,000		**18,28,000**

Note: The arrear of Preference dividends amounts to ₹ 51,200.

A scheme of reconstruction was duly approved with effect from 1 April, 20X1 under the conditions stated below:

a) The unpaid amount on the Equity shares would be called up.

b) The Preference shareholders would forego their arrear dividends. In addition, they would accept a reduction of ₹ 2.5 per share. The dividend rate would be enhanced to 10%.

c) The Equity shareholders would accept a reduction of ₹ 7.5 per share.

d) Sri Ram Ltd. Holds 21,600 shares in Q Ltd. This represents 15% of the Share capital of that company. Q Ltd. Is not a quoted company. The average net profit (after tax) of the company is ₹ 2,50,000. The shares would be valued based on 12% capitalization rate.

e) A bad debt provision at 2% would be created.

f) The other assets would be valued as under:	₹
Intangibles	48,000
Plant	1,40, 00
Freehold premises	3,80,000
Stocks	2,50,000

g) The Profit and Loss account debit balance and the balance standing to the debit of the deferred Revenue Expenditure account would be eliminated.

h) The directors would have to take equity shares at the new face value of ₹ 2.5 per share in settlement of their loan.

i) The Equity shareholders, including the directors, who would receive equity shares in settlement of their loans, would take up two new equity shares for every one held.

j) The Preference shareholders would take up one new preference share for every four held.

k) The authorized Share capital would be restated to ₹ 14,00,000.

l) The new face values of the shares-preference and equity will be maintained at their reduced levels.

You are required to prepare:

i) Necessary Ledger accounts to effect the above; and

m) The Balance Sheet of the company after reconstruction.

Ans.

In the books of Sri Ram Ltd.
Ledger accounts

Dr. **Capital Reduction Account** **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Plant and Equipment A/ (2,40,000 – 1,40,000)	1,00,000	By 8% Cumulative Preference shares capital A/c	1,60,000
To Intangible	20,000	By Equity Share Capital A/c	4,80,000
(68,000 – 48,000)		By Freehold Premises A/c (3,80,000 – 1,40,000)	2,40,000
To Deferred Revenue	48,000		
Expenditure A/c		By Inventories	2,000
To Profit and Loss A/c	4,40,000	(2,50,000 – 2,48,000)	
To Investment A/c	11,500		
To Provision for doubtful debts	6,400		
To Capital reserve account (Balance Transferred)	2,56,100		
	8,82,000		**8,82,000**

Dr. **Equity Share Capital Account** **Cr.**

	₹		₹
To capital Reduction A/c	4,80,000	By Balance b/d (64,000 shares)	4,80,000
To Balance c/d	6,60,000	By Bank A/c (Final Call)	1,60,000
		(64,000 × ₹ 2.5)	
		By Loan from Directors A/c(60,000/2.5= 24,000 shares)	60,000
		By Bank A/c	4,40,000
		(64,000 + 24,000) × 2 × ₹ 2.5)	
	11,40,000		11,40,000
		By Balance b/d	6,60,000

Dr. **8% Cumulative Preference Share Capital Account** **Cr.**

	₹		₹
To 10% Cumulative Preference		By Balance b/d	6,40,000
Share Capital A/c	4,80,000		
To Capital Reduction A/c	1,60,000		
	6 40,000		**6,40,000**

Dr. **10% Cumulative Preferences Share Capital Account** **Cr.**

	₹		₹
To Balance c/d	6,00,000	By 8% cumulative Preference	
		Share Capital A/c	4,80,000
		By Bank (16,000 × ₹ 7.5)	1,20,000
	6,00,000		6,00,000
		By Balance b/d	6,00,000

Dr. **Bank Account** **Cr.**

	₹		₹
To Equity Share Capital A/c	1,60,000	By Balance b/d	2,08,000
To Equity Share Capital A/c	4,40,000	(overdraft)	
To 10% cumulative Preference Share Capital	1,20,000	By Balance c/d	5,12,000
	7,20,000		**7,20,000**
To Balance b/d	5,12,000		

Balance Sheet of Sri Ram Ltd. (After reconstruction)
(as on 1st April 20X1)

	Particulars	Notes No.	Amt (₹)
I.	Equity and Liabilities		
	1. Shareholder's Fund		
	a) Share capital	1	12,60,000
	b) Reserves and Surplus	2	2,56,100
	2. Current Liabilities		
	a) Trade Payables	3	4,40,000
	Total		19,56,100
II.	**Assets**		
	1. Non-current asset		
	Property Plant and Equipment		
	i) Tangible assets	4	5,20,000
	ii) Intangible assets	5	48,000
	2. Other non-current assets		
	Investment in Q Ltd.	6	3,12,500
	3. Current assets		
	a) Inventories (-Stock)		2,50,000
	b) Trade Receivables	7	3,13,600
	c) Cash and cash equivalents	8	5,12,000
	Total		**19,56,100**

Notes to Accounts:

			₹
1.	**Share Capital**		
	Authorized Share Capital Equity Share		14,00,000
	Equity shares		
	2,64,000 equities share ₹2.5 each (64,000+24,000)×2=88,000×2=1,76,000+88,000=2,64,000	6,60,000	
	Preference Shares		
	80,000, 10% Pref. share of ₹7.5 each	6,00,000	12,60,000
2.	Reserves and Surplus		
	Capital Reserve		2,56,100
3.	**Trade Payables**		
	a) Surplus creditors		4,40,000
4.	Tangible Assets		
	Freehold premises	3,80,000	
	Plant and equipment	1,40,000	5,20,000
5.	**Intangibles Assets**		
	Balance before reconstruction	68,000	
	Less Reduction	20,000	48,000
6.	**Other-non-current Assets**		
	Investment		
	Investment in shares of Q Ltd.		
	$\frac{\text{₹}\,2,50,000}{0.12} \times \frac{15}{100} = 3,12,500$		3,12,500
7.	**Trade Receivable**		
	Trade Receivables (Debtors)	3,20,000	
	Less: Provision for Doubtful debts	(6,400)	3,13,600
8.	**Cash and cash equivalents**		
	Bank Balance		5,12,000

Working Note:

1) Reduction in the value of investment in shares of Q Ltd.
   ₹ 3,24,000 - ₹ 3,12,500 = ₹ 11,500

2. The summarized balance sheet of Sri Krishna Limited as on 31st March, 20X1 is as under:

Liabilities	**₹**
Share Capital:	
5,00,000 Equity shares of ₹ 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹ 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account	(14,60,000)
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Total	81,00,000
Assets:	
Non-Current assets:	
Property Plant and Equipment	
i) Tangible Assets:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixture	2,50,000
ii) Intangible Assets:	
Goodwill	10,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000
Discount on issue of debenture	1,00,000
Total	**81,00,000**

Note: Preference dividend is in arrears for last 4 years.
Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹ 1,00,000 and ₹ 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.
The following scheme of reconstruction has been agreed upon and duly approved.
The following scheme of reconstruction has been agreed upon and duly approved.

i) All the equity shares to be converted into fully paid equity shares of ₹ 5. each.
ii) The Preference shares be reduced to ₹ 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.
iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.
iv) Persons relating to trade payables, the than Mr. Y and Mr. Z also agreed to forgo their 50% claims.
v) Directors also waived 60% of their loans and accepted equity shares for the balance.
vi) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.
vii) Directors refunded ₹ 1,00,000 of the fees previously received by them.

viii) Reconstruction expenses paid ₹ 15,000.

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

x) The Assets were revalued as under:

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

You are required to prepare necessary journal entries for all the above-mentioned transaction including amounts to be written off of Goodwill, Patents, loss in Profit and Loss account arid Discount on issue of debenture, And also, prepare Bank Account and Reconstruction Account.

Ans.

Journal Entries in the Books of Sri Krishna Ltd.

			Dr.	Cr.
			₹	₹
i)	Equity Share Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)			
ii)	9% Preference Share Capital (₹ 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c			10,00,000
	To reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
iii)	10% Secured debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			6,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
iv)	10% secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures outstanding A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			

vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being directors loan claim settled by issuing equity shares of ₹ 5 each as per scheme of reconstruction.)			
vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c)			
ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses)			
x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in fully settlement against provision for tax)			
xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
xii)	Reconstruction A/c	Dr.	49,85,000	
	To goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Discount on issue of Debentures A/c			1,00,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

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

Reconstruction Account

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

3. M/s Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the company as on 31st March, 2012 before reconstruction: **16**

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital			
50,000shares of ₹ 50 each fully		Goodwill	22,00,000
Paid up	25,00,000	Land & building	42,70,000
1,00,000 shares of ₹ 50 each		Machinery	8,50,000
₹ 40 paid up	40,00,000	Computers	5,20,000
Capital Reserve	5,00,000	Stock	3,20,000
8% Debentures of ₹ 100 each	4,00,000	Trade Debtors	10,90,000
12% Debentures of ₹ 100 each	6,00,000	Cash at Bank	2,68,000
Trade Creditors	12,40,000	Profit & Loss Account	7,82,000
Outstanding Expenses	10,60,000		
Total	**1,03,00,000**	**Total**	**1,03,00,000**

Following is the interest of Mr. Shiv and Mr. Ganesh in M/s Platinum Limited:

	Mr. Shiv		**Mr. Ganesh**
8% Debentures	3,00,000		1,00,000
12% Debentures	4,00,000		2,00,000
Total	**7,00,000**	**Total**	**3,00,000**

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

1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹ 40 each.
2) The existing shareholders agree to subscribe in cash, fully paid-up equity shares of ₹ 40 each for ₹ 12,50,000.
3) Trade Creditors are given option of either to accept fully paid equity shares of ₹ 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade Creditors for ₹ 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
4) Mr. Shiv agrees to cancel debenture amounting to ₹ 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to ₹ 1,00,000.
5) Mr. Ganesh agrees to cancel debenture amounting to ₹ 50,000 out of total debentures due to him and agree to accept 15% Debenture for the balance amount due.

6) Land &Building to be revalued at ₹ 51,84,000, Machinery at ₹ 7,20,000, Computers at ₹ 4,00,000, Stock at ₹ 3,50,000 and Trade Debtors at 10% less to as they are appearing in Balance Sheet as above.
7) Outstanding expenses are fully paid in cash.
8) Goodwill and Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

Ans.

Journal Entries

Date	Particulars		Amt. (₹)	Amt. (₹)
1.	equity Share Final Call A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(Being final call due @ 10 each on 1,00,000 shares)			
2.	Bank A/c	Dr.	10,00,000	
	To Equity Share Final Call A/c			10,00,000
	(Being final call money received)			
3.	Equity Share Capital (₹ 50) A/c	Dr.	75,00,000	
	To Equity Share Capital (₹ 40) A/c			60,00,000
	To Capital Reduction A/c			15,00,000
	(Being conversion of equity shares of ₹ 50 each into ₹ 40 each as per reconstruction scheme)			
4.	Bank A/c	Dr.	12,50,000	
	To Equity Share Capital A/c			12,50,000
	(Being new shares allotted at ₹ 40 each)			
5.	Trade Creditors A/c	Dr.	12,40,000	
	To Equity Share Capital A/c			7,50,000
	To Bank A/c			3,43,000
	To Capital Reduction A/c			1,47,000
	(Being payment made to creditors in shares or cash to the extent of 70% as per reconstruction scheme)			
6.	8% Debentures A/c	Dr.	3,00,000	
	12% Debentures A/c	Dr.	4,00,000	
	To 15% Debentures A/c			5,00,000
	To Capital Reduction A/c			2,00,000
	(Being cancellation of 8% and 12% debentures of Shiv and issuance of new 15% debenture and balance transferred capital reduction account as per reconstruction scheme)			
7.	Bank A/c	Dr.	1,00,000	
	To 15% Debentures A/c			1,00,000
	(Being new debentures subscribed by Shiv)			
8.	8% Debentures A/c	Dr.	1,00,000	
	12% Debentures A/c	Dr.	2,00,000	
	To 15% Debentures A/c			2,50,000
	To Capital Reduction A/c			50,000
	(Being cancellation of 8% and 12% debentures of Ganesh, & issuance of new 15% debentures and balance transferred to capital reduction account)			

9.	Land and Building (51.84.000-42,70,000)	Dr.	9,14,000	
	Inventories (Stock)	Dr.	30,000	
	To Capital Reduction A/c			9,44,000
	(Being value of assets appreciated)			
10.	Outstanding expenses A/c	Dr.	10,60,000	
	To Bank A/c			10,60,000
	(Being payment of outstanding expenses)			
11.	Capital Reduction A/c	Dr.	33,41,000	
	To machinery A/c			1,30,000
	To Computers A/c			1,20,000
	To Trade Debtors A/c			1,09,000
	To Goodwill A/c			22,00,000
	To Profit and Loss A/c			7,82,000
	(Being amount of Capital Reduction utilized in writing off P& L A/c (Dr.) balance, goodwill and downfall in value of other assets)			
12.	Capital Reserve A/c	Dr.	5,00,000	
	To Capital Reduction A/c			5,00,000
	(Being debit balance of capital reduction account adjusted against capital reserve)			

Balance Sheet (As reduced)
as on 31.3.2012

Particulars		**Notes**	**Amt. (₹)**
I. Equity and Liabilities:			
1) Shareholder's Fund:			
a) Share capital		1	80,00,000
2) Non- current Liabilities			
a) 15% Debenture			8,50,000
	Total		**88,50,000**
II. Assets:			
1) Non- current Assets			
a) Property Plant and Equipment			
i) Tangible Assets		2	63,04,000
2) Current Assets			
a) Trade Receivables (Debtors)			9,81,000
b) Inventories (Stock)			3,50,000
c) Cash and cash equivalents			12,15,000
(Working Note-1)	**Total**		**88,50,000**

Notes to Accounts:

	Particulars	**₹**	**₹**
1.	**Share Capital**		
	Issue of 2,00,000 equity shares of ₹ 40 each		80,00,000
2.	**Tangible Assets**		
	Land and Building	51,84,000	
	Machinery	7,20,000	
	Computer	4,00,000	63,04,000

Working Notes:

1) Cash at Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	2,68,000	By Trade Creditors A/c	3,43,000
To Equity Share final call A/c	10,00,000	By Outstanding expenses	10,60,000
To Equity Share Capital A/c	2,50,000	A/c	12,15,000
To 15% Debentures A/c	1,00,000	By Balance c/d (bal. fig.)	
	26,18,000		**26,18,000**

2) Capital Reduction Account

Particulars	₹	Particulars	₹
To Machinery A/c	1,30,000	By Equity Share Capital A/c	15,00,000
To Computers A/c	1,20,000	By Trade Creditors A/c	1,47,000
To Trade Debtors A/c	1,09,000	By 8% 12% Debentures A/c	2,00,000
To Goodwill A/c	22,00,000	By 8% and 12% Debentures A/c	50,000
To Profit and loss A/c	7,82,000	By Land & Building	9,14,000
		By Stock	30,000
		By Capital Reserve A/c	5,00,000
	33,41,000		**33,41,000**

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