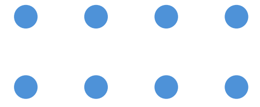
VIVITSU
STRIVING TOWARDS KNOWLEDGE

CA Intermediate

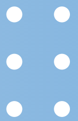
Paper 1

Advanced Accounting



Chapter-wise compilation of RTP, MTP and PYP

May'24



11 Attempts Compilation

Modified as per new scheme

Amended as per May'24

Prakshal Shah | 8779794646

CA Finalist ______________________________

(Once you print this write your name in this blank to give you the much-needed motivation. Remember what you see is what you achieve!)

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GETTING THE MOST FROM THIS BOOK

A QUICK GUIDE

1 INITIAL READING

After your initial reading of a particular chapter in your study material, go through the questions in our 3, 5, and 11 attempt's compilations, focusing on the chapter you've just covered. Make note of challenging questions for later reference.

2 FIRST REVISION

During your first revision, revisit the marked questions. If you still can't answer them, highlight them in red and review the related concepts to improve your understanding. This process helps you to grasp the key concepts and address your weak points

3 KEEP GOING WITH THE REVISIONS

Repeat the reading and revision process as often as possible before your exams. Each iteration will enhance your confidence and knowledge.

4 EXAMINERS COMMENTS

Pay attention to the examiner's comments in our compilations, as they highlight common mistakes. Learning from these errors will help you avoid them in your exams

Frequently Asked Questions

1. **Why RTP's, MTP's and PYP's?**
   RTP's, MTP's, and PYP's are extremely important to ensure that you reproduce ICAI language. These questions train you to understand what is important and what is expected of you. At least 41% of questions* are asked from previous RTP's, MTP's and PYP's.

2. **What is included?**
   In this compiler, all questions from the last 3, 5 or 11 attempts depending on the one you have selected will be available. There will be references to the marks and the attempt from which they were asked. Identical or similar questions have been removed and references for both attempts are mentioned.

3. **What is the benefit of Chapter-wise?**
   We have categorized each and every question from all Old RTPs, MTP's, and PYP's into chapters. This means that you don't have to wait until you've completed your entire syllabus to tackle an RTP, MTP, or past paper. You can start solving these questions to check your conceptual clarity right after finishing a particular chapter.

4. **What does amended for the latest attempt mean?**
   When we reviewed all the questions from the past 11 attempts of RTP, MTP, and PYP'S, we didn't just segregate them Chapterwise; we also updated them to reflect the latest provisions. All the answers provided in the compilation are applicable for the May 2024 examination. So, there's no need to stress about outdated or incorrect information.

5. **How are Old RTP's, MTP's & PYP's beneficial for me?**
   All old RTPs, MTPs, and PYPs have been organized according to the new syllabus issued by ICAI. This means that if a specific chapter from the old scheme is not included in the new scheme, it has been omitted. If a particular chapter in the new scheme is based on concepts from two or more chapters in the old scheme, it has been adapted to align with how the chapter should be in the new scheme. If a chapter is only partially included in the new scheme, the questions related to those specific concepts are only included in the corresponding chapter of the new scheme. A comprehensive reconciliation of the chapters between the new scheme and the old scheme is provided on the following page.

6. **What if a new attempt is added post my purchase?**
   If you have purchased materials for the May 2024 attempt, you will receive a file with the questions segregated Chapterwise specifically for that attempt.

7. **What does N/A mean?**
   It could mean any of the following:
   1. No questions from that chapter have been included in the selected attempts.
   2. The chapter is newly introduced, and as a result, no questions have been previously asked in RTP's, MTP's, or PYP's.

*This is on an average based on the last 11 attempts

Advance Accountancy

Reconciliation of chapters of the new scheme (May'24) with old course

New Chapter No.	Chapter Name as per NEW Syllabus	Paper No. as per Old Course	Comparison with chapters of Old Scheme
1	Introduction to Accounting Standards	Paper 1	Same
2	Framework for Preparation and Presentation of Financial Statements	Paper 1	Same
3	Applicability of Accounting Standards	Paper 1	Same
4	**Chapter 4: Presentation & Disclosures Based Accounting Standards**		Same
4.1	AS 1- Disclosure of Accounting Policies	Paper 1	Same
4.2	AS 3- Cash Flow Statement	Paper 1	Same
4.3	AS 17- Segment Reporting	Paper 5	Same
4.4	AS 18- Related Party Disclosures	Paper 5	Same
4.5	AS 20- EPS	Paper 5	Same
4.6	AS 24- Discontinuing Operations	Paper 5	Same
4.7	AS 25- Interim Financial Reporting*		Not a part of CA inter syllabus in the old scheme
5	**Asset Based Accounting Standards**		
5.1	AS 2- Valuation of Inventory	Paper 1	Same
5.2	AS 10-Property, Plant & Equipment	Paper 1	Same
5.3	AS 13-Accounting for Investments	Paper 1	Same
5.4	AS 16-Borrowing Costs	Paper 1	Same
5.5	AS 19- Leases	Paper 5	Same
5.6	AS 26- Intangible Assets	Paper 5	Same
5.7	AS 28- Impairment of Assets*		Not a part of CA inter syllabus in the old scheme
6	**Liabilities based Accounting Standards**		
6.1	AS 15- Employee Benefits*		Not a part of CA inter syllabus in the old scheme
6.2	AS 29- Provisions, Contingent Liabilities & Contingent Assets	Paper 5	Same
7	**Accounting Standards based on Items Impacting Financial Statement**		
7.1	AS 4- Contingencies & Events occuring after the Balancesheet Date	Paper 5	Same

7.2	AS 5- Net Profit or Loss for the period, Prior period items & Changes in Accounting policies	Paper 5	Same
7.3	AS 11- The Effects of Changes in Foreign Exchange rates	Paper 1	Same
7.4	AS 22- Accounting for Taxes on Income	Paper 5	Same
8	**Revenue Based Accounting Standards**		
8.1	AS 7- Construction Contracts	Paper 5	Same
8.2	AS 9- Revenue Recognition	Paper 5	Same
9	**Other Accounting Standards**		
9.1	AS 12-Accounting for Government Grants	Paper 1	Same
9.2	AS 14- Accounting for Amalgamation	Paper 5	Same
10	**Accounting Standards for Consolidated Financial Statement**		
10.1	AS 21- Consolidated Financial Statement	Paper 5	Same
10.2	AS 23- Accounting for Investments in Associates in Consolidated Financial Statements	Paper 5	Same
10.3	AS 27- Financial Reporting of Interests in Joint Ventures	Paper 5	Same
11	**Financial Statements of Companies**		
11.1	Preparation of Financial Statements	Paper 1	Same
11.2	Cash Flow Statement	Paper 1	Same
12	Buyback of Securities	Paper 5	Same
13	Amalgamation of Companies	Paper 5	Same
14	Accounting for Reconstruction of Companies	Paper 5	Same
15	Accounting for Branches including Foreign Branches	Paper 1	Same

*These Chapters were earlier a part of CA Final Paper 1: Financial Reporting

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21 MTPs: March'18, April'18, Aug'18, Oct'18, May'19, April'19, Oct'19, May'20, Oct'20, March'21, April'21, Oct '21, Nov '21, March '22, April '22, Sep '22, Oct '22, March '23, April '23, Sep '23 & Oct '23

11 PYPs: May'18, Nov'18, May'19, Nov'19, Nov'20, Jan'21, July '21, Dec '21, May'22, Nov '22, May '23

12 RTPs: May'18, Nov'18, May'19, Nov'19, May'20, Nov'20, May'21, Nov '21, May '22, Nov '22, May '23, Nov '23

Chapter 1
Introduction to Accounting Standards

__Question__ **1**

"Accounting Standards standardize diverse accounting policies with a view to eliminate the non-comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting Standards. (MTP 5 Marks, Nov '21 & April '23) (PYP 5 Marks Nov'18,)

__Answer__ **1**

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

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

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

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

__Question 2__

Explain the objective of 'Accounting Standards' in brief. State the advantages of setting Accounting Standards. (PYP 4 Marks Nov '22, Old & New SM)

__Answer 2__

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

Following are the objectives of Accounting Standards:

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

b. Accounting Standards facilitate the preparation of financial statements and make them comparable.

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

The main advantages of setting accounting standards are as follows:

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

b. Accounting Standards prevent any misleading accounting treatment.

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

Chapter 2
Framework for Preparation and Presentation of Financial Statements

Question 1

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss. [MTP 5 Marks March '19 & April '19 , March '21 ,Oct '23] (RTP Nov 18)

Answer 1

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

A brief explanation of each measurement basis is as follows:

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

Question 2

"**One of the characteristics of financial statements is neutrality"- Do you agree with this statement? Comment. [MTP March '18, 5 Marks, PYP Nov '18 5 Marks, Old & New SM)**

Answer 2

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

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

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

Question 3

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

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

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

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

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

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction. (MTP 5 Marks April 21, April 22, Old & New SM)

Answer 3

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

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

Question 4

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

(i) Share application money received in excess of issued share capital.
(ii) Share option outstanding account.
(iii) Unpaid matured debenture and interest accrued thereon.
(iv) Uncalled liability on shares and other partly paid investments.
(v) Calls unpaid.
(vi) Intangible Assets under development.
(vii) Money received against share warrant.
(viii) Cash equivalents. (MTP 4 Marks, Mar'22, 5 Marks, April'19)

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Answer 4

(i) Current Liabilities/Other Current Liabilities
(ii) Shareholders' Fund / Reserve & Surplus
(iii) Current liabilities/Other Current Liabilities
(iv) Contingent Liabilities and Commitments
(v) Shareholders' Fund / Share Capital
(vi) Property, Plant & Equipment
(vii) Shareholders' Fund/Money received against share warrants
(viii) Current Assets

Question 5

How will a company classify its investment in preference shares, which are convertible into equity shares within one year from the balance sheet date? Will it classify the investment as a current asset or a non-current asset? Explain. (MTP 5 Marks, March'19, Oct'18, Aug'18, Mar'18)

Answer 5

In accordance with the Schedule III, an investment realizable within 12 months from the reporting date is classified as a current asset. Such realisation should be in the form of cash or cash equivalents, rather than through conversion of one asset into another non-current asset. Hence, company must classify such an investment as a non-current asset, unless it expects to sell the preference shares or the equity shares on conversion and realise cash within 12 months.

Question 6

M/s Shyam, a proprietorship firm runs a business of stationary items. It provides you the following information relating to assets and liabilities:

Assets & Liabilities	As on 01.04.2019	As on 31.03.2020
Creditors	20,000	15,000
Outstanding Expenses	600	800
Property, Plant & Equipment	12,000	13,000
Stock	10,000	12,000
Cash in hand	7,500	2,000
Cash at Bank	2,500	10,000
Debtors	?	18,000

Details of the year's transactions are as follows:

(1)	Discounts allowed to Debtor	4,000
(2)	Returns from debtors	1,450
(3)	Bad debts	500
(4)	Total sales (Cash and Credit)	72,000
(5)	Discount allowed by creditors	700
(6)	Returns to creditors	400
(7)	Receipts from debtors paid into Bank	76,000
(8)	Cash purchases	1,000
(9)	Expenses paid by cash	9,000
(10)	Drawings by cheque	500
(11)	Purchase of Property, Plant & Equipment by cheque	4,000
(12)	Cash deposited into bank	5,000
(13)	Cash withdrawn from bank	9,000
(14)	Payments to creditors by cheque	60,000

No Property, Plant & Equipment were sold during the year. Any difference in cash account to be considered as cash sales. You are required to prepare Trading and Profit & Loss Account for the year ended 31.03.2020 and the Balance Sheet as at 31.03.2020 from the given information. (MTP 16 Marks, Oct '21, May'20)

Answer 6

In the books of M/s Shyam Trading and Profit and Loss Account for the year ended 31st March, 2020

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		10,000	By Sales:		
To Purchases:			Cash	500	
Cash	1,000		Credit	71,500	
Credit (W.N. 3)	56,100		Less: Returns	(1450)	70,550
	57,100		By Closing Stock		12,000
Less: Returns	400	56,700			
To Gross Profit c/d		15,850			
		82,550			82,550
To Discount allowed		4,000	By Gross profit b/d		15,850
To Bad Debts		500	By Discount received		700

To General expenses (W.N. 5)		9,200	By Net Loss (balancing fig.)		150
To Depreciation (W.N. 4)		3,000			
		16,700		-	**16,700**

Balance Sheet as at 31st March, 2020

Liabilities		₹	Assets		₹
Capital (W.N. 1)	39,850		Property, Plant & Equipment	12,000	
Less: Net loss	150		Add: New asset	4,000	
	39,700			16,000	
Less: Drawings	500	39,200	Less: Depreciation	3,000	13,000
Sundry creditors		15,000	Stock in trade		12,000
Expenses outstanding		800	Sundry debtors (W.N. 2)		18,000
			Cash in hand		2,000
			Cash in Bank		10,000
		55,000			**55,000**

Working Notes:

(1) Ascertainment of Opening Capital - Statement of Affairs as at 1.4.19

Liabilities	₹	Assets	₹
Sundry creditors	20,000	Property, Plant & Equipment	12,000
Outstanding expenses	600	Stock	10,000
Prasad's Capital		Debtors	28,450
(Balancing figure)	39,850	Cash in hand	7,500
		Cash at Bank	2,500
	60,450		**60,450**

(2) Sundry Debtors Account

	₹		₹
To Balance b/d (bal. fig)	28,450	By Cash	76,000
To Sales (72,000 – 500)	71,500	By Discount	4,000
		By Returns (sales)	1,450
		By Bad debts	500
		By Balance c/d (given)	18,000
	99,950		**99,950**

(3) Sundry Creditors Account

	₹		₹
To Bank – Payments	60,000	By Balance b/d	20,000
To Discount	700	By Purchases - credit	56,100
To Returns	400	By (Balancing figure)	
To Balance c/d (closing balance)	15,000		
	76,100		**76,100**

(4) Depreciation on Property, Plant & Equipment

	₹
Opening balance of Property, Plant & Equipment	12,000
Add: Additions	4,000
	16,000
Less: Closing balance of Property, Plant & Equipment	(13,000)
Depreciation	3,000

(5) Expenses to be shown in profit and loss account

Expenses (in cash)	9,000
Add: Outstanding of 2020	800
	9,800
Less: Outstanding of 2019	600
	9,200

(6) Cash and Bank Account

Particulars	Cash	Bank		Cash	Bank
	₹	₹		₹	₹
To balance b/d	7,500	2,500	By Purchases	1,000	-
To debtors	-	76,000	By Expenses	9,000	
To Banks E11 (c)	9,000	-	By Property, Plant & Equipment		4,000
To Cash (c)	-	5,000	By Drawings		500
To sales (balancing as cash sales)	500	-	By Creditors		60,000
			By Cash (C)		9,000
			By Bank (C)	5,000	
			By Balance c/d	2,000	10,000
	17,000	83,500		17,000	83,500

Question 7

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

Balance Sheet (Extract) as on 31st March ,2022

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

You are required to compute Effective Capital as per the provisions of Schedule V to Companies Act, 2013. (MTP 5 Marks, Sep 22 & Oct '23)

Answer 7

Computation of Effective capital

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

Question 8

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2022:

Amount ₹ in lakhs

Securities Premium Account	**80**
Capital Reserve	**60**
General Reserve	**90**

The company had an accumulated loss of ₹ 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013. (MTP 4 Marks Oct '22)

Answer 8

Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

Question 9

The following is the Balance Sheet of Manish and Suresh as on 1 st April, 2021:

Equity and Liabilities	₹	Assets	₹
Capital Accounts:		**Building**	**1,00,000**
Manish	**1,50,000**	**Machinery**	**65,000**
Suresh	**75,000**	**Stock**	**40,000**
Creditors for goods	**30,000**	**Debtors**	**50,000**
Creditors for expenses	**25,000**	**Bank**	**25,000**
	2,80,000		**2,80,000**

They give you the following additional information:

(i) Creditors' Velocity 1.5 month & Debtors' Velocity 2 months. Here velocity indicates the no. of times the creditors and debtors are turned over a year.

(ii) **Stock level is maintained uniformly in value throughout all over the year.**

(iii) **Depreciation on machinery is charged @ 10%, Depreciation on building @ 5% in the current year.**

(iv) **Cost price will go up 15% as compared to last year and also sales in the current year will increase by 25% in volume.**

(v) **Rate of gross profit remains the same.**

(vi) **Business Expenditures are ₹ 50,000 for the year. All expenditures are paid off in cash.**

(vii) **Closing stock is to be valued on LIFO Basis.**

(viii) **All sales and purchases are on credit basis and there are no cash purchases and sales.**

You are required to prepare Trading, Profit and Loss Account, Trade Debtors Account and Trade Creditors Account for the year ending 31.03.2022.

(MTP 16 Marks April 23 & Nov '21)

Answer 9

Trading and Profit and Loss account for the year ending 31st March, 2022

Particulars	Rs.	Particulars	Rs.
To Opening Stock	40,000	By Sales	4,31,250
To Purchases (Working Note)	3,45,000	By Closing Stock	40,000
To Gross Profit c/d (20% on sales)	86,250		
	4,71,250		4,71,250
To Business Expenses	50,000	By Gross Profit b/d	86,250
To Depreciation on:			
Machinery 6,500			
Building 5,000	11,500		
To Net profit	24,750		
	86,250		86,250

Trade Debtors Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	50,000	By Bank (bal. fig.)	4,09,375
To Sales	4,31,250	By Balance c/d (1/6 of 4,31,250)	71,875
	4,81,250		4,81,250

Trade Creditors Account

Particulars	Rs.	Particulars	Rs.
To Bank (Balancing figure)	3,31,875	By Balance b/d	30,000
To Balance c/d/ (1/8 of Rs. 3,45,000)	43,125	By Purchases	3,45,000
	3,75,000		3,75,000

Working Note:

		Rs.
(i)	Calculation of Rate of Gross Profit earned during previous year	
A	Sales during previous year (= 50,000 x 12/2)	3,00,000
B	Purchases (Rs. 30,000 x 12/1.5)	2,40,000

C	Cost of Goods Sold (Rs. 40,000 + Rs. 2,40,000 — Rs. 40,000)	2,40,000
D	Gross Profit (A-C)	60,000
E	Rate of Gross Profit $\frac{Rs.60,000}{Rs.3,00,000}$ X 100	20%
(ii)	Calculation of sales and Purchases during current year	Rs.
A	Cost of goods sold during previous year	2,40,000
B	Add: Increases in volume @ 25 %	60,000
		3,00,000
C	Add: Increase in cost @ 15%	45,000
D	Cost of Goods Sold during Current Year	3,45,000
E	Add: Gross profit @ 25% on cost (20% on sales)	86,250
F	Sales for current year [D+E]	4,31,250

Question 10

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain in brief. (RTP Nov 21, PYP 5 Marks Dec '21)

Answer 10

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

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

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

Question 11

(a) With regard to financial statements, name any five qualitative characteristics and elements. (RTP May'21)

(b) Aman started a business on 1st April 2020 with Rs. 24,00,000 represented by 1,20,000 units of Rs. 20 each. During the financial year ending on 31st March, 2021, he sold the entire stock for Rs. 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 2020-21 if Financial Capital is maintained at historical cost. (RTP May'21, Nov'19) (Same concept different figures Old & New SM, RTP Nov'18)

Answer 11

(a)

(i) Qualitative Characteristics of Financial Statements: Understandability, Relevance, Comparability, Reliability

& Faithful Representation

(ii) Elements of Financial Statements:

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

(b)

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

Question 12

With regard to financial statements name any four.

(i) Users

(ii) Qualitative characteristics

(iii) Elements (RTP Nov 20, RTP May 19, MTP 5 Marks Mar'23)

Answer 12

(i) Users of financial statements:

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

(ii) Qualitative Characteristics of Financial Statements:

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(iii) Elements of Financial Statements:

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

Question 13

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

You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2. (RTP May'20, May'23 & Nov '23)

Answer 13

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

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

Journal entry

Loss on change in production method	Dr.	1,00,000	
To Gamma Ltd.			1,00,000
(Loss due to change in production method)			

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

Question 14

What are fundamental accounting assumptions? (RTP May 19)

Answer 14

Fundamental Accounting Assumptions: Accrual, Going Concern and Consistency

Question 15

Explain main elements of Financial Statements. (RTP May 18) (PYP5 Marks May '18)

Answer 15

Elements of Financial Statements

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

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

Question 16

Summarised Balance Sheet of Cloth Trader as on 31.03.2021 is given below:

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

Additional Information is as follows:

(1) The remaining life of Property, plant and equipment is 8 years. The pattern of use of the asset is even. The net realisable value of Property, plant and equipment on 31.03.2022 was ₹ 3,25,000.

(2) Purchases and Sales in 2021-22 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.

(3) The cost and net realizable value of inventory on 31.03.2022 were ₹ 2,00,000 and ₹ 2,50,000 respectively.

(4) Expenses including interest on loan for the year amounted to ₹ 78,000.

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

(6) Sundry Debtors on 31.03.2022 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successful re-installation of certain product supplied to the customer;

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

(8) Cash balance as on 31.03.2022 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000. You are required to prepare: (Not assuming going concern)

(1) Profit & Loss Account for the year 2021-22.

(2) Balance Sheet as on 31st March, 2022. (RTP May'22, Nov'22, PYP 5 Marks May'19) (Same concept different figures PYP 4 Marks Nov'20, Old & New SM)

Answer 16

Profit and Loss Account for the year ended 2021-22(not assuming going concern)

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

Balance Sheet as at 31st March, 2022 (not assuming going concern)

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

Question 17

What are the qualitative characteristics of the Financial Statements which improve the usefulness of the information furnished therein? (PYP 4 Marks Nov '20, Old & New SM)

Answer 17

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

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

Question 18

Explain how financial capital is maintained at historical cost? Kishore started a business on 1st April, 2019 with ₹ 15,00,000 represented by 75,000 units of ₹20 each. During the financial year ending on 31st March, 2020, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Kishore in the year 2019-20 if Financial Capital is maintained at historical cost. (PYP 4 Marks Jan 21)

Answer 18

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

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

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

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

Question 19

A trader commenced business on April 1, 2020 with ₹ 120,000, represented by 6000 units of a certain product at ₹ 20 per unit. During the year 2020-21 he sold these units at ₹ 30/- per unit and had withdrawn ₹ 60,000. The price of the product at the end of financial year was ₹ 25/- per unit. Compute retained profit of the trader under the concept of physical capital maintenance at current cost. Also, state, whether answer would be different if the trader had not withdrawn any amount. (PYP July'21, 5 Marks) (MTP 5 Marks Sep '23)

Answer 19

Physical Capital Maintenance at Current Cost

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

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

= ₹ 1,50,000

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

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

If the trader had not withdrawn any amount, then the answer would have been as below:
Current cost of opening stock = ₹ 1,80,000

Opening equity at closing current costs = ₹ 1,50,000

Retained Profit = ₹ 1,80,000 – ₹ 1,50,000 = ₹ 30,000

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

Question 20

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

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

You are required to prepare the statement of the effect of aforesaid each transaction on closing balance sheet in the form of Assets – Liabilities = Equity after each transaction. (PYP 5 Marks, Dec '21)

Answer 20

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

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

Question 21

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

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

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

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

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

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

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

You are required to show the effect of the above transactions on Balance Sheet in the form of Assets - Liabilities = Equity equation after each transaction. .(PYP 4 Marks Nov '22)

Answer 21

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

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

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

Question 22

Mille started a business on 01.04.2022 with a capital of ₹ 15,00,000. She purchased ₹ 1,500 units of stock at ₹ 1,000 each. She sold the entire stock for ₹ 1,500 each unit till 31.03.2023.

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

(i) Historical Cost

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

(iii) Physical Capital Maintenance

(Price per unit at the end of year is ₹ 1,350) (PYP 5 Marks May '23)

Answer 22

Financial Capital Maintenance at historical Costs

Sr. No.	Particulars	Computation	₹
(i)	Opening Equity	1,500 x 1,000	15,00,000
(ii)	Closing Equity	1,500 x 1,500	22,50,000
(iii)	Maximum Drawing	(ii)- (i)	7,50,000

Financial Capital Maintenance at current purchasing power

Sr. No.	Particulars	Computation	₹
(i)	Opening Equity	1,500 x 1,000 x 125/100	18,75,000
(ii)	Closing Equity	1,500 x 1,500	22,50,000
(iii)	Maximum Drawing	(ii)- (i)	3,75,000

Financial Capital Maintenance at Physical Capital Maintenance

Sr. No.	Particulars	Computation	₹
(i)	Opening Equity	1,500 x1,350	20,25,000
(ii)	Closing Equity	1,500 x 1,500	22,50,000
(iii)	Maximum Drawing	(ii)- (i)	2,25,000

Chapter 3
Applicability of Accounting Standards

Question 1

M/s X & Co. (a partnership firm) had a turnover of ₹ 5 crores (excluding other income) and borrowings of ₹ 1.5 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.2022. Advise the management of M/s X & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI. (MTP 5 Marks Oct '22) (Same concept different figures MTP Oct'18 5 Marks, Old & New SM)

Answer 1

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

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

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

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

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

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

Question 2

What are the issues, with which Accounting Standards deal? (RTP Nov 20)(Old & New SM)

Answer 2

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

Question 3

(a) A company with a turnover of ` 225 crores and borrowings of ` 51 crore during the year ended 31st March, 2021, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3. 2021. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.

(b) An organization whose objects are charitable or religious, believes that the Accounting Standards are not applicable to it since only a very small proportion of its activities are business in nature. Comment. (RTP May '22)

Answer 3

(a) The question deals with the issue of Applicability of Accounting Standards for corporate entities. The companies can be classified under two categories viz SMCs and Non-SMCs under the Companies (Accounting Standards) Rules, 2021. As per the Companies (Accounting Standards) Rules, 2021, criteria for above classification as SMCs, are:

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

- whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- which is not a bank, financial institution or an insurance company;
- whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and
- which is not a holding or subsidiary company of a company which is not a small and medium-sized company. Since, XYZ Ltd.'s turnover was ` 225 crores which does not exceed ` 250 crores but borrowings of ` 51 crore are more than ` 50 crores, it is not a small and medium sized company (SMC). The exemptions available to SMC are not available to this company.

(b) Accounting Standards apply in respect of any enterprise (whether organized in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes. Accounting Standards however, do not apply to enterprises solely carrying on the activities, which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise were considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those, which are not commercial, industrial or business in nature.

Question 4

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

Answer 4

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

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

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

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

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore ***(as per amendment- Rupees two fifty crore)*** in the immediately preceding accounting year.

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

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

Chapter 4.1
AS 1- Disclosure of Accounting Policies

Question 1

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

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

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

(iii) Explain how it will be disclosed in the annual accounts of HIL Ltd. for the year 2019-20. (MTP 5 Marks March '21, MTP 5 Marks April '22 & MTP 5 Marks April '23) (PYP Nov '18, 5 Marks, PYP 5 Marks Dec'21) (Same concept different figures- MTP 5 Marks Mar'23, RTP May'20 & Nov '23)

Answer 1

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

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

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

Question 2

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

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

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

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

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

(v) **There is no single list of accounting policies which are applicable to all circumstances. (MTP 5 Marks April 21, Oct 19, Mar 22, May'20 & Oct '23, RTP 5 Marks May 20, PYP 5 Marks May '22, Old & New SM)**

Answer 2

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

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

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

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

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

Question 3

In the books of Rani Ltd., closing inventory as on 31.03.2020 amounts to ₹1,75,000 (valued based on FIFO method). The Company decides to change from FIFO method to weighted average method for ascertaining the costs of inventory from the year 2019-20. On the basis of weighted average method, closing inventory as on 31.03.2020 amounts to ₹1,59,000. Realizable value of the inventory as on 31.03.2020 amounts to ₹2,07 ,000. Discuss disclosure requirements of change in accounting policy as per AS 1.(MTP Nov '21, 5 Marks, MTP Oct'18 5 Marks, RTP May 23, PYP 5 Marks Dec'21, Old & New SM)

Answer 3

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

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

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Question 4

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

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017 (MTP Apr'19, Aug'18, Oct'22 5 Marks)

Answer 4

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

Notes on Accounts:

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

Question 5

The draft results of Surya Ltd. for the year ended 31st March, 2020, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided to value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation of inventory at prime cost (Rs. 30 crores). As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2019-2020. (RTP May '21)

Answer 5

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

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

Question 6

What are the three fundamental accounting assumptions recognized by Accounting Standard (AS) 1? Briefly describe each one of them. (RTP Nov'20)

Answer 6

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

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

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

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

Question 7

(i) ABC Ltd. was previously making provision for non-moving stocks based on stocks not issued for the last 12 months up to 31.03.2020. Now, the company wants to make provisions based on technical evaluation during the year ending 31.03.2021. Total value of stock ₹ 133.75 lakhs Provision required based on technical evaluation ₹ 4.00 lakhs Provision required based on 12 months not issued ₹ 5.00 lakhs. (2.5 Marks, Dec '21)

Answer 7

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

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

the year 2020 -21:

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

Question 8

What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'. (PYP May'19, 5 Marks)

Answer 8

The term "Accrual" has been explained in the AS 1 on Disclosure of Accounting Policies, as "Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate"

Reasons for Accrual Basis of Accounting

1. Accrual basis of accounting, attempts to record the financial effects of the transactions, events, and circumstances of an enterprises in the period in which they occur rather than recording them in the period(s) in which cash is received or paid by the enterprise.
2. Receipts and payments of the period will not coincide with the buying producing or selling events and other economic events that affect entity performance.
3. The goal of Accrual basis of accounting is to follow the matching concept of income and expenditure so that reported net income measures an enterprise's performance during a period instead of merely listing its cash receipts and payments.
4. Accrual basis of accounting recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in the future.
5. Important point of difference between accrual and accounting based on cash receipts and outlay is in timing of recognition of revenues, expenses, gains and losses.

Question 9

You are required to comment on the following cases as per the provisions of Accounting Standard-1 'Disclosure of Accounting Policies':

(1) Bee Limited has not complied with AS-2 "Valuation of inventories" and the same is disclosed in the Notes on Accounts. Management is of the view that the financial statements give a true and fair view as non-compliance with AS-2 is disclosed.

(2) Cee Limited sold its Office Building for ` 10,00,000 on 1st March, 2023. The buyer has paid the full amount and taken possession of the building. The book value of the Office Building is ` 4,00,000. On 31st 2023, documentation and legal formalities are pending. The company has not recorded the disposal and the amount received is shown as an advance.

(3) Dee Limited has prepared its accounts on cash basis and the same is not disclosed.

(4) Jee Limited disclosed significant accounting policies adopted in the preparation of financial statements, in the Directors' Report. (PYP 5 Marks May '23)

Answer 9

(1) As per AS-I disclosure of accounting policies is not a remedy for wrong or inappropriate treatment in accounting. In the given case the financial statement does not give a true and fair view as they are not in compliance with AS-2.

(2) Considering the substance over form as per AS-I, documentation and legal formalities represent the form of the transaction, although the legal title has not been transferred, the economic reality and substance are that the rights and beneficial interest in the Office Building have been

transferred. Therefore, recording of acquisition/ disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.

(3) Accrual is a fundamental accounting assumption. If it is not followed by the company, the facts should be disclosed under AS-I. Hence the company should disclose the fact that the cash basis of accounting has been followed in the notes on accounts.

(4) The practice followed by the company is not correct. It should be disclosed as part of financial statements (The director's report is not part of financial statements).

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Chapter 4.2
AS 3- Cash Flow Statements

Question 1

Prepare Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31st March, 2020, in accordance with AS-3 (Revised) from the following Summary Cash Account:

Summary Cash Account

	Rs. in '000	Rs. in'000
Balance as on 01.04.2019		210
Receipts from Customers		16,596
Sale of Investments (Cost Rs. 90,000)		102
Issue of Shares		1,800
Sale of Property Plant & Equipment		768
		19,476
Payment to Suppliers	12,204	
Purchase of Investments	78	
Purchase of Property Plant & Equipment	1,380	
Wages & Salaries	414	
Selling & Administration Expenses	690	
Payment of Income Tax	1,458	
Payment of Dividends	480	
Repayment of Bank Loan	1,500	
Interest paid on Bank Loan	300	(18,504)
Balance as on 31.03.2020		972

(MTP 8 Marks May 20) (Same concept different figures RTP May'20)

Answer 1

Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31st March, 2020

(Rs. '000)

Cash flows from operating activities		
Cash receipts from customers	16,596	
Cash payments to suppliers	(12,204)	
Cash paid to employees	(414)	
Other cash payments (for Selling & Administrative expenses)	(690)	
Cash generated from operations	3,288	
Income taxes paid	(1,458)	
Net cash from operating activities		1,830
Cash flows from investing activities		
Payments for purchase of Property Plant & Equipment	(1,380)	
Proceeds from sale of Property Plant & Equipment	768	
Purchase of investments	(78)	
Sale of investments	102	
Net cash used in investing activities		(588)
Cash flows from financing activities		
Proceeds from issue of share capital	1,800	
Bank loan repaid	(1,500)	
Interest paid on bank loan	(300)	
Dividend paid	(480)	
Net cash used in financing activities		(480)
Net increase in cash and cash equivalents		762
Cash and cash equivalents at beginning of period		210
Cash and cash equivalents at end of period		972

Question 2

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

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

(MTP 5 Marks Oct 20)

Answer 2

As per AS 3, Cash and cash equivalents consists of: (i) Cash in hand and deposits repayable on demand with any bank or other financial institutions and (ii) Cash equivalents, which are short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value. A short-term investment is one, which is due for maturity within three months from the date of acquisition. Investments in shares are not normally taken as cash equivalent, because of uncertainties associated with them as to realizable value.

Computation of Cash and Cash Equivalents as on 31st March, 2019

	₹
Cash balance with bank	10,000
Short term investment in highly liquid sovereign debt mutual fund on 1.3.19	1,00,000
Bank balance in foreign currency account ($1,000 x ₹ 70)	70,000
	1,80,000

Note: Fixed deposit, Shares and Debentures will not be considered as cash and cash equivalents.

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Question 3

Classify the following activities as (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities:

a. Purchase of Machinery.
b. Proceeds from issuance of equity share capital
c. Cash Sales.
d. Proceeds from long-term borrowings.
e. Proceeds from Trade receivables.
f. Cash receipts from Trade receivables.
g. Trading Commission received.
h. Purchase of investment.
i. Redemption of Preference Shares.
j. Cash Purchases. (MTP 5 Marks Oct '18)

Answer 3

(i) Operating Activities: c, e, f, g, j.
(ii) Investing Activities: a, h.
(iii) Financing Activities: b, d, i.

Question 4

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

(i) Received ₹ 4,00,000 as redemption of short-term deposit
(ii) Proceeds of ₹ 20,00,000 from issuance of equity share capital
(iii) Received interest of ₹ 70,000 on Govt. bonds.
(iv) An amount of ₹ 13,00,000 incurred for purchase of goodwill
(v) Proceeds of ₹ 5,00,000 from sale of patent.

(vi) **Proceeds of ₹ 12,00,000 from long term borrowing.**
(vii) **Amount paid for redemption of debentures of ₹ 22,00,000**
(viii) **Underwriting commission of ₹ 40,000 paid on issue of equity share capital**
(ix) **Interest of ₹ 1,44,000 paid on long-term borrowing. (MTP 5 Marks Oct '21)**

Answer 4

Statement showing Cash Flow from Financing Activities

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

Question 5

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

Cash Flow (Abstract)

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

Prepare Cash Flow Statement for the year ended 31st March, 2021 in accordance with AS 3. (MTP 5 Marks April 21, Mar 22, Old & New SM)

Answer 5

Cash Flow Statement for the year ended 31.3.2021

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

Debentures redeemed	(50,000)	
Net cash used in financing activities		2,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 6

Classify the following activities as

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

(1) Cash receipts from Trade Receivables

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

(3) Purchase of investment

(4) Proceeds from long term borrowings

(5) Wages and Salaries paid

(6) Bank overdraft

(7) Purchase of Goodwill

(8) Interim dividend paid on equity shares

(9) Short term Deposits

(10) Underwriting commission paid

(MTP 5 Marks, Sep 22) (PYP May '18, 5 Marks)

Answer 6

(a) Operating Activities: Items 1 and 5.

(b) Investing Activities: Items 3,7 and 9

(c) Financing Activities: Items 4,6,8 and 10

(d) Cash Equivalent: 2

Question 7

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 2022?

(i) 10% Debentures issued: As on 01-04-2021 ₹ 1,10,000
As on 31-03-2022 ₹ 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

(iii) Unpaid Interest on Debentures: As on 01-04-2021 ₹ 275
As on 31-03-2022 ₹ 1,175

(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v) 10% Bonds (Investments): As on 01-04-2021 ₹ 3,50,000
As on 31-03-2022 ₹ 3,50,000

(vi) Accrued Interest on Investments:As on 31-03-2022 ₹ 10,500 (MTP 5 Marks March '23)

Answer 7

Cash Flow Statement of Gagan Ltd. for the year ended March 31, 2022

A	**Cash Flow from Operating Activities**	
	Net Profit as per Profit & Loss A/c	--------
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	**Cash Flow from Investing Activities**	
	Interest on Investments [35,000-10,500]	24,500
C	**Cash Flow from Financing Activities**	
	Interest on Debentures paid [11,000 - (1,175 - 275)]	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) at 5% premium]	(34,650)

Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.

Question 8

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

a. **Proceeds from long-term borrowings.**
b. **Proceeds from Trade receivables.**
c. **Trading Commission received.**
d. **Redemption of Preference Shares.**
e. **Proceeds from sale of investment**
f. **Interim Dividend paid on equity shares.**
g. **Interest received on debentures held as investment.**
h. **Dividend received on shares held as investments.**
i. **Rent received on property held as investment.**
j. **Dividend paid on Preference shares.**
k. **Marketable Securities (RTP May 20)**

Answer 8

Operating Activities: b, c.

Investing Activities: e, g, h, i.

Financing Activities: a, d, f, j.

Cash Equivalent: k.

Question 9

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019. (PYP Nov.'19,5 Marks, Old & New SM) (Same concept lesser adjustments-MTP 4 Marks March 21, MTP 5 Marks April 22 & Oct '23)

Particulars	**Amount (Rs.)**
Machinery acquired by issue of shares at face value	**2,00,000**
Claim received for loss of machinery in earthquake	**55,000**
Unsecured loans given to associates	**5,00,000**
Interest on loan received form associate company	**70,000**

Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of Rs. 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable	
within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred Rs. 9,600)	90,000

Answer 9

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

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

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.
   The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

Question 10

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3(Revised) from the following cash account summary: (PYP July'21, 5 Marks)

Cash summary Account

Inflows	**₹ ('000)**	**Outflows**	**₹ ('000)**
Opening Balance	**945**	**Payment to suppliers**	**54,918**
Receipts from Customers	**74,682**	**Purchase of Investments**	**351**
Sale of Investments (Cost ₹ 4,05,000)	**459**	**Property, plant and equipment acquired**	**6,210**
Issue of Shares	**8,100**	**Wages and salaries**	**1,863**
Sale of Property, Plant and equipment	**3,456**	**Payment of Overheads**	**3,105**
		Taxation	**6,561**
		Dividends	**2,160**
		Repayment of Bank Overdraft	**6,750**
		Interest paid on Bank Overdraft	**1,350**
		Closing Balance	**4,374**
	87,642		**87,642**

Answer 10

Gama Limited Cash Flow Statement for the Year Ended 31st March 2021

Particulars	Amount (₹'000)	Amount (₹'000)
Cash flow from Operating Activities:		
Cash receipts from customers	74,682	
Cash payments to suppliers	(54,918)	
Cash payments for wages & salaries	(1,863)	
Cash payments of overheads	(3,105)	
Cash Generated from Operations	14,796	
Payment of Taxation	(6,561)	
Net Cash from Operating Activities		8,235
Cash Flow from Investing Activities:		
Proceeds from sale of investments	459	
Proceeds from sale of Property, Plant and Equipment	3,456	
Purchase of Investments	(351)	
Purchase of Property, Plant and Equipment	(6,210)	
Net Cash Used in Investing Activities		(2,646)
Cash Flow from Financing Activities:		
Proceeds from issue of shares	8,100	
Payment of Dividend	(2,160)	
Repayment of Bank Overdraft	(6,750)	
Interest paid on Bank Overdraft	(1,350)	
Net Cash Used in Financing Activities		(2,160)
Net Increase in Cash & Cash Equivalent		3,429
Cash and Cash Equivalent in the Beginning of the year		945
Cash and Cash Equivalent in the end of the year		4374

Question 11

Following are the extracts from the Balance Sheet of ABC Ltd.

Liabilities	**31.3.2020**	**31.3.2021**
	(₹)	**(₹)**
Equity Share Capital	**25,00,0000**	**35,60,000**
10% Preference Share Capital	**7,00,000**	**6,00,000**
Securities Premium Account	**5,00,000**	**5,50,000**
Profit & Loss A/c	**20,00,000**	**28,00,000**

Equity Share Capital for the year ended 31st March, 2021 includes ₹ 60,000 of equity shares issued to Grey Ltd. at par for supply of Machinery of ₹ 60,000. Profit & Loss account on 31st March, 2021 includes ₹ 50,000 of dividend received on Equity shares invested in X Ltd. Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised) (PYP 5 Marks, Dec '21)

Answer 11

The related items given in the question will appear in the Cash Flow Statement of ABC Limited for the year ended 31st March, 2021 as follows:

	₹	₹
Cash flows from operating activities		
Closing Balance as per Profit and Loss Account	28,00,000	

Less: Opening Balance as per Profit and Loss Account	(20,00,000)	
	8,00,000	
Less: Dividend received	50,000	
		7,50,000
Cash flows from investing activities		
Dividend received		50,000
Cash flows from financing activities		
Proceeds from issuance of share capital Equity shares issued for cash ₹ 10,00,000 Proceeds from securities premium (₹ 5,50,000 – 5,00,000) ₹ 50,000	10,50,000	
Less: Redemption of Preference shares (₹ 7,00,000 – ₹ 6,00,000)	(1,00,000)	9,50,000

Note:

1. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the cash flow statement.
2. ABC Ltd. has been considered as a non-financial company in the given answer.

Question 12

The following information is provided by Alpha Limited, for the year ended 31st March, 2022:

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 40 lakhs.
(ii) Depreciation on Fixed Assets ₹ 10 lakhs.
(iii) Discount on issue of Debentures written of ₹ 60,000.
(iv) Interest on Debentures paid ₹ 7,00,000.
(v) Book value of investments ₹ 6 lakhs (Sale of Investments for ₹ 6,40,000).
(vi) Interest received on investments ₹ 1,20,000.
(vii) Compensation received ₹ 1,80,000 by the company in a suit filed.
(viii) Income tax paid ₹ 21,00,000
(ix) Current assets and current liabilities in the beginning and at the end of the year were as detailed below:

	As on 31.3.2021 ₹	As on 31.3.2022 ₹
Stock	24,00,000	26,36,000
Sundry Debtors	4,16,000	4,26,200
Cash in hand	3,92,600	70,600
Bills Receivable	1,00,000	80,000
Bills Payable	90,000	80,000
Sundry Creditors	3,32,000	3,42,600
Outstanding Expenses	1,50,000	1,63,600

You are required to prepare Cash Flow Statement from Operating Activities in accordance with AS-3 (revised) using the indirect method for the year ended 31st March,2022. (PYP 5 Marks May'22)

Answer 12

Alpha Ltd.
Cash Flow Statement (from Operating Activities) for the year ended 31st March, 2022

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		40,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	10,00,000	
Discount on issue of debentures	60,000	
Interest on debentures paid	7,00,000	
Interest on investments received	(1,20,000)	
Profit on sale of investments	(40,000)	16,00,000
Operating profit before working capital changes		56,00,000
Adjustments for:		
Increase in inventory	(2,36,000)	
Increase in Sundry Debtors	(10,200)	
Decrease in Bills receivables	20,000	
Increase in Sundry Creditors	10,600	
Increase in Bills payables	(10,000)	
Increase in outstanding expenses	13,600	(2,12,000)
Cash generated from operations		53,88,000
Income tax paid		(21,00,000)
Cash flow from ordinary items		32,88,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,80,000
Net cash flow from operating activities		34,68,000

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 13

Ridgeway Limited, a Non-Financial company has the following activities:

(i) Dividend paid for the year.

(ii) TDS on interest income earned on investments made.

(iii) Loans and advances given to suppliers and interest earned from them.

(iv) Deposit with bank for a term of two years.

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

(vi) Investments made and dividends earned on them.

(vii) Insurance claims received against loss of stock or loss of profits.

(viii) Loans and advances given to subsidiaries and interest earned from them.

(ix) Issue of Bonus Shares.

(x) Term loan repaid.

You are required to classify the above activities in Cash Flow Statement as per 'AS-3'. (PYP 5 Marks Nov '22)

Answer 13

No.		Activities
(i)	Dividend paid for the year	Financing
(ii)	TDS on interest income earned on investments made	Investing
(iii)	Loans and advances given to suppliers and interest earned from them	Operating
(iv)	Deposit with bank for a term of two years	Investing
(v)	Highly liquid Marketable Securities (without risk of change in value)	Cash Equivalent
(vi)	Investments made and dividends earned on them	Investing
(vii)	Insurance claims received against loss of stock	Operating
	or loss of profits	
(viii)	Loans and advances given to subsidiaries and interest earned from them	Investing
(ix)	Issue of Bonus Shares	No Cash Inflow/Cash outflow
(x)	Term Loan repaid	Financing

Question 14

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

Assts	31/03/2023 (₹)	31/03/2022 (₹)
Goodwill	15,000	28,000
Land	5,75,000	6,00,000
Furniture and Fixtures	48,000	44,000
Vehicles	22,000	28,000
Office Equipment	21,000	-
Long-term Investments	60,000	1,10,000
Stock-in-hand	96,000	88,000
Bills Receivables	18,150	14,500
Trade Receivables	46,000	52,000
Cash and Bank Balances	1,29,850	34,500
Total	10,31,000	9,99,000

Liabilities	31/03/2023 (₹)	31/03/2022 (₹)
Equity Shares Capital	6,80,000	5,00,000
General Reserves	90,000	60,000
Profit and Loss Account	93,000	52,000
Capital Reserve	75,000	-
8% Debentures of ₹ 100 each	-	3,00,000
Loan from Mr. Andrew	-	15,000
Bills Payables	11,000	13,000

Trade Payables	49,000	45,000
Creditors for Equipment	10,500	-
Outstanding Expenses	4,500	3,000
Provision for Taxation	18,000	11,000
Total	10,31,000	9,99,000

Additional Information:

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

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

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

iii) Interim dividend of 5,000 was paid during the year.

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

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

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

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

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

(PYP 10 Marks May '23)

Answer 14

Cash Flow Statement of Flora Limited from Operating Activities For the year ended 31st March, 2023

	₹	₹
Net profit before taxation (W.N.1)		92,000
Adjustment: Depreciation on Furniture & Fixtures	5,000	
Depreciation on Vehicles	2,200	
Profit on sale of land (₹ 125000 - ₹ 100000)	(25,000)	
Loss on sale (Vehicle)	800	
Profit on sale of long-term investments	(8,000)	
Interest received	(6,500)	
Interest on debentures	12,000	
Goodwill written off	13,000	(6,500)
Operating profit before working capital changes		85,500
Increase in Stock in Hand	(8,000)	
Increase in Bills Receivables	(3,650)	
Decrease in Trade Receivables	6,000	
Decrease in Bills payable	(2,000)	
Increase in Trade Payables	4,000	
Increase in outstanding expenses	1,500	(2,150)
Cash generated from Operations		83,350
Less: Income taxes paid		9,000
Cash flow from Operating activities		74,350

Alternative presentation:

Cash Flow Statement of Flora Limited from Operating Activities For the year ended 31st March, 2023

		₹
Net profit before taxation (W.N. 1)		92,000
Adjustment: Depreciation on Furniture & fixtures	5,000	
Depreciation on Vehicles	2,200	
Profit on sale of land	(25,000)	
Loss on sale (Vehicle)	800	
Profit on sale of long- term investments	(8,000)	
Interest received	(6,500)	
Interest on debentures	12,000	
Goodwill written off	13,000	(6,500)
Operating profit before working capital changes		85,500
Increase in inventory	(8,000)	
Decrease in Trade receivables*	2,350	
Increase in Trade payables**	2,000	
Increase in outstanding expenses	1,500	(2,150)
Cash generated from Operations		83,350
Less: Income taxes paid		9,000
Cash flow from Operating activities		74,350

*[(18,150 +46,000) - (14,500 + 52,000)] ** [(11,000 49,000) - (13,000+45,000)]

Working Notes:

1. Net Profit before Taxation

Increases in Profit and Loss A/c (93,000-52,000)	41,000
Increases in General Reserve (90,000-60,000)	30,000
Interim dividend Paid	5,000
Transfer – provision for Taxation	16,000
Increase in retained earnings (Net Profit before Taxation)	92,000

2. Provision for Taxation Account

	₹		₹
To Bank (Balancing figure)	9,000	By Balance b/d	11,000
To Balance c/d	18,000	By Profit and loss account	16,000
	27,000		27,000

3. Vehicles Account

Particulars	(₹)
Opening Balance	28,000
Less: Depreciation	(2,200)
Less: Closing Balance	(22,000)
Book value of vehicle sold	3,800
Less: Sale Value	(3,000)
Loss on sale of Vehicle	800

Question 15

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2023 (Using direct method):

(i) Total sales for the year were ₹ 796 crores out of which cash sales amounted to ₹ 524 crores.

(ii) Receipts from credit customers during the year, totalled ₹ 268 crores.

(iii) Purchases for the year amounted to ₹ 440 crores out of which credit purchase was 80%.

Balance in creditors as on 1.4.2022 ₹ 168 crores

31.3.2023 ₹ 184 crores

(i) Suppliers of other consumables and services were paid ₹ 38 crores in cash.

(ii) Employees of the enterprises were paid 40 crores in cash.

(iii) Fully paid 9% Preference shares of the face value of ₹ 64 crores were redeemed. Equity shares of the face value of ₹ 40 crores were allotted as fully paid up at premium of 20%.

(iv) 10% Debentures of ₹ 40 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(v) ₹ 52 crores were paid by way of income tax.

(vi) A new machinery costing ₹ 50 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹ 26 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 30 crores. The balance was paid in cash to the vendor.

(vii) Investment costing ₹ 36 cores were sold at a loss of ₹ 4 crores.

(viii) Dividends totaling ₹ 30 crores was also paid.

(ix) Debenture interest amounting ₹ 4 crore was paid.

(x) Non-cash expenditure incurred during the current year was 1.2 crores.

(ix) Dividends declared during the current year was 15% on equity share capital (ESC = '120 crores).

(x) On 31st March 2022, Balance with Bank and Cash on hand totalled ₹ 4 crores. (RTP Nov '23)

Answer 15

Cash flow statement (using direct method) for the year ended 31st March, 2023

	(₹ in crores)	**(₹ in crores)**
Cash flow from operating activities		
Cash sales	524	
Cash collected from credit customers	268	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(502)	
Cash from operations	290	
Less: Income tax paid	(52)	
Net cash from operating activities		238
Cash flow from investing activities		
Net Payment for purchase of Machine (50 – 30)	(20)	
Proceeds from sale of investments	32	
Net cash from investing activities		12
Cash flow from financing activities		
Redemption of Preference shares	(64)	
Proceeds from issue of Equity shares	48	
Debenture interest paid	(4)	
Dividend Paid	(30)	
Net cash used in financing activities		(50)
Net increase in cash and cash equivalents		200
Add: Cash and cash equivalents as on 1.04.2022		4
Cash and cash equivalents as on 31.3.2023		204

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Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(₹ in crores)
Opening Balance in creditors Account	168
Add: Purchases (440x .8)	352
Total	520
Less: Closing balance in Creditors Account	184
Cash paid to suppliers of goods	336
Add: Cash purchases (440x .2)	88
Total cash paid for purchases to suppliers (a)	424
Add: Cash paid to suppliers of other consumables and services (b)	38
Add: Payment to employees (c)	40
Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)]	502

Chapter 4.3
AS 17- Segment Reporting

Question 1

A Company has an inter-segment transfer pricing policy of charging at cost less 5%. The market prices are generally 20% above cost. You are required to examine whether the policy adopted by the company is correct or not? (MTP 5 Marks Nov '21 & April '23) (RTP May'21, Nov'20, May'22, Nov '19, May'18, Nov'22, Old & New SM)

Answer 1

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter- segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if followed consistently.

Question 2

The Chief Accountant of Cotton Garments Limited gives the following data regarding its five segments: (₹ in Crore)

Particulars	A	B	C	D	E	Total
Segment Assets	40	15	10	10	5	80
Segment Results	(95)	5	5	(5)	15	(75)
Segment Revenue	310	40	30	40	30	450

The Chief Accountant is of the opinion that segment "A" alone should be reported. Is he justified in his view? Examine his opinion in the light of provisions of AS 17 'Segment Reporting'. (MTP 5 Marks March '23) (RTP May '20 & May '23) (PYP 5 Marks, Jan 21) (Similar to RTP Nov 20 & Nov 19 but different figures) (PYP 5 Marks May '23)

Answer 2

As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its **revenue** from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment **result** whether profit or loss is 10% or more of:

(1) The combined result of all segments in profit; or

(2) The combined result of all segments in loss, whichever is greater in absolute amount; or

(iii) Its segment **assets** are 10% or more of the total assets of all segments.

Further, 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.

Accordingly,

(a) On the basis of **revenue from sales** criteria, segment A is a reportable segment.

(b) On the basis of the **result** criteria, segments A & E are reportable segments (since their results in absolute amount is 10% or more of ₹ 100 crore).

(c) On the basis of **asset** criteria, all segments except E are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17.

Hence, the opinion of chief accountant that only segment 'A' is reportable is wrong.

Question 3

a) **Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.**

b) **Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain. (RTP Nov '21)**

Answer 3

a) As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

   (a) the nature of the products of services;
   (b) the nature of the productions processes;
   (c) the type of class of customers for the products or services;
   (d) the methods used to distribute the products or provide the services; and
   (e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors. In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

b) As per AS 17, "Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable." It also states that "some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand and impact of such changes, this Statement requires the disclosure of the nature of change and the financial effect of the change, if reasonably determinable".

In view of the above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting. Accordingly, if the change has a material financial effect on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, should be disclosed.

Question 4

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban. Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17. (RTP May 22) (New SM)

Answer 4

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country". Accordingly, to identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement…". Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment. Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

Question 5

PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA and UK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 per cent is sold in USA and the balance is sold in UK. Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant? (RTP May 19)

Answer 5

As per AS 17 if primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue. Accordingly, for the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 per cent or more of enterprise revenue threshold. However, other secondary segment information as per AS 17 should be disclosed in respect of this segment if the thresholds prescribed in the AS 17 are met.

Question 6

(a) **Calculate the segment results of a manufacturing organization from the following information: (RTP Nov 18 & New SM)**

Segments	A	B	C	Total
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5: 4: 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5: 4: 2 basis)				77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	

Answer 6

Calculation of segment result

Segments	A	B	C	Total
	Rs.	Rs.	Rs.	Rs.
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5: 4: 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue as per AS 17 (A)	6,60,000	4,15,000	2,70,000	13,45,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses as per AS 17 (B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A-B)	2,44,000	1,79,000	69,000	4,92,000

Question 7

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions: (` in Lacs)

Division	A	B	C	D	Total
Segment Revenue	100	300	200	400	1,000
Segment Result	45	-70	80	-10	45
Segment Assets	39	51	48	12	150

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17. (PYP 5 Marks, Nov 20) (Similar to PYP Jan 21 & Nov 19 but different figures, Old & New SM) (MTP 5 Marks Sep '23) (RTP Nov '23)

Answer 7

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

Its segment result whether profit or loss is 10% or more of:

- The combined result of all segments in profit; or
- The combined result of all segments in loss, whichever is greater in absolute amount; or Its segment assets are 10% or more of the total assets of all segments.

On the basis of revenue criteria, segments A, B, C and D - all are reportable segments.

On the basis of the result criteria, segments A, B and C are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs). On the basis of asset criteria, all segments except Dare 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.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question was on AS 17 "segment reporting" and examinees were to identify the segments required to be reported and to discuss whether the view of the accountant considering only two segments as reportable, is justified. Many of the examinees did conclude correctly that all the segments are reportable and did not give the justification by identifying, which segment is reportable, according to which criteria of the standard.

Question 8

M/s Nathan Limited has three segments namely P, Q and R. The assets of the company are ` 15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P - ` 1 crore, Q - ` 0.90 crores and R - ` 0.80 crores. The accountant contends all these three segments are reportable segments. Comment. (PYP 5 Marks, May 18) (Old & New SM)

Answer 8

According to AS 17 "Segment Reporting", segment Assets do not include income tax assets. Therefore, the revised total assets are 12.3 crores [`15 – (` 1 + 0.9 + 0.8). Details of Segment wise assets Segment P holds total assets of ` 3 crores (` 4 crores – ` 1 crores); Segment Q holds ` 5.1 crores (` 6 crores – 0.9 crores); Segment R holds ` 4.2 crores (` 5 crores – ` 0.8 crores). Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments. Hence, the contention of the accountant that all three segments are reportable segments is correct.

Question 9

Answer any four of the following:

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March,2022 has been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	Profit (Loss) ₹ in lakhs
A	225
B	25
C	(175)
D	(20)
E	(105)

(PYP 5 Marks May'22)

Answer 9

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its segment results whether profit or loss is 10% or more of:

- The combined result of all segments in profit; i.e., ₹ 250 Lakhs or
- The combined result of all segments in loss; i.e., ₹ 300 Lakhs Whichever is greater in absolute amount i.e., ₹ 300 Lakhs.

Operating Segment	Absolute amount of Profit or Loss (₹ In lakhs)	Reportable Segment Yes or No
A	225	Yes
B	25	No
C	175	Yes
D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments (since their results in absolute amount is 10% or more of ₹ 300 lakhs i.e., 30 lakhs).

Chapter 4.4
AS 18- Related Party Disclosures

Question 1

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited? Also explain the required related party disclosure requirements under AS 18? (MTP 5 Marks April 21, Sep '23, RTP Nov 22, PYP 5 Marks July'21) (Same concepts but lesser adjustments as RTP Nov'19, May'19)

Answer 1

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

Related Party Disclosures: Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.

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

(i) The name of the transacting related party;

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

(iii) A description of the nature of transactions;

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

- **(a)** Any other elements of the related party transactions necessary for an
- **(b)** understanding of the financial statements;
- **(c)** The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;
- **(d)** Amounts written off or written back in the period in respect of debts due from or to related parties.

Question 2

(i) **Mr. Raj a relative of key management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2020 to 30.6.2020. On 1.7.2020, he left the service. Should the relative be identified as at the closing date i.e. on 31.3.2021 for the purposes of AS 18? (MTP 5 Marks March 21, Oct'20, Mar'22, Old & New SM) (Same concept different figures PYP 2.5 Marks July'21, PYP 2.5 Marks, Nov '18)**

(ii) **X Ltd. sold goods to its associate Company during the 1st quarter ending 30.6.2020. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year need disclosure as related party transaction. (MTP 5 Marks March 21, Oct'20, Mar'22 & Oct '23, Old & New SM)**

Answer 2

(i) According to AS 18 on 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence, Mr. Raj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021.

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

Question 3

You are required to identify the related parties in the following cases as per AS 18: M Ltd. holds 61 % shares of S Ltd. S Ltd. holds 51 % shares of F Ltd. C Ltd. holds 49% shares of F Ltd. (Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.) (MTP 5 Marks May 20 & Sep '22) (PYP 2.5 Marks May 18)

Answer 3

(a) Reporting entity- M Ltd.

- S Ltd. (subsidiary) is a related party
- F Ltd.(subsidiary) is a related party

(b) Reporting entity- S Ltd.

- M Ltd. (holding company) is a related party
- F Ltd. (subsidiary) is a related party

(c) Reporting entity- F Ltd.

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

(d) Reporting entity- C Ltd.

- F Ltd. (associate) is a related party

Question 4

(i) On the basis of provisions of AS 18 'Related Party Disclosures': Identify the related parties in the following cases:

X Limited holds 60% shares of Y Limited Y Limited holds 55% shares of W Limited Z Limited holds 35% shares of W Limited

(ii) Himalaya Limited sold goods for ₹ 40 Lakhs to Aravalli Limited during financial year ended on March 31, 2022. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per AS 18. You are required to comment on this. (MTP 5 Marks March '23, RTP Nov '20) (Same concept different figures RTP May'20, RTP Nov'18, Old & New SM)

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Answer 4

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

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

Question 5

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

(b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would Be Limited be considered a related party for the purpose of financial statements of C Limited? (RTP Nov '21)

Answer 5

(a) Omega Bank Limited would be a related party of B Limited. As per AS 18 "associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venture" are related party relationship. Further, an associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies". Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power. Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

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

Question 6

R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 10% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd. You are required to assess the situation from the view point of AS 18 on Related Party Disclosures. (RTP May 21)

Answer 6

AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Definition for Control

Here, control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and Significant Influence is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

Nature of Relationship

R Ltd. has direct economic interest in T Ltd. to the extent of 10%, and through S Ltd. in which it is the majority shareholders, it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%). These two taken together (10% + 9%) make the total control of 19%.

Conclusion

In the present case, control of R Ltd. in T Ltd. directly and through S Ltd., is only 19%. Significant influence may also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries only 19% of the voting power of the T Ltd. Accordingly, R Ltd. and T Ltd. are not related parties. Hence related party disclosure, as per AS 18, is not required.

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Question 7

Is remuneration paid to Board of Directors a related party transaction? Explain. (RTP May 18)

Answer 7

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP). Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Further, as per Sec 2(76) of Companies Act, 2013, a related party includes a director or his relative. Sec 2(34) defines a director as a director appointed to the Board of a Company. Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 8

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

b) **Define "Key management personnel" in the context of AS 18. (RTP May 22)**

Answer 8

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

- 'ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise". Paragraph 10 of the standard defines significant influence as

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

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

Question 9

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

(i) Maya Ltd. holds 61 % shares of Sheetal Ltd. Sheetal Ltd. holds 51 % shares of Fair Ltd.Care Ltd. holds 49% shares of Fair Ltd. (Give your answer - Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.) (RTP Nov '23)

(ii) Mr. Subhash Kumar is Managing Director of a Ltd. and also holds 72% capital of B Ltd. (PYP 5 Marks May '19)

Answer 9

(i) a) Reporting entity- Maya Ltd.

- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd.(subsidiary) is a related party

(b) Reporting entity- Sheetal Ltd.

- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

(c) Reporting entity- Fair Ltd.

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

(d) Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

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

Question 10

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

Goods sold amounting to Rs. 50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction. (PYP 2.5 Marks, Nov '18)

Answer 10

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

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

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

Question 11

Answer the following with respect to AS-18:

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

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

(iii) Asha Ltd. sells all the manufactured furniture of ` 1,00,00,000 to Sasha Ltd, as per agreement. Sasha Ltd. is the only customer to Asha Ltd. In the financial statements, Asha Ltd. wants to present Sasha company as a related party. Comment on the disclosure requirement. (PYP 5 Marks May '23)

Answer 11

i) As per AS 18, parties are considered to be related if any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party. Transactions of ABC Ltd. with its associate company for the first quarter ending 30.06.2022 only are required to be disclosed as related party transactions as the company has the ability to exercise significant influence only till 30.6.2022.

The transactions for the period in which related party relationship did not exist need not be reported.

ii) In the given case, Arjun Ltd. cannot be said to control the composition of board of directors of Bheem Ltd. as the directors have been appointed in their individual capacity as professionals and not by virtue of their being directors in Arjun Ltd.

Hence, it cannot be concluded that the companies are related merely because the majority of the directors of one company became the majority of the directors of the second in their individual capacity as professionals.

iii) In the context of AS 18, a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business cannot be construed as Related Party Relationship merely by virtue of the resulting economic dependence. There is an economic dependence between the companies but no one controls or exercise significant influence on the other.

In the given case, Asha Ltd. need not report Sasha Company as its related party in its financial statements.

Chapter 4.5

AS 20- EPS

Question 1

From the following information, you are required to compute Basic and Diluted Earnings Per Share (EPS) of M/s. XYZ Limited for the year ended 31st March, 2019:

Net Profit for the year after tax: Rs. 75,00,000

Number of Equity Shares of Rs.10 each outstanding: Rs. 10,00,000

1,00,000, 8% Convertible Debentures of Rs. 100 each were issued by the Company at the beginning of the year. 1,10,000 Equity Shares were supposed to be issued on conversion. Consider rate of IncomeTax as 30% (MTP 5 Marks Oct'18, RTP May 20) (Same concept different figures- MTP 5 Marks Nov'21, RTP Nov'19, RTP May'19, RTP Nov'22, RTP May'18)

Answer 1

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year Rs. 75,00,000 / 10,00,000 = Rs. 7.50 per share

Computation of diluted earnings per share $\frac{\textit{Adjusted net profit for the current year}}{\textit{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	Rs.
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of Rs.8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the Question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

= Rs. 80,60,000/ 11,10,000

= Rs. 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 2

From the following information, you are required to compute the basic and adjusted Earnings per share:

Net profit for 2015-16	**11 lakh**
Net profit for 2016-17	**15 lakh**
No. of shares issued before rights issue	**5 lakhs**
Right issue	**One for every 5 held**
Right issue price	**15 per share**
Last date of exercising right option	**1-06-2016**
Fair value of shares before right issue	**21 per share**

(MTP 5 Marks- Mar'19, Mar'18) (Same concept different figures MTP 5 Marks May'20, MTP 5 Marks Sep'22, RTP Nov'20, RTP Nov'18, May'23, PYP 5 Marks Nov'19, Old & New SM)

Answer 2

Computation of theoretical ex-rights fair value per Share

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

$$\frac{(Rs.21.00 \times 5,00,000\ Shares) + (Rs.15.00 \times 1,00,000\ Shares)}{5,00,000\ Shares + 1,00,000\ Shares}$$

Theoretical ex-rights fair value per share = Rs. 20.00

Computation of earnings per share

(a) Computation of adjustment factor

(b) $\frac{\textit{Fair value per share prior to exercise of rights}}{\textit{Theoretical ex-rights value per share}} = \frac{(21.00)}{(20.00)} = 1.05$

Computation of earnings per share	Year 2015-16	Year 2016-17
EPS for the year 2015-16 as originally reported: (Rs. 11,00,000/5,00,000 shares)	Rs.2.20	
EPS for the year 2015-16 restated for rights issue: [Rs. 11,00,000/ (5,00,000 shares x 1.05)]	Rs.2.10	
EPS for the year 2016-17 including effects of rights issue $\frac{15,00,000}{\left(5,00,000 \times \frac{2}{12}\right) + \left(6,00,000 \times \frac{10}{12}\right)}$		Rs. 2.55

Question 3

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case: (MTP 5 Marks April 21, April 22)

		No. of shares
1st April, 2020	Balance of equity shares	7,20,000
31st August, 2020	Equity shares issued for cash	2,40,000
1st February, 2021	Equity shares bought back	1,20,000
31st March, 2021	Balance of equity shares	8,40,000

Answer 3

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares:

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	= 8,40,000 shares

Question 4

On 1st April, 2021 a company had 6,00,000 equity shares of Rs. 10 each (Rs. 5 paid up by all shareholders). On 1st September, 2019 the remaining Rs. 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2022 was Rs. 21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totaling to Rs. 3,40,000. You are required to compute Basic EPS for the year ended 31st March, 2022 as per Accounting Standard 20 "Earnings Per Share". (MTP 5 Marks Mar'22, Oct '20 & Oct '21, March '23 & Oct '23, PYP 5 Marks, May '18, Old & New SM)

Answer 4

Basic Earnings per share (EPS) $= \frac{Net\ Profit\ attributable\ to\ equity\ shareholders}{Weighted\ average\ number\ of\ equity\ shares\ outstanding\ during\ the\ year}$

$= \frac{21,96,000}{4,57,500\ Shares\ (as\ per\ working\ note)}$ = Rs. 4.80 per share

Working Note:

Calculation of weighted average number of equity shares

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

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
	Rs.	Rs.	Rs.
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 5

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20? (RTP Nov 21)

Answer 5

The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period". With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still attributable to equity shareholders. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

Question 6

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

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

Equity Shares issued as consideration for the acquisition of an asset other than in cash. (RTP May '21) (New SM)

Answer 6

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

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognized.

Question 7

a) **Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.**

b) **X Limited, as at March 31, 2021, has income from continuing ordinary operations of Rs. 2,40,000, a loss from discontinuing operations of Rs. 3,60,000 and accordingly a net loss of Rs. 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS? (RTP May 22)**

Answer 7

a) The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.
AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares". Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

b) As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations". As income from continuing ordinary operations, Rs. 2,40,000 would be considered and not Rs. (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from Rs. 240 to Rs. 200. Thus the basic E.P.S would be Rs. (120) and diluted E.P.S. would be Rs. (100).

Question 8

From the following information given by Sampark Ltd., Calculate Basis EPS and Diluted EPS as per AS 20:

Rs.	
Net Profit for the current year	2,50,00,000
No. of Equity Shares Outstanding	50,00,000
No. of 12% convertible debentures of ₹ 100 each Each debenture is convertible into 8 Equity Shares	50,000
Interest expense for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000

(PYP 5 Marks Nov'18)

Answer 8

Calculation of Basic Earnings Per Share

$$\text{Basic EPS} = \frac{\text{Net Profit for the current year}}{\text{No.of Equity Shares}} = \frac{\text{Rs.2,50,00,000}}{\text{50,00,000}}$$

Basic EPS per share = Rs. 5

Calculation of Diluted Earnings Per Share

$$\textbf{Diluted EPS} = \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no.of Equity Shares}}$$

Adjusted net profit for the current year	Rs.
Net profit for the current year	2,50,00,000
Add: Interest expenses for the current year	6,00,000
Less: Tax saving relating to Tax Expenses	(1,80,000)
	2,54,20,000

No. of equity shares resulting from conversion of debentures: 4,00,000 Shares

Weighted average no. of equity shares used to compute diluted EPS: (50,00,000 + 4,00,000) = 54,00,000 Equity Shares

Diluted earnings per share: (2,54,20,000/54,00,000) = Rs. 4.71 (Approx.)

Question 9

"At the time calculating diluted earnings per share, effect is given to all dilutive potential equity shares that are outstanding during the period". Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

(i)	**Net profit after tax for the year**	**₹ 64,12,500**
(ii)	**No. of equity shares outstanding**	**15,00,000**
(iii)	**No. of 9% convertible debentures of ₹ 100 issued on 1st July,2020**	**75,000**
(iv)	**Each debenture is convertible into 8 Equity Shares**	
(v)	**Tax relating to interest expenses**	**35%**

(PYP 5 Marks Dec'21)

Answer 9

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding* during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share. Basic EPS for the year 2020-21= 64,12,500/15,00,000 = ₹ 4.275 or ₹ 4.28

Computation of diluted earnings per share for year 2020-21

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity Shares}}$$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹ 67,41,562

No. of equity shares resulting from conversion of debentures: 6,00,000 Shares (75,000 × 8)

Weighted average no. of equity shares used to compute diluted EPS:

(15,00,000 X12/12+ 6,00,000X9/12)

= 19,50,000 Shares

Diluted earnings per share: (67,41,562/19,50,000) = ₹ 3.46

Working Note:

Interest expense for 9 months = 75,00,000×9%×9/12 =₹ 5,06,250

Tax expense 35 % on interest is ₹1,77,188 (5,06,250 x 35%)

*Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

Question 10

NAT, a listed entity, as on 1st April,2021 had the following capital structure:

	₹
10,00,000 Equity Shares having face value of ₹ 1 each	**10,00,000**
10,00,000 8% Preference Shares having face value of ₹ 10 each	**1,00,00,000**

During the year 2021-2022, the company had profit after tax of ₹ 90,00,000

On 1st January,2022, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December,2021.

On 1st January,2022, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.

NAT's shares were trading at ₹ 8.05 per share on 31st March,2022.

Further it has been provided that the basic earnings per share for the year ended 31st March,2021 was previously reported at ₹ 62.30.

You are required to:

Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March,2022 including the comparative figure, in accordance with AS-20 Earnings Per Share.

Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share? (5 Marks). (PYP 5 Marks May'22)

Answer 10

I. Calculation of Basic Earnings per share for the year ended 31stMarch, 2022 including the comparative figure:

Earnings for the year ended 31st March, 2021 = EPS x Number of shares outstanding during 2020-2021

= ₹ 62.30 x 10,00,000 equity shares

= ₹ 6,23,00,000

(a) Adjusted Earnings per share after taking into consideration bonus issue

Adjusted Basic EPS = Earnings for the year 2020-2021 / Total outstanding shares +Bonus issue

= ₹ 6,23,00,000 / (10,00,000+ 5,00,000)

= ₹ 6,23,00,000 / 15,00,000

= ₹ 41.53 per share

(b) Basic EPS for the year 2021-2022

Basic EPS = Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 2022)

= (₹ 90,00,000 – ₹ (1,00,00,000 x 8%) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= ₹ 82,00,000 / 15,50,000 shares

= ₹ 5.29 per share

II. In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2021, the earliest period reported.

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Question 11

The following information is provided to you:

Net profit for the year 2022: ₹ 72,00,000 Weighted average number of equity shares outstanding during the year 2022: 30,00,000 shares

Average Fair value of one equity share during the year 2022: ₹ 25.00 Weighted average number of shares under option during the year 2022: 6,00,000 shares

Exercise price for shares under option during the year 2022: ₹ 20.00

You are required to compute Basic and Diluted Earnings Per Share as per AS 20.

(PYP 5 Marks Nov'22)

Answer 11

Computation of Basic earnings per share

	Earnings ₹	Shares	Earnings/ Share ₹
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Basic earnings per share (72,00,000/30,00,000)			2.40

Computation of Diluted earnings per share

	Earnings	Shares	Earnings/Share
	₹		₹
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during		30,00,000	
year 2022			
Number of shares under option		6,00,000	
Number of shares that would have been			
issued at fair value			
(6,00,000 x 20.00)/25.00		(4,80,000)	
Diluted earnings per share	72,00,000	31,20,000	2.31
			(rounded-off)

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

To the extent that partly paid shares are not entitled to participate in dividends during the reporting period they are considered the equivalent of options.

Question 12

Net Profit for FY 2021-22	**30,00,000**
Net Profit for FY 2022-23	**50,00,000**
No. of shares outstanding prior to rights issue	**20,00,000 shares**
Rights Issue Price	**₹ 20**
Last day to exercise rights	**1st June, 2022**

Right issue is one new share for each five equity share outstanding (i.e. 4,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st June, 2022 was ₹ 26.00.

Compute Basic Earnings Per Share for FY 2016-17, FY 2022-23 and restated EPS for FY 2021-22. (Nov '23)

Answer 12

Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)

	Year 2016-17	Year 2017-18
	₹	₹
EPS for the year 2021-22 as originally reported		
$= \frac{\text{Net Profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the Year}}$		
= (₹ 30,00,000 / 20,00,000 shares)	1.5	
EPS for the year 2021-22 restated for rights issue		
= [₹ 30,00,000 / (20,00,000 shares ⍰ 1.04 (W.N. 2)]	1.44 (approx.)	
EPS for the year 2022-23 including effects of rights issue		
$\frac{₹\,50,00,000}{(20,00,000 \text{ shares} \times 1.04 \times 2/12) + (24,00,000 \text{ shares} \times 10/12)}$		
₹ 50,00,000/ 23,46,667 shares		2.13 (approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

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

$$= \frac{(₹\,26 \times 20{,}00{,}000\ Shares) + (₹\,20 \times 4{,}00{,}000\ Shares)}{20{,}00{,}000\ shares + 4{,}00{,}000\ Shares} = \frac{₹\,6{,}00{,}00{,}000}{24{,}00{,}000\ Shares} = ₹\,25$$

2. Computation of adjustment factor

$$= \frac{Fair\ value\ per\ share\ prior\ to\ excercise\ of\ rights}{Theoretical\ ex\text{-}rights\ value\ per\ share} = \frac{₹\,26}{₹\,25\ (Refer\ working\ Note\ 1)} = 1.04$$
(approx..)

Chapter 4.6
AS 24- Discontinuing Operations

Question 1

(i) **What are the disclosure and presentation requirements of AS 24 for discontinuing operations? (RTP May 20, May 22, Old & New SM)**

(ii) **Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances. (RTP May 20, Nov 18, May 22, Old & New SM)**

Answer 1

(i) An enterprise should include prescribed information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs

INITIAL DISCLOSURE

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

a. A description of the discontinuing operation(s)

b. The business or geographical segment(s) in which it is reported as per AS 17

c. The date and nature of the initial disclosure event.

d. The date or period in which the discontinuance is expected to be completed if known or determinable

e. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled

f. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period

g. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto

h. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period

DISCLOSURES OTHER THAN INITIAL DISCLOSURES NOTE

All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last bullet above) which should be shown on the face of the statement of profit and loss.

Other disclosures

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

a. For any gain or loss that is recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss and

b. The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

Updating the disclosures

In addition to these disclosures, an enterprise should include, in its financial statements, for periods

subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.

The disclosures should continue in financial statements for periods up to and including the period in which the discontinuance is completed. Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received. If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefore and its effect should be disclosed.

Separate disclosure for each discontinuing operation Any disclosures required by AS 24 should be presented separately for each discontinuing operation.

Presentation of the required disclosures

The above disclosures should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

a. 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

b. The amount of the pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

(ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations.

Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do so in combination with other circumstances, include:

a. Gradual or evolutionary phasing out of a product line or class of service.

b. Discontinuing, even if relatively abruptly, several products within an ongoing line of business.

c. Shifting of some production or marketing activities for a particular line of business from one location to another and

d. Closing of a facility to achieve productivity improvements or other cost savings.

Questions 2

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.

You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to (ii) above be different if the Company resolves tosell the assets of the passenger car division in a phased but time bound manner? (New SM)

Answers 2

(i) A discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

i) disposing of substantially in its entirety, such as by sellingthe component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of thedefinition, but that might do so in combination with other circumstances, include:

i) Gradual or evolutionary phasing out of a product line or class of service;

ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there isno specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposals were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Question 3

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements? (RTP Nov '21)

Answer 3

A discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:

(i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

(ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

(iii) Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.

c. That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

Question 4

What do you understand by Discontinuing Operations? What are the disclosure and presentation requirements of AS 24 for discontinuing operations? Explain in brief. (RTP Nov 20, PYP 5 Marks Nov'18)

Answer 4

As per AS 24 "Discontinuing Operations", a discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:

- **(i)** Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
- **(ii)** Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
- **(iii)** Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.

c. That can be distinguished operationally and for financial reporting purposes.

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s);
- The business or geographical segment(s) in which it is reported as per AS 17;
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable,
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

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Question 5

What is the disclosure requirement in interim financial reports as per AS 24 for discontinuing operations? (RTP Nov'22)

Answer 5

Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

- **(a)** Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and
- **(b)** Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Question 6

A consumer goods producer has changed the product line as follows:

	Dish washing Bar	Clothes washing Bar
	(Per month)	(Per month)
January 2021 - September 2021	2,00,000	2,00,000
October 2021 - December 2021	1,00,000	3,00,000
January 2022 - March 2022	Nil	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The Board of Directors has passed a resolution in March 2021 to this effect. The company follows calendar year as its accounting year.

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24? (RTP May '23, MTP 5 Marks Apr'19, Aug'18, RTP May'18)

Answer 6

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

(i) that the enterprise, pursuant to a single plan, is:

(1) disposing of substantially in its entirety,

(2) disposing of piecemeal, or

(3) terminating through abandonment; and

(ii) that represents a separate major line of business or geographical area of operations; and

(iii) that can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

Question 7

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner? (PYP 5 Marks July 21) (Same concept lesser adjustments RTP May'21)

Answer 7

As per AS 24, a discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders;

or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(a) Gradual or evolutionary phasing out of a product line or class of service;

(b) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(c) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e., commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposals were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

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Chapter 4.7
AS 25 Interim Financial Reporting

Question 1

Fresh Limited reported a Profit Before Tax (PBT) of Rs. 4 lakhs for the third quarter ending 30-09-2016. On enquiry you observe the following. Give the treatment required under AS 25:

(i) Dividend income of Rs. 4 lakhs received during the quarter has been recognized to the extent of Rs. 1 lakh only.

(ii) 80% of sales promotion expenses Rs. 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.

(iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of Rs.12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only Rs. 3 lakhs.

(iv) Rs. 2 lakhs extra-ordinary gain received in third quarter was allocated equally to thethird and fourth quarter.

(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of Rs. 3 lakhs. Out of this loss Rs. 1 lakh relates to previous quarters.

(vi) Sale of investment in the first quarter resulted in a gain of Rs. 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter. (MTP 5 Marks Oct 17)

Answer 1

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

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. The change in the method of depreciation or inventory valuation is a change in the accounting policy. Therefore, the prior interim periods' financial statements should be restated by applying the change in the method of valuation retrospectively.

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

Statement showing Adjusted Profit Before Tax for the third quarter

	(Rs. in lakhs)
Profit before tax (as reported)	4
Add: Dividend income Rs. (4-1) lakhs	3
Excess depreciation charged in the 3rd. quarter, due to changein the method, should be applied retrospectively Rs. (12-3) lakhs	9
Extra ordinary gain Rs. (2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively Rs. (3-2) lakhs	1
	18
Less: Sales promotion expenses (80% of Rs. 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	1

Question 2

On 30-6-2017, L Limited incurred Rs. 6,00,000 net losses from disposal of a business segment. Also, on 31-7-2017, the company paid Rs. 1,60,000 for property taxes assessed for the calendar year 2017. How should the above transactions be included in determination of net income of L Limited for the six months interim period ended on 30-9-2017? (MTP 4 Marks Aug 17)

Answer 2

Para 28 of AS 25 "Interim Financial Reporting" states that revenues and gains should be recognized in interim reports on the same basis as used in annual reports. As at September 30, 2017, L Ltd. would report the entire Rs. 6,00,000 losses on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since Rs. 1,60,000 property tax payment relates to the entire 2017 calendar year, only Rs. 80,000 of the payment would be reported as an expense at September 30, 2017, while out of the remaining Rs. 80,000, Rs. 40,000 for Jan. 2017 to March, 2017 would be shown as payment of the outstanding amount of previous year and another Rs. 40,000 related to quarter October, 2017 to December, 2017, would be reported as a prepaid expense.

Question 3

A Ltd. is dealing in seasonal products. The following is the quarterly sales pattern of the product:

Quarter 1	II	III	IV
Ending 31st March	30th June	30th September	31st December
20%	20%	50%	25%

For the first quarter ending 31st March, 2020, A Ltd. gives you the following information:

	Rs. in crore
Sales	100
Salary and other expenses	60
Advertisement expenses (routine)	4
Administrative and selling expenses	8

While preparing interim financial report for the first quarter, A Ltd. wants to defer Rs. 42 crore expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business. The expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the A Ltd. view. (RTP Nov 20)

Answer 3

(a) Calculation of the result of first quarter as per AS 25

Particulars	(Rs.in crore)
Result of first quarter ending 31st March, 2020	
Turnover	100
Other Income	Nil
Total (a)	100
Less: Changes in inventories	Nil
Salaries and other expenses	60
Administrative and selling expenses (4 + 8)	**12**
Total (b)	72
Profit (a)-(b)	28

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

deferred only when

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

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

The expenditure of Rs. 42 crores made in the first quarter shall be charge in that quarter only i.e., when they are earned and incurred. Therefore, the argument given by A Ltd. relating to deferment of Rs. 42 crore is not tenable as expenditures are uniform throughout all quarters.

Question 4

Adam Ltd. provides you the following information and asks you to calculate the tax expense for each quarter with reference to AS 25, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income 33,00,000 (inclusive of Estimated Capital Gains of Rs. 8,00,000) Estimated Income of Quarter I is Rs. 7,00,000, Quarter II is Rs. 8,00,000, Quarter III (including Estimated Capital Gains of Rs. 8,00,000) is Rs. 12,00,000 and Quarter IV is Rs. 6,00,000.

Tax Rates:	**On Capital Gains**	**12%**
	On Other Income: First Rs. 5,00,000	**30%**
	Balance Income·	**40%**

(RTP Nov 19)

Answer 4

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

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	Rs.
Estimated annual income exclusive of estimated capital gain (33,00,000 – 8,00,000) (A)	25,00,000
Tax expense on other income:	
30% on Rs. 5,00,000	1,50,000
40% on remaining Rs. 20,00,000	8,00,000
(B)	9,50,000
Weighted average annual income tax rate = $\frac{B}{A}$ (9,50,000/25,00,000) x 100 = 38%	

Tax expense to be recognized in each of the quarterly reports

		Rs.
Quarter I - Rs. 7,00,000 x 38%		2,66,000
Quarter II - Rs. 8,00,000 x 38%		3,04,000
Quarter III - Rs. (12,00,000 - 8,00,000) x 38%	1,52,000	
Rs. 8,00,000 x 12%	96,000	2,48,000
Quarter IV - Rs. 6,00,000 x 38%		2,28,000
		10,46,000

Question 5

Faithful Ltd. is dealing in seasonal product sales pattern of the product, quarter wise is as follows:

1st quarter 30th June — **10%**

2nd quarter 30th September — **10%**

3rd quarter 31st December — **60%**

4th quarter 31st March — **20%**

Information regarding the 1st quarter ending on 30th June, 2018 is as follows:

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

While preparing interim financial report for first quarter Faithful Ltd. wants to defer Rs. 10 crore expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view. (RTP May 19)

Answer 5

According to AS 25 the Income and Expense should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized as and when they occur. Thus, the company's view is not as per AS 25. Correct Statement of Profit or Loss for the quarter ending on 30 th June, 2018 would be

Particulars	**(Rs.in crore)**	
Result of first quarter ending 30th June, 2018		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

Question 6

To comply with listing requirements and other statutory obligations, Prateek Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of Rs. 350 lakhs under Income-tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No deferred tax asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of Rs. 350 lakhs and Rs. 150 lakhs respectively for the first two quarters of financial year 2017-2018 and anticipates net earnings of Rs. 400 lakhs in the coming half year ended March 2018 of which Rs. 50 lakhs will be the loss in the quarter ended December, 2017. The tax rate for the company is 30% with a 10% surcharge. You are required to calculate the amount of tax expense to be reported for each quarter of financial year 2017-2018. (RTP Nov 18)

Answer 6

Estimated tax liability on annual income = [Income Rs. 900 lakhs – b/f losses Rs. 315 lakhs (90% of 350)] x 33% = 33% of Rs. 585 lakhs = Rs. 193.05 lakhs

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

Thus, estimated weighted average annual income tax rate = Rs. 193.05 lakhs divided by Rs. 900 lakhs=21.45%

Tax expense to be recognized in each quarter	Rs. in lakhs
Quarter I – Rs. 350 lakhs x 21.45%	75.075
Quarter II – Rs. 150 lakhs x 21.45%	32.175
Quarter III – (Rs. 50 lakhs) x 21.45%	(10.725)
Quarter IV – Rs. 450 lakhs x 21.45%	96.525
	193.05

Question 7

Estimated annual income **₹ 1 lakh (inclusive of Estimated**

Capital Gains (earned in Quarter II) **₹20,000 The estimated income of**

each quarter is **₹25,000Tax Rates:**

On Capital Gains **10%**

On other income:

First ₹40,000 **30%**

Balance income **40%**

There is no difference between the estimated taxable income and the estimated accounting income. Calculate tax expense for each quarter and for the year. (RTP May 18)

Answer 7

Tax Expense:

On Capital Gains portion of annual income:

10% of ₹20,000 ₹ 2,000

On other income: 30% of ₹40,000 + 40% of ₹40,000 ₹28,000

Total: ₹30,000

Weighted Average Annual Effective Tax Rate:

On Capital Gains portion of annual Income: (2,000 / 20,000) X 100 = 10%

On other income: (28,000/ 80,000) X 100 = 35%

When income of ₹ 25,000 for 2nd Quarter includes capital gains of ₹ 20,000, the tax expense for each quarter will be calculated as below:

		Income	Tax Expense		
Quarter I		₹25,000	35% of ₹25,000 =		₹8,750
Quarter II	Capital Gains:	₹20,000	10% of ₹20,000 =	₹2,000	
	Other:	₹5,000	35% of ₹5,000 =	₹1,750	₹3,750

Quarter III		₹25,000	35% of ₹25,000 =		₹8,750
Quarter IV		₹25,000	35% of ₹25,000 =		₹8,750
Total tax expense for the year					₹30,000

Question 8

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

Calculate the tax expense to be recognized in each quarter. (RTP Nov 17)(New SM)

Answer 8

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

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

Weighted average annual income tax rate = B/A = 3,50,000/ 10,00,000= 35%

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

Chapter 5.1
AS 2- Valuation of Inventory

Question 1

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

You are required to calculate cost of material per KG;

Allocation of material cost. (RTP May 23) (SM)

Answer 1

Calculation of Normal cost per Kg.

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

Allocation of material cost

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

Note: Abnormal losses are recognized as separate expense.

Question 2

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

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories". (MTP 5 Marks, May '20, April '19, Oct '18, Old & New SM)(Same concept different figures PYP May'19 5 Marks)

Answer 2

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

Amount of Normal Loss and Abnormal Loss:

Material used 12,000 MT @ Rs. 150	= Rs. 18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520MT
Abnormal Loss in quantity	150 MT (630 MT less 480 MT)

Abnormal Loss	Rs. 23,437.50

[150 units @ Rs. 156.25 (Rs.18,00,000/11,520)] Amount of Rs. 23,437.50 will be charged to the Profit and Loss statement.

Question 3

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is Rs. 1,000. The entire quantity of waste and finished output is in stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case? What will be treatment for normal and abnormal waste? (MTP 5 Marks, March '21, Apr'22 & April '23, Old & New SM)

Answer 3

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

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

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

Question 4

(i) "In determining the cost of inventories, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred". Provide examples of such costs as per AS 2 'Valuation of Inventories'. (MTP 2.5 Marks April 21 & Oct '23, RTP May'22, Old & New SM)

(ii) X Limited purchased goods at the cost of Rs. 40 lakhs in October, 2020. Till March, 2021, 75% of the stocks were sold. The company wants to disclose closing stock at Rs. 10 lakhs. The expected sale value is Rs. 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct value of closing stock to be disclosed as at 31.3.2021. (MTP 2.5 Marks April 21 & Oct '23)

Answer 4

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

(a) abnormal amount of wasted materials, Labour, or other production costs;
(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
(d) selling and distribution costs.

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

= Rs. 9,90,000. So, the stock should be valued at Rs. 9,90,000.

Question 5

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

Details of Purchases:

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

25-03-2017	15	107

Details of issue of Inventory:

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

Net realizable value of inventory as on 31st March, 2017 is Rs. 107.75 per unit. You are required to compute the value of Inventory as per AS 2. (MTP March '19, 5 Marks, MTP March '18, 5 Marks, RTP May'22)

Answer 5

Net Realizable Value of Inventory as on 31st March, 2017 = Rs. 107.75 x 20 units = Rs. 2,155

Value of inventory as per Weighted Average basis. Total units purchased and total cost:

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

Weighted Average Cost = Rs. 8640/80 units = Rs.108

Total cost =Rs. 108 x 20 units = Rs. 2,160

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

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Question 6

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.

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

Additional Information:

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

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

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is Rs. 800 per unit. (MTP Aug. '18, 5 Marks, RTP Nov'18) (Same concept different figures RTP Nov'20)

Answer 6

When Net Realizable Value of the Chemical Y is Rs. 800 per unit NRV is greater than the cost of Finished Goods Y i.e. Rs. 660 (Refer W.N.)

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

Value of Closing Stock:

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

Working Note:

Statement showing cost calculation of Raw Material X and Chemical Y

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

Question 7

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

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

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

Calculate the value of closing stock, when

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

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit. (MTP Oct '21, 5 marks)

Answer 7

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

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

(ii) When Net Realizable Value of the Finished Good Q is ₹ 340 per unit Since NRV of finished goods Q is less than its cost i.e., ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

Value of Closing Stock:

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

Working Note:

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

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

Question 8

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? (MTP 5 Marks Sep '22, RTP Nov'19)

Answer 8

As per AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value. In this case, the cost of inventory is ₹ 5 lakhs. The net realizable value is ₹ 4.95 lakhs (₹ 5.5 lakhs less cost to make the sale @ 10% of ₹ 5.5 lakhs). So, the closing stock should be valued at ₹ 4.95 lakhs.

Question 9

U.S.A Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material? (MTP 5 Marks Oct '22)

Answer 9

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, USA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question 10

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. (MTP 5 Marks March '23) (RTP May 20)

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	

Answer 10

Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead $\frac{75000 \ X \ 10,200}{15,000}$	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realizable value is less than cost, closing inventory will be valued at ₹ 20.
As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

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

Question 11

On 31st March 2020, a business firm finds that cost of a partly finished unit on that date is ₹ 430. The unit can be finished in 2020-21 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 2% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2020 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further. (RTP Nov 21) (Same concept different figures RTP May 19)(Old & New SM)

Answer 11

Valuation of unfinished unit

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

Question 12

The inventory of Rich Ltd. as on 31st March, 2020 comprises of Product – A: 200 units and Product – B: 800 units.
Details of cost for these products are:
Product – A: Material cost, wages cost and overhead cost of each unit are Rs. 40, Rs. 30 and Rs. 20 respectively, each unit is sold at Rs. 110, selling expenses amounts to 10% of selling costs.
Product – B: Material cost and wages cost of each unit are Rs. 45 and Rs. 35 respectively and normal selling rate is Rs. 150 each, however due to defect in the manufacturing process 800 units of Product-B were expected to be sold at Rs. 70. You are requested to value closing inventory according to AS 2 after considering the above. (RTP May '21)

Answer 12

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

Product – A

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

Product – B

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

Question 13

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers. You are required to advise the company on the valuation of the inventories in line with the provisions of AS 2. (RTP May '18)

Answer 13

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. The standard states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods are often valued at net realizable value at certain stages of production." Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realizable value and not at net realizable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

Question 14

Rohan Pvt. Ltd., a wholesaler in agriculture products, has valued the inventory on Net Realizable Value on the ground that AS 2 does not apply to inventory of agriculture products. (RTP May '22)

Answer 14

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

Question 15

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

(a) **100 coats, which had cost ₹ 2,200 each and normally sold for ₹ 4,000 each. Owing to a defect in**

manufacture their NRV was determined at 50% of their normal selling price.

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

What should the inventory value be according to AS 2 after considering the above items? (RTP Nov'22)

Answer 15

Valuation of closing stock

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

Working Notes:

1. Adjustment for Coats Rs.

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

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

Question 16

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

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

The plant has a capacity to produce 30,000 Units of finished product per annum. However, the actual production of finished products during the year 2020-21 was 20,400 Units. Due to a fall in the market demand, the price of the finished goods in which the raw material has been utilized is expected to be sold @ ₹ 40 per unit. The replacement cost of the raw material was ₹ 19 per kilogram. You are required to ascertain the value of closing inventory as at 31st March, 2021 as per AS 2. (PYP July'21, 5 Marks)

Answer 16

Statement Showing the Computation of Value of Closing Inventory Value of Closing Finished Goods

Particulars	Amount (₹)
Cost of Raw Material consumed (20,400 units X ₹ 20 per kg)	4,08,000
Direct Labour	3,06,000
Fixed Overheads (3,00,000/30,000 x 20,400)	2,04,000
Cost of Production	9,18,000
Cost of Closing Inventory of Finished Goods per unit (₹ 9,18,000/20,400)	45
Net Realizable Value (NRV) per unit	40

Since net realizable value is less than cost, closing inventory of Finished Goods will be valued at ₹ 40 per unit Value of Closing Raw Materials as NRV of finished goods is less than its cost, the relevant raw material will be valued at its replacement cost, which is the best available measure of its NRV

i.e., @ ₹ 19 per kg. Therefore, value of closing inventory would be as under:

Finished Goods 2,400 units @ ₹ 40/- per unit	₹ 96,000
Raw Materials 1,800 kg @ ₹ 19/- per kg	₹ 34,200
Total	₹ 1,30,200

Working Note:

Calculation of raw material consumed during the year

Particulars	Unit (Kg)
Opening Inventory	2,200
Purchases	20,000
Less: Closing Inventory	(1,800)
Raw Material Consumed	20,400

Question 17

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

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

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

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

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

Determine how each item of inventory will be valued as on 31.03.2019. Also calculate the value of total Inventory as on 31.03.2019. (PYP 5 Marks Jan '21) (Sam concept different figures PYP 5 Marks Nov'19, MTP Oct'19 5 Marks, Old & New SM) (MTP 5 Marks Sep '23)

Answer 17

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

Hence the valuation will be done as under:

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

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

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

2021 Valuation of Total Inventory as on 31.03.2019:

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

Question 18

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price. (PYP 1 Mark, May'19)

Answer 18

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

Question 19

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

(i) Sales for the month of June 2021 was ₹30,40,000.

(ii) General overheads cost ₹4,00,000.

(iii) Inventory at beginning 10,000 liters @ ₹ 92 per liter.

(iv) Purchases-June 1, 2021, 20,000 liters @ ₹ 90 per liter, June 30, 2021, 10,000 liters @ ₹ 95 per liter.

(v) Closing inventory 13,000 liters.

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

(i) Value of Inventory on 30th June, 2021.

(ii) Amount of cost of goods sold for June,2021.

(iii) Profit/Loss for the month of June,2021. (PYP 5 Marks May '22)

Answer 19

	₹
Cost of closing inventory for 13,000 liters as on 30th June 2021	
10,000 liters @ ₹ 95	9,50,000
3,000 liters @ ₹ 90	2,70,000
Value of inventory (determined at cost in absence of NRV)	-
	12,20,000
Calculation of cost of goods sold	
Opening inventories (10,000 liters @ ₹ 92)	9,20,000
Purchases June – 1 (20,000 liters @ ₹ 90)	18,00,000
June – 30 (10,000 liters @ 95)	9,50,000
	36,70,000
Less: Closing inventories	(12,20,000)
Cost of Goods Sold	24,50,000
Calculation of Profit	30,40,000
Sales (Given) (A)	24,50,000
Cost of Goods Sold	4,00,000
Add: General Overheads	28,50,000
Total Cost (B)	1,90,000
Profit (A-B)	

Question 20

Following information of Sarah Limited is given:

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

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

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

You are required to calculate the value of Closing Stock of Raw materials and Closing Stock of Finished Goods, as on 31st March, 2022, as per AS 2, when selling price of Finished Goods 'B' is ₹ 360 per unit. (PYP 5 Marks Nov '22)

Answer 20

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

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

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

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

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

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

Question 21

Alpha Ltd. sells flavoured milk to customers; some of the customers consume the milk in the shop run by Alpha Limited. While leaving the shop, the consumers leave the empty bottles in the shop and the company takes possession of these empty bottles. The company has laid down a detailed internal

record procedure for accounting for these empty bottles which are sold by the company by calling for tenders.

Keeping this in view:

Decide whether the inventory of empty bottles is an asset of the company;

If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'? (RTP Nov '23)

Answer 21

As per the 'Framework on Presentation and Preparation of Financial Statements':

Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets.

Alpha Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

As per AS 2, inventories are assets held for sale in the ordinary course of business.

Inventory of empty bottles existing on the Balance Sheet date is the inventory and Alpha Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality.

Thus, inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

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Chapter 5.2
AS 10-Property, Plant & Equipment

Question 1

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period, the company will move its production facilities to another (temporary) site.
The following incremental costs will be incurred:
Setup costs of Rs. 5,00,000 to install machinery in the new location.
Rent of Rs. 15,00,000
Removal costs of Rs. 3,00,000 to transport the machinery from the old location to the temporary location.
Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment". (MTP 5 Marks May 20, April 21, March 18, Oct '18 & Apr'22 & Oct '22) (Old & New SM)

Answer 1

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 2

(i) Entity A carried plant and machinery in its books at ₹ 2,00,000 which were destroyed in a fire. These machines were insured 'New for old' and were replaced by the insurance company with new machines of fair value ₹ 20,00,000. The old destroyed machines were acquired by the insurance company and the company did not receive any cash compensation. State, how Entity A should account for the same? (MTP 2.5 Marks Oct 20, Mar 22)

(ii) Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.
Decide whether Omega Ltd. can capitalize the remodeling cost or not as per provisions of AS 10 "Property plant & Equipment". (MTP 2.5 Marks Oct 20, Oct'19, Mar 22)

Answer 2

(i) Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10 on Property, Plant and Equipment. Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets provided by the insurer.

(ii) The expenditure in remodeling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodeling can be measured reliably, therefore, it should be capitalized in line with AS 10.

Question 3

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to Rs. 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'. Show the treatment of machine in the books of ABC Ltd. (MTP 5 Marks Oct 20, Oct 18, Mar 22, Aug 18, Oct'19)

Answer 3

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

Question 4

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period – Salaries of the staff engaged in preparation of restaurant before its opening Rs. 7,50,000 Construction and remodelling cost of restaurant Rs. 30,00,000.

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment". (MTP 5 Marks March '21, Sep '22 & Oct '23) (PYP Nov'18, 5 Marks)

Answer 4

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodeling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodeling expenditure amounting Rs. 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant Rs. 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, Rs. 7,50,000 should be expensed.

Question 5

In the year 2018-19, an entity has acquired a new freehold building with a useful life of 50 years for Rs. 75,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	Rs. 10,00,000
Roof	25	Rs. 15,00,000
Lifts	20	Rs. 7,50,000
Fixtures	10	Rs. 2,50,000
Remainder of building	50	Rs. 40,00,000
		Rs. 75,00,000

Calculate depreciation for the year 2018-19 as per componentization method. Also state the treatment, in case Roof requires replacement at the end of its useful life. (MTP Oct. '19, 2.5 Marks) (Same concept different figures RTP May'18)

Answer 5

Statement showing amount of depreciation as per Componentization Method

Component	**Depreciation (Per annum) (Rs.)**
Land	Nil
Roof	60,000
Lifts	37,500
Fixtures	25,000
Remainder of Building	80,000
	2,02,500

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognized as a new component.

Question 6

Mohan Ltd. purchased an asset on 1st January 2013 for Rs. 5,00,000 and the asset had an estimated useful life of 5 years and a residual value of nil. On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. You are required to compute the amount of depreciation for each year, if company charges depreciation on Straight Line basis. [MTP April '19, 5 Marks]

Answer 6

The entity has charged depreciation using the straight-line method at Rs. 1,00,000 per annum i.e. (5,00,000/5 years). On 1st January 2017, the asset's net book value is [5,00,000 - (1,00,000 x4)] Rs. 1,00,000. The remaining useful Life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at Rs. 25,000 per annum i.e. (1,00,000/4 years).

Question 7

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

Cost of the plant (cost per supplier's invoice plus taxes)	**Rs. 25,00,000**
Initial delivery and handling costs	**Rs. 2,00,000**
Cost of site preparation	**Rs. 6,00,000**
Consultants used for advice on the acquisition of the plant	**Rs. 7,00,000**
Interest charges paid to supplier of plant for deferred credit	**Rs. 2,00,000**
Estimated dismantling costs to be incurred after 7 years	**Rs. 3,00,000**
Operating losses before commercial production	**Rs. 4,00,000**

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised). (MTP Aug. '18, 5 Marks) (Same concept lesser adjustments MTP 5 Marks Nov'21, MTP 5 Marks Mar'23, Old & New SM, RTP May'19, Nov'18 & Nov '23)

Answer 7

According to AS 10 (Revised), the following costs can be capitalized:

Cost of the plant	Rs. 25,00,000
Initial delivery and handling costs	Rs. 2,00,000
Cost of site preparation	Rs. 6,00,000
Consultants' fees	Rs. 7,00,000
Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
	Rs. 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of Rs.2,00,000 and operating losses before commercial production amounting to Rs.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.

Question 8

A property costing ₹ 10,00,000 is bought on 1.4.2020. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 25 years. The estimated residual value in 25 years' time, based on current year prices, is:

Case (a) ₹ 10,00,000
Case (b) ₹ 9,00,000
You are required to compute the amount of depreciation charged for the year ended 31.3.2021. (RTP Nov 21, Old & New SM)

Answer 8

Case (a)
The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. There is, therefore, no depreciable amount and depreciation is zero.

Case (b)
The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹ 9,00,000 and the depreciable amount is, therefore, ₹ 1,00,000.

Annual depreciation (on a straight-line basis) will be ₹ 4,000 [{10,00,000 – 9,00,000} ÷ 25].

Question 9

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 (Rs. 18 lakhs), salaries of staff (Rs. 2 lakhs) who will be preparing the store before its opening and related utilities costs (Rs. 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?**

(b) **ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)? (RTP May '21)**

Answer 9

(a) 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 Rs. 18 lakhs should be considered as part of the cost of the asset. However, the cost of salaries of the staff Rs. 2 lakh and utilities cost Rs. 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by the management and should be expensed.

(b) AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item

of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

Question 10

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 at ₹ 45,000 per month.

The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized under AS 10. (RTP Nov 20)

Answer 10

Calculation of Cost of Machinery

Particulars			₹
Purchase Price		Given	1,58,00,000
Add:	Site Preparation Cost	Given	1,40,000
	Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x3)	1,35,000
	Initial Delivery Cost	Transportation	50,000
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset			**1,61,55,000**

Question 11

(a) **Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?**

(b) **Entity A purchased an asset on 1st January 2016 for Rs.1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.**

(c) **The following items are given to you:**

ITEMS

a. 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);

b. Costs of conducting business in a new location or with a new class of customer (including costs of staff training);

c. 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

d. Costs of opening a new facility or business, such as, inauguration costs;

e. Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "Property, Plant and Equipment", classify the above items under the following heads:

HEADS

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE. (RTP May 20)

Answer 11

(a) The depreciable amount of a tangible Property Plant & Equipment should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

(b) The entity has charged depreciation using the straight-line method at Rs.10,000 per annum i.e (1,00,000/10 years). On 1st January 2020, the asset's net book value is [1,00,000 – (10,000 x 4)] = Rs.60,000. The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at Rs.15,000 per annum i.e. (60,000 / 4 years). Depreciation is recognized even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

(c)

(1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE".

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carrying amount of an item of PPE.

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE

(4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.

(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

Question 12

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations

were Rs.1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs.45,000 per month. The technician's services were given by Department B to Department A, which billed the services at Rs.49,500 per month after adding 10% profit margin.

The machine was purchased at Rs.1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. Rs.55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of Rs. 30,000 to supervise machinery installation at the factory site.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine. (RTP Nov 19)

Answer 12

Calculation of Cost of Property Plant & Equipment (i.e. Machinery)

Particulars			**₹**
Purchase Price		Given (Rs.158,34,000 x 100/112)	1,41,37,500
Add:	Site Preparation Cost	Given	1,41,870
	Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x3)	1,35,000
	Initial Delivery Cost	Transportation	55,770
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset			1,45,00,140

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Question 13

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. **Import duties paid**
2. **Shipping costs and cost of road transport for taking the machinery to factory**
3. **Insurance for the shipping**
4. **Inauguration costs for the factory**
5. **Professional fees charged by consulting engineer for the installation process**
6. **Costs of advertising and promotional activities**
7. **Administration and other general overhead costs**
8. **Cost of site preparation. (RTP May '22)**

Answer 13

Included in Cost: Point no. 1,2,3,5,8

Excluded from Cost: Point no. 4,6,7

Question 14

RS Ltd. has acquired a heavy plant at a cost of ₹ 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e., the Boiler has become obsolete (which was acquired at price of ₹ 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000. Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year? (RTP Nov'22)

Answer 14

Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The cost old boiler should be de-recognized and the new boiler will be added.

Statement showing cost of new boiler and machine after year 2

Original cost of plant	₹ 2,00,00,000
Less: Accumulated depreciation [(2,00,00,000 /10) x 2]	₹ 40,00,000
Carrying value of the plant after two years	₹ 1,60,00,000
Less: Current Cost of Old Boiler to be derecognized	
Less: WDV of Boiler (replaced) after 2 years (50,00,000/10 x 8)	₹ 40,00,000
	₹ 1,20,00,000
Add: Cost of new Boiler to be recognized	₹ 60,00,000
Revised carrying amount of Plant	₹ 1,80,00,000

Question 15

Star Limited purchased machinery for ₹ 6,80,000 (inclusive of GST of ₹ 40,000). Input credit is available for entire amount of GST paid. The company incurred the following other expense for installation.

	₹
Cost of preparation of site for installation	**21,200**
Total Labour charges	**56,000**

(200 out of the total of 500 men hours worked, were spent on installation of the machinery)

Spare parts and tools consumed in installation	**5,000**
Total salary of supervisor	**26,000**
(Time spent for installation was 25% of the total time worked) **Total technical expense**	**34,000**
(1/10 relates to the plant installation) **Test run and experimental production expenses**	**18,000**
Consultancy charges to architect for plant set up	**11,000**
Depreciation on assets used for installation	**12,000**

The machine was ready for use on 15.01.2021 but was used from 01.02.2021. Due to this delay further expenses of ₹ 8,900 were incurred. Calculate the value at which the plant should be capitalized in the books of Star Limited. (RTP May 23)

Answer 15

Calculation of Cost of Plant

Particulars		**₹**
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour charges	(56,000×200/500) Given	22,400
Spare parts		5,000
Supervisor's Salary	25% of ₹ 26,000	6,500
Technical costs	1/10 of ₹ 34,000	3,400
Test run and experimental production charges	Given	18,000
Architect Fees for set up	Given	11,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		7,79,500

Less: GST credit receivable		(40,000)
Value to be capitalized		7,39,500

Note: Further Expenses of ₹ 8,900 from 15.1.2021 to 1.2.2021 to be charged to profit and loss A/c as plant was ready for production on 15.1.2021.

Question 16

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only. (PYP 5 Marks Nov 20) (MTP 5 Marks Sep '23)

Answer 16

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April,2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (50,000/5 years). On 1st April,2019 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

Question 17

I. A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹ 35,000 per month. The machinery was purchased for ₹ 1,27,50,000 and a sum of ₹ 2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fee of ₹ 37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited. (PYP 2.5 Marks Jul'21)

II. B Limited, which operates a major chain of retail stores, has acquired a new store location. The new

location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited? (PYP 2.5 Marks, July,21, Old & New SM)

Answer 17

I. Statement Showing the Computation of the amount at which the Machinery should be capitalized in the books of A Limited

Particulars		Amount (₹)
Purchase cost of machinery	Given	1,27,50,000
Add: Site Preparation Cost	Given	2,10,000
Architect's Salary	Specific / Attributable overheads for 4 months (₹ 35,000 x 4)	1,40,000
Initial Delivery Cost	Transportation	2,12,500
Professional Fees for Installation	Engineer's Fees	37,500
Total Cost of Machinery to be capitalized		1,33,50,000

II. Management should capitalize the costs of construction and remodeling the store, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The store cannot be opened without incurring the remodeling expenditure, and thus the expenditure should be considered part of the asset. However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the store was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

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Question 18

XYZ Limited provided you the following information for the year ended 31 st March, 2022.

(i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance in the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

You are required to calculate the revaluation loss as per AS 10 (Revised) and give its treatment in the books of accounts.

(ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.

You are required to explain how the disposal should be accounted for in the financial statements as per AS 10 (Revised). (PYP 5 Marks May '22)

Answer 18

(i) As per AS 10, a decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Calculation of revaluation loss and its accounting treatment

		₹
Carrying value of the asset as on 31st March, 2022	a	2,16,000
Revalued amount of the asset	b	(1,90,000)
Total revaluation loss on asset	c=a-b	26,000

Adjustment of previous revaluation reserve	d	(20,000)
Net revaluation loss to be charged to the Profit and loss account	e=c-d	6,000

(ii) AS 10 states that the carrying amount of an item of property, plant and equipment is derecognized on disposal of the asset. It further states that the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognized. Gains should also not be classified as revenue.

Calculation of loss on disposal of the asset and its accounting treatment

		₹
Original cost of the asset	a	76,000
Accumulated depreciation till date	b	62,000
Carrying value of the asset as on 31st March, 2022	c=a-b	14,000
Cash received on disposal of the asset	d	4,000
Loss on disposal of asset charged to the Profit and loss account	e=c-d	10,000

Question 19

In the books of Top maker Limited, carrying amount of Plant and Machinery as on 1stApril, 2022 is ₹ 56,30,000.

On scrutiny, it was found that a purchase of Machinery worth ₹ 21,12,000 was included in the purchase of goods on 1stJune, 2022. On 30thJune, 2022 the company disposed a Machine having book value of ₹ 9,60,000 (as on 1stApril, 2022) for ₹ 8,25,000 in part exchange of a new machine costing ₹ 15,65,000. The company charges depreciation @ 10% p.a. on written down value method on Plant and Machinery.

You are required to compute:

(i) Depreciation to be charged to Profit & Loss Account;

(ii) Book value of Plant & Machinery as on 31stMarch, 2023; and

(iii) Profit/Loss on exchange of Plant & Machinery. (PYP 5 Marks May '23)

Answer 19

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

Particulars	**Amount in ₹**
Depreciation on old Machinery	1,40,750
[10% on ₹ 56,30,000 for 3 months (01.04.2022 to 30.06.2022)] Add: Depreciation on Machinery acquired on 01.06.2022	1,76,000
(₹21,12,000 X 10% X10/12) Add: Depreciation on Machinery after adjustment of Exchange [10% of ₹ 56,30,000 – 9,60,000 + 15,65,000) for 9 months]	4,67,625
Total Depreciation to be charged in Profit & Loss A/c	**7,84,375**

ii) Book value of Plant & Machinery as on 31.3.2023

Particulars		**Amount in ₹**
Balance as per books on 01.04.2022		56,30,000
Add: Included in purchases on 01.06.2022	21,12,000	

Add: Purchases on 30.06.2022	15,65,000	36,77,000 93,07,000
Less: Book value of Machine sold on 30.06.2022		(9,60,000) 83,47,000
Less: Depreciation on Machinery in use ₹ (7,84,375 -24,000)		(7,60,375)
Book Value as on 31.03.2023		75,86,625

Note: The computation of depreciation and book value of Plant & Machinery can be presented in the following alternative manner:

Particulars	**Book Value or Cost or Acquisition**	**Period**	**Depreciation**	**Book Value as on 31.03.2023**
Opening Value	46,70,000 (56,30,000 – 9,60,000)	01.04.2022 to 31.03.2023	4,67,000 (46,70,000 x 10%)	42,03,000
Sold	9,60,000	01.04.2022 to 30.06.2022	24,000 (9,60,000 x 10% x 3/12)	-
Purchases	21,12,000	01.06.2022 to 31.03.2023	1,76,000 (21,12,000 x 10% x 10/12)	19,36,000
New Machinery	15,65,000	01.07.2022 to 31.03.2023	1,17,375	14,47,625
			(15,65,000 x 10% x 9/12)	
Total			7,84,375	75,86,625

iii) Profit/Loss on Exchange of Machinery

Particulars	**Amount in**
Balance as per books on 01.04.2022	9,60,000
Less: Depreciation for 3 months (₹ 9,60,000 x 10 /100 x 3 / 12)	(24,000)
W.D.V. as on 30.06.2022	9,36,000
Less: Exchange value	(8,25,000)
Loss on Exchange of Machinery	1,11,000

Chapter 5.3
AS 13-Accounting for Investments

Question 1

The Investment portfolio of XYZ Ltd. as on 31.03.2020 consisted of the following:

			(Rs. in lacs)	
	Current Investments		Cost	Fair Value as on 31.03.2020
(1)	1000 Equity Shares of A Ltd.		5	7
(2)	500 Equity Shares of B Ltd.		10	15
(3)	1000 Equity Shares of C Ltd.		15	12
		Total	30	34

Give your comments on the following:

(i) **The company wants to value the above portfolio at Rs. 30 lakhs being lower of cost or fair market value.**

(i) **Company wants to transfer 1000 Equity Shares of C Ltd. from current investments to long term investments on 31.03.2020 at cost of Rs. 15 lakhs. (MTP 5 Marks May 20)**

Answer 1

As per AS 13 "Accounting for Investments", Valuation of current investments on overall (or global) basis is not considered appropriate. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly the investments may be carried at the lower of cost and fair value computed category-wise (i.e. equity shares, preference shares, convertible debentures, etc.). However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

(i) Hence the company has to value the current investment at Rs. 27 Lacs (A Ltd. shares at Rs. 5 lacs; B Ltd. shares at Rs. 10 lacs and C Ltd. shares at Rs. 12 lacs). The company's decision to value the portfolio at Rs. 30 lacs are not appropriate.

(ii) Moreover, where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.
Hence, the company has to make transfer of 1,000 equity shares of C Ltd. at Rs. 12 lacs (fair value) and not Rs. 15 lacs (cost) as the fair value is less than cost.

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Question 2

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? What methodology should be adopted for ascertaining the provision for diminution in the value of investment, if any. Explain in brief.(MTP 4 Marks Oct 20, Mar 22)

Answer 2

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made. The reduction in market value should not be considered, in isolation to determine the decline, other than temporary.

The amount of the provision for diminution in the value of investment may be ascertained considering the factors indicated in AS 13.

Question 3

How you will deal with following in the financial statements of the Parish Electronics Ltd. as on 31.3.18 with reference to AS-13?

Also Parish Electronics Ltd. has current investment (X Ltd.'s shares) purchased for Rs. 5 lakhs, which the company want to reclassify as long term investment. The market value of these investments as on date of Balance Sheet was Rs. 2.5 lakhs.

[MTP Aug. '18, 5 Marks, RTP May 19, MTP 5 Marks Oct '22)

Answer 3

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

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

Question 4

Z Bank has classified its total investment on 31-3-2021 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines. 'Held to maturity' investments are carried at acquisition cost less amortized amount. 'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13? (MTP 5 Marks Nov '21, RTP Nov 21, Nov 19)

Answer 4

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

Question 5

A fund purchased 10,000 debentures of a company on June 1, 2018 for Rs. 10.7 lakh and further 5,000 debentures on Nov 1, 2018 for Rs. 5.45 lakh. The debentures carry fixed annual coupon of 12%, payable on every 31 March and 30 September. On Feb 28, 2019 the fund sold 6,000 of these debentures for Rs. 6.78 lakh. Nominal value per debenture is Rs. 100. Show Investment in Debentures A/c in books of the fund. (MTP 5 Marks, Oct'19)

Answer 5

Investment in Debentures A/c

		Rs. Lakh			Rs. Lakh
June 1, 2018	To Bank	10.70	June 1, 2018	By Interest Recoverable (Note 1)	0.20
Nov 1, 2018	To Bank	5.45	Nov 1, 2018	By Interest Recoverable (Note 2)	0.05
Feb 28, 2019	To Interest Recoverable (Note 3)	0.30	Feb 28, 2019	By Bank	6.78
Feb 28, 2019	To Profit on disposal (Note 4)	0.12	Mar 31, 2019	By Balance c/d	9.54
		16.57			16.57

Working Notes:

1. 10,000 x 100 x 12/100 x 2/12 = Rs. 0.20 Lakhs
2. 5,000 x 100 x 12/100 x 1/12 = Rs. 0.05 Lakhs
3. 6,000 x 100 x 12/100 x 5/12 = Rs. 0.30 Lakhs
4. Cost of investments (per unit) = [(10,70,000 -20,000)+(5,45,000– 5,000)]/15,000 units
   = [10,50,000+ 5,40,000]/15,000 = Rs. 106

   Cost of investments sold = Rs. 106 x 6,000 = Rs. 6,36,000
   Sale proceeds = Rs. 6,78,000 - Rs. 30,000(interest) = Rs. 6,48,000
   Profit = Rs. 6,48,000 - Rs. 6,36,000 = Rs. 12,000

Question 6

Akash Ltd. had 4,000 equity share of X Limited, at a book value of Rs. 15 per share (face value of Rs. 10 each) on 1st April 2018. On 1st September 2018, Akash Ltd. acquired 1,000 equity shares of X Limited at a premium of Rs. 4 per share. X Limited announced a bonus and right issue for existing share holders.

The terms of bonus and right issue were -

(1) Bonus was declared, at the rate of two equity shares for every five equity shares held on 30th September, 2018.

(2) Right shares are to be issued to the existing shareholders on 1st December, 2018. The company issued two right shares for every seven shares held at 25% premium. No dividend, was payable on these shares. The whole sum being payable by 31st December, 2018.

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

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

(5) Dividend for the year ended 31st March 2018, at the rate of 20% was declared by the company and received by Akash Ltd., on 20th January 2019.

(6) On 1st February 2019, Akash Ltd., sold half of its share holdings at a premium of Rs. 4 per share.

(7) The market price of share on 31.03.2019 was Rs. 13 per share.

You are required to prepare the Investment Account of Akash Ltd. for the year ended 31st March, 2019 and determine the value of shares held on that date assuming the investment as current investment. (MTP Oct. '19, 10 Marks, RTP Nov 18)

Answer 6

Investment Account-Equity Shares in X Ltd.

Date		No. of shares	Dividend	Amount	Date		No. of shares	Dividend	Amount
			Rs.	Rs.				Rs.	Rs.
2018					2019				
April 1	To Balance b/d	4,000	-	60,000	Jan. 20	By Bank (dividend)		8,000	2,000
Sept 1	To Bank	1,000	-	14,000	Feb. 1	By Bank	4,000		56,000
Sept.30	To Bonus Issue	2,000		-	Mar. 31	By Balance c/d	4,000		42,250
Dec.1	To Bank (Right)	1,000	-	12,500					
2019									
Feb. 1	To Profit & Loss A/c			13,750					
Feb. 1	To Profit & Loss A/c (Dividend income)		8,000						
		8,000	8,000	1,00,250			8,000	8,000	1,00,250
April. 1	To Balance b/d	4,000		42,250					

Working Notes:

	Rs.
(Rs. 60,000 + Rs. 14,000 + Rs. 12,500)	86,500
Less: Dividend on shares purchased on 1st Sept, 2018	(2,000)
Cost of 8,000 shares	84,500
Cost of 4,000 shares (Average cost basis*)	42,250

Sale proceeds (4,000 shares @ 14/-)	56,000
Profit on sale	13,750

1. **Cost of shares sold. Amount paid for 8,000 shares**
   * For ascertainment of cost for equity shares sold, average cost basis has been applied.
2. **Value of investment at the end of the year**
   Closing balance will be valued based on lower of cost (Rs. 42,250) or net realizable value (Rs.13 x 4,000).Thus investment will be valued at Rs. 42,250.
3. **Calculation of sale of right entitlement**
   1,000 shares x Rs. 8 per share = Rs. 8,000
   Amount received from sale of rights will be credited to P & L A/c as per AS 13
4. **Dividend received on investment held as on 1st April, 2018**
   = 4,000 shares x Rs. 10 x 20%
   = Rs. 8,000 will be transferred to Profit and Loss A/c
   Dividend received on shares purchased on 1st Sep. 2018
   = 1,000 shares x Rs. 10 x 20% = Rs. 2,000 will be adjusted to Investment A/c
   Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30th Sept., 2018 and dividend pertains to the year ended 31.3.2018.

Question 7

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

On 1st December, 2016, M/s. Kumar purchased 10,000 of these debentures at Rs.101 cum-interest price, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 2017 the firm sold all of these debentures at Rs.106 cum-interest price, again paying brokerage @ 1 % of cum-interest amount. Prepare Investment Account in the books of M/s. Kumar for the period 1st December, 2016 to 1st March, 2017[MTP March '19, 6 Marks, Old & New SM)

Answer 7

In the books of M/s Kumar Investment Account for the period from 1st December 2016 to 1st March, 2017

(Scrip: 12% Debentures of Royal Ltd.)

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

Working Notes:

(I) Cost of 12% debentures purchased on 1.12.2016		**Rs.**
Cost Value (10,000 xRs.101)	=	10,10,000
Add: Brokerage (1% of Rs.10,10,000)	=	10,100
Less; Cum Interest (10,000 x 100 x12% x 2/12)	=	(20,000)
Total	=	10,00,100
(ii) Sale proceeds of 12% debentures sold on 1st March, 2017		Rs.
Sales Price (10,000 xRs.106)	=	10,60,000
Less; Brokerage (1% of Rs.10,60,000)	=	(10,600)
Less; Cum Interest (10,000 x 100 x12% x 5/12)	=	(50,000)
Total	=	9,99,400

Question 8

Smart Investments made the following investments in the year 2017-18:

12% State Government Bonds having face value Rs. 100

Date	Particulars
01.04.2017	Opening Balance (1200 bonds) book value of Rs. 1,26,000
02.05.2017	Purchased 2,000 bonds @ Rs. 100 cum interest
30.09.2017	Sold 1,500 bonds at Rs. 105 ex interest

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

Equity Shares of X Ltd.

15.04.2017	Purchased 5,000 equity shares @ Rs. 200 on cum right basis Brokerage of 1% was paid in addition (Face Value of shares Rs. 10)
16.08.2017	03.06.2017 The company announced a bonus issue of 2 shares for every 5shares held. The company made a rights issue of 1 share for every 7 shares held
22.8.2017	at Rs. 250 per share. The entire money was payable by 31.08.2017. Rights to the extent of 20% was sold @ Rs. 60. The remaining rights
02.09.2017	were subscribed. Dividend @ 15% for the year ended 31.03.2017 was received on 16.09.2017
15.12.2017	Sold 3,000 shares @ Rs. 300. Brokerage of 1% was incurred extra.
15.01.2018	Received interim dividend @ 10% for the year 2017-18
31.03.2018	The shares were quoted in the stock exchange @ Rs. 220

Prepare Investment Accounts in the books of Smart Investments. Assume that the average cost methodis followed. (MTP Aug. '18, 12 Marks, Old & New SM)

Answer 8

In the books of Smart Investments
12% Govt. Bonds for the year ended 31st March, 2018

Date	Particulars	Nos.	Income	Amount	Date	Particulars	Nos.	Income	Amount
1.4.17	To Opening balance b/d	1,200	3,600	1,26,000	30.6.17	By Bank A/c (Interest) (3,200 x 100 x 12% x 6/12)	-	19,200	-
2.5.17	To Bank A/c	2,000	8,000	1,92,000	30.9.17	By Bank A/c	1,500	4,500	1,57,500
31.3.18	To P & L A/c (Interest)		27,400		31.12.17	By Bank A/c (Interest) (1,700 x 100 x 12% x 6/12)	-	10,200	-
	To P & L A/c (Profit on Sale)			8,437.50	31.3.18	By Bal. c/d	1,700	5,100	1,68,937.50
		3,200	39,000	3,26,437.50			3,200	39,000	3,26,437.50

Investments in Equity shares of X Ltd. for year ended 31.3.2018

Date	Particulars	Nos.	Income	Amount	Date	Particulars	Nos.	Income	Amount
15.4.17	To Bank A/c	5,000		10,10,000					
3.6.17	To Bonus Issue	2,000	-	-	16.9.17	By Bank (Dividend)	-	-	7,500
31.8.17	To Bank A/c	800		2,00,000	15.12.17	By Bank (Sale)	3,000	-	8,91,000

31.3.18	To P & L A/c		4,800	4,28,500	15.1.18	By Bank (interim dividend)		4,800	
					31.3.18	By Bal. c/d	4,800		7,40,000
		7,800	4,800	16,38,500			7,800	4,800	16,38,500

Working Notes:

1. Profit on sale of bonds on 30.9.17

= Sales proceeds – Average cost

Sales proceeds = Rs. 1,57,500

Average cost = Rs. [(1,26,000+1,92,000) x 1,500/3,200] = 1,49,062.50

Profit = 1,57,500– Rs. 1,49,062.50=Rs. 8,437.50

2. Valuation of bonds on 31st March, 2018

Cost = Rs. 3,18,000/3,200 x1,700 = 1,68,937.50

3. Cost of equity shares purchased on 15/4/2017

= Cost + Brokerage

= (5,000 x Rs. 200) + 1% of (5,000 x Rs. 200) = Rs. 10,10,000

4. Sale proceeds of equity shares on 1 5/12/2017

= Sale price – Brokerage

= (3,000 x Rs. 300) – 1% of (3,000 x Rs. 300) = Rs. 8,91,000.

5. Profit on sale of shares on 15/12/2017

= Sales proceeds – Average cost

Sales proceeds = Rs. 8,91,000

Average cost = Rs. [(10,10,000+2,00,000 -7,500) x 3,000/7,800]

= Rs. [12,02,500 x 3,000/7,800] = 4,62,500

Profit = Rs. 8,91,000 – Rs. 4,62,500=Rs. 4,28,500.

6. Valuation of equity shares on 31st March, 2018

Cost =Rs. [12,02,500 x 4,800/7,800] = Rs. 7,40,000

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

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

Note: If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement as per para 13 of AS 13 "Accounting for Investments".

Question 9

Mr. Vijay entered into the following transactions of purchase and sale of equity shares of JP Power Ltd. The shares have paid up value of ₹ 10 per share.

Date	No. of Shares	Terms
01.01.2019	600	Buy @ ₹ 20 per share
15.03.2019	900	Buy @ ₹ 25 per share
20.05.2019	1000	Buy @ ₹ 23 per share
25.07.2019	2500	Bonus Shares received
20.12.2019	1500	Sale @ ₹ 22 per share
01.02.2020	1000	Sale @ ₹ 24 per share

Addition information:

(1) On 15.09.2019 dividend @ ₹ 3 per share was received for the year ended 31.03.2019.

(2) On 12.11.2019 company made a right issue of equity shares in the ratio of one share for five shares held on payment of ₹ 20 per share. He subscribed to 60% of the shares and renounced the remaining shares on receipt of ₹ 3 per share.

(3) Shares are to be valued on weighted average cost basis.

You are required to prepare Investment Account for the year ended 31.03.2019 and 31.03.2020. (MTP 8 Marks Mar'22, Oct 20, PYP May '18 10 Marks)

Answer 9

(a) (i) Investment in Equity shares of JP Power Ltd.

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend ₹	Amount ₹
1.1.19	To Bank A/c	600		12,000	31.3.19	By Balance c/d	1,500		34,500
15.3.19	To Bank A/c	900		22,500				4,500	
		1,500		34,500			1,500		34,500
1.4.19	To Balance b/d	1,500		34,500	15.9.19	By Bank dividend			3,000
20.5.19	To Bank A/c	1,000		23,000	20.12.19	By Bank	1,500		33,000
25.7.19	To Bonus shares	2,500		_	1.2.20	By Bank	1,000		24,000
12.11.19	To Bank A/c	600	4,500	12,000	31.3.20	By Balance c/d	3,100		36,812.50
20.12.19	To P& L A/c (profit on sale)			15,187.50					
1.2.20	To P& L A/c (profit on sale)			12,125					
31.3.20	To P & L A/c (dividend)								
		5,600	4,500	96,812.50			5,600	4,500	96,812.50

Working Notes:

1. **Calculation of Weighted average cost of equity shares**
   600 shares purchased at ₹ 12,000
   900 shares purchased at ₹ 22,500
   1,000 shares purchased at ₹ 23,000
   2,500 shares at nil cost
   600 right shares purchased at ₹ 12,000
   Total cost of 5,600 shares is ₹ 66,500 [₹ 69,500 less ₹ 3,000 (pre-acquisition dividend received on 1,000 shares purchased on 20.5.19].
   Hence, weighted average cost per share will be considered as ₹ 11.875 per share (66,500/5,600).
2. It has been considered that no dividend was received on bonus shares as the dividend pertains to the year ended 31set March, 2019.
3. **Calculation of right shares subscribed by Vijay Right Shares (considering that right shares have been granted on Bonus shares also) = 5,000/5 x 1= 1,000 shares**
   Shares subscribed = 1,000 x 60%= 600 shares
   Value of right shares subscribed = 600 shares @ ₹ 20 per share = ₹ 12,000 Calculation of sale of right renouncement
   No. of right shares sold = 1,000 x 40% = 400 shares
   Sale value of right = 400 shares x ₹ 3 per share = ₹ 1,200
   Note: As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.
4. **Profit on sale of equity shares**
   As on 20.12.19
   Sales price (1,500 shares at ₹ 22) 33,000.00
   Less: Cost of shares sold (1,500 x ₹ 11.875) (17,812.50)
   Profit on sale 15,187.50
   As on 1. 2.20
   Sales price (1,000 shares at ₹ 24) 24,000
   Less: Cost of shares sold (1,000 x ₹ 11.875) (11,875)
   Profit on sale 12,125
   Balance of 3,100 shares as on 31.3.20 will be valued at ₹ 36,812.50 (at rate of ₹ 11.875 per share)

Question 10

A Ltd. purchased on 1st April, 2022 8% convertible debenture in C Ltd. of face value of ₹ 2,00,000 @ ₹ 108. On 1st July, 2022 A Ltd. purchased another ₹ 1,00,000 debentures @ ₹ 112 cum interest. On 1st October, 2022 ₹ 80,000 debentures were sold @ ₹ 105. On 1st December, 2022, C Ltd. give option for conversion of 8% convertible debentures into equity share of ₹ 10 each. A Ltd. received 5,000 equity shares in C Ltd. in conversion of 25% debentures held on that date. The market price of debenture and equity share in C Ltd. on 31st December, 2022 is ₹ 110 and ₹ 15 respectively. Interest on debenture is payable each year on 31 st March, and 30th September. Prepare investment account in the books of A Ltd. on average cost basis for the accounting year ended 31st December, 2022. (MTP 8 Marks April 23, April '22 ,April '21 & Oct '23)(RTP May 19)

Answer 10

Investment Account for the year ending on 31st December, 2022
Scrip : 8% Convertible Debentures in C Ltd.

[Interest Payable on 31st March and 30th September]

Date	Particulars	Nominal value Rs.	Interest Rs.	Cost Rs.	Date	Particulars	Nominal Value Rs.	interest Rs.	Cost (Rs.)
1.4.22	To Bank A/c	2,00,000	-	2,16,000	30.09.2022	By Bank A/c	-	12,000	
1.7.22	To Bank A/c (W.N.1)	1,00,000	2,000	1,10,000		[7 3,00,000 X 8% x (6/12]			
31.12.22	To P & L A/c		14,033	-	1.10.2022	By Bank A/ c	80,000		84,000
	[Interest]				1.10.2022	By P & LA/c (loss) (W.N.3)			2,933
					1.12.2022	By Bank A/c (Accrued interest) (T 55,000 x 08 x 2/12)		733	
					1.12.2022	By Equity shares in C Ltd. (W.N.3 and 4)	55,000		59,767
					31.12.2022	By Balance c/d (W.N.5)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

SCRIP: Equity Shares in C LTD.

Date	Particulars	Cost (Rs.)	Date	Particulars	Cost (Rs.)
1.12.2022	To 8 % debentures	59,767	31.12.2022	By balance c/d	59,767

Working Notes:

(i) Cost of Debenture purchased on 1st July = Rs. 1,12,000 — Rs. 2,000 (Interest)

= Rs. 1,10,000

(ii) Cost of Debentures sold on 1st Oct.

= (Rs.2,16,000 + Rs. 1,10,000) x 80,000/3,00,000

(iii) Loss on sale of Debentures = Rs. 86,933— Rs.84,000 Nominal value of debentures converted into equity shares [(Rs. 3,00,000 — 80,000) x.25]

Interest received before the conversion of debentures

Interest on 25% of total debentures = 55,000 x 8% x 2/12

= 733

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

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

(vii) Closing balance of Debentures has been valued at cost.

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

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

Question 11

On 1st April, 2019, Mr. Vijay had 30,000 Equity shares in X Ltd. (the company) at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 2019, he purchased another 5000 shares of the same company for ₹ 80,000. The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 2019.

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

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

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

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 2020 assuming the shares are being valued at average cost.(MTP 8 Marks,Oct'21 & MTP 10 Marks May'20, Old & New SM)

Answer 11

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

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

Working Notes:

(1) Bonus Shares30,000+50,000)/7=5,000 shares

(2) Rights shares=$\frac{(30,000+5,000+5,000)}{8} \times 3 = 15,000$ shares

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

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

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

Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average

Cost Sales proceeds =Rs.3,00,000

Average cost =

$$=₹\frac{(4,50,000+80,000+1,50,000-10,000)}{50,000} \times 20,000 = Rs. 2,68,000$$

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

(7) Cost of shares on 31.3.2020

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

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

Question 12

On 1st April, 2021, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹ 15 per share (face value ₹ 10 each). He provides you the further information:

(1) On 20th June, 2021 he purchased another 10,000 shares of P Ltd. at ₹ 16 per share.

(2) On 1st August, 2021, P Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31st October, 2021, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹ 15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of ₹ 2 per share and subscribed the rest on 5th November, 2021.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 2022. (MTP 6 Marks Sep 22, MTP 8 Marks March '21, Old & New SM)

Answer 12

In the books of Rajat

Investment Account (Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.21 20.6.21	To Balance b/d To Bank A/c	50,000 10,000	7,50,000 1,60,000	31.3.22	By Balance c/d (Bal. fig.)	90,000	12,10,000
1.8.21	To Bonus issue (W.N.1)	10,000	-				
5.11.21	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

Working Notes:

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

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

(3) Sale of Rights = 30,000 Shares X $\frac{1}{3}$ × ₹ 2 = ₹ 20,000 to be credited to P & L A/c as per As 13.

(4) Rights Subscribed = 30,000 Shares X $\frac{2}{3}$ X ₹15 = Rs. 3,00,000

Question 13

Gopal holds 2,000, 15% Debentures of ₹ 100 each in Ritu Industries Ltd. as on April 1, 2021 at a cost of ₹ 2,10,000. Interest is payable on June, 30th and December, 31st each year. On May 1, 2021, 1,000 debentures are purchased cum-interest at ₹ 1,07,000. On November 1, 2021, 1,200 debentures are sold ex-interest at ₹ 1,14,600. On November 30, 2021, 800 debentures are purchased ex-interest at ₹ 76,800. On December 31, 2021, 800 debentures are sold cum-interest for ₹ 1,10,000. You are required to prepare the Investment Account showing value of holdings on March 31, 2022 at cost, using FIFO Method. (MTP 10 Marks Oct '22 & April '19)

Answer 13

Investment Account of Gopal For the year ended 31.3.2022
(Script: 15% Debentures in Ritu Industries Ltd.) (Interest payable on 30th June and 31st December)

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.04.21	To Balance A/c	2,00,000	7,500	2,10,000	30.06.21	By Bank A/c	-	22,500	
1.05.21	To Bank A/c	1,00,000	5,000	1,02,000	1.11.21	By Bank A/c	1,20,000	6,000	1,14,600
30.11.21	To Bank A/c	80,000	5,000	76,800	1.11.21	By Profit & Loss A/c	-	-	11,400
31.12.21	To Profit & Loss A/c			20,000	31.12.21	By Bank A/c	80,000	6,000	1,04,000
31.03.22	To Profit & Loss A/c		37,250		31.12.21	By Bank A/c	-	13,500	-
	(Bal. fig.)				31.12.21	By Bank A/c	-	6,750	-
					31.3.22	By Bal. c/d	1,80,000	-	1,78,800
		3,80,000	54,750	4,08,800			3,80,000	54,750	4,08,800

Working Notes:

(i) Accrued Interest as on 1st April, 2021 = ₹ 2,00,000 X$\frac{15}{100} \times \frac{3}{12}$ = Rs. 7,500

(ii) Accrued Interest as on 1.5.2021 = ₹ 1,00,000 X$\frac{15}{100} \times \frac{4}{12}$ = Rs. 5,000

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

(iv) Interest received as on 30.6.2021 = ₹ 3,00,000X $\frac{15}{100} \times \frac{6}{12}$ = Rs. 22,500

(v) Accrued Interest on debentures sold on 1.11.2021 = ₹ 1,20,000 X$\frac{15}{100} \times \frac{4}{12}$ = Rs. 6,000

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

(vii) Accrued Interest on sold debentures 31.12.2021 = ₹ 80,000 x$\frac{15}{100} \times \frac{6}{12}$ = Rs. 6,000

(viii) Sale Price of Investment on 31st Dec. 2021 = ₹ 1,10,000-₹ 6,000 = ₹ 1,04,000

(ix) Loss on Sale of Debenture on 1.11.2021

Sale Price of debenture	1,14,600
Less: Cost Price of debenture2,10,000 / 2,00,000 x Rs.1,20,000	1,26,000
Loss on sale	11,400

(x) Accrued interest as on 31.12.2021 = ₹ 1,80,000 x$\frac{15}{100} \times \frac{6}{12}$ = Rs. 13,500

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

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

(xiii) Profit on debentures sold on 31st December

= ₹ 1,04,000 –(₹ 2,10,000x800/2,000) = ₹ 20,000

Question 14

Sanket had 50,000 Equity shares of XYZ Ltd. on 01.01.2022 at a book value of ₹ 25 per share (face value ₹ 10). On 01.06.2022, he purchased another 10,000 shares of the company at ₹ 20 per share.

The director of XYZ Ltd. announces a bonus and right issue. No dividend was payable on these issues. The terms of the issue were as follows:

- **Bonus basis 1:6 (Date: 16.08.2022)**
- **Right basis 3: 7 (Date: 31.08.2022) price ₹15 per share**
- **Due date for payment 30.09.2022**
- **Shareholders can transfer their rights in full or in part.**

Accordingly, Sanket sold 33 1/3% of his entitlement in the market for consideration of ₹ 4 per share on 31.08.2022 & he procured other entitlement by payment.

Dividends for the year ended 31.03.2022 at the rate of 20% were declared by XYZ Ltd. and received by Sanket on 31.10.2022. Dividend amount for shares acquired by him on 01.06.2022 are to be adjusted against the cost of purchase.

On 15.11.2022, Sanket sold 25,000 equity shares at premium ₹ 12 per share. You are required to prepare in books of Sanket.

(i) Investment Account

(ii) Profit & Loss Account (Extract for Investment)

Books of accounts are closed by Sanket on 31.12.2022 and market price of shares on that date is ₹ 20 per share. (10 Marks March '23)(Same concept different figures Old & New SM)

Answer 14

Books of Sanket
Investment Account
(Scrip: Equity Shares in XYZ Ltd.)

		No.	Amount ₹			No.	Amount ₹
1.1.2022 1.6.2022	To Bal b/d To Bank	50,000 10,000	12,50,000 2,00,000	31.10.2022	By Bank (dividend	-	20,000
16.8.2022 30.9.2022	To Bonus (W.N.1) To Bank (Rights Shares) (W.N.3)	10,000 20,000	- 3,00,000		On shares acquired on 1.6.2022) (W.N.4)		
15.11.2022	To Profit (on sale of shares)		69,444	15.11.2022	By Bank (Sale of shares)	25,000	5,50,000
				31.12.2022	By Bal. c/d (W.N.6)	65,000	12,49,444
		90,000	18,19,444			90,000	18,19,444

Profit and Loss Account (An extract for investment)

31.12.2022 To Balance c/d (profit)	2,09,444	31.8.22 By Sale of rights (W.N.3)	40,000
		31.10.22 By Dividend (W.N.4)	1,00,000
		15.11.22 By Profit transferred	69,444
	2,09,444		2,09,444

Working Notes:

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

(2) Right Shares = $\frac{(50,000+10,000+10,000)}{7} X$ 3 = 30,000 shares × 2/3 = 20,000 shares

(3) Right shares renounced = 30,000×1/3 = 10,000 shares

Sale of right shares = 10,000 x 4 = ₹ 40,000

Right shares subscribed = 20,000 shares

Amount paid for subscription of right shares = 20,000 x 15 = ₹ 3,00,000

(4) Dividend received = 50,000 (shares as on 1st April 2022) × 10 × 20% = ₹ 1,00,000

Dividend on shares purchased on 1.6.2022 = 10,000×10×20% = ₹ 20,000 is adjusted to Investment A/c

(5) Profit on sale of 25,000 shares

= Sales proceeds – Average

cost Sales proceeds = ₹ 5,50,000

Average cost = $\frac{(12,50,000+2,00,000+3,00,000-20,000)}{90,000}$ = ₹ 4,80,556

Profit = ₹ 5,50,000 – ₹ 4,80,556 = ₹ 69,444.

(6) Cost of shares on 31.12.2022 $\frac{(17,30,000)}{90,000} X$ 65,000 = ₹ 12,49,444

Market value of share = 65,000 shares × ₹ 20 = 13,00,000

Shares will be valued at ₹ 12,49,444 as market value is more than cost.

Question 15

Omega Limited (listed company) issued ₹ 4,50,000 5% Debentures on 30th September 2020 on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase debentures in the open market for cancellation thereof. On 31 December 2020, investments made for the purpose of redemption were ₹ 67,500. The following purchases were made during the year ended 31st December, 2022 and the cancellation were made on the same date 1st March 2022 - ₹ 75,000 nominal value purchased for ₹ 74,175 ex-interest.

1st September 2022 - ₹ 60,000 nominal value purchased for ₹ 60,375 cum-interest. You are required to draw up the following accounts up to the date of cancellation:

(i) Debentures Account; and

(ii) Own Debenture (Investment) Account. Ignore taxation. (MTP 5 Marks March '23)

Answer 15

Omega Limited
Debenture Account

2022		₹	2022		₹
Mar 1	To Own Debentures	74,175	Jan 1	By Balance b/d	4,50,000
Mar 1	To Profit on cancellation (25,000-24,725)	825			
Sep 1	To Own Debentures (Note 3)	59,124			
Sep 1	To Profit on cancellation (20,000-19,708)	876			
Dec 31	Balance c/d	3,15,000			
		4,50,000			4,50,000

Own Debenture (Investment) Account

		Nominal Cost ₹	Interest ₹	Cost ₹			Nominal Cost ₹	Interest ₹	Cost ₹
2022					2022				
Mar 1	To Bank (W.N. 1)	75000	1563	74,175	Mar 1	By Debentures A/c	75,000	-	74,175
Sep 1	To Bank (W.N. 2 & 3)	60,000	1,251	59,124	Sep 1	By Debentures A/c	60,000	-	59,124
				-	Dec. 31	By P&L A/c	-	2,814	-
		1,35,000	2,814	1,33,299			1,35,000	2,814	1,33,299

Working notes:

1. 75,000 x 5% x 5/12 = 1,563
2. 60,000 x 5% x 5/12 = 1,251
3. 60,375 – 1,251= 59,124

Question 16

Paridhi Electronics Ltd. invested in the shares of Dhansukh Ltd. on 1st May 2020 at a cost of Rs. 10,00,000. Three fourth of these investments were current investments and the remaining investments were intended to be held for more than a year. The published accounts of Dhansukh Ltd. received in January, 2021 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 deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.21 with reference to AS 13? (RTP May '21, Old & New SM) (Same concepts different figures RTP May 18, MTP 4 Marks, Oct'21)

Answer 16

As per AS 13, "Accounting for Investments", carrying amount for current investments is the lower of cost and fair value. But long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. Paridhi Ltd. made three fourth of Rs. 10,00,000 ie. Rs.7,50,000 as current investment and remaining Rs. 2,50,000 as long term. The facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares for both categories of shares to bring them to market value. Hence the carrying value of investments will be shown at amount of Rs. 7,50,000 in the financial statements for the year ended 31st March, 2021 and charge the difference of loss of Rs. 2,50,000 to profit and loss account.

Question 17

A Ltd. on 1-1-2020 had made an investment of ₹ 600 lakhs in the equity shares of B Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2020 became ₹ 200 lakhs as B Ltd. lost a case of copyright. How will you recognize the reduction in the value of the investment in the financial statements for the year ended on 31-3-2020 as per AS 13 considering this downfall in the value of shares as non-temporary? (RTP Nov 20, Old & New SM)

Answer 17

A limited invested ₹ 600 lakhs in the equity shares of B Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by A Limited only for 3 months (from 1.1.2020 to 31.3.2020), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long-term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2020 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long-term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value. Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be charged in the profit and loss account. Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long-term investment, the carrying amount is reduced to recognize the decline.

Here, B Limited has lost a case of copyright which drastically reduced the realizable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long-term investment by ₹ 200 lakhs and show the investments at ₹ 100 lakhs as the downfall in the value of shares is not temporary. The reduction of ₹ 200 lakhs in the carrying value of long-term investment will be charged to the profit and loss account.

Question 18

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

(i) Long term investments in Company A, costing Rs.8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to Rs.6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is Rs.6.8 lakhs.

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

(iii) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these investments was Rs.18 lakhs but had been written down to Rs.12 lakhs to recognize permanent decline as per AS 13. (RTP May 20)

Answer 18

As per AS 13 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer. Accordingly, the re-classification will be done on the following basis:

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

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

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

Question 19

JVR Limited has made investment of ₹ 97.84 Crores in Equity Shares of QSR Limited in 2016-17. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to re-assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investment for the year ended 31st March, 2021. Discuss whether the connection of JVR Limited to bring down the carrying Amount of investment in QSR Limited is in

accordance with Accounting Standards. (RTP May '22)

Answer 19

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments. A current Investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss. A long - term investment is an investment other than a current investment. The investments referred in the question can be classified as long-term investments and long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. The contention of the company to bring down the value of investment may be correct if the decline in value is permanent in nature and the reduction in carrying amount may be charged to the statement of profit and loss. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Question 20

Mother Mart Ltd., wants to re-classify its investment in accordance with AS 13. Decide the treatment to be given in each of the following cases assuming that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller:

(i) A portion of current investments purchased for ₹ 25 lakhs to be reclassified as long-term investments, as the company has decided to retain them. The market value as on the date of balance sheet was ₹ 30 lakhs. The fair value of the investments on the date of transfer is same as the market value on the balance sheet date

(ii) Another portion of current investments purchased for ₹ 20 lakhs has to be re- classified as long-term investments. The Fair value of these investments as on the date of the balance sheet was ₹ 12.5 lakhs.

(iii) One portion of long-term investments, no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹ 15 lakhs, but had been written down to ₹ 11 lakhs to recognize permanent decline as per AS 13.(RTP Nov'22, Old & New SM)

Answer 20

As per AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer. When long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(i) In the first case, the market value of the investments is ₹ 30 lakhs, which is higher than its cost i.e. ₹ 25 lakhs. Therefore, the transfer to long term investments should be made at cost i.e. ₹ 25 lakhs

(ii) In the second case, the market value of the investment is ₹ 12.5 lakhs, which is lower than its cost i.e. ₹ 20 lakhs. Therefore, the transfer to long term investments should be made in the books at the market value i.e. ₹ 12.5 lakhs. The loss of ₹ 7.50 lakhs (20-12.5) should be charged to Profit and Loss statement.

(iii) In the third case, the book value of the investments is ₹ 11 lakhs, which is lower than its cost, i.e. ₹ 15 lakhs. As the transfer should be at carrying amount, hence this re-classified current investment should be carried at ₹ 11 lakhs.

Question 21

Gowtham Limited invested in shares of another company (with the intention to hold the shares for short-term period) on 30th November, 2021 at a cost of ₹ 4,25,000. It also earlier purchased Gold of ₹ 8,00,000 and Silver of ₹ 3,50,000 on 31st March, 2019.

Market values as on 31st March, 2022, of the above investments are as follows:

Shares ₹ 3,50,000

Gold ₹ 10,25,000

Silver ₹ 5,10,000

You are required to explain how will the above investments be shown (individually and in total) in the books of account of Gowtham Limited for the year ending 31st March, 2022 as per the provisions of AS 13. (RTP May 23, Old & New SM) (Same concept different figures RTP Nov'18)

Answer 21

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares - if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹ 4,25,000) and market value (₹ 3,50,000) as on 31 March 2022, i.e., ₹ 3,50,000.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 31stMarch, 2019) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2022, i.e., ₹ 8,00,000 and ₹3,50,000 respectively, though their market values have been increased.

Thus the shares, gold and silver will be shown at ₹ 3,50,000, ₹ 8,00,000 and

₹ 3,50,000 respectively and hence, total investment will be valued at ₹ 15,00,000 for the year ending on 31st March, 2022 as per AS 13.

Question 22

Following transactions of Meeta took place during the financial year 2020 -21:

1st April, 2020	Purchased ₹ 4,500 8% bonds of ₹ 100 each at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.
1st May, 2020	Received half year's interest on 8% bonds.
10 July, 2020	Purchased 6,000 equity shares of ₹ 10 each in Kamal Limited for ₹ 44 each through a broker, who charged brokerage @ 2%.
1st October 2020	Sold 1,125 8% bonds at ₹ 81 Ex-interest.
1st November, 2020	Received half year's interest on 8% bonds.
15th January, 2021	Received 18% interim dividend on equity shares of Kamal Limited.
15th March, 2021	Kamal Limited made a rights issue of one equity share for every four Equity shares held at ₹ 5 per share. Meeta exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹ 2.25 per share.

Prepare separate investment account for 8% bonds and equity shares of Kamal Limited in the books of Meeta for the year ended on 31st March, 2021. Assume that the average cost method is followed. (RTP Nov 21, PYP Nov '18 , 10Marks)

Answer 22

In the books of Meeta
8% Bonds for the year ended 31st March, 2021

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2020 1 April, Oct. 1	To Bank A/c	4,500	15,000	3,47,250	1 May 2020	By Bank-Interest	-	18,000	
2021 March 31	To P & L A/c (W.N.1)	-	-	4,312.50	1 Oct. 2020	By Bank A/c	1,125	3,750	91,125
	To P & L A/c		20,250		1 Nov. 2021	By Bank-Interest		13,500	
					2021 Mar. 31	By Balance c/d (W.N.2)	3,375	-	2,60,437.50

		4,500	35,250	3,51,562.50			4,500	35,250	3,51,562.50

Investment in Equity shares of Kamal Ltd. for the year ended 31 st March, 2021

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2020 July 10	To Bank A/c	6,000	-	2,69,280	2021 Jan 15	By Bank dividend	-	10,800	
2021 March 15	To Bank A/c (W.N. 3)	600	-	3,000	March 31	By Balance c/d (bal. fig.)	6,600		2,72,280
March 31	To P & L A/c	-	10,800						
		6,600	10,800	2,72,280			6,600	10,800	2,72,280

Working Notes:

1. **Profit on sale of 8% Bonds**

   Sales price ₹ 91,125

   Less: Cost of bonds sold = 3,47,250/4,500x 1,125 (₹ 86,812.50)

   Profit on sale ₹ 4,312.50

2. **Closing balance as on 31.3.2021 of 8 % Bonds**

   3,47,250/4,500x 3,375= ₹ 2,60,437.50

3. **Calculation of right shares subscribed by Kamal Ltd.**

   Right Shares = 6,000/4 x 1= 1,500 shares

   Shares subscribed by Meeta = 1,500 x 40%= 600 shares

   Value of right shares subscribed = 600 shares @ ₹ 5 per share = ₹ 3,000

4. **Calculation of sale of right entitlement by Kamal Ltd.**

   No. of right shares sold = 1,500 – 600 = 900 rights for 2,025

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

Question 23

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd Rs. 1,20,000 (face value Rs.100 each). On 5.04.2019 he further purchased 200 cum-right shares for Rs. 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of Rs. 20 each. All the shares held by Shyam had been acquired on cum right basis and the total market price (ex-right) of all these shares after the declaration of rights got reduced by Rs. 3,400. On 10.10.2019 Shyam sold 350 shares for Rs. 140 each. 31.03.2020 The market price of each share is Rs. 125 each. You are required to prepare the Investment account in the books of Mr. Shyam for the year ended 31.03.2020 assuming that the shares are being valued at average cost. (RTP May '21)

Answer 23

In the books of Mr. Shyam
for the year ending on 31-3-2020 (Scrip: Equity Shares of X Limited)

Date	Particulars	Qty	Amount	Date	Particulars	Qty	Amount
1.4.2019	To Balance b/d	1000	1,20,000	8.04.2019	By Bank A/c (W.N.1)		3,400

5.04.2019	To Bank (200x Rs.135)	200	27,000	10.10.2019	By Bank A/c (350x Rs.140)	350	49,000
10.10.2019	To Profit & Loss A/c (W.N.2)		7,117	31.3.2020	By Balance c/d (W.N.3)	850	1,01,717
		1200	1,54,117			1200	1,54,117

Working Notes:

1. **Sale of Rights** Rs. 4,000

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

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

2. **Profit on sale of 350 shares**

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

3. **Valuation of 850 shares as on 31.03.2020**

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

Question 24

(a) **In 2018, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year. On 1st December, 2019, M/s. Kumar purchased 10,000 of these debentures at ₹ 101 (cum-interest) price. On 1st March, 2020 the firm sold all of these debentures at ₹ 106 (cum-interest) price. You are required to prepare Investment (Debentures) Account in the books of M/s. Kumar for the period 1st December, 2019 to 1st March, 2020. (Nov 20)**

(b) **Mr. X acquires 200 shares of a company on cum-right basis for ₹ 60,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 105 each. He does not subscribe but sells all the rights for ₹ 15,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 50,000. What should be the accounting treatment in this case? (RTP Nov 20)**

Answer 24

Investment Account in the books of M/s Kumar for the period from 1st December 2019 to 1st March, 2020(Scrip: 12% Debentures of Royal Ltd.)

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

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

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

Question 25

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

(1) On 1st April, 2019 she purchased 40,000 equity shares of Rs.1 each fully paid up for Rs.60,000.

(2) On 15th May 2019, Meera sold 8,000 shares for Rs.15,200.

(3) At a meeting on 15th June 2019, the company decided:

(i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2019 and

(ii) To give its members the right to apply for one share for every five shares held on 1st June 2019 at a price of Rs.1.50 per share of which 75 paise is payable on or before 15th July 2019 and the balance, 75 paise per share, on or before 15th September, 2019.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2019.

(a) Meera received her bonus shares and took up 4,000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30th September 2019.

(b) On 15th March 2020, she received interim dividend from Kumar Ltd. of 15 per cent in respect of the current financial year.

(c) On 30th March 2020, she received Rs.28,000 from the sale of 20,000 shares.

You are required to record these transactions in the Investment Account in Meera's books for the year ended 31st March 2020 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis. Expenses and tax to be ignored. (RTP May 20, MTP 8 Marks Oct '18, MTP 10 Marks Mar'18)

Answer 25

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

Date	Particulars	No. of Shares	Income	Amount	Date	Particulars	No. of Shares	Income	Amount
2019			Rs.	Rs.	2019			Rs.	Rs.
April 1	To Bank (Purchases)	40,000	-	60,000	May 15	By Bank (Sale)	8,000	-	15,200

May 15	To Profit & Loss A/c (W.N.1)	-	-	3,200					
June15	To Bonus Issue	8,000	-	Nil	2020				
July 15	To Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By Bank (Dividend @ 15% on Rs.32,000)		4,800	-
Sept.	To Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By Bank (Sale)	20,000	-	28,000
2020 Mar. 31	To Profit & Loss A/c (W.N.2)			3,455	Mar. 31	By Balance c/d*	24,000	-	29,455
	To Profit & Loss A/c	-	4,800						
		52,000	4,800	72,655			52,000	4,800	72,655

$*\left(\frac{24,000}{44,000} \times 54,000\right)$

Working Notes:

(1)	**Profit on Sale on 15-5-2019:**		
	Cost of 8,000 shares @ Rs.1.50	Rs.12,000	
	Less: Sales price	Rs.15,200	
	Profit		Rs.3,200
(2)	**Cost of 20,000 shares sold:**		
	Cost of 44,000 shares (48,000 + 6,000)		Rs.54,000
Cost of 20,000 shares $\left(\frac{Rs.54,000}{44,000\ Shares} \times 20,000\ Shares\right)$			Rs.24,545
Profit on sale of 20,000 shares (Rs.28,000 – Rs.24,545)			Rs. 3,455

Question 26

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of Rs.100 each of P Ltd. on 1st May 2018 @ Rs.105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st 2018 the company again purchased 2,500 of such debentures @ Rs.102.50 each on cum interest basis. On 1st October, 2018 the company sold 2,000 Debentures @ Rs.103 each. On 31st December, 2018 the company received 10,000 equity shares of Rs.10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018. The market value of the debentures and equity shares as at the close of the year were Rs.106 and Rs.9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis. (RTP Nov 19)(Similar to May 18 but includes additional adjustments)

Answer 26

Books of A Pvt. Ltd.

Investment in 13.5% Convertible Debentures in P Ltd. Account

(Interest payable 31st March & 30th September)

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

Note 1: Rs.3,713 received on 31.12.2018 represents interest on the debentures converted till date of conversion.

Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

Investment in Equity shares in P Ltd. Account

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

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

Working Notes:

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

2. Interest received on 30th Sept. 2018

   On Rs.5,00,000 = 5,00,000 x 13.5% x ½ = 33,750

   On Rs.2,50,000 = 2,50,000 x 13.5% x ½ = 16,875

   Total Rs. = 50,625

3. Interest paid on Rs.2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018 as part of purchase price:

   2,50,000 x 13.5% x 4/12 = Rs.11,250

4. Loss on Sale of Debentures Cost of

   acquisition

   (Rs.5,19,375 + Rs.2,45,000) x Rs.2,00,000/Rs.7,50,000 = 2,03,833

   Less: Sale Price (2,000 x 103) = 2,06,000

   Profit on sale = Rs. 2,167

5. Interest on 1,100 Debentures (being those converted) for 3 months i.e., Oct-Dec. 2018

1,10,000 x 13.5% x 3/12 = Rs.3,713

6. Cost of Debentures converted to Equity Shares

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

7. Cost of Balance Debentures

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

8. Interest on Closing Debentures for period Oct.- Dec. 2018 carried forward (accrued interest) Rs.4,40,000 x 13.5% x 3/12 = Rs.14,850

Question 27

Mr. Wise had 12% Debentures of Face Value ₹ 100 of Alpha Ltd. as current investments. He provides the following details relating to the investments.

1-4-2020	**Opening balance 4,000 debentures costing ₹ 98 each**
1-6-2020	**Purchased 2,000 debentures @ ₹ 120 cum interest**
1-9-2020	**Sold 3,000 debentures @ ₹ 110 cum interest**
1-12-2020	**Sold 2,000 debentures @ ₹ 105 ex interest**
31-1-2021	**Purchased 3,000 debentures @ ₹ 100 ex interest**
31-3-2021	**Market value of the investments ₹ 105 each**

Interest due dates are 30th June and 31st December. Mr. Wise closes his books on 31-3-2021. He incurred 2% brokerage for all his transactions. Show investment account in the books of Mr. Wise assuming FIFO method is followed. (RTP May '22)

Answer 27

Investment A/c of Mr. Wise

for the year ending on 31-3-2021 (Scrip: 12% Debentures of Alpha Limited)

(Interest Payable on 30th June and 31st December) Amount in ₹

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
1.4.2020	To Balance b/d	4,00,000	12,000	3,92,000	30.6.2020	By Bank (6,00,000 x 6%)	-	36,000	-
1.6.2020	To Bank	2,00,000	10,000	2,34,800	1.9.2020	By Bank	3,00,000	6,000	3,17,400
1.9.2020	To Profit & Loss A/c			23,400	1.12.2020	By Bank	2,00,000	10,000	2,05,800
31.1.2021	To Bank	3,00,000	3,000	3,06,000	1.12.2020	By Profit & Loss a/c	-	-	9,600
31.3.2021	To Profit & Loss A/c (Bal. fig.)		45,000		31.12.20	By Bank (1,00,000 x 6%)	-	6,000	-
					31.3.2021	By Profit & Loss A/c	-	-	3,400
					31.3.2021	By Balance c/d	4,00,000	12,000	4,20,000
		9,00,000	70,000	9,56,200			9,00,000	70,000	9,56,200

Working Notes:

1. **Valuation of closing balance as on 31.3.2021**

	₹	
Market value of 4,000 Debentures at ₹ 105	1,17,400	4,20,000
Cost price of 1,000 debentures at		
3,000 debentures at	3,06,000	4,23,400

Value at the end = ₹ 4,20,000 i.e., whichever is less		

2. **Profit on sale of debentures as on 1.9.2020**

	₹
Sales price of debentures (3,000 x ₹ 110)	3,30,000
Less: Brokerage @ 2%	(6,600)
	3,23,400
Less: Interest for 2 months	(6,000)
Less: Cost price of Debentures $\left(3,92,000 \times \frac{3,000}{4,000}\right)$	(2,94,000)
Profit on sale	23,400

3. **Loss on sale of debentures as on 1.12.2020**

	₹
Sales price of debentures (2,000 x ₹ 105)	2,10,000
Less: Brokerage @ 2%	(4,200)
	2,05,800
Less: Cost price of Debentures (98,000 + 1,17,400)	(2,15,400)
Loss on sale	9,600

4. **Purchase Cost of 2,000 debentures on 1.6.2020**

	₹
2000 Debentures @₹ 120 cum interest	2,40,000
Add: Brokerage @ 2%	4,800
	2,44,800
Less: Interest for 5 months	(10,000)
Purchase cost of 2,000 debentures	2,34,800

5. **Sale value for 3,000 debentures on 1.9.2020**

	₹
Sales price of debentures cum interest (3,000 x ₹ 110)	3,30,000
Less: Brokerage @ 2%	(6,600)
	3,23,400
Less: Interest for 2 months	(6,000)
Sale value for 3,000 debentures	3,17,400

Question 28

Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2021 @ ₹ 105 on cum interest basis. The interest on these debentures is payable on 31st & 30th of March & September respectively. On August 1st 2021 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On October 1st, 2021 the company sold 2,000 Debentures @ ₹ 103 each on ex- interest basis. The market value of the debentures as at the close of the year was ₹ 106. You are required to prepare the Investment in Debentures Account in the books of Alpha Ltd. for the year ended 31st Dec. 2021 on Average Cost Basis. (RTP Nov'22, MTP 8 Marks , Nov '21)

Answer 28

Books of Alpha Ltd.

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

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
2021		₹	₹	₹	2021		₹	₹	₹

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

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

Working Notes:

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2021 for the month of April 2021, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2021

   On ₹ 5,00,000 = 5,00,000 x 13.5% x ½ = 33,750

   On ₹ 2,50,000 = 2,50,000 x 13.5% x ½ = 16,875

   Total ₹ 50,625
3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2021 for April 2021 to July 2021 as part of purchase price:

   2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833

   Less: Sale Price (2,000 x 103) = 2,06,000

   Profit on sale = ₹ 2,167
5. Cost of Balance Debentures

   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 5,50,000/₹ 7,50,000 = ₹ 5,60,542
6. Interest on Closing Debentures for period Oct.-Dec. 2021 carried forward (accrued interest)

   ₹ 5,50,000 x 13.5% x 3/12 = ₹ 18,563

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Question 29

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

₹ 40,000 face value of the Govt. securities were sold at ₹ 97 cum-interest. On 1st December, the company purchased the same security ₹ 10,000 at par ex-interest. On 1st March, the company sold ₹ 10,000 face value of the government securities at ₹ 95 ex- interest.

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

Calculation shall be made to the nearest rupee or multiple thereof. (RTP May 23)

Answer 29

In the Books of Remo Ltd.
9% Government Securities (Investment) Account

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

Working Notes:

1. Interest accrued on 1st April 2021 = ₹1,00,000 x 9% x 3/12 = ₹ 2,250
2. Accrued Interest on 800 units as on 01 05.2021 = ₹ 80,000 x 9/100 x 4/12 = ₹ 2,400
3. Cost of Investment for purchase on 01.05.2021 = ₹ 76,000 - ₹ 2,400 = ₹ 73,600
4. Accrued Interest on 600 units as on 01 06.2021 = ₹ 60,000 x 9/100 x 5/12 = ₹ 2,250
5. Profit on Securities sold on 1st June = ₹ 54,150 (56,400 – 2,250)- ₹ 54,000

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

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

Question 30

A Limited invested in the shares of XYZ Ltd. on 1st December, 2019 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 Limited also earlier purchased Gold of ₹ 1,00,000 and Silver of ₹ 30,00,000 on 1st April, 2019. Market value as on 31st March, 2020 of above investments 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 Limited for the year ended 31st March, 2020 as per the provisions of AS 13 (Revised)? (PYP 5 Marks Nov '20)

Answer 30

As per AS 13 (Revised) 'Accounting for Investments, for investment in shares - if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value.

In the given case ₹ 25,000 shares held as current investment will be carried in the books at ₹ 23,750 (₹ 47,500/2).

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognize a decline, if other than temporary, in the value of the 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, 2019) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2020. Thus Gold at ₹ 1,00,000 and Silver at ₹ 30,00,000 respectively will be shown in the books.

Question 31

Kunal Securities Ltd. wants to reclassify its investments in accordance with AS-13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investment in Company A, costing ₹ 10.5 lakhs is to be re-classified as current investment. The company had reduced the value of these investments to₹ 9 lakhs to recognize a permanent decline in value. The fair value on the date of reclassification is ₹ 9.3 lakhs.

(ii) Long term investment in Company B, costing ₹ 14 lakhs is to be re-classified as current investment The fair value on the date of reclassification is ₹ 16 lakhs and book value is ₹ 14 lakhs.

(iii) Current investment in Company C, costing ₹12 lakhs is to be re-classified as long term investment as the company wants to retain them. The market value on the date of reclassification is ₹ 13.5 lakhs. Current investment in Company D, costing ₹ 18 lakhs is to be re-classified as long term investment. The market value on the date of reclassification is ₹ 16.5 lakhs. (PYP 5 Marks Jan '21, Old & New SM)(MTP 5 Marks Sep '23)

Answer 31

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

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

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 9 lakhs in the books.

(ii) The carrying / book value of the long-term investment is same as cost i.e., ₹ 14 lakhs. Hence this long-term investment will be reclassified as current investment at book value of ₹ 14 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹ 12 lakhs as cost are less than its market value of ₹ 13.5 lakhs.

(iv) Market value of the investment is ₹ 16.5 lakhs, which is lower than its cost i.e., ₹ 18 lakhs. Therefore, the transfer to long term investments should be done in the books at the market value i.e., ₹ 16.5 lakhs.

Question 32

On 15th June, 2018, 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, 2017 are to be re-classified as current investments. The original cost of these investments was Rs. 14 lakhs but had been written down by Rs. 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was Rs. 11 lakhs.**

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

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

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

on 31st March, 2018 Rs. 3.5 lakhs

on 15th June, 201 Rs. 3.8 lakhs

(PYP May '19, 5 Marks)

Answer 32

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

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

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

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

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

*** (Rs. 8,56,667 - Rs. 2,00,000)**

** Considering that Rs. 13,00,000 was debited to Building WIP A/c earlier.

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

Question 33

Mr. Mohan has invested some money in various Mutual funds. Following information in this regard is given:

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

You are required to:

1. **Classify his investment in accordance with AS-13 (revised).**
2. **Value of Investment in mutual fund as on 31.03.2021(PYP 5 Marks , Dec '21)**

Answer 33

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

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

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

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

Question 34

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

As per the provisions of AS-13, a current investment is an investment, that by its nature, is readily realizable and is intended to be held for not more than six months from the date on which such investment is made (PYP 1 Mark May'19)

Answer 34

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

Question 35

(i) **An unquoted long term investment made in the shares of Rachel Limited is carried in the books of Ziva Limited at a cost of ₹ 1,00,000. The audited financial statements of Rachel Limited received in May,2021 showed that the company had been incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 55,000.**

(ii) **On 1st December, 2021 Ziva Limited had made an investment of ₹ 5,00,000 in 4,000 Equity Shares of Garry Limited at a price of ₹ 125 per share with an intention to hold it for not more than six months. In the first week of March, 2022, Garry Limited suffered heavy loss due to an earthquake; the loss was not covered by an insurance policy. On 31st March,2022, the shares of Garry Ltd. were traded at a price of ₹ 80 per share on the Stock Exchange.**

How would you deal with the above investments in the books of Ziva Limited for the year ended 31st March,2022 as per the provisions of Accounting Standard 13 'Accounting for Investments'? (PYP 5 Marks Nov '22)

Answer 35

I. Investments classified as long -term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

On this basis, the facts of the given case, it would be appropriate to reduce the carrying value of Long-term investments to ₹ 55,000 in the financial statements for the year ended 31st March, 2022.Thus the unquoted investment in the shares of Rachel Ltd. will be valued at

₹ 55,000

The provision for diminution amounting ₹ 45,000 should be made to reduce the carrying amount of the investments.

II. Equity Shares in Garry Ltd. will be considered as current investment as intended to hold for not more than six months. As per AS 13, "Accounting for Investments", carrying amount for current investments is the lower of cost and fair value. In respect of current Investments for which as active market exists, market value generally provides the best evidence of fair value.

Since on 31st March,2022, the shares of Garry Limited were trading at a price of ₹ 80 per share on the stock exchange, the equity shares of Garry Ltd. should be carried in the financial statements at realizable value i.e. at ₹ 3,20,000 (4,000 shares @ ₹ 80 per share).The reduction of ₹ 1,80,000 in carrying value of current investment will be charged to the statement of profit and loss for the year ended 31 st March,2022.

Question 36

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

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

Due dates of interest are 30th June and 31st December. Brokerage at 1% is to be paid for each transaction.Mr, Harsh closes his books on 31.3.2019. Show investment account as it would appear in his books assuming FIFO method is followed. (PYP Nov.'19,10 Marks)

Answer 36

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

Date	Particulars	Nominal Value Rs.	Interest Rs.	Cost Rs.	Date	Particulars	Nominal Value Rs.	Interest Rs.	Cost Rs.
1.4.18	To Balance b/d	12,50,000	31,250	12,25,000	30.6.18	By Bank 21,500 x 100 x 10% x 1/2	-	1,07,500	-
1.6.18	To Bank (ex-Interest) (W.N.1)	9,00,000	37,500	8,90,820	31.12.19	By Bank 33,500 x 100 x10% x 1/2		1,67,500	
1.11.18	To Bank (cum-Interest) (W.N.2)	12,00,000	40,000	13,53,800	31.1.19	By Bank (W.N.3)	13,50,000	11,250	14,58,900
31.1.19	To Profit & Loss A/c (W.N.3)			1,34,920	31.3.19	By Balance c/d	20,00,000	50,000	21,45,640
						(W.N.4)			-
31.3.19	To Profit & Loss A/c (Bal. fig.)		2,27,500						
		33,50,000	3,36,250	36,04,540			33,50,000	3,36,250	36,04,540

Working Notes:

7. **Purchase of debentures on 1.6.18**
   Interest element = 9,000 x 100 x 10% x 5/12 = Rs. 37,500
   Investment element = (9,000 x 98) + [1%(9,000 x 98)] = Rs. 8,90,820
8. **Purchase of debentures on 1.11.2018**
   Interest element = 12,000 x 100 x 10% x 4/12 = Rs. 40,000
   Investment element = 12,000 X 115 X 101% less 40,000 = Rs. 13,53,800
9. **Profit on sale of debentures as on 31.1.19**

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

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

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

Cost of

8,000 Debentures	=	8,90,820/ 9,000 X 8,000 =	7,91,840
12,000 Debentures	=		13,53,800
Total			21,45,640

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

Question 37

Mr. Z has made following transactions during the financial year 2020-21: Investment 1: 8% Corporate Bonds having face value ₹ 100.

Date	Particulars
01-06-2020	Purchased 36,000 Bonds at ₹ 86 cum-interest. Interest is payable on 30th September and 31st March every year
15-02-2021	Sold 24,000 Bonds at ₹ 92 ex-interest

Interest on the bonds is received on 30th September and 31st March.

Investment 2 : Equity Shares of G Ltd having face value ₹ 10

Date	Particulars
01-04-2020	Opening balance 8000 equity shares at a book value of ₹ 190 per share
01-05-2020	Purchased 7,000 equity shares@ ₹ 230 on cum right basis; Brokerage of 1% was paid in addition.
15-06-2020	The company announced a bonus issue of 2 shares for every 5 shares held
01-08-2020	The company made a rights issue of 1 share for every 7 shares held at₹ 230 per share. The entire money was payable by 31.08.2020
25-08-2020	Rights to the extent of 30% of his entitlements was sold @ ₹ 75 per share. The remaining rights were subscribed.
15-09-2020	Dividend @ ₹ 6 per share for the year ended 31.03.2020 was received on 16.09.2020. No dividend payable on Right issue and Bonus issue.
01-12-2020	Sold 7 ,000 shares @ 260 per share. Brokerage of 1% was incurred extra.
25-01-2021	Received interim dividend @ ₹ 3 per share for the year 2020-21.
31-03-2021	The shares were quoted in the stock exchange @ ₹ 260.

Both investments have been classified as Current investment in the books of Mr. Z. On 15th May 2021, Mr. Z decides to reclassify investment in equity shares of Z Ltd. as Long term Investment. On 15th May 2021, the shares were quoted in the stock exchange @ ₹ 180.

You are required to:
Prepare Investment Accounts in the books of Mr. Z for the year 2020-21, assuming that the average cost method is followed. Profit and loss Account for the year 2020-21, based on the above information. Suggest values at which investment in equity shares should be reclassified in accordance with AS 13. [PYP July'21, 20 Marks] (MTP 15 Marks Sep '23)

Answer 37

I. In the books of Mr. Z
Investment in 8% Corporate Bonds Account For the period 01 April 2020 to 31 March 2021

Date	Particulars	Nos	Interest (₹)	Amount (₹)	Date	Particulars	Nos	Interest (₹)	Amount (₹)
1/6/20	To Bank A/c (WN1)	36,000	48,000	30,48,000	30/9/20	By Bank A/c (Interest 36,000 x 100 x 8% x 6/12)		1,44,000	
15/2/21	To Profit & Loss A/c (WN 3)			1,76,000	15/2/21	By Bank A/c (WN2)	24,000	72,000	22,08,000
31/3/21	To Profit & Loss A/c		2,16,000		31/3/21	By Bank A/c (Interest 12,000 x 100 x 8% x 6/12)		48,000	
						By Balance c/d (WN 4)	12,000		10,16,000
	Total	36,000	2,64,000	32,24,000		Total	36,000	2,64,000	32,24,000

Note: For computing the interest on the bonds sold on 15 Feb 2021, if number of days (138 days) is taken instead of months, the interest received on 15.02.2021 should be ₹72,592 and the total interest transferred to Profit & Loss Account should be ₹ 2,16,592. Wrongly printed as Z Ltd. in the Question paper. It should have been given as G Ltd.

Investment in Equity Shares of G Ltd
For the period 1st April 2020 to 31 March 2021

Date	Particulars	Nos	Dividend (₹)	Amount (₹)	Date	Particulars	Nos	Dividend (₹)	Amount (₹)
01/4/20	To Balance b/d	8,000		15,20,000	16/9/20	By Bank A/c (WN 7)		48,000	42,000
01/5/20	To Bank A/c (WN 5)	7,000		16,26,100	1/12/20	By Bank A/c (WN 8)	7000		18,01,800
15/6/20	To Bonus Shares	6,000			25/1/21	By Bank A/c (WN 10)		48,300	
25/8/20	To Bank A/c (Right Shares) (WN 6)	2,100		4,83,000					
01/12/20	To Profit & Loss A/c (Sale of shares) (WN 9)			7,14,800					
31/3/21	To Profit & Loss A/c		96,300		31/3/21	By Balance c/d (WN 11)	16,100		25,00,100

	Total	23,100	96,300	43,43,900		Total	23,100	96,300	43,43,900

Working Notes

1. Computation of the Interest element in the bonds purchased on 01 June 2020

No of Bonds purchased	36,000
Face value per bond	₹ 100
Face value of the bonds purchased	₹ 36,00,000
Interest Rate	8%
Interest Amount	36,00,000 x 8% x 2/12
	₹ 48,000
Cum-interest per bond	₹ 86
Value of bond excluding interest	36,000 x 86 – 48,000
	₹ 30,48,000

2. Computation of the Interest element in the bonds sold on 15 Feb 2021

No of Bonds sold	24,000
Face value per bond	₹ 100
Face value of the bonds sold	₹ 24,00,000
Interest Rate	8%
Interest Amount	24,00,000 x 8% x 4.5/12 = ₹ 72,000

3. Computation of Profit on Sale of Bonds on 15 Feb 2021

No of Bonds sold	24,000
Face value per bond	₹ 100
Ex- interest Rate per bond	₹ 92
Sales proceeds	₹ 22,08,000
Average Cost of Bonds	(30,48,000/36,000) x 24,000
	₹ 20,32,000
Profit on sale of bonds	Sale Proceeds – Average Cost
	22,08,000 – 20,32,000
	₹ 1,76,000

4. Valuation of Bonds as on 31 March 2021

No of Bonds held as on 31 Mar 2021	12,000
Average Cost of Bonds	(30,48,000/36,000) x 12,000
	₹ 10,16,000

5. Computation of the cost of the equity shares purchased on 01 May 2020

No of shares purchased	7,000
Cum right price per share	₹ 230
Cost of purchase	₹ 16,10,000
Brokerage @1%	₹ 16,100
Cost including brokerage	₹ 16,26,100

6. Right Shares

No of Right Shares Issued	(8,000+7,000+6,000)/7 = 3,000 shares
No of right shares sold	3,000 shares x 30% = 900 shares
Proceeds from sale of right shares to be credited to statement of profit & loss	900 shares x ₹ 75 = ₹ 67,500
No of right shares subscribed	3,000-900 = 2,100 shares
Amount of right shares subscribed	2,100 x 230 = ₹ 4,83,000

7. Computation of Dividend Received on 16 Sept 2020

No of shares held during the period of dividend	8,000 shares
Dividend per share	₹ 6
Dividend Amount	8,000 x 6 = ₹ 48,000
No of shares received after the period of dividend (excluding bonus & right shares)	7,000 shares
Dividend per share	₹ 6
Dividend Amount	7,000 x 6 = ₹ 42,000

The amount of dividend for the period for which the shares were not held by the investor has been treated as capital receipt. Thus ₹ 42,000 shall be treated as capital receipt.

8. Sale Proceeds for the shares sold on 1st Dec. 2020

No of shares sold	7,000 Shares
Sale price per share	₹ 260
Proceeds from sale of share	7,000 x 260 = ₹ 18,20,000
Less: Brokerage @ 1%	₹ 18,200
Net Sale Proceeds	₹ 18,01,800

9. Profit on sale of shares on 1st Dec. 2020

Sales Proceeds	₹ 18,01,800
Average Cost	(15,20,000+16,26,100+4,83,000-42,000)/23,100x7000
	= ₹ 10,87,000
Profit on sale of shares	Sales Proceeds – Average Cost
	= ₹ 18,01,800-10,87,000 = ₹ 7,14,800

10. Computation of Amount of Interim Dividend

No of shares held	8,000+7,000+6,000+2,100-7,000
	= 16,100
Dividend per share	₹ 3 per share
Dividend Received	16,100 shares x ₹ 3 per share
	= ₹ 48,300

11. Valuation of Shares as on 31 March 2021

Cost of Shares	(15,20,000 + 16,26,100 + 4,83,000 – 42,000) / 23,100 x 16,100
	= 25,00,100
Market Value of Shares	₹ 260 x 16,100 = ₹ 41,86,000
Closing stock of equity shares has been value at ₹ 25,00,100 i.e. cost being lower than its market value.	

II. Profit & Loss Account (Extract)

For the period 01 April 2020 to 31 March 2021

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	12,70,600	By Investment in 8% Corporate Bonds Account (Profit on sale of bonds)	1,76,000
		By Investment in 8% Corporate Bonds Account (Interest on bonds)	2,16,000
		By Sale of Right Shares	67,500
		By Investment in Equity Shares of G Ltd (Profit on sale of shares)	7,14,800

		By Investment in Equity Shares of G Ltd (Dividend Income)	96,300

III. As per AS 13, when investments are classified from Current Investments to Long term Investments, transfer is made at Cost and Fair value, whichever is less (as on the date of transfer). So, in the given case valuation shall be done as follows:
Date of reclassification/transfer – 15 May 2021
Per Unit Cost of 16,100 shares held – ₹ 25,00,100/16,100 shares – ₹ 155.29

Market Price/Fair Value per share – ₹ 180

As the cost per unit is lower than its fair value, the shares are to be transferred at its cost i.e., at ₹ 155.29 per share on 15 May 2021

Note:

1. In the eight last line of the Question, investment in equity shares of G Ltd. was wrongly printed as Z Ltd. in the Question paper. In the above solution, it has been considered as investment in G Ltd. If considered as Investment in equity shares in Z Ltd. (some other investment and not investment in G Ltd.), then the cost of the investment for shares in Z Ltd. will not be available.

2. The entire amount of sale proceeds from rights has been credited to Profit and Loss account in the above solution. However, the sale proceeds of rights in respect of 7,000 shares (purchased cum right on 1.5.20) can be applied to reduce the carrying amount of such investments (without crediting it to profit and loss account) considering that the value of these shares has reduced after becoming their ex -right. In that case, ₹ 22,500 (67,500X 7/21) will be applied to reduce the carrying amount of investment and ₹ 45,000 will be credited to profit and loss account.

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Question 38

During the year ended 31st March, 2021, Purple Ltd. entered into the following transactions:

1st April, 2020	**Purchased ₹ 4,00,000, 10% Govt. loan 1(interest payable on 30th April and 31st October) at ₹ 70 cum interest.**
1st April, 2020	**Purchased 6,000 Equity shares of ₹ 5 each in XY Ltd. for ₹ 1,26,000.**
1st October, 2020	**Sold ₹ 80,000, 10% Govt. loan at ₹75 ex-interest.**
15th January, 2021	**XY Ltd. made a bonus issued of four equity shares for every three shares held. Purple Ltd. sold all of the bonus shares for ₹ 10 each.**
1st March, 2021	**Received dividend @ 22% on shares in XY Ltd. for the year ended 31st December, 2020.**

Prepare Investment accounts in the books of Purple Ltd. (PYP 10 Marks , Dec '21)

Answer 38

In the books of Purple Ltd.
10% Govt. Loan
[Interest Payable: 30th April & 31st October]

Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.4.20	To Bank A/c (W.N.1)	4,00,000	16,667	2,63,333	30.4.20	By Bank A/c (4,00,000 x 10% x 6/12)	-	20,000	-
1.10.20	To Profit & Loss A/c (W.N 5)			7,333	1.10.20	By Bank A/c (W.N.2)	80,000	3,333	60,000
					31.10.20	By Bank A/c	-	16,000	-
31.3.21	To Profit & Loss A/c		35,999		31.3.21	By Balance c/d	3,20,000	13,333	2,10,666

						(W.N.3)			
		4,00,000	52,666	2,70,666			4,00,000	52,666	2,70,666

Investment in Equity Shares of XY Ltd. Account (of ₹ 5 each)

Date	Particulars	No.	Dividend (₹)	Cost (₹)	Date	Particulars	No.	Dividend (₹)	Cost (₹)
1.4.20	To Bank A/c	6,000		1,26,000	15.1.21	By Bank A/c	8,000	4,950	80,000
15.1.21	To Bonus Issue	8,000			1.3.21	By Bank A/c (W.N.6)			1,650
15.1.21	To Profit & Loss A/c. (W.N.4)			8,000					
31.3.21	To Profit & Loss A/c		4,950		31.3.21	By Balance c/d	6,000		52,350
		14,000	4,950	1,34,000			14,000	4,950	1,34,000

Working Notes:

1. Cost of investment purchased on 1st April, 2020

4,000, 10% Govt. loan were purchased @ ₹ 70 cum-interest. Total amount paid 4,000 bonds x ₹ 70 = 2,80,000 which includes accrued interest for 5 months, i.e., 1st November, 2020 to 31st March, 2021. Accrued interest will be ₹ 4,00,000 x 10% x 5/12 = ₹ 16,667. Therefore, cost of investment purchased = ₹ 2,80,000 – ₹ 16,667 = ₹ 2,63,333.

2. Sale of 10% Govt. loan on 1st October, 2020

800, 10% Govt. loan were sold@ ₹ 75 ex-interest, i.e., Total amount received = 800 x 75 + accrued interest for 5 months = ₹ 60,000 + ₹ 3333

3. Cost of 10% Govt. loan on 31.3.2021

Cost of 10% Govt. loan on 31.3.2021 will be ₹ 2,63,333 x 3,20,000/4,00,000 = ₹ 2,10,666.

Interest accrued on 10% Government Loan on 31.3.2021 = ₹ 3,20,000 x 10% x 5/12 = ₹ 13,333

4. Profit on sale of bonus shares

Cost per share after bonus = ₹ 1,26,000/ 14,000 = ₹ 9 (average cost method being followed)

Profit per share sold (₹ 10 – ₹ 9) = ₹ 1.

Therefore, total profit on sale of 8,000 shares = 8,000 x ₹ 1 = ₹ 8,000.

5. Profit on sale of 10% Govt. loan ₹

Sale value = 60,000

Cost of ₹ 80,000 10% Government Loan = 2,63,333 x 80,000/ 4,00,000 = 52,667 Profit

= 7,333

6. Dividend on equity shares = 6,000 x 5 x 22% = ₹ 6,600 out of which ₹ 1,650 will be treated as capital receipt as it has been received for the period of 3 months during which shares were not held.

Note: It has been considered that dividend received relates for the period of 12 months ended 31st Dec., 2020, strictly based on the information, given in the Question. Hence, dividend received for the period of 3 months (1st January, 20 to 31st March, 20) has been treated as pre-acquisition.

Question 39

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

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

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

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

(iii) No dividend was payable on these issues.

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

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

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

You are required to prepare Investment account in the books of Mr. H for the year ending 31st March, 2020, assuming the shares are valued at average cost. . (PYP 10 Marks Nov '20)

Answer 39

In the books of Mr. H

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

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

Working Notes:

1. Calculation of no. of bonus shares issued Bonus Shares = (30,000 + 10,000) divided by 4
   = 10,000 shares

2. **Calculation of right shares subscribed**

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

   = 10,000 shares

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

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

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

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

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

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

Total holding = 30,000 shares original
10,000 shares purchased
10,000 shares bonus
6,000 shares right shares
56,000

50% of the holdings were sold i.e. 28,000 shares (56,000 x1/2) were sold.

Cost of total holdings of 56,000 shares

= ₹ 5,40,000 + ₹ 1,62,400 + ₹ 72,000– ₹ 20,000 = ₹ 7,54,400

Average cost of shares sold would be:
= 7,54,400 / 56,000 X 28,000 = Rs. 3,77,200

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

5. Dividend received on investment held as on 1st April, 2019
= 30,000 shares x ₹ 10 x 20%
= ₹ 60,000 will be transferred to Profit and Loss A/c and
Dividend received on shares purchased on 10th June, 2019
= 10,000 shares x ₹ 10 x 20% = ₹20,000 will be adjusted to Investment A/c

6. Calculation of closing value of shares (on average basis) as on 31st March, 2020
7,54,000 /56,000 X 28,000 = Rs. 3,77,200

Question 40

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

The term of bonus and right issue were:

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

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

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

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

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

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

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

You are required to prepare the Investment account of P Ltd. for the year ended 31st March,2020 and determine the value of shares held on that date, assuming the investment as current investment. Consider average cost basis for ascertainment for cost for equity shares sold. (PYP 10 Marks Jan 21)

Answer 40

Investment Account-Equity Shares in K Ltd.

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

Working Notes:

1. **Right shares**
   No. of right shares issued = (8,000 + 2,000 + 4,000)/ 7 X 2= 4,000
   No. of right shares subscribed = 4,000 x 50% = 2,000 shares
   Value of right shares issued = 2,000 x ₹12.50 = ₹ 25,000
   No. of right shares sold = 2,000 shares
   Sale of right shares = 2,000 x ₹ 8 = ₹ 16,000 to be credited to statement of profit and loss
2. **Cost of shares sold — Amount paid for 16,000 shares**

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

3. **Value of investment at the end of the year**
   Assuming investment as current investment, closing balance will be valued based on lower of cost or net realizable value. Here, Net realizable value is ₹13 per share i.e., 8,000 shares x ₹ 13 = ₹ 1,04,000 and cost = 84,500. Therefore, value of investment at the end of the year will be ₹ 84,500.

Question 41

Mr. Saurabh held 10,000 equity shares of BT Limited on 1st April,2021. Nominal value of the shares is ₹ 2 each and their book value is ₹ 7 per share.

- On 4th July,2021 he purchased another 7,500 shares at ₹ 10 each.
- On 31st July 2021 the company announced a Bonus and Right issue.
- Bonus was declared of one share for every five shares held and was received on 5th August,2021.
- Right issue to be issued on 12th September,2021, which entitled the holders to subscribe to additional 2 shares for every 7 shares held at ₹ 2 per share. Shareholders were entitled to transfer their rights in full or part. Mr. Saurabh sold whole of his entitlements to Mr. Nihal at ₹ 1.50 per share.
- Dividend was declared for the year ended 31st March,2021 @ 25% and received by Mr. Saurabh on 19th September 2021.
- On 11th December 2021 Mr. Saurabh sold 7,500 shares at ₹ 8 per share.
- The market price of the shares on 31st March,2022 was ₹ 7 per share.

You are required to prepare the Investment Account of Mr. Saurabh on 31st March,2022 considering the above mentioned points, also state the value of shares held on that date. (Assume investment as current investment) (PYP 10 Marks Nov '22)

Answer 41

Investment Account in Books of Saurabh

(Script: Equity Shares in BT Ltd.)

		No.	Divi- dend	Amount			No.	Divi- dend	Amount
				₹					₹
1.4.21	To Bal b/d	10,000		70,000	19.9.2021	By Bank (dividend on shares acquired on 4.7. 2021)		5,000	3,750
4.7.21	To Bank	7,500		75,000					
5.8.21	To Bonus	3,500		0					
11.12.21	To P&L A/c (Profit on sale of shares)			9,554	11.12.2021	By Bank (Sale of shares)	7,500		60,000
31.3.22	To P&L A/c		5,000		31.3.2022	By Bal. c/d	13,500		90,804
		21,000	5,000	1,54,554			21,000	5,000	1,54,554

Working Notes:

(1) Right Shares = $\frac{(10{,}000+7{,}500+3{,}500)}{7} \times 2 = 6{,}000$

Sale of rights amounting ₹ 9,000 (₹ 1.5 x 6,000 shares)

It will not be shown in investment A/c but will directly be taken to P & L statement.

(2) Profit on sale of 7,500 shares

= Sales proceeds – Average cost Sales

proceeds = ₹ 60,000

Average cost = (70,000 + 75,000 – 3,750) /21,000 x 7,500 = ₹ 50,446 Profit =

₹ 60,000 – ₹ 50,446 = ₹ 9,554.

(3) **Value of investments**

Current investments are valued at lower of cost or net realizable value. Here,

cost= (70,000 + 75,000 – 3,750)/ 21,000 X 13,500 = ₹ 90,804

Net realizable value of the shares = ₹ 94,500

Therefore, value of investments will be taken lower of above i.e.₹ 90,804

Note: As question is silent, Average cost basis has been considered for calculation of cost of shares in above solution. Alternatively, FIFO method can also be considered for calculation of cost of shares. An alternative solution is given below based on FIFO method-

Alternative Solution

Investment Account in Books of Saurabh

(Script: Equity Shares in BT Ltd.)

		No.	Dividend	Amount			No.	Dividend	Amount
				₹					₹
1.4.21	To Bal b/d	10,000		70,000	19.9.21	By Bank (Dividend on shares acquired on 4.7. 2021)		5,000	3,750
4.7.21	To Bank	7,500		75,000					
5.8.21	To Bonus	3,500		0					
11.12.21	To P&L A/c (Profit on sale of shares)			7,500	11.12.21	By Bank (Sale of shares)	7,500		60,000
31.3.22	To P&L A/c		5,000		31.3.22	By Bal. c/d	13,500		88,750
		21,000		1,52,500			21,000		1,52,500

Working Note:

(1) Right Shares = $\frac{(10,000+7,500+3,500)}{7} \times 2 = 6,000$

Sale of rights amounting ₹ 9,000 (₹ 1.5 x 6,000 shares)

It will not be shown in investment A/c but will directly be taken to P & L statement.

(2) Profit on sale of 7,500 shares

= Sales proceeds – Cost Sales

proceeds = ₹ 60,000 Cost = 7,500 X

₹ 7= ₹ 52,500

Profit = ₹ 60,000 – ₹ 52,500 = ₹ 7,500.

(3) Value of investments

Current investments are valued at lower of cost or net realizable value Here,

cost= (2500 X₹7) + (7500 X₹10) -₹3750 = ₹ 88,750

Net realizable value of the shares = ₹ 94,500

Therefore, value of investments will be taken lower of above i.e.₹ 88,750

Question 42

On 1st April 2021 Ms. Jayshree has 5,000 equity shares of Rama Limited (a listed company) of face value of₹ 10 each. Ms. Jayshree has purchased the above shares at ₹ 15 per share and paid a brokerage of 2% and stamp duty of 1 %.

On 15th May,2021 Ms. Jayshree purchased another 5,000 shares of Rama Limited at ₹ 18 including brokerage and stamp duty.

On 26th August,2021 Rama Limited issued one bonus equity share for every 1 equity share held by the shareholders.

On 23rd October,2021 Rama Limited announced a Right Issue which entitles the holders to subscribe 1 equity share for every 2 equity shares held at ₹ 20 per share. Shareholders can exercise their rights in full or in part. Ms. Jayshree sold 1/4th of entitlement to Mr. Mike for a consideration of ₹ 10 per

share and subscribed the rest on 1st November 2021.

Ms. Jayshree also sold 10,000 shares at ₹ 25 per share on 1st November,2021. The shares of Rama Limited were quoted at ₹ 11 per share on 31st March,2022.

You are required to prepare Investment account for Ms. Jayshree for the year ended 31st March 2022. (5 Marks) (May 22)

Answer 42

In the books of Ms. Jayshree
Investment Account (Equity shares in Rama Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.21 15.5.21	To Balance b/d To Bank A/c	5,000 5,000	77,250 90,000	1.11.21	By Bank A/c	10,000	2,50,000
26.8.21	To Bonus issue (W.N.1)	10,000	-	31.3.22	By Balance c/d	17,500	1,92,500
1.11.21	To Bank A/c (right shares) (W.N.4)	7,500	1,50,000	31.3.22	By Profit & Loss A/c (loss on valuation)		9,386
1.11.21	To Profit & Loss A/c		1,34,636				
		27,500	4,51,886			27,500	4,51,886

Working Notes:

(1) Profit on sale of shares (average cost basis) on 1.11.21 10,000 shares @ ₹ 25 per share = 2,50,000

Cost of shares sold = [(77,250 + 90,000 + 1,50,000)/27,500 x 10,000]

= ₹ 1,15,364

Profit on sale of shares = ₹ 1,34,636

(2) Value of shares on 31.3.22 [(77,250 + 90,000 + 1,50,000)/27,500 x 17,500]
= ₹ 2,01,886 or ₹ 1,92,500 (17,500 shares at ₹ 11)

Shares will be valued at ₹, 1,92,500 as market value is less than cost.

Note: Average cost basis has been considered for valuation of shares at the year end and for calculation of cost of shares sold in the given answer.

Question 43

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

01.04.2022	**Mr. Atwood has 3,000 equity shares in Sun Limited at a book value of ₹ 3,30,000 (nominal value ₹ 100 each.)**
01.07.2022	**Purchased 1,500 equity shares in Sun Limited for ₹ 1,38,600.**
01.08.2022	**Purchased 5,000.9% Bonds at ₹ 97 cum-interest (face value ₹ 100). The due dates of interest are 1st September and 1st March.**
02.10.2022	**Dividend declared on equity shares and paid by Sun Limited for the year 2021- 2022 @ 10%.**
15.10.2022	**Sun Limited made a bonus issue of two equity shares for every five shares held.**
01.01.2023	**1,000 equity shares in Sun Limited sold @₹ 115 per share.**
31.03.2023	**Sold 4,000,9% Bonds @ ₹ 99 ex-interest**

- **The market price of Equity Shares of Sun Limited is ₹ 125 each and Bonds ₹ 98 each on 31st March 2023.**

- **Interest on bonds was received on due dates.**

You are required to prepare Investment Account in the books of Mr. Atwood for the year ended 31stMarch 2023, assuming that the investments are valued at the average cost or market value, whichever is lower. (Round off to nearest Rupee) (PYP 10 Marks May '23)

Answer 43

In the books of Atwood

Investment in Equity Shares of Sun Ltd. Account

Date	Particulars	No.	Dividend	Amount	Date	Particulars	No.	Dividend	Amount
			(₹)	(₹)				(₹)	(₹)
1.04.22	To Balance b/d	3,000		3,30,000	2.10.22	By Bank A/c (W.N. 5)		30,000	15,000
1.07.22	To Bank A/c	1,500		1,38,600	1.1.23	By Bank A/c	1,000		1,15,000
15.10.22	To Bonus Issue	1,800			31.3.23	By Balance c/d (W.N.7)	5,300		3,81,600
1.01.23	To Profit & Loss A/c (W.N. 6)			43,000					
31.3.23	To Profit & Loss A/c		30,000						
		6,300	30,000	5,11,600			6,300	30,000	5,11,600

9% Bonds Account **[Interest Payable: 1st September & 1st March]**

Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.8.22	To Bank A/c (W.N.1)	5,00,000	18,750	4,66,250	1.9.22	By Bank A/c (5,00,000 x 9% x 6/12)	-	22,500	-
31.3.23	To Profit & Loss A/c (W.N 3)			23,000	1.3.23	By Bank A/c	-	22,500	-
					31.3.23	By Bank A/c (W.N 2)	4,00,000	3,000	3,96,000
31.3.23	To Profit & Loss A/c		30,000		31.3.23	By Balance c/d (W.N.4)	1,00,000	750	93,250
		5,00,000	48,750	4,89,250			5,00,000	48,750	4,89,250

Working Notes:

1. Cost of Bond purchased on 1st August, 2022

5,000, 9% bonds were purchased @ ₹ 97 cum-interest. Total amount paid 5,000 bonds x ₹ 97 = 4,85,000 which includes accrued interest for 5 months, i.e., 1st March, 2022 to 31st July, 2022. Accrued interest will be ₹ 5,00,000 x 9/100x 5/12 = ₹ 18,750. Therefore, cost of Bond purchased = ₹ 4,85,000 – 18,750 = ₹ 4,66,250.

2. Sale of bonds on 31st March, 2023

4,000 bonds were sold@ ₹ 99 ex-interest, i.e., Total amount received = 4,000 x 99 + accrued interest for 1 month = ₹ 3,96,000 + ₹ 3,000 (4,00,000 x 9/100 x 1/12)

3. Profit on sale of bonds ₹

Sale value = 3,96,000

Cost of 4,00,000 9% bonds = 4,66,250/5,000x 4,000 = 3,73,000

Profit = 23,000

4. Value of bonds on 31.3.2023 Lower of:

Cost of bonds on 31.3.2023 will be ₹ 4,66,250/ 5,000 x 1,000 = ₹ 93,250.

Market Value on 31.3.2023 will be ₹ 1,000 X 98 = 98,000

Value of bonds on 31.3.2023 = ₹ 93,250

Interest accrued on bonds on 31.3.2023 = 1,00,000 x 9% x 1/12 = ₹ 750

5. Dividend on equity shares for 2021-22

Post acquisition dividend = 3,00,000 x 10% = ₹ 30,000 transferred to Profit & Loss account

Pre-acquisition dividend = 1,50,000 X 10% = ₹ 15,000 credited to investment A/c

6. Profit on sale of equity shares ₹

Sale value = 1,15,000

Cost of shares = 4,53,600 / 6,300 x 1,000 = 72,000 Profit = 43,000

(Average cost method being followed)

7. Value of equity shares at end of year Lower of:

Cost of shares on 31.3.2023 will be ₹ 4,53,600 / 6,300 x 5,300 = ₹ 3,81,600

Market Value on 31.3.2023 will be ₹ 5,300 x 125 = 6,62,500

Value of shares = ₹ 3,81,600

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STRIVING TOWARDS KNOWLEDGE

Question 44

On 1st April, 2022, Alpha has 1,00,000 equity shares of Beta Ltd. at a book value of ₹ 15 per share (nominal value ₹ 10 each). He provides you the further information:

1. **On 20th June, 2022 he purchased another 20,000 shares of Beta Ltd. at ₹ 16 per share**
2. **On 1st August, 2022, Beta Ltd. issued one equity bonus share for every six shares held by the shareholders.**
3. **On 31st October, 2022, the directors of Beta Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹ 15 per share. Shareholders can transfer their rights in full or in part.**

Alpha sold 1/3rd of entitlement to Umang for a consideration of ₹ 2 per share and subscribed the rest on 5th November, 2022.

You are required to prepare Investment A/c in the books of Alpha for the year ending 31st March, 2023. (RTP Nov '23)

Answer 44

In the books of Alpha

Investment Account (Equity shares in Beta Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.2022	To Balance b/d	1,00,000	15,00,000	31.3.2023	By Balance c/d (Bal. fig.)	1,80,000	24,20,000
20.6.2022	To Bank A/c	20,000	3,20,000				

1.8.2022	To Bonus issue (W.N.1)	20,000	-				
5.11.2022	To Bank A/c						
	(right shares) (W.N.4)	40,000	6,00,000				
		1,80,000	24,20,000			1,80,000	24,20,000

Working Notes:

(1) Bonus Shares = $\frac{1,00,000+20,000}{6}$ = 20,000 Shares

(2) Right Shares = $\frac{1,00,000+20,000+20,000}{7}$ X 3 = 60,000 Shares

(3) Sale of Rights = 60,000 Shares $\times \frac{1}{3} \times$ Rs. 2 = Rs. 40,000 to be credited to Statement of Profit & Loss

(4) Right subscribed = 60,000 Shares $\times \frac{1}{3} \times$ Rs. 15 = Rs. 6,00,000

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Chapter 5.4
AS 16-Borrowing Costs

Question 1

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16. (MTP 5 Marks April 21, April 22, RTP Nov'18)

Answer 1

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa. The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 2

U Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernization of its Factory on 1st April, 2020. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2021. An expenditure of ₹ 564 lacs was incurred on this Plant and Machinery and the balance loan of ₹ 56 lacs has been used for working capital purposes. The company has paid total interest of ₹ 68.20 lacs during financial year 2020-2021 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 2021?(MTP 5 Marks , Oct '21)

Answer 2

Borrowing Cost: As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

Qualifying Asset: A qualifying asset is an asset that necessarily takes a substantial period of time (ordinarily, a period of twelve months unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case) to get ready for its intended use or sale.

(i) When construction of asset completed on 30th April, 2021

The treatment for total borrowing cost of ₹ 68.20 lakhs will be as follows:

Purpose	Nature	Interest to be capitalized ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Plant and machinery	Qualifying asset	[68.20 x (564/620)]	
Under Modernization		= 62.04	
And renovation			
scheme			
Working Capital	Not a qualifying		[68.20 x (56/620)]
	asset		= 6.16
		62.04	6.16

(ii) When construction of assets is completed by 28th February, 2019

In this scenario, when the process of renovation gets completed in less than 12 months, the plant and machinery will not be considered as qualifying assets (until and unless the entity specifically considers that the asset took substantial period of time for completing their construction) and the whole of interest will be required to be charged off / expensed off to Profit and loss account.

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Question 3 (Includes concepts of AS 11- Effects of changes in Foreign Exchange Rates)

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2021-22 for its residential project at 4%. The interest is payable at the end of the Financial Year. At the time of availment of loan exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2022 was ₹ 62 per US $. If Omega Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2022 as per applicable Accounting Standards. (MTP 5 Marks Sep'22,Mar'18, Mar'19, MTP 4 Marks March 21 & Oct '23, RTP May '21)

Answer 3

(i) Interest for the period 2021-22

= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency

= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing

= ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 4

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2021, to be utilized as under:

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

In March 2022, construction of the factory building was completed and machinery was installed and ready for it intended use. Total interest on debentures for the financial year ended 31.03.2022 was ₹ 11,00,000. During the year 2021-22, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000. Explain the treatment of interest under Accounting Standard 16 and also explain nature of assets. (MTP 5 Marks Oct '22, MTP Oct. '18, MTP Aug. '18, MTP Oct. '19, 5 Marks, RTP May 20)

Answer 4

As per AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred. Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be Capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

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

Question 5

Vital Limited borrowed an amount of ₹150 crores on 1.4.2021 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 31.3.2022. 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. (MTP 5 Marks March '23, RTP Nov 20)

Answer 5

Para 10 of AS 16 'Borrowing Costs' states that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for 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. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2021-22 should be calculated as follows:

Actual interest for 2021-22 (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 2021-22	₹ 13.50 crores

Question 6

ABC Limited has started construction of an asset on 1st December, 2021, which continues till 31st March, 2022 (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 2021 and ₹ 4 lakh in each of the months of January to March 2022. 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, 2022. Interest was paid on the overdraft at 10% until 1st January, 2022 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'. (5 Marks Nov'21 & April 23)

Answer 6

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	**Period of Outstanding balance**	**Amount of loan(Rs.)**	**Rate of interest p.a.**	**Weighted average amount of Interest (Rs.)**
	a	b	c	d=[bXc)X(a/12)]
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		2,26,000

Weighted average cost of borrowings

=(20,00,000 x(12/12))+(4,00,000 x(11/12))+(8,00,000 x (1/12)} = 24,33,334

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

Question 7

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31 st March, 2021 amounted to ₹ 25 lakhs. the company wants to treat ₹ 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan

was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16. (RTP Nov 21, Nov 19, May'18)

Answer 7

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 8

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief. (RTP May '21, Nov'20, Old & New SM)

Answer 8

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 9

Zen Bridge Construction Limited obtained a loan of Rs. 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	Rs. 50 crores
(ii)	Purchase of Equipment and Machineries	Rs. 6 crores
(iii)	Working Capital	Rs. 4 crores
(iv)	Purchase of Vehicles	Rs. 1crore
(v)	Advances for tools/cranes etc.	Rs. 1crore
(vi)	Purchase of Technical Know how	Rs. 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2018	Rs. 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited. (RTP May 19)

Answer 9

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized Rs. in crores	Interest to be charged to Profit & Loss A/c Rs. in crores	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No		0.05	1.6/64 x 2
Total		1.25	0.35	

*Note: It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

Question 10

(a) **An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?**

(b) **Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress? (RTP May '22)**

Answer 10

(a) As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

(b) As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete". The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the cost of the asset.

Question 11

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over s everal years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I	Phase II	Phase III	Phase IV
	₹	₹	₹	₹
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year. (RTP Nov '22)

Answer 11

	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 = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment:

1. **For Phase I and Phase II**
Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

2. **For Phase III and Phase IV**
Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Question 12

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2021. Money raised from debentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40

Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:
Interest on debentures for the Financial Year 2021-2022 was paid by the Company.

During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

In March, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).

In March 2022, Machinery was installed and ready for its intended use.

Furniture was put to use at the end of March 2022.

Truck is going to be received in April, 2022.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2022 in the Books of Expert Limited. (RTP May 23)

Answer 12

According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As per the Standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount o f borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = ₹ 10,00,000 (100 lakhs x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory	Qualifying Asset	9,50,000x40/100	NIL
building		= ₹ 3,80,000	
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100
			= 1,42,500
Purchase of and	Not a Qualifying Asset	NIL	9,50,000x2/100
furniture			=19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100
			= 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100
			= ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

Question 13

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

	₹ (in lakhs)
Construction for factory shed	**240**
Purchase of Machinery	**30**
Working capital	**24**
Purchase of Vehicles	**12**
Advance for tools/cranes etc.	**8**
Purchase of technical know how	**6**

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was ₹ 40 lakhs.
In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets. (PYP 5 Marks Nov '20)(MTP 5 Marks Sep '23)

Answer 13

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are non-qualifying assets and related borrowing cost will be charged to Profit and Loss statement. Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs. Note: Assumed that construction of factory shed completed on 31st March, 2020.

Question 14

First Ltd. began construction of a new factory building on 1st April, 2017. It obtained Rs. 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

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

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

Date	Amount (Rs.)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS 16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building. (PYP May '19, 5 Marks)

Answer 14

(i) Computation of average accumulated expenses

		Rs.
Rs. 3,00,000 x 12 / 12	=	3,00,000
Rs. 2,40,000 x 10 / 12	=	2,00,000
Rs. 4,00,000 x 8 / 12	=	2,66,667
Rs. 3,60,000 x 3 / 12	=	90,000
		8,56,667

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (₹)
4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	14%	= 42,000
Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000} \times 100\right)$		1,38,000
		= 11.5%

(iii) Amount of interest to be capitalized

Interest on average accumulated expenses:	Rs.
Specific borrowings (Rs. 2,00,000 x 8%)	= 16,000
Non-specific borrowings (Rs. 6,56,667* x 11.5%)	= 75,517
Amount of interest to be capitalised	= 91,517

(iv) Total expenses to be capitalized for building

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

(v) Journal Entry

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
31.3.2018	Building A/c Dr.	13,91,517	
	To Building WIP* A/c		13,00,000
	To Borrowing costs A/c (Being amount of cost of building and borrowing cost thereon capitalized)		91,517

Question 15

Zebra Limited began construction of a new plant on 1st April,2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

	₹
1st April,2021	**10,00,000**
1st August,2021	**24,00,000**
1st January,2022	**4,00,000**

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March,2022. You are required to:

(a) **Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".**

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant. (PYP 5 Marks May'22)

Answer 15

Total expenses to be capitalized for borrowings as per AS 16 "Borrowing Costs":

	₹
Cost of Plant (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalized (W.N.)	3,24,000
	41,24,000

Journal Entry

			₹	₹
31st March, 2022	Plant A/c	Dr.	41,24,000	
	To Bank A/c			
	[Being amount of cost of plant and borrowing cost thereon capitalized]			41,24,000

Working Note:

Computation of interest to be capitalized:

	Expenditure			₹
1st April, 2021	10,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021	24,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021		On non-specific borrowings	₹ 14,00,000$\times\frac{8}{12}$ x 12%	1,12,000
1st January, 2022	4,00,000	On non-specific borrowings	₹ 4,00,000 $\times\frac{8}{13}\times$12	12,000
				3,24,000

Alternatively, interest cost to be capitalized can be derived by computing average accumulated expenses in the following manner.

Computation of Average Accumulated Expenses:

1st April, 2021	10,00,000 x 12/12	10,00,000
1st August, 2021	10,00,000 x 12/12 14,00,000 x 8/12	10,00,000 9,33,333
1st January, 2022	4,00,000 x 3/12	1,00,000
		30,33,333

Computation of interest to be capitalized:

		₹
On specific borrowing	₹ 20,00,000 x 10%	2,00,000
On non-specific borrowing	₹ (30,33,333- 20,00,000) x 12%	1,24,000
		3,24,000

NOTE: Since specific borrowings are earmarked for construction of a particular qualifying asset, it cannot be used for construction of any other qualifying asset except for temporary investment. Therefore, once the commencement of capitalization of borrowing cost criteria are met, actual borrowing cost incurred on specific borrowing shall be capitalized irrespective of the fact that amount had been utilized in parts.

Question 16

On 1stApril, 2022 Workhouse Limited took a loan from a Financial Institution for ₹ 25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

i)	**8%**	**Debentures**	**₹ 15,00,000**
ii)	**15%**	**Term Loan**	**₹ 30,00,000**
iii)	**10%**	**Other Loans**	**₹ 18,00,000**

The company has utilised the above funds in construction / purchase of the following assets:

(i)	**Building**	**₹ 70,00,000**
(ii)	**Furniture**	**₹ 22,00,000**
(iii)	**Plant & Machinery**	**₹ 90,00,000**
(iv)	**Factory Shed**	**₹ 43,00,000**

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 1stApril 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets. (PYP 5 Marks May '23)

Answer 16

Interest to be Capitalized (on qualifying asset)

	Particulars	**Computation**	**₹**
i.	On specific Borrowings	25,00,000x12%	3,00,000
ii.	On non-specific borrowings	(W.N.1)	6,67,500
iii.	Amount of interest to be Capitalised	(i+ii)	9,67,500

Interest transferred to P&L (on non-qualifying asset)

	Particulars	Computation	₹
i.	On non-specific Borrowings	(W.N.1)	82,500

Working note:

1. Treatment of interest under AS 16 on non-specific borrowings

	Particulars	**Qualifying asset**	**# Computation**	**Interest-Capitalized**	**Interest charged to P&L A/c**
i.	Building	Yes	45,00,000/2,00,00,000 x 63,00,000 x 11.9048%	1,68,750	-
ii.	Furniture	No	22,00,000/2,00,00,000 x 63,00,000 x 11.9048%	-	82,500
iii.	Plant & Machinery	Yes	90,00,000/2,00,00,000 x 63,00,000 x 11.9048%	3,37,500	-
iv.	Factory shed	Yes	43,00,000/2,00,00,000 x 63,00,000 x 11.9048%	1,61,250	-
	Total			6,67,500	82,500

NOTE: Alternative manner of presentation for Treatment of interest under AS 16 on non-specific borrowings:

	Particulars	Qualifying asset	Expenses Incurred ₹	Share in borrowings ₹	Interest-Capitalized ₹	Interest charged to P&L A/c ₹
i.	Building	Yes	45,00,000	7,50,000 x 45/200	1,68,750	-
ii.	Furniture	No	22,00,000	7,50,000 x 22/200	-	82,500
iii.	Plant & Machinery	Yes	90,00,000	7,50,000 x 90 /200	3,37,500	-
iv.	Factory shed	Yes	43,00,000	7,50,000 x 43 / 200	1,61,250	-
	Total		**2,00,00,000**		**6,67,500**	**82,500**

2. Weighted Average interest rate for non-specific borrowings

Particulars	Amount of loan (a)	Rate of interest (b)	Amount of interest (c) = (a) x (b)
Debentures	15,00,000	8%	1,20,000
Term loan	30,00,000	15%	4,50,000
Other loans	18,00,000	10%	1,80,000
	63,00,000	# Weighted Average Rate of Interest = 7,50,000 / 63,00,000 x 100 = 11.9048%	7,50,000

Question 17

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. (RTP Nov '23)

Answer 17

Interest on Foreign Currency Loan:

= US $ 20,000 x₹ 50 per US $ x 6% = ₹ 60,000.

Foreign Exchange Loss on Foreign currency loan:

= US$ 20,000 x₹ (50-48) = ₹ 40,000.

Interest that would have been if the loan was taken in Indian currency i.e. local currency:

= US $ 20,000 x 48 x 11% = ₹1,05,600

Difference between interest on local currency borrowing and foreign currency borrowing:

= ₹ 1,05,600 - ₹ 60,000 = ₹45,600

The entire exchange difference of 40,000 would be considered as borrowing costs. The total borrowing cost would be ₹ 100000 (₹ 60000+ ₹ 40000).

Chapter 5.5
AS 19- Leases

Question 1

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being Rs. 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays Rs. 3,50,000. The lessee has guaranteed a residual value of Rs. 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be Rs. 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, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year. (MTP 5 Marks Apr'19, Oct'19, Mar'19, RTP May 20, RTP Nov 18)

Answer 1

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the stand point of the lessee.

Value of machinery

In the given case, fair value of the machinery is Rs. 10, 00,000 and the net present value of minimum lease payments is Rs. 10, 07,020 (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 value of Rs. 10,00,000.

Calculation of finance charges for each year

Year	Finance charge	Payment	Reduction in outstanding liability	Outstanding liability
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
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	37,366
Working Note:				

Present value of minimum lease payments

Annual lease rental x PV factor

Rs. 3,50,000 x (0.8621 + 0.7432 + 0.6407+ 0.5523) — Rs. 9,79 ,405

Present value of guaranteed residual value Rs. 50,000 x (0.5523) — Rs. 27,615

Rs. 10,07,020

Question 2

A Ltd. sold machinery having WDV of Rs. 40 lakhs to B Ltd. for Rs. 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Explain the accounting treatment as per AS 19 in the following cases:

(i) **Sale price of Rs. 50 lakhs is equal to fair value.**

(ii) **Fair value is Rs. 45 lakhs and sale price is Rs. 38 lakhs.**

(iii) **Fair value is Rs. 40 lakhs and sale price is Rs. 50 lakhs.**

(iv) **Fair value is Rs. 46 lakhs and sale price is Rs. 50 lakhs**

(v) **Fair value is Rs. 35 lakhs and sale price is Rs. 39 lakhs. (MTP 5 Marks Mar'18, Oct'18, PYP 5 Marks, May '18) (Same concept different figures PYP 5 Marks Jan 21, MTP 5 Marks Oct'20, MTP 5 Marks Oct'21, Old & New SM)**

Answer 2

Following will be the treatment in the given cases:

(i) When sale price of Rs. 24 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of Rs. 4 lakhs (i.e. 24 – 20) in its books.

(ii) When fair value is Rs. 20 lakhs & sale price is Rs. 24 lakhs then profit of Rs. 4 lakhs is to be deferred and amortised over the lease period.

(iii) When fair value is Rs. 22 lakhs & sale price is Rs. 25 lakhs, profit of Rs. 2 lakhs (22 - 20) to be immediately recognised in its books and balance profit of Rs.3 lakhs (25-22) is to be amortised/deferred over lease period.

(iv) When fair value of leased machinery is Rs. 25 lakhs & sale price is Rs. 18 lakhs, then loss of Rs. 2 lakhs (20–18) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.

(v) When fair value is Rs. 18 lakhs & sale price is Rs. 19 lakhs, then the loss of Rs. 2 lakhs (20-18) to be immediately recognised by A Ltd. in its books and profit of Rs. 1 lakhs (19-18) should be amortised/deferred over lease period.

Question 3

Sun Limited wishes to obtain a machine costing Rs. 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Star Ltd., for a lease rental for Rs. 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sun Limited is not sure about the treatment of these lease rentals and seeks your advise. You are required to explain the necessary accounting treatment in line with AS 19. (use annuity factor at @ 15% for 3 years as 3.36) (MTP 5 Marks, Aug'18, RTP Nov '19, RTP May 21)

Answer 3

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5) 3.36 (approx.)

Present Value of minimum lease payments (Rs. 3 lakhs each year) Rs. 10.08 lakhs (approx.)

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

Question 4

You are required to give the necessary journal entry at the inception of lease to record the asset taken on finance lease in books of lessee from the following information:
Lease period = 5 years;
Annual lease rents = Rs. 50,000 at the end of each year.
Guaranteed residual value = Rs. 25,000
Fair Value at the inception (beginning) of lease = Rs. 2,00,000
Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively). (MTP 5 Marks April 21, April 22)

Answer 4

Present value of minimum lease payment is computed below:

Year	MLP Rs.	DF (12.6%)	PV Rs.
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = Rs. 1,91,500 Fair value of leased asset = Rs. 2,00,000

As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease payments from the standpoint of the lessee. The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

	Rs.	Rs.
Asset A/c Dr.	1,91,500	
To Lessor (Lease Liability) A/c		1,91,500
(Being recognition of finance lease as asset and liability)		

Question 5

S. Square Private Limited has taken machinery on finance lease from S.K. Ltd. The information is as under: Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000 Lease rent = ₹ 6,25,000 p.a. at the end of year Guaranteed residual value = ₹ 1,25,000 Expected residual value = ₹ 3,75,000 Implicit interest rate = 15% Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

You are required to calculate the value of the lease liability as per AS-19 and also disclose impact of this on Balance sheet and Profit & loss account at the end of year 1. (MTP 5 Marks Nov '21 & April '23, Old & New SM)(Same concept different figures MTP 5 Marks Oct'22, PYP 5 Marks May '19)

Answer 5

According to AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

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

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

Minimum Lease Payment of 4th year includes guaranteed residual value amounting ₹ 1,25,000

Question 6

Sun Limited leased a machine to Moon Limited on the following terms:

	(Amount in ₹)
Fair value at inception of lease	**50,00,000**
Lease Term	**4 Years**
Lease Rental per annum	**16,00,000**
Guaranteed residual value	**3,00,000**
Expected residual value	**4,50,000**
Implicit Interest rate	**15%**

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

Calculate the value of Lease Liability and ascertain Unearned Finance Income as per AS-19.(MTP 5 Marks Sep'22) (Same concept different figures Old & New SM)

Answer 6

According to AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @15%)	Present value ₹
1	16,00,000	0.8696	13,91,360
2	16,00,000	0.7561	12,09,760
3	16,00,000	0.6575	10,52,000
4	19,00,000	0.5718	10,86,420
Total	67,00,000		47,39,540

Present value of minimum lease payments i.e. ₹ 47,39,540 is less than fair value at the inception of lease i.e. ₹ 50,00,000, therefore, the value of lease is ₹ 47,39,540 and lease liability should be recognized in the books at ₹ 47,39,540 as per AS 19.

Calculation of Unearned Finance Income

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:

I. **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)

= [(₹ 16,00,000 ×4 years) + ₹ 3,00,000] + ₹ 1,50,000 = ₹ 68,50,000

II. **Present value of minimum lease payment from Lessor's view point**

Lease liability ₹ 47,39,540 + present value of (URV) unguaranteed residual value

(₹ 1,50,000 x 0.5718) = ₹ 48,25,310

Unearned Finance Income = (a) – (b) = ₹ 68,50,000 – ₹ 48,25,310= ₹ 20,24,690

*Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e 16,00,000 + 3,00,000 =19,00,000.

Question 7

(a) Classify the following into either operating or finance lease:

(i) If Present value (PV) of Minimum lease payment (MLP) = "X" ; Fair value of the asset is "Y" and X=Y.

(ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee . (RTP Nov 20)

(b) Viral Ltd. sold machinery having WDV of Rs. 40 lakhs to Saral Ltd. for Rs. 50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –

(i) Fair value is Rs. 45 lakhs and sale price is Rs. 38 lakhs.

(ii) Fair value is Rs. 40 lakhs and sale price is Rs. 50 lakhs.

(iii) Fair value is Rs. 46 lakhs and sale price is Rs. 50 lakhs (RTP Nov 20, May 22)

Answer 7

(a) (i) The lease is a finance lease if X = Y, or if X substantially equals Y.

(ii)The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

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

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately.

Situation 2: Sale Price < Fair Value

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

Situation 3: Sale Price > Fair Value

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

Following will be the treatment in the situations given in the question:

(i) When fair value of leased machinery is Rs. 45 lakhs & sales price is Rs. 38 lakhs, then loss of Rs. 2 lakhs (40 – 38) to be immediately recognized by Viral Ltd. in its books provided loss is not compensated by future lease payment.

(ii) When fair value is Rs. 40 lakhs & sales price is Rs. 50 lakhs then, profit of Rs. 10 lakhs is to be deferred and amortized over the lease period When fair value is Rs. 46 lakhs & sales price is Rs. 50 lakhs, profit of Rs. 6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of Rs.4 lakhs (50-46) is to be amortized/deferred over lease period.

Question 8

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

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income. (RTP May 19)(MTP 5 Marks Sep '23)

Answer 8

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year = Rs. 50,000 x 0.7513= Rs. 37,565

Present value of lease payments = Rs. 5,00,000 – Rs. 37,565= Rs. 4,62,435

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

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

Calculation of Unearned Finance Income

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

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

= (Rs. 1,85,956 × 3) + Rs. 50,000

= Rs. 5,57,868 + Rs. 50,000 = Rs. 6,07,868

Unearned finance income

= Gross investment - Present value of minimum lease payments and unguaranteed residual value

= Rs. 6,07,868 – Rs. 5,00,000 = Rs. 1,07,868

Question 9

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively. (RTP May'18, May '23)

Answer 9

I. Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500.00

II. Computation of Unearned Finance Income

	₹
Total lease payments (₹ 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00

Less: Present value of investment (lease payments and residual value) (₹ 1,00,258.5+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question 10

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

(1) **Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.**

(2) **Lessee has option to purchase the asset at lower than fair value at the end of lease term.**

(3) **Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.**

(4) **Present Value (PV) of Minimum Lease Payment (MLP) = "X" Fair value of the asset is "Y" And X = Y.**

(5) **Economics 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. (PYP 5 Marks, Nov '19, Old & New SM)**

Answer 10

(i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.

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Question 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 of ₹ 2,25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

(i) **Annual Lease Rent**

(ii) **Lease Rent income to be recognized in each operating year and**

(iii) **Depreciation for 3 years lease (PYP 5 Marks Dec'21, MTP 4 Marks March 21 , MTP 4 Marks May 20, Old & New SM)**

Answer 11

i. **Annual lease rent**

Total lease rent

= 130% of ₹ 2,25,000 X Output during lease period/ Total output

= 130% of ₹ 2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = ₹ 1,46,250

Annual lease rent = ₹ 1,46,250 / 3 = ₹ 48,750

ii. **Lease rent Income to be recognized in each operating year**

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹ 39,000,

Year 2 ₹ 48,750 and

Year 3 ₹ 58,500.

iii. Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 2,25,000 should be allocated over useful life 5 years in proportion of output,

i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is ₹ 30,000, year 2 = 37,500 and year 3 = 45,000.

Question 12

What are the disclosures requirements for operating leases by the lessee as per AS-19? (PYP 5 Marks May'22)(New SM)

Answer 12

As per AS 19, lessees are required to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non- cancelable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Note: The Level II and Level III non-corporate entities (and SMCs) need not make disclosures required by (a), (b) and (e) above.

Question 13

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹ 11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each year, lessee pays ₹ 3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹ 70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹ 25,000. The implicit rate of return is 10% p.a. and present value factors at 10% are : 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19.(RTP Nov '23)

Answer 13

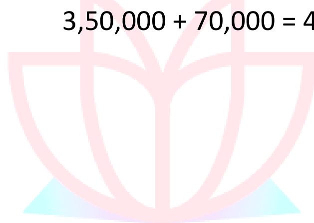
According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments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

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

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @10%)	Present value ₹
1	3,50,000	0.909	3,18,150
2	3,50,000	0.826	2,89,100
3	3,50,000	0.751	2,62,850
4	4,20,000*	0.683	2,86,860
Total	14,70,000		11,56,960

Present value of minimum lease payments ₹ 11,56,960 is more than fair value at the inception of lease i.e. ₹ 11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹ 11,50,000 as per AS 19.

* Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 3,50,000 + 70,000 = 4,20,000.



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Chapter 5.6
AS 26- Intangible Assets

Question 1

A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of Rs. 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in lakhs)	Net operating cash flow (Rs. in lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method. (MTP 5 Marks Oct'19, Apr'19)

Answer 1

As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used. In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	Net operating Cash in flow (Rs.)	Ratio	Amortize amount (Rs. in lakhs)
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200	0.11 (bal.)	22
	27,400	1.00	200

Question 2

K Ltd. launched a project for producing product X in October, 2016. The Company incurred Rs. 40 lakhs towards Research and Development expenses up to 31st March, 2018. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard. (MTP-Mar'19 5 Marks, RTP Nov 19, May 18, RTP Nov'22, Old & New SM)

Answer 2

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the

given case. Hence, the expenses amounting Rs.40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.

Question 3

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred Rs. 10 lakh on research during first 5 months of the financial year 2020-21. The development of the process began on 1st September, 2020 and up to 31st March, 2021, a sum of Rs. 8 lakhs were incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of Rs. 2 lakhs per annum for next five years. The cost of capital is 10%. The present value of annuity factor of Rs. 1 for 5 years @ 10% is 3.7908. Decide the treatment of Research and Development Cost of the project as per AS 26. (MTP 5 Marks April 21)

Answer 3

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product Rs. 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2020-21. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting Rs. 8 lakhs incurred up to 31st March, 2021 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	Rs. 2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (Rs. 2 lakhs x 3.7908)	Rs. 7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value Rs. 8 lakhs or present value of future net cash flows Rs. 7.582 lakhs.

Hence, cost of an internally generated intangible asset will be Rs. 7.582 lakhs.

The difference of Rs. 0.418 lakhs (i.e. Rs. 8 lakhs – Rs. 7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21. Amortization - The company can amortise Rs. 7.582 lakhs over a period of five years by charging Rs. 1.516 lakhs per annum from the financial year 2021-2022 onwards.

Question 4

Sudesh Ltd. acquired a patent at a cost of Rs. 2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at Rs. 48,00,000 per annum. After two years it was found that the product life -cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be Rs. 36,00,000, Rs. 46,00,000, Rs. 44,00,000, Rs. 40,00,000 and Rs. 34,00,000. Find out the amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years. (MTP 5 Marks Oct '20, Mar'22 & Oct '23)(Same concept different figures RTP Nov'18, Old & New SM, PYP 5 Marks May'18)

Answer 4

The entity amortized Rs. 48,00,000 per annum for the first two years i.e. Rs. 96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortization may be found as follows:

Year	Net cash flows Rs.	Amortization Ratio	Amortization Amount Rs.
I	-	0.20	48,00,000
II	-	0.20	48,00,000
III	36,00,000	0.180	25,92,000
IV	46,00,000	0.230	33,12,000

V	44,00,000	0.220	31,68,000
VI	40,00,000	0.200	28,80,000
VII	34,00,000	0.170	24,48,000
Total	2,00,00,000	1.000	2,40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

Question 5

During 2019-20, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	Rs.
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts. (MTP 5 Marks May '20, Oct'21 & April '23, Old & New SM)

Answer 5

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model. In this case, Rs. 90,000 would be recorded as an expense (Rs. 50,000 for completion of detailed program design and Rs. 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) = Rs. 1,00,500. Packing cost Rs. 16,500 should be recognized as expenses and charged to Profit & Loss A/c.

Question 6

PIL Ltd. is showing an intangible asset at Rs. 72 lakhs as on 31-3-2022. This asset was acquired for Rs. 120 lakhs as on 01-04-2016 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis. You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books. (MTP 5 Marks April 22, MTP 4 Marks March'21, RTP Nov '21)

Answer 6

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2022 at Rs. 48 lakhs i.e. Rs. 120 lakhs less Rs. 72 lakhs (Rs. 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of Rs. 24 Lakhs (Rs. 72 lakhs – Rs. 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of Rs. 48 lakhs will be amortized over remaining 4 years by amortizing Rs. 12 lakhs per year.

The necessary journal entry (for rectification) will be Revenue Reserves Dr.	Rs. 24 Lakhs	
To Intangible Assets		Rs. 24 Lakhs

(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

Question 7

Surya Ltd. had the following transactions during the year ended 31 st March, 2021.

(i) **It acquired the business of Gomati Limited on a going concern basis for ₹ 25,00,000 on 1st June,2020. The fair value of the Net Assets of Gomati Limited was ₹ 18,75,000. Surya Ltd. believes that due to popularity of the products of Gomati Limited in the market, its goodwill exists.**

(ii) **On 20th August, 2020, Surya Ltd. incurred cost of ₹ 6,00,000 to register the patent for its product. Surya Ltd. expects the Patent's economic life to be 8 years.**

(iii) **On 1st October, 2020, Surya Ltd. has taken a franchise to operate an ice cream parlour from Volga Ltd. for ₹ 4,50,000 and at an Annual Fee of 10 % of Net Revenues (after deducting expenditure). The franchise expires after six years. Net Revenue for the year ended 31st March, 2021 amounted to ₹ 1,50,000.**

Surya Ltd. follows an accounting policy to amortize all Intangibles on Straight Line basis (SLM) over the maximum period permitted by the Accounting Standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business is to be amortized over 5 years (SLM).

Prepare an extract showing the Intangible Assets section in the Balance Sheet of Surya Ltd. as at 31st March, 2021. (MTP 5 Marks Oct'22, RTP May '21)

Answer 7

Surya Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2021

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	14,00,000

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	5,00,000	
	Patents (Refer to Note 2)	5,25,000	
	Franchise (Refer to Note 3)	3,75,000	14,00,000

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	25,00,000
	Less: Fair value of net assets acquired	(18,75,000)
	Goodwill	6,25,000
	Less: Amortization. over 5 years (as per SLM)	(1,25,000)
	Balance to be shown in the balance sheet	5,00,000
(2)	Patent	6,00,000
	Less: Amortization (over 8 years as per SLM)	(75,000)
	Balance to be shown in the balance sheet	5,25,000
(3)	Franchise	4,50,000
	Less: Amortization (over 6 years)	(75,000)
	Balance to be shown in the balance sheet	3,75,000

Question 8

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers

that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya". X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks? .(MTP 5 Marks March '23, RTP Nov'20)

Answer 8

As per para 59 of AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs must be recognised as an expense.

Question 9

A company acquired patent right for Rs.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 (Rs. 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 Rs. 150 lakhs. You are required to determine the amortization pattern under Accounting Standard 26. (RTP May 20),(Same concept different figures PYP 5 Marks Nov'20)

Answer 9

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (Rs. in lakhs)	Amortization Ratio	Amortized Amount (Rs. in lakhs)
1	600	.25	300
2	600	.25	300
3	600	.25	300
4	300	.40 (Revised)	120
5	300	.40 (Revised)	120
6	150	.20 (Revised)	60
			1,200

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be Rs. 300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Question 10

PQR Ltd. has acquired a Brand from another company for Rs. 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards. (May 22)

Answer 10

AS 26 'Intangible Assets" provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and

any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

Question 11

X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of Accounting Standards. (RTP May 22)

Answer 11

As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Question 12

As per provisions of AS-26, how would you deal to the following situations:

(1) ₹ 23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.

(2) During the year 2021-22, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product. (RTP May '23, PYP Nov '19 5 Marks) (Same concept different figures RTP May'19, Old & New SM)

Answer 12

As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹ 23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(ii) The company is required to expense the entire amount of ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 2022 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹ 25,00,000 and it should be recognized as expense

(iv) Expenditure of ₹ 50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account

Question 13

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹ 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%

(ii) Additional Import Duty 5%

(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses ₹ 1,50,000.

Professional fees for clearance from customs ₹ 50,000. Compute the cost of software to be Capitalized as per relevant AS. (PYP 5 Marks , Jan 21)

Answer 13

Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	170,91,875

Note: Since entry tax has been mentioned as a recoverable / refundable tax, it is not included as part of the cost of the asset.

Question 14

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹ 80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹ 42 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹ 90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹ 82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out :

(1) **What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?**

(2) **What is the carrying amount of the intangible asset as on 31st March, 2019?**

(3) **What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020 ?**

(4) **What is the carrying amount of the intangible asset as on 31st March, 2020? (PYP 5 Marks Nov 20 & Dec '21) (Same concept lesser adjustments MTP 5 Marks Sep'22 & Sep '23)**

Answer 14

As per AS 26 'Intangible Assets'

(i) **Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019**

₹ 42 lakhs is recognized as an expense because the recognition criteria were not met until 1st November, 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) **Carrying value of intangible asset as on 31.03.2019**

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

(iii) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020**

	(₹ in lacs)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and loss account	46

₹ 46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

(iv) **Carrying value of intangible asset as on 31.03.2020**

	(₹ in lacs)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

Question 15

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹ 600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	**1**	**2**	**3**	**4**	**5**
Cash Flows (₹ in lacs)	**300**	**300**	**300**	**150**	**150**

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.(RTP Nov '23)

Answer 15

Amortization of cost of patent as per AS 26

Year	**Estimated future cash flow (₹ in lakhs)**	**Amortization Ratio**	**Amortized Amount (₹ in lakhs)**
1	300	.25	150
2	300	.25	150

3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	600

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).The unamortized amount of the patent after third year will be ₹ 150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

Chapter 5.7
Accounting Standard 28 Impairment of Assets

Question 1

Wow Ltd. is developing a new production process. During the financial year ending 31st March, 2018, the total expenditure incurred was Rs. 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2017. Expenditure incurred till this date was Rs.22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2019 was Rs. 80 lakhs. As at 31st March, 2019, the recoverable amount of know-how embodied in the process is estimated to be Rs. 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

i. Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2018 and carrying value of intangible as on that date.

ii. Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2019.
Ignore depreciation. (MTP Oct 18 4 Marks)

Answer 1

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2018

(1) Carrying value of intangible as on 31.03.2018:

At the end of financial year 31st March 2018, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2017).

(2) Expenditure to be charged to Profit and Loss account:

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2018. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2019

(1) **Expenditure to be charged to Profit and Loss account:**

	(Rs. in lakhs)
Carrying Amount as on 31.03.2018	28
Expenditure during 2018 –2019	80
Total book cost	108
Recoverable Amount	(72)
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2019.

(2) **Carrying value of intangible as on 31.03.2019:**

	(Rs.in lakhs)
Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2019	72

Question 2

H Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2018, the Government put restriction on export of goods exported by H Ltd. and due to that restriction H Ltd. impaired its assets. H Ltd. acquired identifiable assets worth of Rs. 4,000 lakh for Rs. 6,000 lakh at the end of the year 2014. The difference is treated as goodwill. The useful life of identifiable assets is 15

years and depreciated on straight line basis. When Government put the restriction at the end of 2018, the company recognised the impairment loss by determining the recoverable amount of assets for Rs. 2,720 lakh. In 2020 Government lifted the restriction imposed on the export and due to this favourable change, H Ltd. re-estimate recoverable amount, which was estimated at Rs. 3,420 lakh.

Required:

(i) Calculation and allocation of impairment loss in 2018.

(ii) Reversal of impairment loss and its allocation as per AS 28 in 2020. (RTP Nov 20)

Answer 2

(i) Calculation and allocation of impairment loss in 2018(Amount in Rs. lakh)

	Goodwill	**Identifiable assets**	**Total**
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortization (4 yrs.)	(1,600)	(1,067)	(2,667)
Carrying amount before impairment	400	2,933	3,333
Impairment loss*	(400)	(213)	(613)
Carrying amount after impairment loss	0	2,720	2,720

Notes:

1. As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:
   (a) first, to goodwill allocated to the cash-generating unit (if any); and
   (b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.
2. Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortise over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.

(ii) Carrying amount of the assets at the end of 2020 (Amount in Rs. lakh)

End of 2020	**Goodwill**	**Identifiable assets**	**Total**
Carrying amount in 2020	0	2,225	2,225
Add: Reversal of impairment loss (W.N.2)	-	175	175
Carrying amount after reversal of impairment loss	-	2,400	2,400

Working Note:

1. Calculation of depreciation after impairment till 2020 and reversal of impairment loss in 2020

(Amount in Rs. lakh)			
	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in 2018	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	–	(495)	(495)
Carrying amount	0	2,225	2,225

Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted at the end of the year 2020.

2. Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of 2020

(Amount in Rs. lakh)

End of 2020	Identifiable assets
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N.1)	2,225
Amount of reversal of impairment loss	175

Notes:

1. As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:

   (a) its recoverable amount (if determinable); and

   (b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

   Hence impairment loss reversal is restricted to Rs. 175 lakh only.

2. The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

Question 3

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self - created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economiclives and replace them immediately with new titles for the same customer segment.

What is the cash-generating unit as per AS 28? (RTP May 20)(New SM)

Answer 3

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

Question 4

M Ltd. has three cash-generating units: A, B and C. Due to adverse changes in the technological environment, M Ltd. conducted impairment tests of each of its cash- generating units. On 31st March, 2018, the carrying amounts of A, B and C are Rs. 100 lakhs, Rs. 150 lakhs and Rs. 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is Rs. 200 lakhs: a headquarter building of Rs. 150 lakhs and a research centre of Rs. 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

Following is the remaining estimated useful life of:

	A	B	C	Head quarter assets
Remaining estimated useful life	10	20	20	20

The headquarter assets are depreciated on a straight-line basis.

The recoverable amount of each cash generating unit is based on its value in use sincenet selling price for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	B	C	M Ltd. as a whole
Recoverable amount	199	164	271	720*

***The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.**

Calculate and show allocation of impairment loss as per AS 28. Ignore tax effects. (RTP Nov 18)

Answer 4

1. **Identification of Corporate Assets of M Ltd.**

   Here, the corporate assets are the headquarter building and the research centre.

   For corporate building

   Since, the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a ₹bottom-up₹ test is necessary.

   For research centre

   Since the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual CGU under review. Therefore, a ₹top-down₹ test will be applied in addition to the ₹bottom-up₹ test.

2. **Allocation of Corporate Assets**

   Since the estimated remaining useful life of A₹s CGU is 10 years, whereas the estimated remaining useful lives of B and C₹s CGU are 20 years, the carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit on weight basis.

3. **Calculation of a weighted allocation of the carrying amount of the headquarter building (Amount in Rs. lakhs)**

On 31st March, 2018	A	B	C	Total
Carrying amount **(A)**	100	150	200	450
Useful life	10 years	20 years	20 years	
Weight based on useful life	1	2	2	
Carrying amount after weight	100	300	400	800
Pro-rata allocation of the building	12.5%	37.5%	50%	100%
	(100/800)	(300/800)	(400/800)	
Allocation of the carrying amount of thebuilding (based on pro-rata above) **(B)**	18.75	56.25	75	150
Carrying amount (after allocation of thebuilding)	118.75	206.25	275	600

4. Calculation of Impairment Losses

a. Application of ₹bottom-up₹ test (Amount in Rs. lakhs)

31st March, 2018	A	B	C
Carrying amount (after allocation of the building)(Refer point 3 above)	118.75	206.25	275
Recoverable amount (given in the question)	199	164	271
Impairment loss	0	(42)	(4)

Allocation of the impairment losses for cash-generating units B and C (Amount in Rs. lakhs)

Cash-generating unit	B	C
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

Since the research centre could not be allocated on a reasonable and consistent basis to A, B and C₹s CGU, M Ltd. compares the carrying amount of the smallest CGU to which the carrying amount of the research centre can be allocated (i.e.,M as a whole) to its recoverable amount, in accordance with the ₹top-down₹ test.

Application of the ₹top-down₹ test (Amount in Rs. lakhs)

31st March, 2018	A	B	C	Building	Research Centre	M Ltd.
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the ₹bottom-up₹ test	–	(30)	(3)	(13)	–	(46)
Carrying amount after the ₹bottom-up₹ test	100	120	197	137	50	604
Recoverable amount						720

Since recoverable amount is more than the carrying amount of M Ltd., no additional impairment loss has been resulted from the application of the top- down test. Only an impairment loss of Rs. 46 lakhs will be recognized as a result of the application of the ₹bottom-up₹ test.

Question 5

M Ltd. produces a single product and owns plants A, B and C. Each plant is located in a different continent. Plant A produces a component that is assembled in either plant B or plant C. The combined capacity of plants B and C is not fully utilised.M Ltd.₹s products are sold world-wide from either plants B or C i.e. plant B₹s production can be sold in plant C₹s continent if the products can be delivered fasterfrom plant B than from plant C. Utilisation levels of plant B and plant C depend onthe allocation of sales between the two sites.

For each of the following cases, what are the cash-generating units for plants A, Band C?

Case 1: There is an active market for plant A₹s products.

Case 2: There is no active market for plant A₹s products. (RTP May 18)

Answer 5

(a) Case 1: It is likely that A is a separate cash-generating unit because there is an active market for its products.

Although there is an active market for the products assembled by B and C, cashinflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

In determining the value in use of A and B plus C, M Ltd. adjusts financial budgets/forecasts to reflect its best estimate of future market prices forA₹s products.

Case 2: It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) there is no active market for A's products. Therefore, A's cash inflows dependon sales of the final product by B and C; and

(b) although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

As a consequence, it is likely that A, B and C together (i.e., M Ltd. as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

Question 6

G Ltd., acquired a machine on 1st April, 20X0 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.(New SM) (PYP 5 Marks May '18) (MTP 4 Marks Oct '17)

Answer 6

Statement Showing Impairment Loss

(₹ in crores)	
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X	

$\left[\frac{7\ Crores}{7\ Years} \times 4\ years\right]$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserveaccount)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10
Less: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\left[\frac{5.10\ Crores}{3\ Years} \times 4\ years\right]$	(3.40)
Carrying amount as on 31.03.20X6	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve	
20X4-20X5 & 20X5-20X6=[(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 “Impairment of Assets”	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

Question 7

C Ltd. acquired S Ltd. business (a cash generating unit) on 31-3-2016 for ₹ 8,000 Lakhs. The details of acquisition are us under: -

Fair value of identifiable asset	**6000 Lakhs**
Goodwill	**2000 Lakhs**

The anticipated useful life of acquired assets is 5 years Goodwill is to be amortised in 4 years C Ltd. uses straight-line method of depreciation with no residual values anticipated. On 31-3-2018, C Ltd. estimated the significant decline in production due to change in Government policies. The net selling price of identifiable asset is not determinable. The cash flow forecast based on recent financial budget for next 7 years after considering change in Govt. policies are as follows. Incremental financing cost is 8% which represent current market assessment of the time value of money.

			₹ in Crore
Year	**Cash flow**	**Year**	**Cash flow**
2019	**800**	**2022**	**600**
2020	**800**	**2023**	**600**
2021	**800**	**2024**	**500**
		2025	**400**

You are required to calculate:

(i) Value in use

(ii) Impairment loss

(iii) Revised carrying amount on 31-3-2018 (PYP Nov 18 5 Marks)

Answer 7

(i) Value in Use

Year ended on 31st March	Cash flow (₹ in lakh)	Discounting factor @ 8%	Present Value (₹ in lakh)
2019	800	0.926	740.80
2020	800	0.857	685.60
2021	800	0.794	635.20
2022	600	0.735	441.00
2023	600	0.681	408.60
2024	500	0.630	315.00
2025	400	0.583	233.20 3459.40

(ii) Impairment loss

Impairment loss = Carrying amount of the asset - Recoverable Amount

= ₹ 4,600 lakhs - ₹ 3,459.40 lakhs (Refer W.N.)

= ₹ 1,140.60 lakhs

(iii) Revised Carrying Amount on 31.3.2018

As per para 87 of AS 28 'Impairment of Assets', an impairment loss should be allocated to reduce the carrying amount of the assets of CGU in the following order:

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value. **(₹ in lakh)**

	Goodwill	Identifiable assets	Total
Useful life	4 years	5 years	
Historical cost	2,000	6,000	8,000
Accumulated depreciation/amortization (for 2 years)	(1,000)	(2,400)	(3,400)
Carrying amount before impairment	1,000	3,600	4,600
Impairment loss	(1,000)	(140.60)	(1,140.60)
Revised carrying amount after impairment loss	0	3,459.40	3,459.40

Working Note:

Calculation of Recoverable Amount

Recoverable amount = Higher of Asset's Net Selling Price or Value in Use

Where, Asset's net selling price is not determinable

Recoverable Amount of the asset will be equal to the Value in use ie. ₹ 3,459.40 lakh.

Question 8

Himalaya Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2014, the Government put restriction on export of goods exported by Himalaya Ltd. and due to that restriction Himalaya Ltd. impaired its assets. Himalaya Ltd. acquired identifiable assets worth of ₹ 4,000 lakhs for ₹ 6,000 lakh at the end of the year 2010. The difference is treated as goodwill. The useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 2014, the company recognised the impairment loss by determining the recoverable amount of assets for ₹ 2,720 lakh. In 2016 Government lifted the restriction imposed on the export and due to this favourable change, Himalaya Ltd. re-estimate recoverable amount, which was estimated at ₹ 3,420 lakh.

Required:

(i) Calculation and allocation of impairment loss in 2014.

(ii) Reversal of impairment loss and its allocation as per AS 28 in 2016. (PYP Nov 17)

Answer 8

(i) Calculation and allocation of impairment loss in 2014 **(Amount in ₹ lakhs)**

	Goodwill	Identifiable assets	Total
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortization (4 yrs.)	(1,600)	(1,067)	(2,667)
Carrying amount before impairment	400	2,933	3,333
Impairment loss*	(400)	(213)	(613)
Carrying amount after impairment loss	0	2,720	2,720

* Notes:

1. As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.

2. Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortise over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.

(ii) Carrying amount of the assets at the end of 2016 **(Amount in ₹ lakhs)**

End of 2016	**Goodwill**	**Identifiable assets**	**Total**
Carrying amount in 2016	0	2,225	2,225
Add: Reversal of impairment loss (W.N.2)	-	175	175
Carrying amount after reversal of impairment loss	-	2,400	2,400

Working Note:

Calculation of depreciation after impairment till 2016 and reversal of impairment loss in 2016

(Amount in ₹			lakhs)
	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in 2014	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	–	(495)	(495)
Carrying amount	0	2,225	2,225
Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted atthe end of the year 2016.

Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of 2016

(Amount in ₹ lakhs)

End of 2016	Identifiable assets
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N. 1)	2,225
Amount of reversal of impairment loss	175

Notes:

1. As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:

   (a) its recoverable amount (if determinable); and

   (b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognized for the asset in prior accounting periods.

   Hence impairment loss reversal is restricted to ₹175 lakhs only.

2. The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance inthe goodwill account in the 6th year even without impairment loss. Hencein W.N. 2 above there is no column for recalculation of goodwill.

Chapter 6.1
Employee Benefits

Question 1

Kumar Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employee is estimated to be 6 years. You are required to advise the company. (MTP May 20)

Answer 1

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of Rs. 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Kumar Ltd. cannot spread the actuarial gain of Rs. 6 lakhs over the next 2 years by reducing the annual contributions to Rs. 2 lakhs instead of Rs. 5 lakhs. It has to contribute Rs. 5 lakhs annually for its pension schemes.

Question 2

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (MTP 5 Marks Aug 18)

Answer 2

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 3

Samvit Ltd. has three business segments which are FMCG, Batteries and Sports Equipment. The Battery segment has been consistently underperforming and Samvit Ltd. after several discussions with labour unions have finally decided on closure of this segment. Under the agreement with the labour union, the employees of the Battery Segment will earn no further benefit as the arrangement

is a curtailment without settlement wherein the employees of the discontinued segment will continue to receive benefits for services rendered when the segment was functioning. As a result of the curtailment, the company's obligations that were arrived on the basis of actuarial valuations before the curtailment have come down. The following information is also furnished:

(i) The value of gross obligations before the curtailment calculated on actuarial basis was Rs. 6,000 lakhs.

(ii) The value of unamortized past service costs is Rs. 150 lakhs.

(iii) The curtailment will bring down gross obligations by Rs. 750 lakhs and Samvit Ltd. anticipates a proportional decline in the value of unamortized past service costs also.

(iv) The fair value of plan assets on date is estimated at Rs. 4,875 lakhs.

You are required to calculate the gain from curtailment and also show the li ability to be recognized in the Balance Sheet of Samvit Ltd. after the curtailment. (Mar 17) (MTP) (5 Marks)

Answer 3

Gain from curtailment

	(Rs. in lakhs
Reduction in gross obligation [(750/6,000) x 100] = 12.5%	750.00
Less: Proportion of unamortised past service cost	
(12.5% of Rs. 150)	(18.75)
Gain from curtailment	731.25

The liability to be recognised after curtailment in the balance sheet of Samvit Ltd. is estimated as under:

	Rs.
Reduced gross obligation (Rs. 6,000 - Rs. 750)	5,250.00
Less: Fair value of plan assets	(4,875.00)
	375.00
Less: Unamortised past service cost (150.00 – 18.75)	(131.25)
Liability to be recognised in the balance sheet	243.75

Question 4

Luv limited is a private Limited company. As per HR policy of Luv Limited, Grade F employees are eligible for sabbatical leave (Long term compensated absences as per AS 15). Till previous year, there were 15 employees who are eligible for Sabbatical leave and company had duly recorded the liability for long term compensated absences based on the actuarial valuation for eligible employees. During the current period out of total 15 employees, 13 employees have left the organization and only 2 employees are continuing in LUV Limited. Due to budget constraint, CFO has denied to involve actuary and told finance manager to determine the liability based on the recent actuarial report available with them. Finance manager ensured the following:

- **There is no material change in interest rate**
- **There is no change in fair value of plan assets.**

Based on that, Finance manager have manually computed an amount of Rs. 5,00,000 (considering last year actuarial report as base) towards long term compensation liability without involving Actuary during the period ended 31.03.2020. Is this treatment is in line with AS 15?
(RTP Nov 20)

Answer 4

As per para 58 of the AS 15, the detailed actuarial valuation of the present value of defined benefit obligations may be made at intervals not exceeding three years. However, with a view that the amounts recognized in the financial statements do not differ materially from the amounts that would be

determined at the balance sheet date, the most recent valuation is reviewed at the balance sheet date and updated to reflect any material transactions and other material changes in circumstances (including changes in interest rates) between the date of valuation and the balance sheet date. The fair value of any plan assets is determined at each balance sheet.

Since AS-15 (Para 58) states that actuarial valuation needs to be done at least once in three years. Since management had done the actuarial valuation in Previous Year, they can go ahead with exemption for this year subject to evaluation and conclusion by management as at balance sheet date that there are no significant changes in the amount of liability compared to previous year. Hence working done by the finance manager is appropriate. It is in line with AS 15, since company had recently done the actuarial valuation in previous year and there is no material changes in the external environment.

Question 5

Synergy Ltd., is in engineering industry. The companyreceived an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employee is estimated to be 6 years.You are required to advise the company. (RTP Nov 19)

Answer 5

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediatelyin the statement of profit and loss as income or expense. Therefore, surplus of Rs. 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Synergy Ltd. cannot spread the actuarial gain of Rs. 6 lakhs over the next 2 years by reducing the annual contributions to Rs. 2 lakhs instead of Rs. 5 lakhs. It has to contribute Rs. 5 lakhs annually for its pension schemes

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 6

Peter Ltd. discontinues a business segment. Under the agreement with employee₹s union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Peter Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at Rs. 18 (10% of Rs. 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Peter Ltd. on the basis of given information:

(a) Immediately before the curtailment, gross obligation is estimated at Rs. 6,000 based on current actuarial assumption.

(b) The fair value of plan assets on the date is estimated at Rs. 5,100.

(c) The unamortized past service cost is Rs. 180.

(d) Curtailment reduces the obligation by Rs. 600, which is 10% of the gross obligation. (RTP May 19)(New SM)

Answer 6

Gain from curtailment is estimated as under:

	Rs.
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	Rs.
Reduced gross obligation (90% of Rs. 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of Rs. 180)	(162)
Liability to be recognised in the balance sheet	138

Question 7

Neerav Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employee is estimated to be 6 years. You are required to advise the company in accordance with AS 15. (RTP May 18)

Answer 7

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Neerav Ltd. cannot spread the actuarial gain of ₹ 6 lakhs over the next 2 years by reducing the annual contributions to ₹ 2 lakhs instead of ₹ 5 lakhs. It has to contribute ₹ 5 lakhs annually for its pension schemes.

Question 8

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for the class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump-sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employees. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it should account for liability on an actual "on claim" basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (RTP May 17)

Answer 8

The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the Statement of Profit and Loss. The contention of the Company that the settlement allowance will be accounted for 'on

claim basis' is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control.

Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Chapter 6.2
AS 29- Provisions, Contingent Liabilities & Contingent Assets

Question 1

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. You are required to comment on the validity of the treatment done by the company in line with the provisions of AS 29. (MTP 5 Marks- Oct'19, Aug'18, Nov'21 & April '23)

Answer 1

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29. The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

Question 2

Sun Ltd. has entered into a sale contract of Rs. 5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is Rs. 1 crore. The delivery of goods to take place during the first month of 2016- 2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of Rs. 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015- 2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29? Explain.

(ii) Should provision be measured as the excess of compensation to be paid over the profit? (MTP 5 Marks Mar'19, Mar'18) (Same concept lesser adjustments RTP Nov'20)

Answer 2

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs. 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting Rs. 1.50 crores.

Question 3

S Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2016-17, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2016-17 on the estimated basis as the report of the commission is yet to come. As per the contracts with the 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 this employee s on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of Rs. 680 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/recognise the income by Rs. 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the Accountant with reference to relevant accounting standards. (MTP 5 Marks Oct'18)

Answer 3

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

Accordingly, 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. In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 680 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 Rs. 680 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 Rs. 680 lakhs is not as per AS-29 and also the concept of prudence will not be followed if Rs. 680 lakhs is simultaneously recognized as income. Rs. 680 lakhs is 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 Rs. 680 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.

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 4

(i) XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of Rs. 200 lacs. The Directors are of the view that the claim can be successfully resisted by the Company. How would the matter be dealt in the annual accounts of the Company in the light of AS 29? Explain in brief giving reasons for your answer.(RTP Nov 18, May 19)

(ii) What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard? (MTP 5 Marks April 21, April 22)

Answer 4

(i) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of Rs. 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

(ii) As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

Question 5

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. With reference to AS 29, how would you deal with this in the annual accounts of the company at the Balance Sheet date? Explain. (MTP 5 Marks March 21, RTP May'20, PYP 2.5 Marks Nov'20, Old & New SM)

Answer 5

The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

Question 6

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2022 and needs your expert advice on the following issues in line with the provisions of AS 29:

(i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of Rs. 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of Rs. 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 had committed to supply a consignment worth Rs. 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 Rs. 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth Rs. 30 lakhs which was in transit. (MTP 5 Marks Oct '21 ,March '23 & Oct '23)

Answer 6

(i) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty. However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2021-2022.

(ii)	Loss due to accident		Rs. 30,00,000
	Insurance claim receivable by company = Rs. 30,00,000 x	=	Rs. 27,00,000

	90%		
	Loss to be recognised in the books for 2019-2020		Rs. 3,00,000
	Insurance claim receivable to be recorded in the books		Rs. 27,00,000

Compensation claim by dealer against company to be provided for in the books
= Rs. 30,00,000 x 15% = Rs. 4,50,000

Question 7

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that th e company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29. (MTP 5 Marks Mar'22 & Sep '22, RTP Nov'19)

Answer 7

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision. It is apparent from the Question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 8

A Company dealing in software provides after sales warranty for 2 years to its customer. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year: 3% provision

More than 1 year: 4% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2019	1,20,000
29th January, 2020	75,000
15th October, 2020	2,70,000

You are required to calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2020 and 31st March, 2021. Also compute the amount to be debited to Profit and Loss Account for the year ended 31st March, 2021. (MTP 5 Marks Oct'22, PYP 5 Marks Nov '19, RTP May '23)

Answer 8

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2020 = ₹ 1,20,000 x .03 + ₹ 75,000 x .04

= ₹ 3,600 + ₹ 3,000 = ₹ 6,600

As at 31st March, 2021 = ₹ 75,000 x .03 + ₹ 2,70,000 x .04

= ₹ 2,250 + ₹ 10,800 = ₹ 13,050

Amount debited to Profit and Loss Account for year ended 31st March, 2021

	₹
Balance of provision required as on 31.03.2021	13,050
Less: Opening Balance as on 1.4.2020	(6,600)
Amount debited to profit and loss account	6,450

Note: No provision will be made on 31st March, 2021 in respect of sales amounting ₹ 1,20,000 made on 19th January, 2019 as the warranty period of 2 years has already expired.

Question 9

(a) A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

(b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29? (RTP Nov '21)

Answer 9

(a) As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

From the above, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts and circumstances of the case.

(b) As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

Question 10

(a) The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to examine in line with the provisions of AS 29. (RTP May 21, May 18)

(b) Explain whether provision is required in the following situations in line with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote. (RTP May 21)

Answer 10

(a) As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the Question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

(b)

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognized. Disclosures are required for the provision.

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

Question 11

(a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief. (RTP Nov 20)

Answer 11

(a) A Contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

A present obligation that arises from past events but is not recognized because:

(i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may

never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

(b) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting Rs. 2 crores as per AS 29.

Question 12

With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31st Dec. 2019, it goes into liquidation. (Balance Sheet date 31-3-19). (RTP May 20)

Answer 12

(i) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 2019.Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

Question 13

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

(i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay Rs. 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(ii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of Rs. 10,00,000 for the said upgrade.

(iii) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of Rs. 5 crores.

Kindly give your Answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29. (RTP May'22)

Answer 13

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

(i) an entity has a present obligation (legal or constructive) as a result of a past event;

(ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as Rs. 3,00,000, there is a present obligation. Hence, provision should be recognised for Rs. 3,00,000 for the amount which may be required to settle the obligation.

(ii) Under new regulation, an entity is required to upgrade its facilities by 31 st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

(iii) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows: Probability of warranty cases for the entity where repair/replacement may be required as per past experience

= 1% of Rs. 5,00,00,000 = Rs. 5,00,000

Estimated cost of repair / replacement = Rs. 5,00,000 x 10% = Rs. 50,000.

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Question 14

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

(i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of ` 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.

(ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ` 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(iii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ` 10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29. (RTP Nov'22)

Answer 14

Principles for recognition of provisions:

As per AS 29, "a provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) In this case, there is no present obligation arising out of a past event as the goods are scheduled for

delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

(ii) On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ` 3,00,000, there is a present obligation. Hence, provision should be recognised for ` 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

Question 15

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.(PYP 2.5 Marks , Nov 20)

Answer 15

(i) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff. The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

Question 16

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalisation of the accounts for the year ended 31 st March,2022 and needs your advice on the following issues in line with the provisions of AS-29:

I. On 1stApril,2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March,2022, the company does not provide any provision for replacement of lining of the furnace.

II. A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalization of the case. There are 70% chances that the penalty may not be levied.. (PYP 5 Marks May'22)

Answer 16

I. A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is **recognized** as per AS 29. The cost of replacement of lining of furnace is not recognized as a provision because it is a future obligation. Even a legal requirement does not require the company to make a provision for the cost of replacement because there is no present obligation. Even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

II. As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 70% chances that the penalty may not be levied. Accordingly, Alloy Fabrication Ltd. should not make the provision for penalty. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

However, a provision should be made for remaining 40% fees of the lawyer amounting₹ 2,00,000 in the financial statements of financial year 2021-2022

Question 17

At the end of the financial year ending on 31stMarch, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Particulars	Probability	Loss (₹)
In respect of five cases	100%	-
(Win) Next ten cases (Win)	50%	-
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases	50%	-
Win Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29. (PYP 5 Marks Nov 22)

Answer 17

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 12,00,000 + 10% of ₹ 20,00,000

= ₹ 4,80,000 + ₹ 2,00,000

= 6,80,000

Expected loss in remaining five cases = 30% of ₹ 10,00,000 + 20% of ₹ 21,00,000

= ₹ 3,00,000 + ₹ 4,20,000

= ₹ 7,20,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of 1,04,00,000 (₹ 6,80,000 X 10 + ₹ 7,20,000 X 5) as contingent liability.

Question 18 (Includes concepts from AS 9- Revenue Recognition)

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March. (PYP 5 Marks, July 21, MTP Sep'23)

Answer 18

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(₹ in lacs)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80
Profit mark up on sales (80/400) x 100 = 20%	

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees did not determine the amount of provision to be made and revenue to be recognized correctly as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.

Question 19

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.(RTP Nov '23)(MTP 5 Marks Sep '23)

Answer 19

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig.

However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

Chapter 7.1

AS 4- Contingencies & Events occurring after the Balance Sheet Date

Question 1

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

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

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

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

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

A major fire had damaged the assets in a factory on 5th April, 2020. However, the assets were fully insured. With reference to AS 4, state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date. (MTP 5 Marks Oct '20, May'20, March'22, Old & New SM, RTP-May 20, May 18,PYP 5 Marks July 21, PYP 5 Marks May'19, RTP May'22)

Answer 1

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

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

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

(iv) Non-adjusting event: Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. In the given case, sale of immovable property was under proposal stage (negotiations only started) on the balance sheet date, and was not finalized. Therefore, adjustment to assets for sale of immovable property is not necessary in the financial statements for the year ended 31st March, 2020. Disclosure may be given in Report of approving Authority.

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

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

July 21 - Majority of the examinees failed to state that the events are to be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet date with reasons in line with the provisions of AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

May 19 - Majority of the examinees were not able to classify the events as 'contingencies', adjusting or non-adjusting event as per the provisions of AS-4 "Contingencies and events occurring after the balance sheet date".

Question 2

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at Rs. 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of Rs. 4,000 per machine.

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

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of Rs. 7,50,000 which is being carried in the books at Rs. 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of Rs. 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020. You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020. (MTP 5 Marks Oct '21 & Oct '23, RTP May'22)

Answer 2

Events occurring after the balance sheet date are those significant events, both favourable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to Rs. 4,000 per machine. Total value of inventory in the books will be 50 machines x Rs. 4,000 = Rs. 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020 -2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to

fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

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

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

Question 3

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2021. The accounting year of the company ended on 31.3.2021. The accounts were approved on 30.6.2021. The loss from earthquake is estimated at Rs. 25 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company. (MTP 5 Marks Nov '21 & April '23, RTP Nov 19, Old & New SM)

Answer 3

AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to earthquake is not to be recognized in the financial year 2020-2021. However, according the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the Question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of Rs. 25 lakhs should be disclosed in the Report of the Directors for the financial year 2020-2021.

Question 4

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for Rs. 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31 st March, 2016? Comment with reference to relevant Accounting Standard. (MTP 5 Marks March 19, April'19, RTP Nov 18)

Answer 4

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date. A debtor for Rs. 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date. Accordingly, full provision for bad debts amounting Rs. 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting Rs. 19,00,000 shall be made (20,00,000 x 95%).

Question 5

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of Rs. 2 per equity share (on 2 crore fully paid up

equity shares of Rs. 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders. Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements. (MTP 5 Marks Aug'18, Mar'18, RTP May'19)

Answer 5

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements. No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of Rs. 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

Question 6

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2022 (accounts were approved on 25th July, 2022):

(1) **Negotiations with another company for acquisition of its business was started on 21st January, 2022. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2022.**

(2) **The company made a provision for bad debts @ 4% of its total debtors (as per trend followed from the previous years). In the second week of March 2022, a debtor for ₹ 2,50,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In May, 2022 the debtor became bankrupt.**

(3) **During the year 2021-22, Hari Ltd. was sued by a competitor for ₹ 13 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Hari Ltd. provided for a sum of ₹ 8 lakhs in its financial statements for the year ended 31st March, 2022. On 26th May, 2022, the Court decided in favour of the party alleging infringement of the trademark and ordered Hari Ltd. to pay the aggrieved party a sum of ₹ 12 lakhs.**

(4) **Cashier of Hari Ltd. embezzled cash amounting to ₹ 3,00,000 during March, 2022. However the same comes to the notice of Company management during August, 2022.**

(5) **Cheques dated 31st March, 2022 collected in the month of April, 2022. All cheques are presented to the bank in the month of April, 2022 and are also realized in the same month in the normal course after deposit in the bank.(MTP 5 Marks Sep'22, Old & New SM)**

Answer 6

I. As per AS 4'Contingencies and Events Occurring After the Balance Sheet Date', disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2022 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

II. As per AS 4, adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date. A debtor for ₹ 2,50,000 suffered heavy loss due to earthquake in the second week of March, 2022 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in May, 2022 (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 ₹

2,50,000 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 2022.

III. As per AS 4, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. In the given case, since Hari Ltd. was sued by a competitor for infringement of a trademark during the year 2021- 22 for which the provision was also made by it, the decision of the Court on 26 th May, 2022, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Hari 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.

IV. As the embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" and the same will not be adjusted in the financial statements for the year ended 31st March, 2022. This being an extra-ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2023, in a manner, that its impact on current profit or loss can be perceived.

V. Collection of cheques after balance sheet date is not an adjusting event even if the cheques bear the date of 31st March. Recognition of cheques in hand is therefore not consistent with requirements of AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise and no disclosure of such collections in the Directors' Report is necessary.

Question 7

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

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a. A major property was sold (it was included in the balance sheet at Rs. 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of Rs. 26,50,000.

b. On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company.

c. A claim for damage amounting to Rs. 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020. (RTP Nov 21, PYP 5 Marks Nov'22)

Answer 7

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(a)	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property Rs. 1,50,000 would be considered.
(b)	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

(c)	On the basis of evidence provided, the claim against the company will not succeed. Thus, Rs. 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

Question 8

A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 2019-2020. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements were approved on 31st May, 2020. Shall company account for such tax in the year 2019-2020 or shall it account for in the year 2020-2021? (RTP May '21)

Answer 8

To decide whether, the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date.

Here both the conditions are satisfied. Court order is a conclusive evidence which has been received before approval of the financial statements since the liability is related to earlier year. The event will be considered as an adjusting event and accordingly the amount will be adjusted in accounts of 2019-2020.

Question 9

A fire, on 2nd April, 2020, completely destroyed a manufacturing plant of Omega Ltd. whose financial year ended on 31st March, 2020, the financial statements were approved by their approving authority on 15th June, 2020. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company. How will you disclose it in the financial statements of Omega Ltd. for the year ended 31st March, 2020. (RTP Nov 20)

Answer 9

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.

Question 10

AS 4 Contingencies and Events occurring after the Balance Sheet Date

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date". (RTP Nov'22)

Answer 10

Accounting Treatment of Contingent Gains Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate

Question 11

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

1. **Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.**
2. **On 05.03.2021, ` 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.**
3. **One building got damaged due to occurrence of fire on 23.05.221. Loss was estimated to be `**

81,00,000. (PYP 5 Marks Dec '21)

Answer 11

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

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes if such events relate to conditions existing at the balance sheet date. In the given case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus loss amounting ` 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

(iii) AS 4 states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ` 81 lakhs should be disclosed in the report of the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

<u>EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:</u>

Majority of the examinees were not able to give the correct bifurcation of events into Adjusting or Non-adjusting events in accordance with AS 4 "Contingencies and Events occurring after balance sheet date".

Question 12

As per the provisions of AS-4, a contingency is a condition or situation, the ultimate outcome of which (gain or loss) will be known or determined only on the occurrence of one or more uncertain future events (PYP 1 Mark, May'19)

Answer 12

False: A contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

<u>EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:</u>

Most of the examinees stated whether the given statements were 'True' or 'False' but failed to substantiate their answer with adequate reasoning.

Question 13

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again. State with reasons, whether the loss due to fire is an adjusting or non- adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised). (PYP 5 Marks, Nov 18)

Answer 13

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

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner: "Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees failed to state the nature of loss due to fire (adjusting or non-adjusting event) and were not able to give its correct treatment as per provisions of AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

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Chapter 7.2
AS 5- Net Profit or Loss for the period, Prior period items & Changes in Accounting policies

Question 1 (Also includes concepts from AS 29-Provisions, Contingent Liabilities & Contingent Assets)

EXOX Ltd. is in the process of finalizing its accounts for the year ended 31 st March, 2017. The company seeks your advice on the following:

(i) The Company's sales tax assessment for assessment year 2014-15 has been completed on 14th February, 2017 with a demand of Rs. 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. (RTP May'21)

(ii) The Company has entered into a wage agreement in May, 2017 whereby the labour union has accepted a revision in wage from June, 2016. The agreement provided that the hike till May, 2017 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, 2017.

You required to examine and give suggestions in line with the relevant Accounting Standards. (MTP 5 Marks April '19)

Answer 1

(i) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2017. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs. 2.10 crore.

(ii) The arrears for the period from June, 2016 to March, 2017 are required to be provided for in the accounts of the company for the year ended on 31st March, 2017.

Question 2

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

Answer 2

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

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

Question 3

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

revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5? (MTP 4 Marks March 21, MTP 5 Marks April 22)

Answer 3

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting Rs. 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020-21. As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

Question 4

The Accountant of a company has sought your opinion with relevant reasons, whether the following will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) **Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019-2020, the rate of provision has been changed to 3%.**

(ii) **During the year ended 31st March, 2020, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.**

(iii) **Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.**

(iv) **Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.**

(v) **During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories. (MTP 5 Marks Oct'19, May'20, Mar'19, Oct'18, Old & New SM, RTP May 22, RTP Nov 18, RTP Nov 19, RTP Nov '20, RTP May'20, PYP 5 Marks Nov'22)**

Answer 4

(i) In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 5

The management of Pluto Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as changes in Accounting Policy or not for the year ended 31st March, 2021. Please advise them in the following situations in accordance with the provisions of Accounting Standard 5:

(i) **During the year ended 31st March, 2021, the management has introduced a formal retirement**

gratuity scheme in place of ad-hoc ex-gratia payments to its employees on retirement.

(ii) **Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees would receive a pension of ₹ 25,000 per month. Earlier there was no such scheme of pension in the organization.**

(iii) **Provision for doubtful Trade Receivables was created @2.5% till 31 st March, 2020. From 1st April,2020, the rate of provision has been changed to 5%**

(iv) **For the year ended 31st March,2021 there was change in the cost formula in measuring the cost of Inventories.**

(v) **Till the end of the previous year, Computers were depreciated on Straight Line Basis over a period of 5 years. From current year, the useful life of Computers has been changed to 3 years.(MTP 5 Marks Oct'22)**

Answer 5

(i) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous transaction, will not be treated as change in an accounting policy.

(ii) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(iii) In the given case, company has created 2.5 % provision for doubtful debts till 31st March, 2020. Subsequently from 1st April, 2020, the company revised the estimates based on the changed circumstances and wants to create 5% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(iv) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

(v) Change in useful life of computers from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

Question 6

a) **There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021. (RTP Nov 21)**

b) **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 Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization. Explain whether this will constitute a change in accounting policy or not as per AS 5. (RTP Nov 21, May 20)**

Answer 6

a) Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

b) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously

occurring events or transactions, will not be considered as a change in accounting policy. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

Question 7

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of Rs.10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at Rs. 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of Rs. 2 lakhs was disclosed as net profit from sale of assets.

You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5. (RTP May 18 & Nov 22)

Answer 7

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss .

Question 8

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) **Capitalization of borrowing cost on working capital.**

(vi) **Legislative changes having long term retrospective application.**

(vii) **Change in the method of depreciation from straight line to WDV.**

(viii) **Government grant becoming refundable.**

(ix) **Applying 10% depreciation instead of 15% on furniture.**

(x) **Change in useful life of fixed assets. (RTP May '23, PYP 5 Marks Jan 21)**

Answer 8

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)	Capitalization of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

Question 9

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period. (PYP 1 Mark, May 19)

Answer 9

False: The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees stated whether the given statements were 'True' or 'False' but failed to substantiate their answer with adequate reasoning.

Question 10

PQR Ltd. is in the process of finalizing its accounts for the year ended 31 st March, 2018. The company seeks your advice on the following:

(i) **Goods worth ` 5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ` 3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31 st March, 2018.**

(ii) **Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18.**
Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra ordinary item or prior period item? (PYP 5 Marks, May 18, RTP May 19)

Answer 10

(i) As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived. In the given

instance, it is clearly a case of error/omission in preparation of financial statements for the year 2015-16. Hence, claim received in the financial year 2017- 18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

(ii) In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS 5, the revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

The effect of such change should be shown in the profit and loss account for the year ending 31st March, 2018.

Question 11

TQ Cycles Ltd. is in the manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the Government enhanced the minimum wages payable to workers with retrospective effect from the 1st January,2022. Due to this legislative change, the additional wages for the period from January 2022 to March 2022 amounted to ₹ 30 lakhs. The management asked the Finance manager to charge ₹ 30 lakhs as prior period item while finalizing financial statements for the year 2022-23. Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra-ordinary item in the Profit and loss account for the financial year 2021-22.
Discuss with reference to applicable Accounting Standards. (PYP 5 Marks May'22)

Answer 11

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the 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.

It is given that revision of wages took place in April, 2022 with retrospective effect from 1st January, 2022. Therefore, wages payable for the period from 1 01.2022 to 31.3.2022

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. The full amount of wages payable to workers will be treated as an expense of current year and it will be charged to profit & loss account for the year 2022-23 as normal expenses.

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. Therefore, finance manager is incorrect in treating increase as extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Therefore, additional wages liability of ₹ 30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31st March, 2023.

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Chapter 7.3
AS 11- The Effects of Changes in Foreign Exchange rates

Question 1

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2020, payable after three months. Company entered into a forward contract for three months @ Rs. 49.15 per dollar. Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognize the profit or loss on forward contract in the books of Rau Ltd.? (MTP 5 Marks, May '20, RTP Nov'21, RTP May'19, Old & New SM)(Same concept different figures PYP 2.5 Marks Nov'22)

Answer 1

Forward Rate	Rs. 49.15
Less: Spot Rate	(Rs. 48.85)
Premium on Contract	Rs. 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	Rs. 30,000

Contract period 3 months

Two months falling in the year ended 31st March, 2020; therefore, loss to be recognized (30,000/3) x 2 = Rs. 20,000. Balance amount of Rs. 10,000 will be recognized in the following financial year.

Question 2

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakhs on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment. (MTP 5 Marks Oct 20, Oct 21)

Answer 2

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US $ 10 lakhs, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakhs $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh

US $ x (62.00-60.00) = ₹ 80 lakh. So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 Each + 100 lakh) = ₹ 620 lakh.

Question 3

"Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Property Pant & Equipment. (MTP 5 Marks Nov '21 & April '23)

Answer 3

As per AS 11'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 4

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2021, which was repaid as on 31/07/2021. ABC Ltd. prepares financial statement ending on 31/03/2021. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2021	**1 US$ =**	**₹ 68.50**
31/03/2021	**1 US $ =**	**₹ 69.50**
31/07/2021	**1 US $ =**	**₹ 70.00**

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11. (MTP 5 Marks , Sep '22, PYP May '18, 5 Marks)(Same concept different figures as Old & New SM)

Answer 4

Journal Entries in the Books of ABC Ltd.

Date	Particulars		₹ (Dr.)	₹ (Cr.)
Jan. 01, 2021	Bank Account (5,00,000 x 68.50)	Dr.	342,50,000	
	To Foreign Loan Account			342,50,000
March 31, 2021	Foreign Exchange Difference Account	Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 x (69.50-68.50)]			5,00,000
Jul. 31, 2021	Foreign Exchange Difference Account [5,00,000 x (70-69.5)]	Dr.	2,50,000	
	Foreign Loan Account	Dr.	347,50,000	
	To Bank Account			350,00,000

Question 5

Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabi lities Account and the Loss, if any, is charged to revenue. You are required to comment in line with AS 11. (MTP 5 Marks Oct '22)(RTP May 20, Old & New SM)

Answer 5

Financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. Individual items in the financial statements of the

foreign operation are translated at the actual rate on the date of transaction. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate. Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

Question 6

(a) Classify the following items into Monetary and Non-monetary:

(i) Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment

(b) Trade payables of CAT Ltd. include amount payable to JBB Ltd., Rs. 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US $1 = Rs. 80.00. The exchange rate on balance sheet date (31.03.2020) was US $1 = Rs. 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd. (RTP May '21)

Answer 6

(a) Share capital - Non-monetary; Trade Payables - Monetary

Cash balance – Monetary; Property, plant and equipment - Non-monetary

(b) Amount of Exchange difference and its Accounting Treatment

	Foreign Currency Rate	**Rs.**
Trade payables		
Initial recognition US $ 12,500 (Rs.10,00,000/80)	1 US $ = Rs. 80	10,00,000
Rate on Balance sheet date	1 US $ = Rs. 85	
Exchange Difference loss US $ 12,500 x Rs. (85-80)		62,500
Treatment: Debit Profit and Loss A/c by Rs. 62,500 and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting Rs. 62,500 is required to be transferred to Profit and Loss.

Question 7

(a) Classify the following items as monetary or non-monetary item: Share Capital, Trade Receivables, Investment in Equity shares & Fixed Assets. (RTP Nov 20, Nov 18, Old & New SM)

(b)

	Exchange Rate per $
Goods purchased on 1.1.2019 for US $ 15,000	**₹ 75**
Exchange rate on 31.3.2019	**₹ 74**
Date of actual payment 7.7.2019	**₹ 73**

You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11. (RTP Nov 20, Nov 18, Old & New SM)

Answer 7

(a)

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

(b) As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2019 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75) According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.201 9 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2018-19. On 7.7.2019, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2019-20.

Question 8

(i) Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh Rs.5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= Rs.58.50. US $ 1 = Rs.61.20 on 31.3.2019. Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019. (RTP Nov 19)

(ii) Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @Rs.64.25 per Dollar. On 31st October, 2018, the exchange rate was ₹61.50 per Dollar. You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019. (RTP Nov 19, May 18)

Answer 8

(I) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise. Accordingly, exchange difference on trade receivables amounting Rs.23,076 {Rs.5,23,076(US $ 8547 x Rs.61.20) less Rs. 5,00,000} should be charged to profit & Loss account.

(II) Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract = ($ 50,000 × Rs.2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019	5 months
Hence, Loss for 5 months will be Rs.1,37,500 × $\frac{5}{6}$ =	Rs.1,14,583

Thus, the loss amounting to Rs.1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

Question 9

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US$) on different dates are as under:

31-12-2020	**1 US $ = ₹ 44.00**
31-03-2021	**1 US $ = ₹ 44.50**
30-06-2021	**1 US $ = ₹ 44.75**

(i) Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.

(ii) if borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US $ = ₹ 44.20 then what entry should be passed? (RTP May '22)

Answer 9

(i) As per AS 11 'The Effect of Changes in Foreign Exchange Rates", a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Moreover, at each balance sheet date, foreign currency monetary items should be reported using the closing rate. Accordingly, on 31.12.2020 borrowings will be recorded at ₹ 1,32,00,000 (i.e., ₹ 3,00,000 × ₹ 44.00). On 31.3.2021 borrowings (monetary items) will be recorded at ₹ 1,33,50,000 (i.e. $ 3,00,000 × ₹ 44.50).

Journal of Kumar Ltd.

Date	Particular		Dr. (₹)	Cr. (₹)
31-12-2020	Bank A/c	Dr.	1,32,00,000	
	To Foreign Loan Account			1,32,00,000
31-03-2021	Foreign Exchange A/c Difference Account	Dr.	1,50,000	
	To Foreign Loan Account			1,50,000
30-06-2021	Foreign Loan Account A/c	Dr.	1,33,50,000	
	Foreign Exchange Difference Account A/c		75,000	
	To Bank A/c			1,34,25,0000

In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

Date	Particular		Dr. (₹)	Cr. (₹)
28-02-2021	Foreign Loan Account A/c	Dr.	1,32,00,000	
	Foreign Exchange Difference Account A/c	Dr.	60,000	
	To Bank A/c			1,32,60,000

Working Notes:

(i) The exchange difference of ₹ 1,50,000 is arising because the transaction has been reported at different rate (₹ 44.50 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $)

(ii) The exchange difference of ₹ 75,000 is arising because the transaction has been settled at an exchange rate (₹ 44.75 = 1 US$) different from the rate at which reported in the last financial statements (₹ 44.50 = 1 US$).

(iii) The exchange difference of ₹ 60,000 is arising because the transaction has been settled at a different rate (i.e., ₹ 44.20 = 1 US $) than the rate at which initially recorded (1 US $ = ₹ 44.00)

Question 10

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2022, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2022 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2022, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2022 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss (RTP Nov'22)

Answer 10

As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables is a monetary item, hence should be valued at the closing rate i.e, ₹ 48 at 31st March, 2022 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of ₹ 5 (₹ 48-₹ 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2022 and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of ₹ 1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

Question 11

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2020-21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2021 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).(RTP May 23)

Answer 11

(i) Interest for the period 2020-21
= US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 15 lakhs × ₹ 72 x 9.5% = ₹ 102.60 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 102.60 lakhs less ₹ 57 lakhs = ₹ 45.60 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45.60 lakhs.

Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 12

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020

(i) Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 72.00 US $ 1=₹73.50 on 31st March,2020 US $ 1= ₹ 72.50 on 1st April,2019.

(ii) Long term loan taken on 1st April, 2019 from a U.S. company amounting to ₹ 75,00,000. ₹5,00,000 was repaid on 31st December, 2019, recorded at US $ 1 = ₹ 70.50. interest has been paid as and when debited by the US company. US $1= ₹ 73.50 on 31st March,2020 US $1=1₹ 72.50 on 1st April, 2019. (PYP 5 Marks Jan '21) (Same concepts different figures Old & New SM)

Answer 12

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long - term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

	Foreign Currency Rate	₹
Debtors		
Initial recognition US $12,500 (9,00,000/72)	1 US $ = ₹72	9,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Gain US $ 12,500 X (73.50- 72)		18,750
Treatment: Credit Profit and Loss A/c by ₹ 18,750		
Long term Loan		
Initial recognition US $ 1,03,448.28 (75,00,000/72.50)	1 US $ = ₹ 73.50	75,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Loss after adjustment of exchange gain on repayment of ₹ 5,00,000		
₹ 67,987.48 [82,171.88 (US $ 96,356.08 X ₹ 73.5 less ₹ 70,00,000) less profit 14,184.40		
[US $ 7,092.2 (5,00,000/70.5) X ₹ 2)] NET LOSS Treatment: Credit Loan A/c and Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48		67,987.48*

Thus, Exchange Difference on Long term loan amounting ₹ 67,987.48 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of ₹ 9 lakhs have not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2020.

Question 13

Karan Enterprises having its Head office in Mangalore, Karnataka has a branch in Greenville, USA. Following is the trial balance of Branch as at 31-3-2019:

Particulars	Amount ($) Dr.	Amount ($) Cr.
Fixed assets	8,000	
Opening inventory	800	
Cash	700	
Goods received form Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account		4,300
	28,350	28,350

(i) Fixed assets were purchased on 1st April, 2019
(ii) Depreciation at 10% p.a. is to be charged on fixed assets on straight line method,
(iii) Closing inventory at branch is $ 700 as on 31-3-2019.
(iv) Goods received form Head Office (HO) were recorded at Rs. 1,85,500 in HO books.
(v) Remittances to HO were recorded at Rs. 1,62,000 in HO books.
(vi) HO account is recorded in HO books at Rs. 2,84,500.
(vii) Exchange rates of US Dollar at different dates can be taken as:
1-4-2015 Rs. 63;
1-4-2018 Rs. 65 and
31-3-2019 Rs. 67.

Prepare the trial balance after been converted into Indian rupees in accordance with AS-11. (PYP Nov.'19,5 Marks)

Answer 13

Trial Balance of Foreign Branch (converted into Indian Rupees) as on March 31, 2019

Particulars	$ (Dr.)	$ (Cr.)	Conversion Basis	Rate	₹ (Dr.)	₹ (Cr.)
Fixed Assets	8,000		Transaction Date			
			Rate	63	5,04,000	
Opening Inventory	800		Opening Rate	65	52,000	
Goods Received			Actuals		1,85,500	
from HO	2,800					
Sales		24,050	Average Rate	66	15,87,300	
Purchases	11,800		Average Rate	66	7,78,800	
Expenses	1,800		Average Rate	66	1,18,800	
Cash	700		Closing Rate	67	46,900	
Remittance to HO	2,450		Actuals		1,62,000	
HO Account		4,300	Actuals			2,84,500
Exchange Rate						
Difference			Balancing Figure		23,800	
	28,350	**28,350**			**18,71,800**	**18,71,800**
Closing Stock	700		Closing Rate	67	46,900	
Depreciation	800		Fixed Asset Rate	63	50,400	

Question 14

ABC Ltd. an Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to Rs.30,00,000. It was recorded at US $1 = Rs.60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet data (31.03.2018) was US $1 = Rs. 62.00.
Trade receivable includes amount receivable from Prakash Ltd., Rs. 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = Rs. 59.00. The exchange rate on balance sheet data (31.03.2018) was US $1 = Rs. 62.00.
You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.
(PYP Nov.'18, 5 Marks)(Same concept different figures -PYP Dec'21 5 Marks, MTP 5 Marks Apr'23)

Answer 14

Amount of Exchange difference and its Accounting Treatment

Long term Loan	Foreign Currency Rate	Rs.
(i) Initial recognition US $50,000 Rs. (30,00,000/60)	1 US $ = Rs. 60	30,00,000
Rate on Balance sheet date	1 US $ = Rs. 62	
Exchange Difference Loss Us $ 50,000 X Rs. (62 - 60)		1,00,000
Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by Rs. 1,00,000		
Trade receivables		
(ii) Initial recognition US $ 16,949.152* (Rs. 10,00,000/59)	1 US $ = Rs. 59	10,00,000
Rate on Balance sheet date	1 Us $ = Rs. 62	
Exchange Difference Gain US $ 16,949.152* x Rs. (62-59)		50,847.456*
Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* And Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting Rs. 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting Rs. 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 15

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ f 62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2018	**Rs. 60.75 per dollar**
On 31st March, 2018	**Rs. 63.00 per dollar**

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.
(PYP Nov.'18, 5 Marks, RTP May 20)

Answer 15

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate	Rs.62.50
Less: Spot Rate	(Rs. 60.75)
Premium on Contract	Rs. 1.75

Contract Amount	US$5,00,000
Total Loss (5,00,000 x 1.75)	₹8,75,000

Contract period 5 months 3 months falling in the year 2017-18; therefore, loss to be recognized in 2017-18 (8,75,000/5) x 3 = Rs. 5,25,000. Rest Rs. 3,50,000 will be recognized in the following year 2018-19.

Question 16

Trade Payables of Jared Limited includes amount due to Sterling Limited ₹ 9,75,000 recorded at the prevailing exchange rate on the date of purchase; transaction recorded at US $ 1 = ₹ 75.00. The exchange rate on Balance Sheet date (31st March,2022) was US $ 1 = 79.00 The payment was made on 1st May,2022 when the exchange rate was US $ 1 = ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as per AS 11 in the books of Jared Limited. (PYP 2.5 Marks Nov '22)

Answer 16

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Trade payables	Foreign Currency Rate	Amount ₹
Initial recognition US $13,000 (9,75,000/75)	1 US $ = ₹ 75	
Exchange Rate on Balance sheet date	1 US $ = ₹ 79	
Exchange Difference Loss US $ 13,000 X (79-75)		52,000
Exchange Rate on Settlement date	1 US $ = ₹ 78.30	
Exchange Difference Profit US $ 13,000x(79-78.30)		9,100

For the year ended 31st March, 2022 exchange diffefence loss amounting ₹ 52,000 will be charged to statement of Profit & Loss A/c.

However, there is exchange difference gain of ₹ 13,000 x (79-78.30) = 9,100 on 1st May, 2022. Thus gain of ₹ 9,100 will be credited to statement of Profit & Loss A/c for the year ended 31st March, 2023.

Question 17

Trower Limited is an Indian importer. It imports goods from True View Limited situated at London. Trower Limited has a payable of £50,000 to True View Limited as on 31st March, 2023. True View Limited has given Trower Limited the following two options:

(i) Pay immediately with a cash discount of 1% on the payable.

(ii) Pay after 6 months with interest @ 5% p.a. on the payable.

The borrowing rate for Trower Limited in rupees is 15% p.a.

The following are the exchange rates:

Date	₹
31st March,2023	97
30th September, 2023	99

You are required to give your opinion to Trower Limited on which of the above two options to be chosen. (PYP 5 Marks May '23)

Answer 17

Option

(i) Pay immediately with Cash discount of 1% on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x ₹ 97)	48,50,000
Less: Cash discount	(48,500)
	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months	3,60,112
If payment made immediate	51,61,612

Option

(ii) Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x ₹ 99)	49,50,000
Interest for 6 months @ 5%	1,23,750
If payment made after 6 months	50,73,750

Thus, Option

(iii) is beneficial to Trower Limited as the Rupee outflow will be lower by

₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

Note: The above answer be presented in the alternative manner given as below:

Option (i) Pay immediately with Cash discount of 1% on the payable

Total amount payable on 31.3.2023	50,000
Less: Cash discount (50,000 x 1 / 100)	(500)
	49,500 48,01,500
49,500 x ₹ 97	3,60,112
Add: Borrowing cost @ 15% p.a. for 6 months	₹ 51,61,612
If payment made immediate	

Option (ii)

Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable on 31.3.2023	50,000
Interest for 6 months @ 5% (50,000 x 5 / 100 x 6 / 12)	1.250
	51,250
If payment made after 6 months (51,250 x 99)	50,73,750

Thus, Option (ii) is beneficial to Trower Limited as the Rupee outflow will be lower by ₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 18

Explain "monetary item" as per Accounting Standard 11.

How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non-monetary item:

Share Capital.
Trade Receivables.
Investments.
Fixed Assets. (Nov '23)

Answer 18

As per AS 11, Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date.

In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Classification of items as monetary or non-monetary item:

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary Fixed
Assets (PPE)	Non-monetary

VIVITSU STRIVING TOWARDS KNOWLEDGE

Chapter 7.4
AS 22- Accounting for Taxes on Income

Question 1

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is Rs. 1,000 lakhs and Rs. 2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by Rs. 50 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account. (MTP Oct 19 5 Marks, RTP Nov'18)(Same concept different figures Old & New SM)

Answer 1

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of Rs. 1,000 lakhs depreciation, timing difference amounting Rs. 400 lakhs (Rs. 50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for Rs. 600 lakhs (Rs. 1,000 lakhs . Rs. 400 lakhs), deferred tax liability will be recognized for Rs. 240 lakhs (40% of Rs. 600 lakhs) in first year. In the second year, the entire amount of timing difference of Rs. 2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting Rs. 800 lakhs (40% of Rs. 2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be Rs. 1,040 lakhs (240 lakhs + 800 lakhs).

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 2

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22. ? (RTP Nov '21)

Answer 2

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

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

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

Question 3

(a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books — Rs. 2,80,000

Depreciation for tax purpose — Rs. 1,90,000

The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing Rs. 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 Rs. 6,40,000 before depreciation and taxes.

(iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22? (RTP May 21, PYP 5 Marks Nov '22)

Answer 3

(a) Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)

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

Working Notes:

1. Computation of taxable income

	Amount (Rs.)
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 (Rs.)
(i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000
	Net impact				NIL

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

Question 4

(a) Write short note on Timing differences and Permanent differences as per AS 22

(b) Rama Ltd., has provided the following information:

	Rs.
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%. (RTP Nov 20, PYP 5 Marks May'18, Old & New SM, PYP 5 Marks May'19)(Same concept different figures May'18, Old & New SM)

Answer 4

(a) **Accounting income and taxable income for a period are seldom the same. Permanent** differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is not allowable as a deduction for tax purposes. Timing differences are those which arise in one perio d and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

(b) Table showing calculation of deferred tax asset / liability

Particulars	**Amount**	**Timing differences**	**Deferred tax**	**Amount @ 30%**
	Rs.			**Rs.**
Excess depreciation as per tax records (Rs. 10,00,000 – Rs. 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

Question 5

The following transactions were reported by PQR Ltd. during the year 2020-2021:

i.	**Tax Rate**	**30%**
ii.	**Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.**	**(Rs. in lakh)** **20.00**
iii.	**Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.**	**20.00**
iv.	**Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).**	**10.00**

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021. (RTP May 22)

Answer 5

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	**Analysis**	**Nature of difference**	**Effect**	**Amount**
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	Rs. 20 lakh X 30% = Rs. 6 lakh

Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 6

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advice to the company. (RTP May 19)

Answer 6

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

Question 7

Define followings as per AS 22:

(i) Accounting income (loss)

(ii) Taxable income (tax loss)

(iii) Tax expense (tax saving) (RTP Nov'22)

Answer 7

Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.
Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.
Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Question 8

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	**28.00**
Deferred Tax Assets (Dr.)	**14.00**

The following transactions were reported during the year 2020 -2021:

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.

Tax Rate to be taken at 40%. You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021. (PYP 5 Marks July 21)

Answer 8

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs X 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs X 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs X 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs X 40% =28 lakhs

Question 9

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31 -3-2019 :

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	**60.00**
Deferred Tax Assets (Dr.)	**30.00**
The following transactions were reported during the year 2019-20 : **Depreciation as per accounting records**	**160.00**
Depreciation as per income tax records	**140.00**
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	**20.00**
Donation to Private Trust	**20.00**
Tax rate	**30%**

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22. (PYP 5 Marks Jan 21, RTP May 20)

Answer 9

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

(1) Difference in Depreciation- Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. It is timing difference for which reversal of Deferred tax liability is required. Reversal of DTL= ₹ (160 – 140) Lakhs X 30% = ₹6 Lakhs

(2) Disallowances, as per IT Act of earlier years- Due to disallowance tax payable for the earlier years was

higher on this account. It is responding timing difference which required Reversal of Deferred tax assets. Reversal of Deferred tax assets = ₹20 Lakhs X 30% = ₹ 6 Lakhs

(3) Donations to private trusts is not an allowable expenditure under IT Act. It is permanent difference. Hence, no reversal of tax is required.

Question 10

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	₹
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year. (PYP 5 Marks, Nov 20) (Same concept different figures RTP Nov'19 & Nov '23, PYP 5 Marks Nov'19, Old & New SM)

Answer 10

Tax as per accounting profit 15,00,000X20%= ₹ 3,00,000

Tax as per Income-tax Profit 2,50,000X20% =₹ 50,000

Tax as per MAT 7,50,000X7.50%= ₹ 56,250

Tax expense= Current Tax +Deferred Tax

₹ 3,00,000 = ₹ 50,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020 Current Tax +

Deferred Tax liability + Excess of MAT over current tax

= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

Question 11

Write short note on Timing difference and Permanent Difference as per AS 22. (PYP 5 Marks, May 19)

Answer 11

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income may be different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as Permanent Difference. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable incom e, known as Timing Difference.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

Chapter 8.1
AS 7- Construction Contracts

Question 1

X Ltd. negotiates with Bharat Petroleum Corporation Ltd (BPCL), for construction of "Franchise Retail Petrol Outlet Stations". Based on proposals submitted to different Zonal offices of BPCL, the final approval for one outlet each in Zone A, Zone B, Zone C, Zone D, is awarded to X Ltd. Agreement (in single document) is entered into with BPCL for Rs. 490 lakhs. The agreement lays down values for each of the four outlets (Rs. 88 + 132 + 160 + 110 lakhs) in addition to individual completion time. You are required to examine and comment whether X Ltd., will treat it as a single contract or four separate contracts. (MTP Oct '19, MTP Mar'18, MTP Aug'18 5 Marks) (Same concepts different figures RTP May'19)

Answer 1

As per AS 7 on 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;
(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
(c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Office, which canbe separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one document of contract. Therefore, four separate contract accounts have to be recorded and maintained in the books of X Ltd. For each contract,principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS 7.

Question 2

M/s Highway Constructions undertook the construction of a highway on 01.04.2016. The contract was to be completed in 2 years. The contract price was estimated at Rs.150 crores. Up to 31.03.2017 the company incurred Rs. 120 crores on the construction. The engineers involved in the project estimated that a further Rs. 45 crores would be incurred for completing the work. What amount should be charged to profit and loss statement for the year 2016 -17 as per the provisions of Accounting Standard 7 "Construction Contracts"? (MTP Oct'18 5 Marks)

Answer 2

Statement showing amount to be charged to Profit and Loss Statement as per AS 7

	Rs. in crores
Cost of construction incurred upto 31.03.2017Add:	120
Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165 x 100)	72.73%
Revenue recognized (72.73% of 150)	109 (approx)
Total foreseeable loss (165 – 150)	15
Less: Loss for the current year (120 – 109)	11
Loss to be provided for in the P&L statement	4

Question 3

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

	(Rs. crore)
Total Contract Price	**2,400**
Work Certified	**1,250**
Work pending certification	**250**
Estimated further cost to completion	**1,750**
Stage wise payments received	**1,100**
Progress payments in pipe line	**300**

Using the given data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2021.

(ii) Arrive at the contract work in progress as at the end of financial year 2020-21.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end. (MTP 5 Marks Oct '21 & April '23)(Same concept different figures MTP 5 Marks Mar'22, PYP 5 Marks May'18 & May '23)

Answer 3

(i)	**Calculation of profit/ loss for the year ended 31st March, 2021**	*(Rs. in crores)*
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	**Contract work-in-progress i.e. cost incurred to date**	*(Rs. in crores)*
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250) X 100 = 46.15%

Revenue to be recognized till date = 46.15% of Rs. 2,400 crores = Rs. 1,107.60 crores.

(iv) Amount due from / to customers = Contract costs + Recognized profits – Recognized losses – (Progress payments received + Progress payments to be received)

= Rs. [1,500 + Nil – 850 – (1100 + 300)] crores

= Rs. [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = Rs. 750 crores.

Question 4

A contractor firm obtained a contract for construction of bridge. The following details are available in the records kept for the year ended March 31, 2021:

	(Rs. In Crore)
Total Contract Price	**500**
Work Certified	**250**
Work not Certified	**80**
Estimated further Cost to Completion	**220**
Progress Payment Received	**200**
Payment to be Received	**70**

You are required to calculate :

(i) The amount of revenue to be recognized.

(ii) The amount of profit or loss to be recognized.

(iii) The amount due from/ to customers.
Also present relevant disclosures as per AS-7 (Revised). (MTP 5 Marks Nov '21)(Same concept different figures Old & New SM)

Answer 4

(i) Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction = [(250 + 80) / (250 +80 +

220)]X 100 = 60% Revenue to be recognized till date = 60% of Rs. 500 crore = Rs. 300 crore.

(ii)

Calculation of profit/ loss for the year ended 31st March, 2021		(Rs. in crore)
Total estimated cost of construction		
Work certified	250	
Work not certified	80	
Estimated further cost to completion	220	550
Less: Total contract price		(500)
Total foreseeable loss to be recognized as expense		50

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

(iii) **Amount due from / to customers** = Contract costs incurred till date + Recognized profits – Recognized losses – (Progress payments received + Progress payments to be received)

= Rs. [(250 + 80) + Nil – 50 – (200 + 70)] crore = Rs. [330 – 50 – 270] crore

Amount due from customers (shown as an asset) = Rs. 10 crore.

(iv) **The relevant disclosures under AS 7 (Revised) are given below:**

	Rs. in crores
Contract revenue till 31st March, 2021	300
Contract expenses till 31st March, 2021	330
Recognized losses for the year 31st March, 2021	50
Progress billings Rs. (200+ 70)	270
Progress (billed but not received from contractee)	70
Gross amount due from customers	10

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Question 5

Bricks Ltd. signed on 01/04/21, a construction contract for Rs. 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/22:

- **Materials issued Rs. 75,00,000**
- **Labour charges paid Rs. 36,00,000**
- **Hire charges of plant Rs. 10,00,000**
- **Other contract cost incurred Rs. 15,00,000**
- **Out of material issued, material lying unused at the end of period is Rs. 4,00,000**
- **Labour charges of Rs. 2,00,000 are still outstanding on 31.3.22.**
- **It is estimated that by spending further Rs. 33,50,000 (including material unused Rs. 4,00,000), the work can be completed in all respect. You are required to compute profit/loss to be taken to Profit & Loss Account and additional provision for foreseeable loss as per AS 7. (MTP 5 Marks April 22, Mar 21 ,Oct 20 & Oct '23 Old & New SM)**

Answer 5

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	Rs.	Rs.
	Material Issued	75,00,000	
Less:	Unused Material at the end of period	4,00,000	71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.2022	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000

	Other Contract cost incurred	15,00,000
	Cost incurred upto 31.03.2022	1,34,00,000
Add:	Estimated future cost	33,50,000
	Total Estimated cost of construction	1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)	80%
	Revenue recognized (80% of 1,50,00,000)	1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)	17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)	14,00,000
	Loss to be provided for	3,50,000

Question 6

On 1st December, 2019, Mahindra Construction Co. Ltd. undertook a contract to construct a building for ₹ 170 lakhs. On 31st March, 2020, the company found that it had already spent ₹ 1,29,98,000 on the construction. Prudent estimate of additional cost for completion was ₹ 64,02,000. Calculate total estimated loss on contract and what should be shown in statement of profit and loss account as contract revenue and contract cost in the final accounts for the year ended 31 st March, 2020, as per provision of Accounting Standard 7 (Revised).(MTP 5 Marks Sep'22) (Same concept different figures Old & New SM, RTP Nov'19, Nov'22)

Answer 6

	₹
Cost incurred till 31st March, 2020	129,98,000
Prudent estimate of additional cost for completion	64,02,000
Total cost of construction	194,00,000
Less: Contract price	(170,00,000)
Total foreseeable loss	24,00,000

VIVITSU
STRIVING TOWARDS KNOWLEDGE

As per AS 7 Construction Contracts, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Hence the foreseeable loss of ₹ 24,00,000 should be recognized as an expense immediately in the year ended 31st March 2020.

Contract work in progress = 129,98,000/194,00,000 X 100= 67% Proportion of contract value recognized as turnover as per AS 7 = 67% of ₹ 170,00,000 = ₹ 113,90,000.

Question 7

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 Suh-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.(MTP 5 Marks Oct'22, PYP 5 Marks July 21)

Answer 7

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees failed to compute the percentage of completion, contract revenue and contract cost to be recognized in accordance with the provisions of AS 7 "Construction Contracts".

Question 8

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.

(b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs. 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss. (RTP Nov '21)

Answer 8

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;

(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

(b) According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

Question 9

(a) Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The

company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract.

As per the terms of the contract, Sky Limited will receive an additional Rs. 50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The Accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

(b) ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units i .e. Rs. 50 lakh, Rs. 60 lakh and Rs. 75 lakh respectively. Agreement also lays down the completion time for each unit.

Comment, with reference to AS 7, whether ABC Ltd., should treat it as a single contract or three separate contracts. (RTP May '21 May '23 & Nov '23)

Answer 9

(a) According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when both the conditions are met:

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

(ii) the amount of the incentive payment can be measured reliably.

In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing Rs. 50 lakhs as revenue is not correct.

(b) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

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

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

Question 10

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2019 and is likely to be completed by the next financial year. The contract is for a fixed price of Rs. 12 crore with an escalation clause. You are given the following information for the year ended 31.03.2019:

Cost incurred upto 31.03.2019	**Rs. 4 crore**
Further cost estimated to complete the contract	**Rs. 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. (RTP Nov'20, Nov '18 & May '18)

Answer 10

	Rs. in crore
Cost of construction of bridge incurred upto 31.3.2019	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= (4/10)X100 = 40%

Revenue and Profit to be recognized for the year ended 31st March, 2019 as per AS 7:

Proportion of total contract value recognized as revenue

= Contract price x percentage of completion

= Rs. 12.60 crore x 40% = Rs. 5.04 crore Profit for the year ended 31st March, 2019 = Rs. 5.04 crore – Rs. 4 crore = 1.04 crore.

Question 11

A construction contractor has a fixed price contract for Rs. 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

(Amount Rs. 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 Rs. 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.**

****Excludes Rs. 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). (RTP May'20, Old & New SM)

Answer 11

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in Rs. Lakhs)

	Up to the reporting date	**Recognized in previous years**	**Recognized in current year**
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	**247**	**-**	**247**
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	**740**	**247**	**493**
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	**1,000**	**740**	**260**
Working Note:			
	Year 1	**Year 2**	**Year 3**
Revenue after considering variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting	2,093	6,068	8,200
date (B)		(6,168 -100)	(8,100+100)
Degree of completion (B/A)	26%	74%	100%

Question 12

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹ 53 crores.
Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain. (RTP May 22)

Answer 12

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

(i) Whether or not work has commenced on the contract;
(ii) Stage of completion of contract activity; or
(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

Question 13

On 1st December, 2021, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2022, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2022 as per provisions of AS-7? (RTP May '23 & Nov '23 , PYP 5 Marks May '19)

Answer 13

	₹ in lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60)X 100 = 68.28%

Proportion of total contract value recognized as revenue for the year ended 31st March, 2022 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs.

	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

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

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees were not able to give the required answer in line with AS 9 'Revenue recognition'. Few examinees were able to calculate the correct amount to be recognized as revenue but failed to substantiate it with valid reasons.

Question 14

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. (PYP 5 Marks , Nov 20)(MTP 5 Marks Sep '23)

Answer 14

(a) 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 (cumulative) = 20,00,000 x 76.95% = 15,39,000

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

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

Year 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 (cumulative) = 20,00,000 ×76.95%
= 15,39,000

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

Revenue to be recognized in Year 1 = Rs. 6,14,200

Year 3

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

Question 15

Grace Ltd., a firm of contractors provided the following information in respect of a contract for the year ended on 31st March,2022:

Particulars	(₹ in '000)
Fixed Price Contract with an escalation clause Work Certified	35,000
Work not Certified (includes ₹ 26,25,000 for materials issued, out of which material lying unused at the end of the period is ₹ 1,40,000)	17,500
Estimated further cost to completion	3,815
Progress Payment Received Payment to be Received	17,325
Escalation in cost is by 8% and accordingly the contract price is increased by 8%	14,000
	4,900

From the above information, you are required to:

I. **Compute the contract revenue to be recognized.**

II. **Calculate Profit /Loss for the year ended 31st March,2022 and additional provision for loss to be made, if any, for the year ended 31st March,2022.(MTP 5 Marks May'22)**

Answer 15

Calculation of total estimated cost of construction

		₹ in thousand
Cost of Contract incurred till date		
Work certified	17,500	
Work not certified (3,815 thousand – 140 thousand)	3,675	21,175
Add: Estimated future cost		17,325
Total estimated cost of construction		38,500
Contract Price (35,000 thousand x 1.08)		37,800

Stage of completion

Percentage of completion till date to total estimated cost of construction = [Cost of work completed till date / total estimated cost of the contract] x 100

= [₹ 21,175 thousand / ₹ 38,500 thousand] x 100= 55%

Revenue to be recognized for the year ended 31stMarch, 2022

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = ₹ 37,800 thousand x 55% = ₹ 20,790 thousand

Loss to be recognized for the year ended 31st March, 2022

Loss for the year ended 31stMarch, 2022 = Cost incurred till date – Revenue to be recognized for the year ended 31st March, 2022

= ₹ 21,175 thousand – ₹ 20,790 thousand = ₹ 385 thousand

Provision for loss to be made at the end of 31stMarch, 2022

		₹ in thousand
Total estimated loss on the contract		
Total estimated cost of the contract	38,500	
Less: Total revised contract price	(37,800)	700
Less: Loss recognized for the year ended 31st March, 2022		(385)
Provision for loss to be made at the end of 31stMarch, 2022		315

Chapter 8.2
AS 9- Revenue Recognition

Question 1

Given below are the following information of B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2023 but at the request of the buyer these were delivered on 15-04-2023.

(ii) On 13-01-2023 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2023.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2022. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2023 and no approval or disapproval received for the remaining goods till 31-03-2023.

You are required to advise the accountant of B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2023 in above cases in the context of AS-9.(RTP Nov '23) Old & New SM)

Answer 1

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should recognize the entire sale of ₹ 50,000 for the year ended 31st March, 2023.

Case (ii)

In case of consignment sale revenue should not be recognized until the goods are sold to a third party.20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,00,000 (80% of ₹ 1,25,000).

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 1,00,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹ 2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2023 in the books of B.S. Ltd.

Question 2

Ruby Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to Rs. 5 lakhs. The accountant of Ruby Ltd. booked Rs. 5 lakhs as interest income in the year ended 31st March, 2017. Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition". (MTP 5 Marks Apr'19, Oct'18)

Answer 2

As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of Rs. 5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 5 lakhs as interest amount.

Question 3

New Era Publications publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2020 issue was made in February 2020. The magazine was published on its scheduled date. It received Rs. 2,40,000 on 10.3.2020 and Rs. 60,000 on 10.4.2020 for the March, 2020 issue. Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2020. What will be the treatment if the publication is delayed till 2.4.2020? (MTP 5 Marks Oct 20, Mar 22 & Oct '23)

Answer 3

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished. In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.20 20 is the date of publication of the magazine. Hence, Rs. 3,00,000 (Rs. 2,40,000 + Rs. 60,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of Rs. 3,00,000 will be recognized in the March, 2020, Rs. 60,000 will be treated as amount due from advertisers as on 31.03.20 20 and Rs. 2,40,000 will be treated as payment received against the sale. However, if the publication is delayed till 02.04.2020 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of Rs. 3,00,000 will be recognized in the year ended 31.03.2020 after the magazine is published on 02.04.2020. The amount received from sale of advertising space on 10.03.2020 of Rs. 2,40,000 will be considered as an advance from advertisers as on 31.03.2020.

Question 4

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2021:

(i) On 15th January, 2021 garments worth Rs. 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2021.

(ii) Garments worth Rs. 1,95,000 were sold to Shine boutique on 25th March, 2021 but at the request of Shine Boutique, these were delivered on 15th April, 2021.

(iii) On 1st November, 2020 garments worth Rs. 2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2020 and no approval or disapproval received for the remaining goods till 31st March, 2021.

You are required to advise the accountant of Fashion Limited, the amount to be recognized as

revenue in above cases in the context of AS 9. (MTP 5 Marks Nov ’21, Oct’19, Aug’18, RTP Nov’18, RTP Nov’20)(PYP 5 Marks May ’23)

Answer 4

As per AS 9 “Revenue Recognition”, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i): 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for Rs. 3,00,000 (75% of Rs. 4,00,000) for the year ended on 31.3.21. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (ii): The sale is complete but delivery has been postponed at buyer’s request. Fashion Ltd. should recognize the entire sale of Rs.1,95,000 for the year ended 31st March, 2021.

Case (iii): In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting Rs. 2,50,000 as the time period for rejecting the goods had expired. Thus total revenue amounting Rs. 7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2021 in the books of Fashion Ltd.

Question 5

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March, 2022:

(i) On 31st December, 2021 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, 2022.

(ii) On 10th January, 2022, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2022.

(iii) On 21st March, 2022 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, 2022.

You are required to advise the accountant of Tonk Tanners when amount is to be recognised as revenue in 2021-2022 in above cases in the context of AS 9. (MTP 5 Marks March ’23, RTP May ’21)

Answer 5

i. **Shoes sent to Mohan Shoes (consignee) for consignment sale**

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2021-2022, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for ₹ 3,20,000 x 75% = ₹ 2,40,000.

ii. **Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date**

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognized as revenue in the year 2021 -2022. Hence, sale of ₹ 4,50,000 to Shani Shoes should not be recognized as revenue.

iii. **Delivery is delayed at buyer's request**

On 21st March, 2022, 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 2021 -2022 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

Question 6

Old Era Publication Publishes a popular monthly magazine on 15 th 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 2023 issue of the magazine was sold in the month of February, 2023. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2023 and ₹ 30,000 was received on 10th April, 2023 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 31 st March, 2023. (MTP 5 Marks April '23, Oct'21)

Answer 6

Definition: As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2023, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2023. 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 31.03.2023 and ₹ 2,70,000 will be treated as payment received against the sale.

Question 7

(a) How will you recognize revenue in the following cases:

1. **Installation Fees;**
2. **Advertising and insurance agency commissions;**
3. **Subscriptions for publications.**

(b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9. (RTP Nov '21)

Answer 7

(a) **Installation Fees**: In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Subscription for publications: Revenue received or billed should be deferred and recognized either

on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

(b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

Question 8 (Last Day Revision)

The following information of Meghna Ltd. is provided:

(i) **Goods of Rs. 60,000 were sold on 20-3-2019 but at the request of the buyer these were delivered on 10-4-2019.**

(ii) **On 15-1-2019 goods of Rs. 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31 -3-2019.**

(iii) **Rs. 1,20,000 worth of goods were sold on approval basis on 1 -12-2018. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2019 and no approval or disapproval received for the remaining goods till 31-3-2019.**

(iv) **Apart from the above, the company has made cash sales of Rs. 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. (RTP May'20)(Same concept different figures MTP 5 Marks Oct'22, PYP 5 Marks May '19)

Answer 8

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer 's request. M/s Paper Products Ltd. should recognize the entire sale of Rs.60,000 for the year ended 31st March, 2019.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for Rs. 1,20,000 (80% of Rs. 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting Rs. 1,20,000 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus Rs. 39,000 should be deducted from the amount of turnover of Rs. 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be Rs. 7,41,000.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Few examinees erred in the computation of amount to be charged to revenue as per provisions of AS 7 'Construction Contracts'. Some of them wrongly concluded three separate proposals for individual units of commercial complex as a single contract instead of treating as separate construction contracts.

Question 9

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive Rs. 15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include Rs. 15 lakhs in the sales for 2018-2019. Advise. (RTP Nov'19)

Answer 9

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive Rs. 15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized in 2018-2019 vide para 10 of AS 9.

Question 10

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing Rs. 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of Rs. 30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth Rs. 15,00,000 ready for dispatch. Raj Ltd. accounted Rs. 15,00,000 as sales and transferred the balance to Advance received against Sales account. Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9. (RTP May'19)

Answer 10

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognizethe entire sale of Rs. 30,00,000 (Rs. 5,00,000 x 6) and no part of the same is to be treated as Advance Received against Sales.

Question 11

A manufacturing company has the following stages of production and sale in manufacturing fine paper rolls:

Date	Activity	Cost to Date(Rs.)	Net Realizable Value(Rs.)
15.1.16	Raw Material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000

20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and calculate how much would be net profit for year ending 31.3.16 on this product as per AS 9. (RTP May'18)

Answer 11

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit Rs. 1,50,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2016.

Question 12

An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not. (RTP May 22)

Answer 12

AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

Question 13

When revenue will be recognized in the following situation:

(i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

(ii) Where seller concurrently agrees to repurchase the same goods at a later date.

(iii) Where goods are sold to distributors, dealers or others for resale.

(iv) Commissions on service rendered as agent on insurance business. (RTP Nov'22)

Answer 13

i. Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

ii. For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

iii. Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

iv. Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

Question 14

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree? (RTP May '23)

Answer 14

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, PQR Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

Question 15

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

(1) **Trade discount and column received.**

(2) **Whether goods are sold to distributor or others for resale.**

(3) **Whether seller concurrently agrees to repurchase the same goods at a late date.**

(4) **Insurance agency commission for rendering services.**

(5) **On 11-3-2019 cloths worth Rs. 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019. (PYP 5 Marks Nov'19, RTP May'22)**

Answer 15

(1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees were not able to explain whether revenue should be recognized and when it should be recognized as per AS 9 "Revenue Recognition".

Question 16

Given the following information of Rainbow Ltd.

(i) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

(ii) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

(iii) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchase the same goods on 14th April.

(iv) Dew Ltd, used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 as interest and royalties respectively from Dew Ltd. during the year 2020 -21.

(v) On 25th December, goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year-end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.(PYP 5 Marks Dec '21)(MTP 5 Marks Sep '23)

Answer 16

(i) As per AS 9 "Revenue Recognition", in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period for rejecting the goods had expired.

(ii) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 2,40,000 for the year ended 31st March.

(iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

(iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The royalty should be recognized on accrual basis in accordance with the terms of relevant

agreement.

(v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

> **EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:**
>
> Few examinees were not able to quantify the amount to be recognized as revenue under the provisions of AS 9 "Revenue Recognition" for the given situations.

Question 17

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

(i) Delivery is delayed at buyer's request but buyer takes title and accepts billing.

(ii) Instalment Sales.

(iii) Trade discounts and volume rebates.

(iv) Insurance agency commission for rendering services.

(v) Advertising commission. (PYP 5 Marks Nov 22)

Answer 17

(i) **Delivery is delayed at buyer's request and buyer takes title and accepts billing** : Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

(ii) **Instalment sales**: When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the date of sale. The interest element should be recognized as revenue, proportionately to the unpaid balance due to the seller.

(iii) **Trade discounts and volume rebates**: Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(iv) **Insurance agency commissions for rendering services**: Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(v) **Advertising commission**: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

Chapter 9.1
AS 12-Accounting for Government Grants

Question 1

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2018-19 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 2021-22, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2021-22 in profit and loss account? (MTP 5 Marks, Sep '22 May 20, March '21, RTP May '19)

Answer 1

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2021-22. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 2

Ram Ltd. purchased machinery for Rs. 80 lakhs (useful life 4 years and residual value Rs. 8 lakhs). Government grant received was Rs. 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant had been credited to Deferred Grant A/c. (MTP 5 Marks April 21, April 19, April 22 & Oct '23)

Answer 2

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (Rs. 32 lakhs /4 years) = Rs. 8 lakhs x 2 years= Rs. 16 lakhs will be credited to Profit and Loss Account and Rs. 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		Rs.	Rs.
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
To Bank A/c			32 lakhs
(Being Government grant refunded)			

1. **Value of Fixed Assets after two years but before refund of grant**
   Fixed assets initially recorded in the books = Rs. 80 lakhs
   Depreciation for each year = (Rs. 80 lakhs – Rs.8 lakhs)/4 years = Rs. 18 lakhs per year
   Book value of fixed assets after two years = Rs. 80 lakhs – (Rs. 18 lakhs x 2 years) = Rs. 44 lakhs
2. **Value of Fixed Assets after refund of grant**
   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at Rs. 44 lakhs.
3. **Amount of depreciation for remaining two years**
   Depreciation will continue to be charged at Rs. 18 lakhs per annum for the remaining two years.

Question 3

Caseworker Limited received a specific grant of ₹ 6 crore for acquiring the plant of ₹ 30 crore on 1.4.2016 having useful life of 10 years. At the beginning of the financial year 2021-2022, due to non-compliance of conditions laid down for the grant of ₹ 6 crore, the company had to refund the grant to the Government. What should be the treatment of the refund if grant was deducted from the cost of the plant during financial year 2016-2017? Assume depreciation is charged on fixed assets as per Straight Line Method. (MTP 5 Marks April 23 & Nov '21)

Answer 3

As per AS 12, the amount refundable in respect of grant related to specific fixed assets should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

Where grant was deducted from the cost of the asset, initial value of the plant after deduction of grant amount of Rs. 6 crore would have been = Rs. 30 crore — Rs. 6 crore = Rs. 24 crore.

Carrying value of the plant after 5 years on 1.4.2021 = [(Rs. 24 crore / 10 years) x 5 years] = Rs. 12 crore. Annual depreciation charge would be Rs. 2.4 crore.

On refund of grant to the Government, the book value of the plant shall be increased by Rs. 6 crore i.e. Rs. 12 crore + Rs. 6 crore = Rs. 18 crore. The increased cost of Rs. 18 crore of the plant should be amortised prospectively over remaining 5 years of useful residual life. Depreciation charge in the year 2021-2022 would be Rs. 18 crore 15 years = Rs. 3.6 crore instead of earlier Rs. 2.4 crore.

Question 4

Darshan Ltd. purchased a Machinery on 1st April, 2016 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. Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019 & 31st March, 2020. Darshan Ltd. follows straight line method for charging depreciation.(MTP 5 Marks Oct '21, PYP 5 Marks Jan '21)

Answer 4

As per 12 "Accounting for government grants", grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Amount of depreciation and grant to be recognized in the profit and loss account each year

Depreciation per year:

	₹ in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year (70lakhs / 4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Question 5

On 01.04.2018, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method. The company had to refund the entire grant in 2nd April, 2021 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant. How do you deal with the refund of grant to the Government in the books of XYZ Ltd. as per AS 12? (MTP 5 Marks, Mar'22, MTP 5 Marks Oct 20) (PYP 5 Marks May '18 & Nov '20)

Answer 5

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 2018	Acquisition cost of machinery (₹ 500 – ₹ 100)	400.00
31st March, 2019	Less: Depreciation @ 20%	(80)
1st April, 2019	Book value	320.00
31st March, 2020	Less: Depreciation @ 20%	(64)
1st April, 2020	Book value	256.00
31st March, 2021	Less: Depreciation @ 20%	(51.20)
1st April, 2021	Book value	204.80
2nd April, 2021	Add: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 6

D Ltd. acquired a machine on 01-04-2017 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

Particulars	**₹**
Machine (Original Cost)	**20,00,000**
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	**12,00,000**
	8,00,000
Less: Grant received	**(16,00,000)**
Balance	**(8,00,000)**

You are required to explain how should the company deal with this asset in its accounts for 2020-21? (MTP 5 Marks March '23) (RTP Nov 21, May 18)

Answer 6

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c. The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2020-21 or 2021-22 as the depreciable amount is now Nil.

Question 7

(i) Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2020. The company debited the said amount to its machinery account in 2020 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not. (RTP May '21, May'23)

(ii) ABC Ltd. received two acres of land received for set up of plant. It also received Rs.2 lakhs received for purchase of machinery of Rs. 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? (RTP May '21)

Answer 7

(i) As per the facts of the case, Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book

value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

(ii) ABC Ltd. should recognize the grants in the following manner:

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognized at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of Rs. 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at Rs. 10 lakhs – Rs. 2 lakhs = Rs. 8 lakhs and depreciation will be charged on it as follows:

  Rs. 8 lakhs/ 5 years = Rs. 1.60 lakhs per year.

  Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Rs. 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 40,000 [Rs. 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 8

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) Rs.35 Lakhs received from the Local Authority for providing Medical facilities to the employees. (RTP Nov 20, RTP May 20, MTP Oct'22, 5 Marks, Old & New SM)

(ii) Rs.100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area. (RTP Nov 20, RTP May 20, MTP Oct'22, 5 Marks, Old & New SM)

(iii) Rs.10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment. (RTP May 20, MTP Oct'22, 5 Marks)

Answer 8

(i) Rs.35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, Rs.35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of Rs.100 lakhs should be credited to capital reserve.

(iii) Rs.10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, Rs.10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

Question 9

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 Rs.80 crores in the eligible investments. The company is eligible for the subsidy and has received Rs.20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company. Do you approve the action of the company in accordance with the Accounting Standard? (RTP Nov'19, Nov'22)

Answer 9

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof. US $ 8,547 = 5,00,000/58.50 Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question 10

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017 -18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017? You are required to explain in the line with provisions of AS 12. (RTP Nov 18)

Answer 10

As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56+15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

Question 11

A fixed asset is purchased for ₹ 30 lakhs. Government grant received towards it is ₹ 12 lakhs. Residual Value is ₹ 6 lakhs and useful life is 4 years. The company charges depreciation based on Straight-Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 7.5 lakhs due to non-compliance with certain conditions. You are required to give necessary journal entries for second year. (RTP May '22)

Answer 11

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
2nd	Fixed Asset Account	Dr.	7.5	
	To Bank Account			7.5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.)	Dr.	5.5	
	To Fixed Asset Account			5.5
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	5.5	
	To Depreciation Account			5.5
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Note:

Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	30
Less: Government grant received	(12)
Less: Depreciation for the first year [18-6 / 4]	18
	3
	15
Add: Government grant refundable	7.5
Depreciation for the second year [22.5-6 / 3]	22.5

Question 12

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non- compliance of certain conditions. How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20. Pass necessary Journal Entries for the year 2019-20. (PYP 5 Marks Nov '20) (Same concept different figures MTP 5 Marks, Mar'22, MTP 5 Marks Oct 20, PYP 5 Marks May'18)

Answer 12

		(₹ in lakhs)
1st April, 2016	Acquisition cost of machinery Less: Government Grant	300.00 60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value Less: Depreciation @10% for 2 months	174.96 (2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account (Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)			22.253

Question 13

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve. (PYP May '19, 1 Mark)

Answer 13

True: When grants in the nature of promoters' contribution becomes refundable, in part or in full to the government on non-fulfillment of some specified conditions, the relevant amount refundable to the government is reduced from the capital reserve.

Question 14

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

(i) ₹ 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.

(ii) ₹ 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.

(iii) ₹ 25 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants". (PYP July'21, 5 Marks)

Answer 14

(i) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outly and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up an industrial undertaking in Medak is neither in relation to specific fixed asset nor in relation in revenue. Thus, the amount of ₹ 120 Lacs should be credited to capital reserve.
(Note: Subsidy for setting up an industrial undertaking is considered to be in the nature of promoter's contribution)

(ii) As per AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –

a. The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

b. Grants related to depreciable asset 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.

In the given case, ₹ 15 Lacs was received as grant from the Central Government for installation of Effluent Treatment Plant. Since the grant was received for a fixed asset, either of the above methods can be adopted.

(iii) ₹ 25 lacs received from State Government for providing medical facilities to its workmen during the pandemic is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as "Other Income". Alternatively, ₹ 25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

Question 15

Answer the following Questions:

(a) **Suraj Limited provides you the following information:**

(i) **It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores.**

(ii) **It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region.**

(iii) **It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.**

(iv) **It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.**

(v) **It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.**

State, how you will treat the above in the books of Suraj Limited.(PYP 5 Marks, May'22)

Answer 15

(i) As per AS 12 "Accounting for Govt. Grants", two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under the first alternative, the grant of ₹ 10 crores (40% of 25 crores) is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized the profit and loss statement over the useful
life of a depreciable asset by way of a reduced depreciation charge. Under second alternative method, grant amounting ₹ 10 crores is treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(ii) In the given case, the grant amounting ₹ 150 lakhs received from the Central Government for setting up a plant in notified backward area may be considered as in the nature of promoters' contribution. Thus, amount of ₹ 150 lakhs should be credited to capital reserve and the plant will be shown at ₹ 300 lakhs.

(iii) ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water in notified area should be credited to capital reserve.
Alternatively, if it is assumed that the project consists of capital asset only, then the amount of ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water should either be deducted from cost of asset of the project concerned in the balance sheet or treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(iv) ₹ 5 lakhs received from the local authority for providing corona vaccine to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss account, either separately or under a general heading 'Other Income'. Alternatively, ₹ 5 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(v) ₹ 500 Lakhs will be reduced from the renovation cost of power plant or will be treated as deferred income irrespective of the expenditure done by the entity out of it as it was specifically received for the purpose major renovation of power plant. However, it may be, later on, decided by the Govt. whether the grant will have to be refunded or not due to non-compliance of conditions attached to the grant.

Question 16

On 1stApril 2021, Eleanor Limited purchased a manufacturing Plant for ₹ 60 lakhs, which has an estimated useful life of ₹ 10 years with a salvage value of ₹ 10 lakhs. On purchase of the Plant, a grant of ₹ 20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

(i) If the grant amount is deducted from the value of Plant.

(ii) If the grant is treated as deferred income.

(iii) If the grant amount is deducted from the value of Plant, but at the end of the year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions.

(iv) If the grant is treated as the promoter's contribution.

(Assume depreciation on the basis of Straight-Line Method.) (PYP 5 Marks May '23)

Answer 16

Calculation of depreciation as per AS 12 for the financial year 2022-23:

(i) If the grant amount is deducted from the value of Plant, then the amount of deprecation will be ₹ 3,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) / 10 year.

(ii) If the grant is treated as deferred income, then amount of depreciation will be ₹ 5,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000) / 10 year.

(iii) If the grant amount is deducted from the value of plant, but at the end of the year 2022-23 grant is refunded to the extent of ₹ 4 lakh then the amount of depreciation will be ₹ 3,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) /10 year for year 202122 and for the year 2022-23 Depreciation will be ₹ 3,00,000 calculated as follows, (₹60,00,000 - ₹ 10,00,000 - ₹ 20,00,000– ₹ 3,00,000) / 10 years.

Note: It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as ₹ 3,44,444 calculated as follows, (₹ 60,00,000 - ₹10,00,000 - ₹ 20,00,000 + 4,00,000– ₹ 3,00,000 / 9 years

(iv) If the grant is treated as promoter's contribution, then the amount of depreciation will be ₹ 5,00,000 p.a. (₹ 60,00,000 -10,00,000) /10 year.

NOTE: The answer can be presented in the following alternative manner:

		(i)	(ii)	(iii)	(iv)
Date	**Particulars**	**Grant Value deducted from Plant**	**Grant treated as Deferred Income**	**Grant Refunded**	**Grant is treated as Promoter's Contribution**
01.04.2021	Cost of Plant Less: Salvage	60,00,000 10,00,000	60,00,000 10,00,000	60,00,000 10,00,000	60,00,000 10,00,000
		50,00,000	**50,00,000**	**50,00,000**	**50,00,000**
01.04.2021	Less: Grant	20,00,000	-	20,00,000	-
		30,00,000	50,00,000	30,00,000	50,00,000
	Useful Life (years)	10	10	10	10
31.03.2022	Depreciation FY 2021-22	3,00,000	5,00,000	3,00,000	5,00,000
1.4.2022	Cost of Plant Less: Salvage			60,00,000 10,00,000	
				50,00,000	
	Less: Grant			20,00,000	
	Less:			30,00,000	
	Depreciation FY 2022-23			3,00,000	
				27,00,000	

	Book value at the time of refund of grant i.e. at the end of period			4,00,000	
	Add: Grant Refundable at end of 22-23 Book value available for remining 8 years.			31,00,000	

Note:

It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as:

Cost of Plant	60,00,000
Less: Salvage	10,00,000
	50,00,000
Less: Grant	20,00,000
	30,00,000
Add: Grant Refundable	4,00,000
	34,00,000
Less: Depreciation For 2021-22	3,00,000
	31,00,000
Useful Life (years)	9
Depreciation For 2022-23	3,44,444

Question 17

S Ltd. has received a grant of 18 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed 12 crores as dividend.

Also, S 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. (RTP Nov '23)

Answer 17

As per AS 12, when government grant is received for a specific purpose, it should be utilized for the same. Thus, the grant received for setting up a factory is not available for distribution of dividend.

As per AS-12, if an asset is acquired free of cost it is to be recorded at a nominal value.

Thus, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value.

The treatment of both the elements of the grant is incorrect as per AS 12.

Chapter 9.2
AS 14- Accounting for Amalgamation

Question 1

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14. (New SM)(MTP 4 Marks Oct '23)

Answer 1

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

The Pooling of Interest Method

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Question 2

Distinguish between Amalgamation, Absorption and External Reconstruction of Company. (PYP 5 Marks May '19)

Answer 2

Difference between Amalgamation, Absorption and External Reconstruction

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and a new company is formed to take over their business.	In this case, an existing company takes over the business of one or more existing companies.	In this case, a newly formed company takes over the business of an existing company.
Minimum number of Companies involved	At least three are companies involved.	At least two companies are involved.	Only two companies are involved.
Number of new resultant companies	Only one resultant Company is formed. Two companies are wound up to form a single resultant company.	No new resultant company is formed.	Only one resultant company is formed. Under this case a newly formed company takes over the business of an existing company.
Objective	Amalgamation is done to cut competition and reap the economies in large scale.	Absorption is done to cut competition and reap the economies in large scale.	External reconstruction is done to reorganize the financial structure of the company.
Example	A Ltd. and B Ltd. amalgamate to form C Ltd.	A Ltd. takes over the business of another existing company B Ltd.	B Ltd. is formed to take over the business of an existing company A Ltd.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees failed to give detailed explanation and unable to summarize all the required points to distinguish between Amalgamation, Absorption and External Reconstruction of Company.

Chapter 10.1
As – 21 Consolidated Financial Statements

Question 1

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2010 at cost of Rs. 10,00,000 when B Ltd. had an equity share capital of Rs. 10,00,000 and reserves and surplus of Rs. 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of Rs. 2,50,000, Rs. 4,00,000, Rs. 5,00,000 and Rs. 1,20,000 respectively. Thereafter in 2014-15, B Ltd. experienced turnaround and registered an annual profit ofRs. 50,000. In the next two years i.e. 2015-16 and 2016-17, B Ltd. recorded annual profits of Rs. 1,00,000and Rs. 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation. (MTP 10 Marks Mar 19, MTP 12 Marks Oct 19, RTP May ’23, PYP 10 Marks May ’19, Old & New SM)

Answer 1

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, **make** good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority’s share of losses previously absorbed by the majority has been recovered. Accordingly, the minority interests will be computed as follows:

Year	Profit/(Loss)Interest (30%)	Minority P& L (Dr.) Cr.	Additional Consolidated	Minority’s Share oflosses borne by A Ltd. Rs.	Balance	Cost of Control
At the		3,24,000				
time of		(W.N.)				
acquisition						
in 2010			-			
2010-11	(2,50,000)	(75,000)	(1,75,000)			2,44,000
						(W.N.)
Balance		2,49,000				
2011-12	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
2012-13	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of	21,000	(21,000)	21,000	21,000	
	minority					
	borne					
	by Holding					
	Co.					
Balance		Nil	(3,71,000)			
2013-14	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of	36,000	(36,000)	36,000	57,000	
	minority bor					
	by Holding					
	Co.					
Balance		Nil	(1,20,000)			
2014-15	50,000	15,000	35,000			2,44,000
	Profit share c	(15,000)	15,000	(15,000)	42,000	
	minority					
	adjusted					
	against losses					
	of minority					
	absorbed by					

	Holding Co.	Nil	50,000			
2015-16	1,00,000	30,000	70,000			
	Profit share c	(30,000)	30,000	(30,000)	12,000	2,44,000
	minority					
	adjusted					
	against losses					
	of minority					
	absorbed by					
	Holding Co.					
Balance		Nil	100,000			
2016-17	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

	100% (Rs.)	**Share of Holding Co. 70% (Rs.)**	**Minority Interest 30% (Rs.)**
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 2

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for Rs. 2,80,000. The issued capital of ABCLtd., on 1st January, 2016 was Rs. 2,00,000 and the balance in the Profit & Loss Account was Rs. 1,20,000. During the year ended 31st December, 2016, ABC Ltd. earned a profit of Rs. 40,000 and at year end,declared and paid a dividend of Rs. 60,000. Show by an entry how the dividend should be recorded in the books of XYZ Ltd. What is the amount of minority interest as on 1st January, 2016 and 31st December, 2016? (MTP 5 Marks, Apr 19, Mar 18) (Same concept different figures New SM)

Answer 2

Total dividend paid = Rs. 60,000

Out of post-acquisition profit = Rs. 40,000

Out of pre-acquisition profit = Rs. 20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = Rs. 60,000 X 80% = Rs. 48,000

In the books of XYZ Ltd.

		Rs.	**Rs.**
Bank A/c	Dr.	48,000	
To Profit & Loss A/c			32,000
To Investments in ABC Ltd.			16,000
(Dividend received from ABC Ltd. 1/3 credited to investment			
A/c being out of capital profits – as explained above)			
Goodwill on Consolidation:			Rs.
Cost of shares less dividend out of capital profits			2,64,000
Less: Face value of capital i.e. 80% of capital		1,60,000	
Add: Share of capital profits [1,20,000-20,000			
(dividend portion out of pre-acquisition profits)] X 80 %		80,000	2,40,000

Goodwill			24,000
Minority interest on: 1st January, 2016: 20% of			
Rs. 3,20,000 [2,00,000 + 1,20,000]			64,000
31st December, 2016: 20% of Rs. 3,00,000			
[2,00,000 + 1,20,000 + 40,000 – 60,000]			60,000

Question 3

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

	Hello Ltd. (Rs. in lacs)	Sun Ltd. (Rs. in lacs)
Incomes:		
Sales and other income	**10,000**	**2,000**
Increase in Inventory	**2,000**	**400**
	12,000	**2,400**
Expenses :		
Raw material consumed	**1,600**	**400**
Wages and Salaries	**1,600**	**300**
Production expenses	**400**	**200**
Administrative Expenses	**400**	**200**
Selling and Distribution Expenses	**400**	**100**
Interest	**200**	**100**
Depreciation	**200**	**100**
	4,800	**1,400**
Profit before tax	**7,200**	**1,000**
Provision for tax	**2,400**	**400**
Profit after tax	**4,800**	**600**
Dividend paid	**2,400**	**300**
Balance of Profit	**2,400**	**300**

Other Information:

Hello Ltd. sold goods to Sun Ltd. of Rs. 240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing Rs. 48 lacs. Administrative expenses of Sun Ltd. include Rs. 10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include Rs. 20 lacs paid to Sun Ltd. as commission. Hello Ltd. holds 80% of equity share capital of Rs. 2,000 lacs in Sun Ltd. prior to 2015-2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017.

(MTP 16 Marks Aug 18, RTP- May 18) (Same concept different figures to MTP 12 Marks Mar'18 & Oct '18)

Answer 3

Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended on 31st March, 2017

	Particulars	**Note No.**	**Rs. in Lacs**
I.	Revenue from operations	1	11,730
II.	Total revenue		11,730
III.	Expenses		
	Cost of Material purchased/Consumed	3	2,360

	Changes of Inventories of finished goods	2	(2,392)
	Employee benefit expense	4	1,900
	Finance cost	6	300
	Depreciation and amortization expense	7	300
	Other expenses	5	1,070
	Total expenses		3,538
IV.	Profit before Tax(II-III)		8,192
V.	Tax Expenses	8	2,800
VI.	Profit After Tax		5,392
	Profit transferred to Consolidated Balance Sheet		
	Profit After Tax		5,392
	Dividend paid		
	Hello Ltd.	2,400	
	Sun Ltd.	300	
		2,700	
	Less: Share of Hello Ltd. in dividend of Sun Ltd.		
	80% of Rs. 300 lacs	(240)	(2,460)
	Profit to be transferred to consolidated balance sheet		2,932

Notes to Accounts

		Rs. in Lacs	Rs. in Lacs
1.	Revenue from Operations		
	Sales and other income		
	Hello Ltd.	10,000	
	Sun Ltd.	2,000	
		12,000	
	Less: Inter-company Sales	(240)	
	Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	
	Commission received by Sun Ltd. from Hello Ltd.	(20)	11,730
2.	Increase in Inventory		
	Hello Ltd.	2,000	
	Sun Ltd.	400	
		2,400	
	Less: Unrealized profits Rs. 48 lacs ×20/120	(8)	2,392
			14,122
3.	Cost of Material purchased/consumed		
	Hello Ltd.	1,600	
	Sun Ltd.	400	
		2,000	
	Less: Purchases by Sun Ltd. from Hello Ltd.	(240)	1,760
Direct	Expenses		
	Hello Ltd.	400	

	Sun Ltd.	200	600
			2,360
4.	Employee benefits and expenses		
	Wages and Salaries:		
	Hello Ltd.	1,600	
	Sun Ltd.	300	1,900
5.	Other Expenses		
	Administrative Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	
		600	
	Less: Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	590
	Selling and Distribution Expenses:		
	Hello Ltd.	400	
	Sun Ltd.	100	
		500	
	Less: Commission received from Sun Ltd. from Hello Ltd.	(20)	480
			1,070
6.	Finance Cost		
	Interest:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
7.	Depreciation and Amortization		
	Depreciation:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
8.	Provision for tax		
	Hello Ltd.	2,400	
	Sun Ltd.	400	2,800

Note: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not added to consolidated opening retained earnings (which is also not given).

Question 4

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

	H Ltd. (Rs.)	S Ltd. (Rs.)
Share Capital		
Equity Share Capital (fully paid up shares of Rs. 10 each)	**12,00,000**	**2,00,000**
Reserves and Surplus		
General Reserve	**4,35,000**	**1,55,000**
Cr. Balance in Profit and Loss Account	**2,80,000**	**65,000**
Current Liabilities		
Trade Payables	**3,22,000**	**1,23,000**
Non-Current Assets		
Property, Plant and Equipment		
Machinery	**6,40,000**	**1,80,000**
Furniture	**3,75,000**	**34,000**

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Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ Rs. 20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000

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

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

You are required to prepare the Consolidated Balance Sheet of H Ltd. With its subsidiary as at 31st March, 2021. (MTP 16 Marks April 21, MTP 15 Marks Mar 22, RTP Nov 19, PYP 20 Marks May 18)

Answer 4

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2021

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

Notes to Accounts

				`
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	

	Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200
2.	Trade Payables			8,16,200
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
4.	Intangible assets			13,10,500
	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
6.	Trade Receivables			3,25,000
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	7,05,000
	Less: Mutual transaction			(35,000)
7.	Cash and Bank			6,70,000
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

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

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

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

	Machinery	***Furniture***
Upward/ (Downward) Revaluation	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.

Difference [(short)/excess]	(10,000)	1,500

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

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

4. **Minority Interest**

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

5. **Cost of Control or Goodwill**

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

Question 5

A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd sells inventories costing Rs. 180 lacs to B Ltd at a price of Rs. 200 lacs. The entire inventories remain unsold with B Ltd at the financial year end i.e. 31 March 2020. What will be the accounting treatment for this transaction in the consolidated financial statements of A Ltd? (MTP 5 Marks Oct 20, MTP 4 Marks Mar 22 & Oct '23)

Answer 5

This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 2020, entire transaction of sale and purchase of Rs. 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of Rs. 20 lacs (i.e. Rs. 200 lacs – Rs. 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 2020, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 2020.

Question 6

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 2019 for Rs. 2,10,000. The issued

capital of Power Ltd., on 1st January, 2019 was Rs. 1,50,000 and the balance in the Profit & Loss Account was Rs. 90,000. During the year ended 31st December, 2019, Power Ltd. earned a profit of Rs. 30,000 and at year end, declared and paid a dividend of Rs. 22,500. What is the amount of minority interest as on 1st January, 2019 and 31st December, 2019? Also compute goodwill/ capital reserve at the date of acquisition. (MTP 6 Marks Oct 20, Old & New SM)

Answer 6

Total dividend paid is Rs. 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account.

Hemant Ltd.'s share of dividend = Rs. 22,500 X 80% = Rs. 18,000

Goodwill on consolidation (at the date of acquisition):	Rs.	Rs.
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on: - **1st January, 2019:** 20% of Rs. 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 2019:** 20% of Rs.2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		49,500

Question 7

The summarized Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2020 are given below:

Rs. in Lakhs

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

The following information is also given:

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

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

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

(iv) **A Ltd. holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2018-19 is Rs.1,500 Lakhs. Prepare a consolidated Profit and Loss Account of A Ltd. with its subsidiary B Ltd. for the year ended 31st March, 2020. (MTP 15 Marks May 20)**

Answer 7

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd. for the year ended on 31st March, 2020

Particulars		Note No.	Rs. in Lacs
I.	Revenue from operations	1	8,797
II.	Total revenue		8,797
III.	Expenses		
	Cost of Material purchased/consumed	3	1,770
	Changes of Inventories of finished goods	2	(1,794)
	Employee benefit expense	4	1,425
	Finance cost	6	225
	Depreciation and amortization expense	7	225
	Other expenses	5	802
	Total expenses		2,653
IV.	Profit before Tax(II-III)		6,144
V.	Tax Expenses	8	2,100
VI.	Profit After Tax		4,044

Notes to Accounts

		Rs. in Lacs	*Rs. in Lacs*
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealized profits Rs. 180×1/6 x 25/125	(6)	1,79 4
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	

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		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortization		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225
8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	300	2100

Question 8

A Ltd. had acquired 80% shares of B Ltd. for Rs. 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for Rs. 30 lakhs and net assets of B Ltd. on the date of disposal was Rs. 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd. (MTP 4 Marks Oct '21 & Oct '23)

Answer 8

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	Rs.
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd.	(28,00,000)
	2,00,000

Working Note:

A Ltd.'s share in net assets of B Ltd.

	Rs.
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of Rs. 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

Question 9

On 31st March, 2023 H Ltd. and its subsidiary S Ltd. give the following information:

	H Ltd.	**S Ltd.**
	Rs.	**Rs.**
Shareholders' Fund:		
Equity shares of Rs. 10 each	**13,40,000**	**2,40,000**
Reserves and Surplus	**4,80,000**	**1,80,000**
Profit & Loss Account	**2,40,000**	**60,000**
Secured Loans:		
12% Debentures	**1,00,000**	**-**
Current Liabilities:		
Creditors	**2,00,000**	**1,22,000**
Bank Overdraft	**1,00,000**	**-**

Bills Payable	60,000	14,800
Property, Plant & Equipment:		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
Investments:		
Investments in S Ltd.	3,84,000	-
(19,200 shares at Rs. 20 each)		
Current Assets:		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000

The following information is also provided to you:

(a) **H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at Rs. 60,000 and Rs. 36,000 respectively.**

(b) **Machinery (Book value Rs. 2,40,000) and Furniture (Book value Rs. 48,000) of S Ltd were revalued at Rs. 3,60,000 and Rs. 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%).**

(c) **On 31st March, 2022, Bills payable of Rs. 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.**

(d) **You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023.(MTP 20 Marks Nov '21 & March '23 & April '23, PYP 20 Marks Jan 21)**

Answer 9

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023

Particulars			Note No.	(Rs.)
I.		Equity and Liabilities		
	1	Shareholder's Funds		
		(a) Share Capital	1	13,40,000
		(b) Reserves and Surplus	2	8,27,040
	2	(Minority Interest		1,15,560
	3	Non- Current Liabilities		
		(a) 12% Debentures		1,00,000
	4	Current Liabilities		
		(a) Trade Payables	3	3,84,800
		(b) Short term Borrowings (Bank)		1,00,000
		Total		28,67,400
II.		Assets		
	1	Non-current assets		
		(a)		
		(i) Property, Plant and Equipment	4	14,34,600
		(ii) Intangible assets	5	28,800
	2	Current assets		
		(a) Inventory (6,00,000+2,00,000)		8,00,000
		(b) Trade Receivables	6	5,08,000
		(c) Cash and Cash equivalents		96,000
		Total		28,67,400

Notes to Accounts

		Rs.

1.	Share Capital Equity share capital 1,34,000 shares of Rs. 10 each fully paid up			13,40,000
2.	Reserves and Surplus			
	Reserves		4,80,000	
	Add: 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3)		96,000	5,76,000
	Profit and Loss Account		2,40,000	
	Add: 4/5th share of S Ltd.'s post-acquisition profits (W.N.4)		11,040	2,51,040
				8,27,040
3.	Trade Payables			
	Creditors			
	H Ltd.	2,00,000		
	S Ltd.	1,22,000	3,22,000	
	Bills Payables			
	H Ltd.	60,000		
	S Ltd.	14,800	74,800	
			3,96,800	
	Less: Mutual Owings		(12,000)	3,84,800
4.	Property Plant and Equipment			
	Machinery			
	H. Ltd.		7,20,000	
	S Ltd.	2,40,000		
	Add: Appreciation	1,20,000		
		3,60,000		
	Less: Depreciation (3,60,000 X 10%)	(36,000)	3,24,000	
	Furniture			
	H. Ltd.		3,60,000	
	S Ltd.	48,000		
	Less: Decrease in value	(12,000)		
		36,000		
	Less: Depreciation (36,000 X 15%)	5,400	30,600	14,34,600
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.	Trade receivables			
	H Ltd.	3,00,000		
	S Ltd.	90,000	3,90,000	
	Bills Receivables			
	H Ltd.	1,00,000		
	S Ltd.	30,000	1,30,000	
			5,20,000	
	Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

1. Pre-acquisition profits and reserves of S Ltd.	*Rs.*
Reserves	60,000
Profit and Loss Account	36,000
	96,000
H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
Minority Interest= 1/5 (or 20%) × 96,000	19,200
2. Profit on revaluation of assets of S Ltd.	
Profit on Machinery Rs. (3,60,000 – 2,40,000)	1,20,000

Less: Loss on Furniture Rs.(48,000 –36,000)			(12,000)
Net Profit on revaluation			1,08,000
H Ltd.'s share 4/5 × 1,08,000			86,400
Minority Interest 1/5 × 1,08,000			21,600
3. Post-acquisition reserves of S Ltd. Total reserves Less: Pre- acquisition reserves			1,80,000 (60,000)
Post-acquisition reserves			1,20,000
H Ltd.'s share 4/5 × 1,20,000			96,000
Minority interest 1/5 × 1,20,000			24,000
4. Post -acquisition profits of S Ltd.			
Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = Rs. 60,000 – 36,000)			24,000
Add: Excess depreciation charged on furniture @ 15%			
on Rs. 12,000 i.e. (48,000 – 36,000)			1,800
Less: Under depreciation on machinery @ 10%			25,800
on Rs. 1,20,000 i.e. (3,60,000 – 2,40,000)			(12,000)
Adjusted post-acquisition profits			13,800
H Ltd.'s share 4/5 × 13,800			11,040
Minority Interest 1/5 × 13,800			2,760
5. Minority Interest			
Paid-up value of (24,000 – 19,200) = 4,800 shares			
held by outsiders i.e. 2,40,000 X 20%			48,000
Add: 1/5th share of pre-acquisition profits and reserves			19,200
1/5th share of profit on revaluation			21,600
1/5th share of post-acquisition reserves			24,000
1/5th share of post-acquisition profit			2,760
6. Cost of Control or Goodwill			1,15,560
Price paid by H Ltd. for 19,200 shares (A) *Less:* Intrinsic value of the shares			3,84,000
Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%			1,92,000
Add: 4/5th share of pre-acquisition profits and reserves			76,800
4/5th share of profit on the revaluation			86,400
Intrinsic value of shares on the date of acquisition	(B)		3,55,200
Cost of control or Goodwill B)	(A	–	28,800

Question 10

Consider the following information of subsidiary MNT Ltd.

	2020-21	2021-22
	Amount in ₹	**Amount in ₹**
Share Capital		
Issued and subscribed 7500 Equity Shares of ₹ 100 each	**7,50,000**	**7,50,000**
Reserve and Surplus		
Revenue Reserve	**2,14,000**	**5,05,000**
Securities Premium	**72,000**	**2,07,000**
Current Liabilities and Provisions		
Trade Payables	**2,90,000**	**2,46,000**

Bank Overdraft	-	1,70,000
Provision for Taxation	2,62,000	4,30,000
Non-current assets		
Property, Plant and equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment at Cost	-	5,30,000
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500

Other Information:

1. **MNT Ltd. is a subsidiary of LTC Ltd.**
2. **LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2020-21 and increased by ₹ 12,000 at the end of 2021-22. (Inventory of 2020-21 has been sold out during the year 2021-22)**
3. **MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.**
4. **Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25,000 in 2020-21 and ₹ 12,500 in 2021-22 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2020-21, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2020-21.**

Restate the balance sheet of MNT Ltd. as on 31st March, 2022 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.(MTP 10 Marks Sep'22, MTP 16 Marks Oct '21 & Oct '23, PYP 10 Marks Nov '19) (Same concept different figures MTP 12 Marks Apr 19)

Answer 10

Restated Balance Sheet of MNT Ltd. as at 31st March, 2022

Particulars	Note No.	(₹)
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) **Current Liabilities**		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		**23,14,500**
II. **Assets**		
(1) **Non-current assets**		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) **Current assets**		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\frac{3,43,000}{98} \times 100$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		**23,14,500**

Notes to Accounts

			₹
1.	Reserves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	

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

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98]	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 11

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

Case	Subsidiary Company	% of Share Owned	Cost	Date of Acquisition		Consolidation date	
				01-01-2021		31-12-2021	
				Share Capital	Profit and Loss A/c	Share Capital	Profit and Loss A/c
				₹	₹	₹	₹
Case-i	X	85%	1,85,000	1,35,000	60,000	1,35,000	70,000
Case-ii	Y	70%	1,60,000	1,25,000	45,000	1,25,000	5,000
Case-iii	Z	65%	83,000	25,000	5,000	25,000	5,000
Case-iv	M	90%	60,000	45,000	20,000	45,000	40,000
Case-v	N	100%	85,000	25,000	25,000	25,000	50,000

(MTP 5 Marks Sep'22, PYP 5 Marks Nov '19, RTP Nov 20, Old SM) (Same concept different figures RTP May'19)

Answer 11

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2021

B = Profit & loss account balance on 1.1.2021 C = Share capital on 31.12.2021

D = Profit & loss account balance on 31.12.2021

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] ₹	Minority interest as at the date of consolidation [E] X [C + D] ₹
Case i [100-85]	15%	29,250	30,750

Case ii [100-70]	30%	51,000	39,000
Case iii [100-65]	35%	10,500	10,500
Case iv [100-90]	10%	6,500	8,500
Case v [100-100]	NIL	NIL	NIL

Question 12

Sun Ltd. acquired 3,200 ordinary shares of ₹ 100 each of Star Ltd. on 1st October, 2021. On 31st March, 2022, the balance sheets of the two companies were as given below:

Balance Sheet of Sun Ltd. and its subsidiary, Star Ltd. as at 31st March, 2022

Particulars	Note No.	Sun Ltd. (₹)	Star Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	10,00,000	4,00,000
(b) Reserves and Surplus	2	5,94,400	3,64,000
(2) Current Liabilities			
(a) Trade Payables		94,200	34,800
(b) Short term borrowings	3	1,60,000	-
Total		18,48,600	7,98,800
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	4	7,80,000	6,30,000
(b) Non-current Investments	5	6,80,000	
(2) Current assets			
(a) Inventories		2,40,000	72,800
(b) Trade receivables		1,19,600	80,000
(c) Cash & Cash equivalents	6	29,000	16,000
Total		18,48,600	7,98,800

Notes to Accounts

		Sun Ltd. `	Star Ltd.. `
1	**Share Capital** 10,000 shares of ` 100 each, fully paid up	10,00,000	
	4,000 shares of ` 100 each, fully paid up		4,00,000
	Total	10,00,000	4,00,000
2	**Reserves and Surplus** General Reserves	4,80,000	2,00,000
	Profit & loss	1,14,400	1,64,000
	Total	5,94,400	3,64,000
3	**Short term borrowings** Bank overdraft	1,60,000	
4	**Property plant and equipment** Land and building	3,00,000	3,60,000

	Plant & Machinery	4,80,000	2,70,000
	Total	7,80,000	6,30,000
5	**Non-current Investments** Investment in Star Ltd. (at cost)	6,80,000	
6	**Cash & Cash equivalents** Cash	29,000	16,000

The Profit & Loss Account of Star Ltd. showed a credit balance of ₹ 60,000 on 1st April, 2021 out of which a dividend of 10% was paid on 1st November, 2021; Sun Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 3,00,000 on 1st April, 2021 was considered as worth ₹ 3,60,000 on 1st October, 2021; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).Prepare consolidated Balance Sheet as at 31st March, 2022. (MTP 20 Marks Oct'22)(Same concept different figures PYP 15 Marks Nov'20, MTP 15 Marks Sep'23, Old & New SM)

Answer 12

Consolidated Balance Sheet of Sun Ltd.and its subsidiary, Star Ltd. as at 31st March, 2022

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	10,00,000
(b) Reserves and Surplus	2	6,17,600
(2) Minority Interest		1,67,200
(3) Current Liabilities		
(a) Trade Payables	3	1,29,000
(b) Short term borrowings	4	1,60,000
Total		20,73,800
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	14,82,000
(b) Intangible assets	6	34,400
(2) Current assets		
(a) Inventories	7	3,12,800
(b) Trade receivables	8	1,99,600
(c) Cash & Cash equivalents	9	45,000
Total		20,73,800

Notes to Accounts

1	Share Capital		
	10,000 shares of ₹ 100 each		
2	Reserves and Surplus		
	Reserves	4,80,000	
	Profit & loss (Refer to W.N 8)	1,37,600	
	Total		6,17,600
3	Trade Payables		
	Sun Ltd. 94,200		
	Add: Star Ltd. 34,800		1,29,000
	Total		
4	Short term borrowings		
	Bank overdraft		1,60,000
5	Property, plant and equipment		
	Land and building- Sun Ltd.	3,00,000	
	Add: Land and building- Star Ltd.	3,60,000	6,60,000

	Plant & Machinery (Refer to W.N 7)		8,22,000
	Total		14,82,000
6	Intangible assets		-
	Goodwill (refer to W.N 6)		34,400
7	Inventories		
	Sun Ltd.	2,40,000	
	Star Ltd..	72,800	
	Total		3,12,800
8	Trade Receivables		
	Sun Ltd.	1,19,600	
	Star Ltd.	80,000	
	Total		1,99,600
9	Cash & Cash equivalents		
	Cash of Sun Ltd	29,000	
	Add: cash of Star Ltd..	16,000	
	Total	-	45,000

Share holding Pattern

Total Shares of Star Ltd.	4,000 shares
Shares held by Sun Ltd	3,200 shares i.e. 80 %
Minority Shareholding	800 shares i.e. 20 %

Working Notes:

1.The dividend @ 10% on 3,200 shares - ₹32,000 received by Sun Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. Sun Ltd., must pass a rectification entry, viz.

Profit & Loss Account Dr.	₹ 32,000	
To Investment		₹ 32,000

2.The Plant & Machinery of Star Ltd. would stand in the books at ₹ 2,85,000 on 1st Oct, 2021, considering only six months' depreciation on ₹ 3,00,000 total depreciation being ₹ 30,000. The value put on the assets being ₹ 3,60,000, there is an appreciation to the extent of ₹ 75,000 (3,60,000 – 2,85,000).

3.**Capital profits of Star Ltd.**

	₹	₹
Reserve on 1st April, 2021 (Assumed there is no movement in reserves during the year and hence balance as on 1st April 2021 is same as of 31st March, 2022)		2,00,000
Profit & Loss Account Balance on 1st April, 2021	60,000	
Less: Dividend paid	(40,000)	20,000
Profit for 2021-22:		
Total ₹ 1,64,000		
Less: (₹ 20,000)		
₹ 1,44,000		
Proportionate upto 1st Oct, 2021 on time basis (₹ 1,44,000/2)		72,000
Appreciation in value of Plant & Machinery		75,000
		3,67,000
Less: 20% due to outsiders		(73,400)
Holding company's share		2,93,600

4.**Revenue profits of Star Ltd.:**

Profit after 1st Oct, 2021 [(1,64,000 – 20,000) x ½]		72,000
Less: Depreciation		
10% depreciation on ₹ 3,60,000 for 6 months	18,000	
Less: Depreciation already charged for 2nd half year on 3,00,000	(15,000)	(3,000)
		69,000
Less: 1/5 due to outsiders		(13,800)

Share of Sun Ltd.	55,200

5.**Minority interest:**

Par value of 800 shares (4,00,000 X 20%)	80,000
Add: 1/5Capital Profits [WN 3]	73,400
1/5 Revenue Profits [WN 4]	13,800
	1,67,200

6.**Cost of Control:**

Amount paid for 3,200 shares	6,80,000	
Less: Dividend out of pre-acquisition profits	(32,000)	6,48,000
Par value of shares	3,20,000	-
Capital Profits –share of Sun Ltd. [WN 3]	2,93,600	(6,13,600)
Cost of Control or Goodwill		34,400

7.**Value of Plant & Machinery:**

Sun Ltd.		4,80,000
Star Ltd.	2,70,000	
Add: Appreciation on 1st Oct, 2021 [3,60,000 – (3,00,000 – 15,000)]	75,000	
	3,45,000	
Add: Deprecation for 2nd half charged on pre-revalued value	15,000	
Less: Depreciation on ₹3,60,000 for 6 months	(18,000)	3,42,000
		8,22,000

8.**Profit & Loss Account (Consolidated):**

Sun Ltd.as given	1,14,400	
Less: Dividend transferred to Investment A/c	(32,000)	82,400
Share of Sun Ltd.in revenue profits of Star Ltd.(WN 4)		55,200
		1,37,600

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Question 13

On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for Rs. 12,00,000. The position of Q Ltd. on that date was as under:

	Rs.
Property, plant and equipment	**10,50,000**
Current Assets	**6,45,000**
1,50,000 equity shares of Rs. 10 each fully paid	**15,00,000**
Pre-incorporation profits	**30,000**
Profit and Loss Account	**60,000**
Trade payables	**1,05,000**

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

	P Ltd. **Rs.**	**Q Ltd.** **Rs.**
Equity shares of Rs. 10 each fully paid (before bonus issue)	**45,00,000**	**15,00,000**
Securities Premium	**9,00,000**	**–**
Pre-incorporation profits	**–**	**30,000**
General Reserve	**60,00,000**	**19,05,000**
Profit and Loss Account	**15,75,000**	**4,20,000**
Trade payables	**5,55,000**	**2,10,000**
Property, plant and equipment	**79,20,000**	**23,10,000**
Investment: 1,05,000 Equity shares in Q Ltd. at cost	**12,00,000**	**-**
Current Assets	**44,10,000**	**17,55,000**

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of Rs. 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest;

(iii)Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares.

(b) Immediately after issue of bonus shares. (RTP Nov 21, Old & New SM)

Answer 13

Shareholding pattern

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

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

(a) Before issue of bonus shares

(i)	Cost of control/capital reserve	Rs.	Rs.
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control		87,000
(ii)	Minority Interest		Rs.
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	Consolidated profit and loss account – P Ltd.		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

(i)	Cost of control/capital reserve	Rs.	Rs.
	Face value of investments (Rs. 10,50,000 + Rs. 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	Minority Interest		Rs.
	Share Capital (Rs. 4,50,000 + Rs. 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	Consolidated Profit and Loss Account – P Ltd.		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits	Revenue Profits	
	(Before and after issue of bonus shares) Rs.	Before Bonus Issue Rs.	After Bonus Issue Rs.
Pre-incorporation profits	30,000		

Profit and loss account on 31.3.2015	60,000		
	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 2015 to 31st March, 2021 (Rs. 4,20,000 – Rs. 60,000)		3,60,000	3,60,000
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

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

Question 14

A Ltd. acquired 70% equity shares of B Ltd. @ Rs.20 per share (Face value - Rs.10) on 31st March, 2021 at a cost of Rs. 140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021: (RTP May 21)

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

Answer 14

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

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

Question 15

A Ltd holds 75% of the equity capital and voting power in B Ltd. A Ltd purchases inventories costing Rs. 150 lacs from B Ltd at a price of Rs. 200 lacs. The entire inventories remain unsold with A Ltd at the financial year end i.e. 31 March 2019. Suggest the accounting treatment for this transaction in the consolidated financial statements of A Ltd giving reference of the relevant accounting standard. (RTP Nov 20)

Answer 15

As per para provisions of AS 21, Intragroup balances and intragroup transactions and resulting

unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered. Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and Property, Plant & Equipment, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

The case given in the Question is the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 2019, entire transaction of sale and purchase of Rs. 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of Rs. 50 lacs (i.e. Rs. 200 lacs – Rs. 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 2019, by reducing the value of closing inventories by Rs. 50 lacs as of 31 March 2019. In the consolidated balance sheet as of 31 March 2019, A Ltd's share of profit from B Ltd will be reduced by Rs. 37.50 lacs (being 75% of Rs. 50 lacs) and the minority's share of the profits of B Ltd would be reduced by Rs. 12.50 lacs (being 25% of Rs. 50 lacs).

Question 16

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

Particulars	Amounts as at 31st March, 2017	
	X Ltd. (Rs. in lakhs)	Y Ltd. (Rs. in lakhs)
LIABILITIES		
Share Capital:		
Authorised	20,000	8,000
Issues and subscribed:		
Equity share of Rs. 10 each, fully paid up	15,000	6,000
15% preference shares of Rs. 10 each, fully paid up	4,000	1,000
General Reserves	2,500	1,450
Profit & Loss Account	2,750	1,250
Trade payables	1,646	1,027
	25,896	10,727
ASSESTS		
Land & Building	3,550	1,510
Plant & Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd.: 450 Lakh Equity share in		
Y Ltd. purchased on 1st April, 2016	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	1,174	560
	25,896	10,727

The following information is also given to you

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

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

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

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

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

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

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31stMarch, 2017 giving working notes. (Ignoring dividend on preference shares). (RTP Nov 18)

Answer 16

Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017

	Particulars	Note No.	Rs. in lakhs
I	Equity and Liabilities		
1	Shareholders' Funds		
	(a) Share Capital	1	19,000
	(b) Reserves and Surplus	2	5,620
2.	**Minority interest**	3	3,400
3.	**Current Liabilities**		
	(a) Trade payables	4	2,623
	Total		30,643
II	**Assets**		
1	**Non Current Assets**		
	Property, Plant & Equipment		
	(i) Tangible Assets	5	17,435
2	**Current Assets**		
	(a) Inventories	6	6,632
	(b) Trade Receivables	7	4,842
	(c) Cash and Cash equivalents	8	1,734
			30,643

Notes to Accounts

		Rs. in lakhs	
1.	**Share Capital**		
	Issued, Subscribed and Paid up (1,500 lakh Equity Shares of Rs. 10 each fully paid up)		15,000
	400 lakh Preference Shares of Rs. 10 each fully paid up		4,000
2.	**Reserves and Surplus**		19,000
	Credit Balance of Profit & Loss Account	2,750	
	Less: Capital Receipt wrongly credited (Dividend @ 10% on Rs. 4500 Lakh Equity Shares)	450	
		2,300	
	Add: Share in Y Ltd. Revenue Profit (Working Note i)	825	
		3,125	
	Less: Unrealised Profit (Working Note iv)	30	3,095
	Capital Reserve (Working Note iii)	25	
	General Reserve	2,500	2,525
3.	Minority interest		5,620
	100 Lakh Preference Shares of Rs. 10 fully paid up	1,000	
	150 Lakh Equity Shares of Rs.10 each fully paid up	1,500	2,500
	Share in Revenue Profits (Working Note i)	275	

	Share in Capital Profit (working Note ii)	625	900
4.	Trade payables		3,400
	X Ltd.	1,646	
	Y Ltd.	1,027	
		2,673	
	Less: Mutual owing	50	2,623
5.	Tangible Assets		
	Land & Building		
	X Ltd.	3,550	
	Y Ltd	1,510	5,060
	Plant & Machinery		
	X Ltd.	5,275	
	Y Ltd (Working note v)	4,500	9,775
	Furniture & Fixtures		
	X Ltd.	1,945	
	Y Ltd	655	2,600
6.	Inventories		17,435
	X Ltd.	4,142	
	Y Ltd	2,520	
		6,662	
	Less: Unrealized Profit	(30)	6,632

Working Notes:

i. Calculation of Revenue Profits Y's Ltd Profit & Loss Account

	Rs. in lakh		Rs. in lakh
To Equity Dividend		By Balance b/d	650
10 % of 6,000 lakh	600	By Net profit for the year (Bal Fig.)	1,200
To balance c/d	1,250		
	1,850		**1,850**

Depreciation provided on Plant & Machinery	
Balance as on 1st April, 2016	4,000
Less Balance as 31st March 2017	3,600
	400
Hence rate of Depreciation = 400/4000 x 100	10%
Net Profit for the year ended 31st March 2017	1,200
Less: Additional Depreciation	100
Revenue Profit	1,100
X Ltd's share- 1100 x 450/600	825
Y Ltd's share = 1100 x150/600	275

ii. Calculation of Capital Profits	
Profit & Loss Balance as on 1st April, 2016	650
Less: Dividend Paid	600
	50
Add: General Reserve as on 1st April, 2016	1,450
Add: Profit on Revaluation of Plant & machinery	1,000
Capital Profit	2,500
X Ltd's Share in Capital Profit = 2,500 x 450/600	1,875

Y Ltd's Share in Capital Profit = 2,500 x 150/600 **iii. Calculation of Capital Reserve**	625
Paid up value of 450 Lakh equity shares	4,500
Add: Share in Capital Profits	1,875
	6,375
Amount Paid to acquire the 450 Lakh Equity Shares	6,800
Less: Dividend received out of Pre acquisition profits	450
	6,350
Capital Reserve = 6,375-6,350 **iv. Unrealized Profit**	25
Rs. 150 Lakh x 25/125* = 30 lakh	

v. Plant & Machinery of Y Ltd.

Balance as on 31st March, 2017		3,600
Add: Addition due to revaluation	1,000	
Less: Depreciation on additional Value of Plant & Machinery @ 10 %	100	900
		4,500

* Rs. 150 lakh considered as cost to Y Ltd.

Question 17

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

	Beta Ltd.	Gamma Ltd.
	Rs.	Rs.
Share Capital:		
Shares of Rs. 100 each	**15,00,000**	**2,50,000**
Reserves	**5,00,000**	**1,87,500**
Profit and Loss Account	**2,50,000**	**62,500**
Trade Payables	**3,75,000**	**1,42,500**
Property, plant and Equipment:		
Machinery	**7,50,000**	**2,25,000**
Furniture	**3,75,000**	**42,500**
Other non-current assets	**11,00,000**	**3,75,000**
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at Rs. 200 each	**4,00,000**	

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at Rs. 62,500 and Rs. 37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020.

Machinery (Book-value Rs. 2,50,000) and Furniture (Book value Rs. 50,000) of Gamma Ltd. were revalued at Rs. 3,75,000 and Rs. 37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.] (RTP May 22, RTP May'20, Old & New SM)

Answer 17

Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd. as at 31st March, 2021

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		15,00,000
(b) Reserves and Surplus	1	8,61,500
(2) Minority Interest (W.N.5)		1,20,375
(3) Current Liabilities		
(a) Trade Payables	2	5,17,500

Total		29,99,375
II. Assets		
(1) Non-current assets		
(a) (i) Property, Plant & Equipment	3	14,94,375
(ii) Intangible assets	4	30,000
(b) Other non- current assets	5	14,75,000
Total		29,99,375

Notes to Accounts

				Rs.
1.	Reserves and Surplus			
	Reserves		5,00,000	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition reserves (W.N.3)		1,00,000	6,00,000
	Profit and Loss Account		2,50,000	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition profits (W.N.4)		11,500	2,61,500
2.	Trade Payables			8,61,500
	Beta Ltd.		3,75,000	
	Gamma Ltd.		1,42,500	5,17,500
3.	Property, Plant & Equipment			
	Machinery			
	Beta Ltd.		7,50,000	
	Gamma Ltd.	2,50,000		
	Add: Appreciation	1,25,000		
		3,75,000		
	Less: Depreciation	(37,500)	3,37,500	
	Furniture			
	Beta Ltd.		3,75,000	
	Gamma Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,37
4.	Intangible assets			
	Goodwill [WN 6]			30,000
5.	Other non-current assets			
	Beta Ltd.		11,00,000	
	Gamma Ltd.		3,75,000	14,75,00

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Working Notes:

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

3. Post-acquisition reserves of Gamma Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = Rs. 1,87,500 – 62,500)	1,25,000
Beta Ltd.'s share 4/5 × 1,25,000	1,00,000
Minority interest 1/5 × 25,000	25,000
4. Post -acquisition profits of Gamma Ltd.	
Post-acquisition profits (Profit & loss account balance less pre- acquisition profits = Rs. 62,500 – 37,500)	25,000
Add: Excess depreciation charged on furniture @ 15%	
on Rs. 12,500 i.e. (50,000 – 37,500)	1,875
Less: Under depreciation on machinery @ 10%	26,875
on Rs. 1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
Adjusted post-acquisition profits	14,375
Beta Ltd.'s share 4/5 × 14,375	11,500
Minority Interest 1/5 × 14,375	2,875
5. Minority Interest	
Paid-up value of (2,500 – 2,000) = 500 shares	
held by outsiders i.e. 500 × Rs. 100	50,000
Add: 1/5th share of pre-acquisition profits and reserves	20,000
1/5th share of profit on revaluation	22,500
1/5th share of post-acquisition reserves	25,000
1/5th share of post-acquisition profit	2,875
6. Cost of Control or Goodwill	1,20,375
Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 × Rs. 100	2,00,000
Add: 4/5th share of pre-acquisition profits and reserves	80,000
4/5th share of profit on the revaluation	90,000
Intrinsic value of shares on the date of acquisition	3,70,000
Price paid by Beta Ltd. for 2,000 shares	4,00,000
Less: Intrinsic value of the shares	(3,70,000)
Cost of control or Goodwill	30,000

Question 18

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

	H Ltd. (` in 000's)	**S Ltd. (` in 000's)**
Equity Share Capital – Authorised	**5,000**	**3,000**
Issued and subscribed in Equity Shares of ` 10 each fully paid	**4,000**	**2,400**
General Reserve	**928**	**690**
Profit and Loss Account (Cr. Balance)	**1,305**	**810**
Trade payables	**611**	**507**
Provision for Taxation	**220**	**180**
Other Provisions	**65**	**17**
Plant and Machinery	**2,541**	**2,450**
Furniture and Fittings	**615**	**298**
Investment in the Equity Shares of S Ltd.	**1,500**	**-**
Inventory	**983**	**786**
Trade receivables	**820**	**778**
Cash and Bank Balances	**410**	**102**
Sundry Advances (Dr. balances)	**260**	**190**

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the following

balances stood in the books of S Ltd.:
General Reserve ` 1,500 thousand; Profit and Loss Account ` 633 thousand.

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

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

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

(e) **Details of Trade payables and Trade receivables:**

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

Prepare a consolidated Balance Sheet as on 31st March, 2022. (RTP Nov'22)

Answer 18

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2022

Particulars	Note No.	(` in 000's)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(a) Reserves and Surplus	2	3,063
(2) Minority Interest (W.N.6)		1,560
(3) Current Liabilities		
Trade payables	3	1,118
Short term provisions	4	482
Total		10,223
II. Assets		
(1) Non-current assets		
PPE	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade receivables	7	1,598
(c) Cash and cash equivalents	8	512
(d Short term loans and advances	9	450
Total		10,223

Notes to Accounts

		(` in 000's)	(` in 000's)
1.	Share Capital		
	Authorised share capital		
	5 lakhs equity shares of ` 10 each		5,000
	Issued, Subscribed and Paid up		
	4 lakhs equity shares of ` 10 each fully paid		4,000
2.	Reserves and surplus		
	Capital Reserve (Note 5)	679.8	
	General Reserve	928	
	Profit and Loss Account:		

	H Ltd. ` 1,305 Add: Share in S Ltd ` 340.20		
	` 1,645.20		
	Less: Dividend wrongly credited ` (180)		
	` 1,465.20		
	Less: Unrealised profit (50 X 1/5) ` (10)	1,455.20	3,063
3.	Trade payables		
	H Ltd.	611	
	S Ltd.	507	1,118
4.	Short –term provisions		
	Provision for Taxation H Ltd. ` 220		
	S Ltd. ` 180	400	
	Other Provisions H Ltd ` 65		
	S Ltd. ` 17	82	482
5.	PPE		
	Plant and Machinery		
	H Ltd. ` 2,541		
	S Ltd. ` 2,450	4,991	
	Furniture and fittings		
	H Ltd. ` 615		
	S Ltd. ` 298	913	5,904
6.	Inventories		
	Inventory H Ltd. ` 983 S Ltd. `786	1,769	
	Less: Unrealised profit (` 50 x 1/5)	(10)	1,759
7.	Trade receivables		
	H Ltd.	820	
	S Ltd.	778	1,598
8.	Cash and cash equivalents		
	Cash and Bank Balances H Ltd	410	
	S Ltd.	102	512
9.	Short term loans and advances		
	Sundry Advances H Ltd.	260	
	S Ltd.	190	450

Working Notes:

Share holding pattern

Particulars	Number of Shares	% of holding
a. S Ltd. (i) Purchased on 01.04.2021	90,000	
(ii) Bonus Issue (90,000/5 x 3)	54,000	
Total	1,44,000	60% (1,44,000 /2,40,000*x100)
b. Minority Interest	96,000	40%

*2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022

1.**S Ltd. General Reserve**

		(` in 000)			(` in 000)
To	Bonus to equity shareholders $\frac{2,400 \times 3}{8}$	900	By By	Balance b/d Profit and Loss A/c	1,500
To	Balance c/dType equation here.	690		(Balancing figure)	90

		1,590			1,590

2. **S Ltd.'s Profit and Loss Account**

		(` in 000)			(` in 000)
To	General Reserve	90	By	Balance b/d	633
To	Dividend paid on 14.7.2021 $\frac{1,500 \times 20}{100}$	300	By	Net Profit for the year (Balancing figure)	567*
To	Balance c/d	810			
		1,200			1,200

* Out of ` 5,67,000 profit for the year, ` 90,000 has been transferred to reserves by S Ltd.

3. **Distribution of Revenue Profits**

	` in '000
Revenue Profit as above	567.00
Share of H Ltd. (60%)	340.20
Share of Minority shareholders (567– 340.20)	226.80

4. **Computation of Capital Profits**

	` in 000	` in 000
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		(900)
Profit and Loss Account balance on the date of acquisition	633	600
Less: Dividends paid	(300)	333
		933
Share of H Ltd. (60%)		559.80
Share of Minority shareholders		373.20

5. **Computation of Capital Reserve**

		` in '000
60% of share capital of S Ltd.		1,440
Add: Share of H Ltd. in the capital profits as in working note (4)		559.80
Less: Investments in S Ltd.	1,500	1,999.80
Less: Dividends received out of pre- acquisition profits $\frac{`30 \times 60}{100}$	(180)	(1,320)
		679.80

6. **Calculation of Minority Interest**

	` in '000
40% of share capital of S Ltd.	960.00
Add: Share of Revenue Profits (Note 3)	226.80
Share of Capital Profits (Note 4)	373.20
	1,560.00

Question 19

G Ltd.. and its subsidiary K Ltd. give the following information for the year ended 31stMarch, 2023:

Particulars	G Ltd.	K Ltd

Sales and other Income	3000	750
Increase in Inventory	750	100
Raw material consumed	600	100
Wages and Salaries	600	75
Production expenses	100	50
Administrative expenses	75	50
Selling and Distribution expenses	100	25
Interest	75	30
Depreciation	75	30

The following information is also given:

(i) **G sold goods of ` 200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventory of K Ltd. at the end of the year)**

(ii) **G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is ` 800 crores on 01.04.2022 (date of acquisition of shares)**

(iii) **Administrative expenses of K Ltd. include ` 5 crore paid to G Ltd. as consultancy fees. Also, selling and distribution expenses of G Ltd. include ` 20 crores paid to K Ltd. as commission.**

Prepare a consolidated statement of Profit and Loss of G Ltd. with its subsidiary K. Ltd. for the year ended 31st March, 2023. (PYP 15 Marks May '23) (Same concept different figures MTP 15 Marks March 21, Apr 22, Old & New SM)

Answer 19

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd. for the year ended on 31st March, 2023

Particulars	Note No.	` in Crores
I. Revenue from operations	1	3,525
II. Total Income		3,525
III. Expenses Cost of material purchased/consumed	2	650
Changes of inventories of finished goods	3	(842)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225
Total expenses		918
IV. Profit before tax (II-III)		2,607

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Notes to Accounts

		` in Crores	` in Crores
1.	Revenue from operations Sales and other income G Ltd.	3,000	
	K Ltd.	750 3,750	
	Less: Inter-company sales	(200)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,525
2.	Cost of material purchased/consumed G Ltd.	600	

	K Ltd.	100 700	
	Less: Purchases by K Ltd. from G Ltd.	(200)	500
	Direct expenses (Production) G Ltd.	100	
	K Ltd.	50	150 650
3.	Changes of inventories of finished goods G Ltd.	750	
	K Ltd.	100 850	
	Less: Unrealized profits ` 40 crores × 25/125	(8)	842
4.	Employee benefits and expenses Wages and salaries: G Ltd.	600	
	K Ltd.	75	675
5.	Finance cost Interest: G Ltd.	75	
	K Ltd.	30	105
6.	Depreciation G Ltd.	75	
	K Ltd.	30	105
7.	Other expenses Administrative expenses G Ltd.	75	
	K Ltd.	50 125	
	Less: Consultancy fees received by G Ltd. from K Ltd.	(5)	120
	Selling and distribution Expenses: G Ltd.	100	
	K Ltd.	25 125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105 225

Note: The information (i) given in the question states that G Ltd. sold goods of ` 200 crores to K Ltd. at cost plus 25%. In the above solution it has been considered that the amount of ` 200 crores is sale value. Alternatively, ` 200 crores may be assumed as the cost of the goods sold. In that case, the solution will differ and will be as follows:

Alternative solution:

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd. for the year ended on 31st March, 2023

Particulars	**Note No.**	**` in Crores**
I. Revenue from operations	1	3,475
II. Total Income		3,475
III. Expenses Cost of material purchased/consumed	2	600

Changes of inventories of finished goods	3	(840)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225
Total expenses		870
IV. Profit before tax (II-III)		2,605

Notes to Accounts

		` in Crores	` in Crores
1.	Revenue from operations Sales and other income G Ltd.	3,000	
	K Ltd.	750 3,750	
	Less: Inter-company sales	(250)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,475
2.	Cost of material purchased/consumed G Ltd.	600	
	K Ltd.	100 700	
	Less: Purchases by K Ltd. from G Ltd.	(250)	450
	Direct expenses (Production) G Ltd.	100	
	K Ltd.	50	150 600
3.	Changes of inventories of finished goods G Ltd.	750	
	K Ltd.	100 850	
	Less: Unrealized profits ` 40 crores × 25/100	(10)	840
4.	Employee benefits and expenses Wages and salaries: G Ltd.	600	
	K Ltd.	75	675
5.	Finance cost Interest: G Ltd.	75	
	K Ltd.	30	105
6.	Depreciation G Ltd.	75	
	K Ltd.	30	105

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7.	Other expenses Administrative expenses G Ltd.	75	
	K Ltd.	50 125	
	Less: Consultancy fees received by G Ltd. from K Ltd.	(5)	120
	Selling and distribution Expenses: G Ltd.	100	
	K Ltd.	25 125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105 225

Question 20

H Ltd acquired 15000 shares in S Ltd. for 1,55,000 on July 1, 2022. The Balance sheet of the two companies as on 31st March, 2023 were as follows:

	H Ltd.`	**S Ltd.`**
Equity and Liabilities:		
Equity Share Capital	**9,00,000**	**2,50,000**
(Fully paid shares of ` 10 each)		
General Reserve	**1,60,000**	**40,000**
Surplus i.e., Balance in Statement of Profit and Loss	**80,000**	**25,000**
Bills payable	**40,000**	**20,000**
Trade Creditors	**50,000**	**30,000**
Total	**12,30,000**	**3,65,000**
Assets		
Machinery	**7,00,000**	**1,50,000**
Furniture	**1,00,000**	**70,000**
Investment in Equity Shares of S Ltd.	**1,55,000**	**-**
Stock-in Trade	**1,00,000**	**50,000**
Trade Debtors	**60,000**	**35,000**
Bills Receivable	**25,000**	**20,000**
Cash at Bank	**90,000**	**40,000**
Total	**12,30,000**	**3,65,000**

The following additional information is provided to you:

(i) General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March, 2022.

(ii) Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to ` 20,000.

(iii) H Ltd. sold goods to S Ltd. costing ` 8,000 for ` 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.

(iv) Creditors of S Ltd. include ` 4000 due to H Ltd. on account of these goods.

(v) Out of Bills payable issued by S Ltd. ` 15,000 are those which have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, ` 8000 worth of bills receivable in favour of its creditors.

You are required to draw a consolidated Balance Sheet as on 31st March, 2023. (PYP 15 Marks May '23)

Answer 20

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2023

Particulars	Note No.	(`)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	9,00,000
(b) Reserves and Surplus	2	2,73,500
(2) Minority Interest	3	1,26,000
(3) Current Liabilities		
(a) Trade Payables	4	1,29,000
Total		14,28,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	10,20,000
(2) Current assets		
(i) Inventory	6	1,49,500
(ii) Trade Receivables	7	1,29,000
(iii) Cash & cash equivalent	8	1,30,000
Total		14,28,500

Notes to Accounts

			`
1.	Share capital Authorised, issued, subscribed and paid up capital 90,000 equity shares of ` 10 each, fully paid up		9,00,000
2.	Reserves and Surplus General Reserves	1,60,000	
	Profit and Loss Account (W.N.5) Capital Reserve (W.N. 4)	88,500 25,000	2,73,500
3.	Minority interest in S Ltd. (WN 3)		1,26,000
4.	Trade payables Bills Payable H Ltd. 40,000 S Ltd. 20,000 60,000 Less: Mutual payables (7,000)	53,000	
	Trade Creditors H Ltd. 50,000 S Ltd. 30,000 80,000 Less: Mutual owing (4,000)	76,000	1,29,000
5.	Property, plant and equipment Machinery H Ltd. 7,00,000 S Ltd. 1,50,000	8,50,000	
	Furniture H Ltd. 1,00,000 S Ltd. 70,000	1,70,000	10,20,000
6.	Inventory H Ltd.	1,00,000	

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	S Ltd.	50,000	
	Less: Unrealized profit (2,000x 25%)	500	1,49,500
7.	Trade receivables Bills receivable H Ltd. 25,000 S Ltd. 20,000 45,000 Less: Mutual payables (7,000)	38,000	
	Debtors H Ltd. 60,000 S Ltd. 35,000 95,000 Less: Mutual owing (4,000)	91,000	1,29,000
8.	Cash & cash equivalent Cash at Bank H Ltd.	90,000	
	S Ltd.	40,000	1,30,000

Working Notes:

1. **Percentage of holding**

		No. of Shares	Percentage
Holding Co.	:	15,000	(60%)
Minority shareholders	:	10,000	(40%)
Total Shares	:	25,000	

2. **Analysis of Profits**

	Pre-acquisition profits and reserves of S Ltd. (`)	**Post-acquisition profits of S Ltd. (`)**
General Reserve	40,000	---
Opening balance of Profit and Loss	5,000	---
Current Year's profit (in 1:3)	5,000	15,000
	50,000	15,000
H Ltd.'s share (60%)	30,000	9,000
Minority Interest (40%)	20,000	6,000

3. **Minority Interest**

Paid up value of 10,000 shares @ ` 10 each	` 1,00,000
Add: Share in pre-acquisition profits and reserve (40%)	` 20,000
Add: Share in post-acquisition profits (40%)	` 6,000
	` 1,26,000

4. **Capital Reserve for H Ltd.**

(A)	Cost of acquiring 15,000 shares of S Ltd.	` 1,55,000
(B)	Paid up value of 15,000 shares of S Ltd. @ ` 10 each	` 1,50,000
	Add: Share in pre-acquisition profit and reserves of S Ltd.	` 30,000
		` 1,80,000
	Capital Reserve (B-A)	` 25,000

5. **Consolidated Balance of Profits of H Ltd.**

Balance as per Statement of Profit and Loss Add: Share in post-acquisition profits of S Ltd. Less: Unrealised Profit in unsold stock of S Ltd.	` 80,000 ` 9,000 ` (500) ` 88,500

Question 21

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

	X Limited (Rs. In 000)		Y Limited (Rs. In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of Rs. 100 each)		**2,000**		**400**
7% Preference share capital		**-**		**400**
Reserves		**600**		**200**
6% Debentures		**400**		**400**
Trade Receivables/Trade Payables	**160**	**180**	**100**	**120**
Profit & Loss A/c balance		**40**		**30**
Purchases /Sales	**1,000**	**1,800**	**1,200**	**1,900**
Wages and Salaries	**200**		**300**	
Debenture Interest	**24**		**24**	
General Expenses	**160**		**120**	
Preference share dividend up to 30.09.2020		**7**	**14**	
Inventory (as on 31.03.2021)	**200**		**100**	
Cash at Bank	**27**		**12**	
Investment in Y Limited	**1,056**		**-**	
Property, Plant & Equipment	**2,200**		**1,580**	
Total	**5,027**	**5,027**	**3,450**	**3,450**

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

- **After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being Rs. 1,20,000, one fourth of such goods were still lying in inventory at the end of the year.**
- **Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Property, Plant & Equipment.**

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021. (15 Marks , July 21)

Answer 21

Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, 2021

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

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

Notes to Accounts

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

Working Note

1. **Profit of Subsidiary** Rs.

Revenue from Operations		19,00,000
Less: Expenses		
Cost of Material purchased/Consumed	12,00,000	
Changes of Inventories of finished goods	-	
Employee benefit expense	3,00,000	
Finance cost	24,000	
Depreciation and amortization expense	2,37,000	
Other expenses	1,20,000	

Total expenses		(18,81,000)
Profit Before Tax		19,000
Less: Preference Dividend	14,000	
Less: Preference Dividend Payable	14,000	(28,000)
Profit available for shareholders		(9,000)
Minority Share (20% of loss Rs. 9,000)		(1,800)

2. **Inventory reserve** = $\left[\frac{120,000}{4} \times \frac{25}{125}\right]$ =Rs. 6,000
3. **Pre-acquisition loss** = 80% of 3 month's profit up to 30th June,2020 i.e. 80 % of ¼ of loss Rs. 9,000. Hence, pre-acquisition loss = Rs. 1,800
4. Investment account includes Preference dividend for 3 months prior to acquisition i.e. Rs. 4,00,000 X 50% X 7% X1/4 = Rs. 3,500

Question 22

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

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

The following information is also given:

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

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

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

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

Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2018. [PYP 10 Marks , Nov '18]

Answer 22

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.
for the year ended on 31st March, 2018

Particulars		**Note No.**	**Rs.in Lacs**

I. Revenue from operations		1	8,797
II. Total revenue			8,797
III. Expenses			
Cost of Material purchased/Consumed		3	1,770
Changes of Inventories of finished goods expense		2	(1,794)
Employee benefit expense		4	1,425
Finance cost		6	225
Depreciation and amortization e		7	225
Other expenses		5	802
Total expenses			2,653
IV. Profit before Tax(II-III)			6,144
V. Tax Expenses		8	2,100
VI. Profit After Tax			4,044

Notes to Accounts

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

5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from BLtd.	(8)	442
	Selling and Distribution Expenses:		

	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortisation		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225
8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	300	2100

Note: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. Alternative Answer is possible considering is otherwise.

Question 23

White Ltd. acquired 2,250 shares of Black Ltd. on 1st October,.2020. The summarized balance sheets of both the companies as on 31st March, 2021 are given below:

	White Ltd. (₹)	Black Ltd. (₹)
(I) Equity and Liabilities		
(1) Shareholder's fund		
Share capital (Equity shares of ₹ 100 each fully paid up)	6,50,000	3,00,000
Reserves and Surplus General Reserve	60,000	30,000
Profit and loss account	1,50,000	90,000
(2) Current Liabilities	1,15,000	75,000
Trade payables Due to White Ltd.	-	30,000
Total	9,75,000	5,25,000
(II) Assets:		
Non-current assets		
Property, Plant and Equipment	5,80,000	3,51,000
Investments		
Shares in Black Ltd. (2,250 shares)	2,70,000	
Current assets		
Inventories	50,000	1,20,000
Due from Black Ltd.	36,000	
Cash and Cash equivalents	39,000	54,000
Total	9,75,000	5,25,000

Other information:

(i) **During the year, Black Limited fabricated a machine, which is sold to White Ltd. for ₹ 39,000, the transaction being completed on 30th March,2021.**

(ii) **Cash in transit from Black Ltd. to White Ltd. was ₹ 6,000 on 31st March,2021. Profits during the year 2020-2021 were earned evenly**

(iii) **The balances of Reserve and Profit and Loss account as on 1st April,2020 were as follows:**

Reserves	Profit and Loss A/c
₹	₹

White Ltd.	**30,000**	**15,000 Profit**
Black Ltd.	**30,000**	**10,000 Loss**

You are required to prepare consolidated Balance Sheet of the group as on 31st March,2021 as per the requirement of Schedule III of the Companies Act, 2013.(PYP 15 Marks May '22)

Answer 23

Consolidated Balance Sheet of White Ltd. and its Subsidiary Black Ltd.
as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,50,000
(b) Reserves and Surplus	2	2,55,000
(2) Minority Interest	3	1,05,000
(3) Current Liabilities		
(a) Trade Payables	4	1,90,000
Total		12,00,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	9,31,000
(2) Current assets		
(i) Inventory	6	1,70,000
(ii) Cash & cash equivalent	7	99,000
Total		12,00,000

Notes to Accounts

			₹
1.	Share capital		
	6,500 equity shares of ₹ 100 each, fully paid up		6,50,000
	Total		6,50,000
2.	Reserves and Surplus		
	General Reserves		60,000
	Profit and Loss Account	1,50,000	
	Add: 75% share of Black Ltd.'s post-acquisition profits (W.N.1)	37,500	1,87,500
	Capital reserve (W.N. 5)		7,500
	Total		2,55,000
3.	Minority interest in Black Ltd. (WN 4)		1,05,000
4.	Trade payables		
	White Ltd.	1,15,000	
	Black Ltd.	75,000	1,90,000
5.	Property, plant and equipment		
	White Ltd.	5,80,000	
	Black Ltd.	3,51,000	9,31,000
6	Inventory		
	White Ltd.	50,000	
	Black Ltd.	1,20,000	1,70,000
7	Cash & cash equivalent		
	White Ltd.	39,000	
	Black Ltd.	54,000	
	Cash in transit	6,000	99,000

Working Notes:

	₹
1. Post-acquisition profits of Black Ltd.	

profits earned during the year = ₹ 90,000 + ₹10,000		1,00,000
Pre-acquisition profits (1.4.20 to 30.9.20)		50,000
Post-acquisition profits (1.10.20 to 31.3.21)		50,000
White Ltd.'s share 75% of 50,000		37,500
Minority Interest 25% of 50,000		12,500
2. Pre-acquisition profits and reserves of Black Ltd.		
Reserves as on 1.4.2020		30,000
Profit and Loss Account [10,000 (loss as on 1.4.20) +50,000 (6 month Adjusted pre-acquisition profits)]		40,000
		70,000
White Ltd.'s = (75%) × 70,000		52,500
Minority Interest= (25%) × 70,000		17,500
3. Post-acquisition reserves of Black Ltd.		
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 30,000 – 30,000)		nil
4. Minority Interest		
Paid-up value of (3,000 – 2,250) = 750 shares		
held by outsiders i.e. 750 × ₹ 100		75,000
Add: 25% share of pre-acquisition reserves & Profit		17,500
25% share of post-acquisition profit		12,500
5. Capital Reserve		1,05,000
Price paid by White Ltd. for 2,250 shares (A)		2,70,000
Intrinsic value of the shares-		
Paid-up value of 2,250 shares held by White Ltd. i.e. 2,250 × ₹ 100	2,25,000	
Add 75% share of pre-acquisition reserves & profit (70,000 x 75%)	52,500 (B)	2,77,500
Capital reserve (A – B)		7,500

Question 24

H Ltd. and S Ltd. provide the following information as at 31st March,2022:

	H Ltd.₹	S Ltd.₹
Property, Plant and Equipment	**2,00,000**	**2,60,000**
Investments (14,000 Equity Shares of S Ltd.)	**2,52,000**	**-**
Current Assets	**1,48,000**	**1,40,000**
Share capital (Fully paid equity shares of ₹ 10 each)	**3,00,000**	**2,00,000**
Profit and loss account	**1,00,000**	**80,000**
Trade Payables	**2,00,000**	**1,20,000**

Additional information:

H Ltd. acquired the shares of S Ltd. on 1stJuly, 2021 and Balance of profit and loss account of S Ltd. on 1stApril, 2021 was ₹ 60,000. Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 2022. (PYP 15 Marks Nov '22)

Answer 24

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2022

		Note No	Amount (₹)
	I Equity and Liabilities		
1	Shareholders' Fund:		
	(a) Share Capital	1	3,00,000
	(b) Reserve and Surplus	2	1,10,500
2	Minority interest	3	84,000

3	Current Liabilities		
	Trade payables	4	3,20,000
	Total		8,14,500
	II Assets		
1	Non-Current Assets:		
	Property, plant and equipment	5	4,60,000
	Intangible Asset	6	66,500
2	Current Assets	7	2,88,000
	Total		8,14,500

Notes to Accounts

		Amount (₹)
1	Share capital 30,000 Equity Shares @ ₹10 each	3,00,000
2	Reserve and Surplus Profit and loss account (₹ 1,00,000 + 70% of 9/12 x 20,000 i.e. ₹ 10,500)	1,10,500
3	Minority Interest (W/N 2)	84,000
4	Trade payables H Ltd. S Ltd.	2,00,000 1,20,000
		3,20,000
5	Property, plant and equipment H Ltd. S Ltd.	2,00,000 2,60,000
		4,60,000
6	Intangible Asset: Goodwill (W/N 3)	66,500
7	Current Assets H Ltd. S Ltd.	1,48,000 1,40,000 2,88,000

Working Notes:

1. **Percentage of holding**

	No. of Shares	Percentage
Holding Co. :	14,000	(70%)
Minority shareholders:	6,000	(30%)
Total Shares :	20,000	

2. **Calculation of Minority Interest**

Share capital (30% of ₹ 2,00,000)	60,000	
Share in Profit and loss account (₹ 80,000 X 30%)	24,000	84,000

3. **Calculation of Cost of Control (Goodwill)**

Cost of Investment	2,52,000
Less: Paid up value of shares (70% of ₹ 2,00,000)	(1,40,000)
Share in pre-acquisition profits 70% of [60,000+3/12(80,000-60,000)]	(45,500)
	66,500

Question 25

Chand Ltd. and its subsidiary Sitara Ltd. provided the following information for the year ended 31st March, 2023:

Particulars	Chand Ltd (₹)	Sitara Ltd. (₹)
Equity Share Capital	20,00,000	6,00,000
Finished Goods Inventory as on 01.04.2022	4,20,000	3,01,000
Finished Goods Inventory as on 31.03.2023	8,57,500	3,76,250
Dividend Income	1,68,000	43,750
Other non-operating Income	35,000	10,500
Raw material consumed	13,93,000	4,72,500
Selling and Distribution Expenses	3,32,500	1,57,500
Production Expenses	3,15,000	1,40,000
Loss on sale of investments	26,250	Nil
Sales and other operating income	33,25,000	19,07,500
Wages and Salaries	13,30,000	2,45,000
General and Administrative Expenses	2,80,000	1,22,500
Royalty paid	Nil	5,000
Depreciation	31,500	14,000
Interest expense	17,500	5,250

Other information

- **On 1st September 2020 Chand Ltd., acquired 5,000 equity shares of ₹ 100 each fully paid up in Sitara Ltd.**
- **Sitara Ltd. paid a dividend of 10% for the year ended 31st March 2022. The dividend was correctly accounted for by Chand Ltd.**
- **Chand Ltd. sold goods of ₹ 1,75,000 to Sitara Ltd. at a profit of 20% on selling price. Inventory of Sitara Ltd. includes goods of ₹ 70,000 received from Chand Ltd.**
- **Selling and Distribution expenses of Sitara Ltd. include ₹ 21,250 paid to Chand Ltd. as brokerage fees.**
- **General and Administrative expenses of Chand Ltd. include ₹ 28,000 paid to Sitara Ltd. as consultancy fees.**
- **Sitara Ltd. used some resources of Chand Ltd., and Sitara Ltd. paid ₹ 5,000 to Chand Ltd. as royalty.**

Consultancy fees, Royalty and brokerage received is to be considered as operating revenues. Prepare Consolidated Statement of Profit and Loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended 31st March, 2023 as per Schedule III to the Companies Act, 2013.(RTP Nov '23)(Same concepts different figures PYP 15 Marks Dec'21)

Answer 25

Consolidated statement of profit and loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended on 31st March, 2023

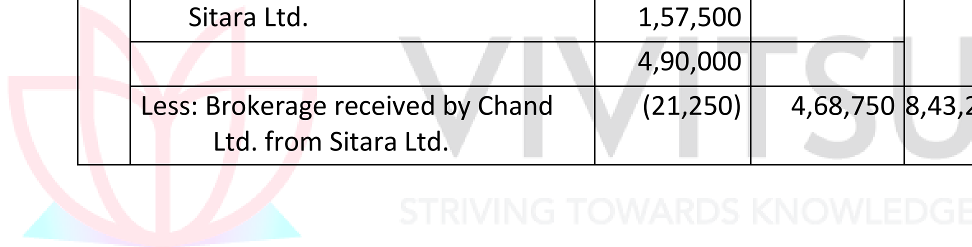
Particulars	Note No.	₹
Revenue from operations	1	50,03,250
Other Income	2	1,81,000
Total revenue (I)		51,84,250
Expenses:		
Cost of material purchased/consumed	3	21,45,500
Changes (Increase) in inventories of finished goods	4	(4,98,750)
Employee benefit expense	5	15,75,000
Finance cost	6	22,750
Depreciation and amortization expense	7	45,500
Other expenses	8	8,43,250
Total expenses (II)		41,33,250

Profit before tax (II-III)		10,51,000

Notes to Accounts:

			₹	₹
1.	Revenue from operations			
	Sales and other operating revenues			
	Chand Ltd.		33,25,000	
	Sitara Ltd.		19,07,500	
			52,32,500	
	Less: Inter-company sales		(1,75,000)	
	Consultancy fees received by Sitara Ltd. from Chand Ltd.		(28,000)	
	Royalty received by Chand Ltd. from Sitara Ltd.		(5,000)	
	Brokage received by Chand Ltd. from Sitara Ltd.		(21,250)	50,03,250
2.	Other Income			
	Dividend income: Chand Ltd.	1,68,000		
	Sitara Ltd.	43,750	2,11,750	
	Loss on sale of investments Sitara Ltd.		(26,250)	
	Other Non-operating Income			
	Chand Ltd.	35,000		
	Sitara Ltd.	10,500		
	Less: Dividend realized from Sitara Ltd. (5,00,000 x 10%)	(50,000)	4,500	1,81,000
3.	Cost of material purchased/consumed			
	Chand Ltd.	13,93,000		
	Sitara Ltd.	4,72,500		
		18,65,500		
	Less: Purchases by Sitara Ltd. From Chand Ltd.	(1,75,000)	16,90,500	
	Direct expenses (Production)			
	Chand Ltd.	3,15,000		
	Sitara Ltd.	1,40,000	4,55,000	21,45,500
4.	Changes (Increase) in inventories of finished goods			
	Chand Ltd.		4,37,500	
	Sitara Ltd.		75,250	
			5,12,750	
	Less: Unrealized profits ₹ 7,00,00 × 20/100		(14,000)	4,98,750
5.	Employee benefits and expenses			
	Wages and salaries:			
	Chand Ltd.		13,30,000	
	Sitara Ltd.		2,45,000	15,75,000

6	Finance cost			
	Interest:			
	Chand Ltd.		17,500	
	Sitara Ltd.		5,250	22,750
7.	Depreciation			
	Chand Ltd.		31,500	
	Sitara Ltd.		14,000	45,500
8.	Other expenses			
	General & Administrative expenses:			
	Chand Ltd.	2,80,000		
	Sitara Ltd.	1,22,500		
		4,02,500		
	Less: Consultancy fees received by Sitara Ltd. from Chand Ltd.	(28,000)	3,74,500	
	Royalty: Sitara Ltd. Less: Received by Chand Ltd. Selling and distribution Expenses:	 5,000 (5,000)	 Nil	
	Chand Ltd.	3,32,500		
	Sitara Ltd.	1,57,500		
		4,90,000		
	Less: Brokerage received by Chand Ltd. from Sitara Ltd.	(21,250)	4,68,750	8,43,250



Chapter 10.2

As 23 Accounting for Investments in Associates in Consolidated Financial Statements

Question 1

Long Limited acquired 60% stake in Short Limited for a consideration of Rs. 112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was Rs. 100 lakhs, Revenue Reserve was Rs. 40 lakhs and balance in Profit & Loss Account was Rs. 30 lakhs. From the above information you are required to calculate Goodwill / Capital Reserve in the following situations:

(i) On consolidation of Balance Sheet.

(ii) If Long Limited showed the investment in subsidiary at a carrying amount of Rs. 104 lakhs.

(iii) If the consideration paid for acquiring the 60% stake was Rs. 92 lakhs. (PYP 5 Marks, July 21)

Answer 1

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

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

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

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

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

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Chapter 11.1
Preparation Financial Statements

Question 1

Future Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2019:

	Amount Rs. in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of Rs. 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013. (MTP Oct. 19, 4 Marks, Old & New SM)

Answer 1

Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head Surplus. Similarly, the balance of Reserves and Surplus, after adjusting negative balance of surplus, shall be shown under the head Reserves and Surplus even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceed the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of Reserves and Surplus after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet. Thus, the treatment done by the company is incorrect.

Question 2

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March20X1 as required by Part I, Schedule III of the Companies Act, 2013.

Particulars		Debit Rs.	Credit Rs.
Equity Share Capital (Face value of Rs. 100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory:			
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000

The following additional information is also provided:

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

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

(iii) The cost of the Assets was: Building Rs. 30,00,000, Plant & Machinery Rs. 35,00,000 and Furniture Rs. 3,12,500

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

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

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

~~(vii)~~ Board of directors has declared dividend of 5% on the paid-up capital. ~~The dividend distribution tax Lly is Corporate Dividend Tax Rate @ 17.304 (wherein Base Rate is 15%) *As per amendment (17.472%)*~~.

(MTP March ₹19,20 Marks, MTP Aug₹18 16 Marks, MTP Apr₹19 16 Marks, MTP March ₹18 15 Marks, MTP Oct 18 15 Marks, MTP March 21, 15 Marks, Old & New SM) (Same concept different figures and fewer adjustments MTP 15 Marks Sep₹22, RTP May₹20, RTP May₹23, PYP Nov₹19 10 Marks)

Answer 2

Alpha Ltd. Balance Sheet as on 31st March, 20X1

Particular	Notes	Rs.
Equity and Liabilities **1 Shareholders₹ funds**		
a Share capital	1	49,95,000
b Reserves and Surplus (amended)	2	**12,33,750**
2 non-current liabilities		
Long-term borrowings	3	13,17,500
3 Current liabilities		
a Trade Payables		8,00,000
b **Other Current liabilities (amended)**	4	**2,87,250**
C Short term provisions	5	6,40,000
Short term borrowings		2,00,000
		94,73,500
Assets		
1 non-current assets		
Property, Plant & equipment		
Tangible assets	6	56,25,000
2 Current assets		
a Inventories		12,50,000
b Trade receivables		10,00,000
c Cash and bank balances		13,85,000
d Short-term loans and advances		2,13,500
e **Total**		**94,73,500**

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Notes to accounts

			Rs.
1. Share Capital			
Equity share capital			
Issued & subscribed & called up			
50,000 Equity Shares of Rs. 100 each			
(of the above 10,000 shares have been issued for			
consideration other than cash)		50,00,000	

Less; Calls in arrears		(5,000)	49,95,000
	Total		**49,95,000**
2 Reserves and Surplus			
General Reserve		10,50,000	
Add: current year transfer		20,000	10,70,000
Profit & Loss balance			
Profit for the year		4,33,500	
Less; Appropriations:			
Transfer to General reserve		(20,000)	
Dividend Payable (Refer W N)		(2,49,750)	
~~DOT on dividend (Refer W N)~~ ~~**(As per amendment)**~~		~~(50,843)~~ ~~**(51,337)**~~	**1,63,750**
	Total		**12,33,750**
3 Long-term borrowings			
Secured Term Loan			
State Financial Corporation Loan (7,50,000-37,500)			
(Secured by hypothecation of Plant and Machinery)			7,12,500
Unsecured Loan			6,05,000
	Total		**13,17,500**
4 Other current liabilities			
Interest accrued but not due on loans (SFC)			37,500
Dividend (Refer W N)		2,49,750	
~~DOT on dividend (Refer W N)~~ ~~**(as per amendment of change in rate of SHEC the DDT rate is 17.472%)**~~		~~50,843~~ ~~**(51,337)**~~	**2,49,750**
			2,87,250
5 Short-term provisions			
Provision for taxation			6,40,000
6 Tangible assets			
Land and Building		30,00,000	
Less; Depreciation		(2,50,000) (b.f.)	27,50,000
Plants Machinery		35,00,000	
Less; Depreciation		(8,75,000) (b.f.)	26,25,000
Furniture & Fittings		3,12,500	
Less; Depreciation		(62,500) (b.f.)	2,50,000
	Total		**56,25,000**
7 Inventories			
Raw Materials			2,50,000
Finished goods			10,00,000
	Total		**12,50,000**
8 Trade receivables			
Outstanding for a period exceeding six months			2,60,000
Other Amounts			7,40,000
	Total		**10,00,000**
9 Cash and bank balances			
Cash and cash equivalents			
Cash at bank			
with Scheduled Banks		12,25,000	
with others (Omega Bank Ltd.)		10,000	12,35,000
Cash in hand			1,50,000

VIVITSU STRIVING TOWARDS KNOWLEDGE

Other bank balances			Nil
			13,85,000

Working Note:

Calculation of grossing-up of dividend

Particulars	**Rs.**
Dividend distributed Alpha Ltd. (5% of 49,95,000)	2,49,750
~~Add: Increases for the purpose of grossing up of dividend 15/100-15 X 2,49,750~~	~~44,074~~
~~Gross dividend~~	~~2,93,824~~

Question 3

On 31st March, 2020, SR Ltd. provides the following ledger balances after preparing its Profit &Loss Account for the year ended 31st March, 2020.

Particulars	**Amount (Rs.)**	
	Debit	**Credit**
Equity Share Capital, fully paid shares of Rs. 50 each		**80,00,000**
Calls in arrear	**15,000**	
Land	**25,00,000**	
Buildings	**30,00,000**	
Plant & Machinery	**24,00,000**	
Furniture &Fixture	**13,00,000**	
Securities Premium		**15,00,000**
General Reserve		**9,41,000**
Profit & Loss Account		**5,80,000**
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		**26,30,000**
Other Long Term Loans		**22,50,000**
Short Term Borrowings		**4,60,000**
Inventories: Finished goods	**45,00,000**	
Raw materials	**13,00,000**	
Trade Receivables	**17,50,000**	
Advances: Short Term	**3,75,000**	
Trade Payables		**8,13,000**
Provision for Taxation		**3,80,000**
Dividend payable		**70,000**
Cash in Hand	**70,000**	
Balances with Banks	**4,14,000**	
Total	**1,76,24,000**	**1,76,24,000**

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

(1) 50,000 fully paid equity shares were allotted as consideration for land.

(2) The cost of assets was:

Building	**Rs. 32,00,000**
Plant and Machinery	**Rs. 30,00,000**
Furniture and Fixture	**Rs. 16,50,000**

(3) Trade Receivables for Rs. 4,86,000 due for more than 6 months.

(4) Balances with banks include Rs. 56,000, the Naya bank, which is not a scheduled bank.

(5) Loan from Public Finance Corporation repayable after 3 years.

(6) The balance of Rs. 26,30,000 in the loan account with Public Finance Corporation is inclusive of Rs. 1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

(7) Other long-term loans (unsecured) include:

(i) Loan Taken from Nixes Bank - Rs 13,80,000 (Amount repayable within 1 year Rs 4,80,000)
(ii) Loan taken from Directors Rs. 8,50,000

(8) Bills Receivable for Rs. 1,60,000 maturing on 15th June, 2020 has been discounted.

(9) Short term borrowings include:
(i) Loan Taken from Naya Bank - Rs 1,16,000 (Secured)
(ii) Loan taken from Directors Rs. 48,000

(10) Transfer of Rs. 35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.

(11) Inventory of finished goods includes loose tools costing Rs. 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 2020 as required under Part – I of Schedule III of the Companies Act, 2013. Ignore previous year figures.(MTP 20 Marks May ₹20, MTP 16 Marks Oct₹21, Old & New SM)

Answer 3

SR Ltd. Balance Sheet as on 31st March, 2020

Particulars	Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities		
1 **Shareholders₹ funds**		
a Share capital	**1**	79,85,000
b Reserves and Surplus	**2**	30,21,000
2 non-current liabilities		
a Long-term borrowing	**3**	42,66,000
1 **3. Current liabilities**		
a Short-term borrowing	**4**	4,60,000
b Trade Payables		8,13,000
c Other current liabilities	**5**	6,84,000
d Short-term provisions	**6**	3,80,000
Total		1,76,09,000
Assets		
1. **Non-current assets**		
A PPE	**7**	92,00,000
2 Current assets		
A Inventories	**8**	58,00,000
B Trade receivables	**9**	17,50,000
C Cash and cash equivalents	**10**	4,84,000
D Short-term loans and advances		3,75,000
Total		**1,76,09,000**

Notes to accounts

			Rs.
1.	**Share Capital** Equity share capital Issued, subscribed and called up 1,60,000 Equity Shares of Rs. 50 each (Out of the above 50,000 shares have been issued for consideration other than cash)	80,00,000	
	Less: Calls in arrears	(15,000)	**79,85,000**
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss account Securities premium	35,000	9,76,000

	Surplus (Profit & Loss A/c)	5,80,000	15,00,000
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	**Long-term borrowings**		
	Secured: Term Loans		
	Loan from Public Finance Corporation [repayable after 3 years (Rs. 26,30,000 - Rs. 1,34,000 for interest accrued but not due)]		24,96,000
	Secured by hypothecation of land Unsecured		
	Bank Loan (Nixes bank) 9,00,000		
	(Rs. 13,80,000 - Rs. 4,80,000 repayable within 1 year)		
	Loan from Directors 8,50,000		
	Others 20,000		17,70,000
	Total		**42,66,000**
4.	**Short-term borrowings**		
	Loan from Naya bank (Secured)	1,16,000	
	Loan from Directors	48,000	
	Others	2,96,000	**4,60,000**
5.	**Other current liabilities**		
	Loan from Nixes bank repayable within one year	4,80,000	
	Dividend payable	70,000	
	Interest accrued but not due on borrowings	1,34,000	**6,84,000**
6.	**Short-term provisions**		
	Provision for taxation		**3,80,000**
7.	**PPE**		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		**92,00,000**
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
	Trade receivables		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		**17,50,000**
	Cash and cash equivalents		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	**4,14,000**
	Cash in hand		70,000
	Total		**4,84,000**

Note: There is a Contingent Liability amounting Rs. 1,60,000

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 4

Medha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20 20 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Medha Ltd. for the year ended 31st March, 2020 according to Schedule III.(MTP 4 Marks , Oct 20)

Answer 4

As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria:

(i) it is expected to be settled in the company₹s normal operating cycle;
(ii) it is held primarily for the purpose of being traded;
(iii) it is due to be settled within twelve months after the reporting date; or
(iv) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

In the given case, instalments due on 30.09.2020 and 31.03.2021 will be shown under the head ₹other current liabilities₹. Therefore, in the balance sheet as on 31.3.2020, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading ₹Long term Borrowings₹ and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading ₹Other Current Liabilities₹ as current maturities of loan from bank.

Question 5

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

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

Additional Information: -

1. **Share Capital consists of-**
   (a) **1,20,000 Equity Shares of Rs. 100 each fully paid up.**
   (b) **40,000, 10% Redeemable Preference Shares of Rs. 100 each fully paid up.**
2. **Write off the amount of Miscellaneous Expenses in full, amounting Rs. 2,32,000.**

(MTP 14 Marks April 22, April 21 & Oct ₹23) (Same concept different figures RTP Nov₹18)

Answer 5

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

			Note	₹
I	EQUITY AND LIABILITIES:			
(1)	(a)	Share Capital	1	1,60,00,000
	(b)	Reserves and Surplus	2	110,68,000
(2)	Non-current Liabilities			
		Long term Borrowings- Terms Loans (Secured)		40,00,000
(3)	Current Liabilities			

	(a)	Trade Payables		45,80,000
	(b)	Other current liabilities	3	8,00,000
	(c)	Short-term Provisions (Provision for taxation)		10,20,000
		Total		**3,74,68,000**
II	ASSETS			
(1)	Non-current Assets			
	(a)	Property, Plant and Equipment	4	214,00,000
	(b)	Non- current Investments		9,00,000
(2)	Current Assets:			
	(a)	Inventories	5	48,00,000
	(b)	Trade Receivables	6	48,20,000
	(c)	Cash and Cash Equivalents		38,40,000
	(d)	Short-term Loans and Advances	7	17,08,000
		Total		**3,74,68,000**

Notes to accounts

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

	Less: Provision for Doubtful Debts	(80,000)	48,20,000
7.	Short term loans & Advances		
	Staff Advances*	2,20,000	
	Other Advances*	14,88,000	17,08,000

*Considered to be short term.

Question 6

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

From the following particulars ascertain the amount that can be utilized from general reserves,

according to the Companies Rules, 2014:	(Rs.)
8,00,000 Equity Shares of Rs. 10 each fully paid up	80,00,000
General Reserves	25,00,000
Revaluation Reserves	6,50,000
Net profit for the year	1,42,500

Average rate of dividend during the last five years has been 12%. (MTP 5 Marks April 21, MTP 5 Marks April 22, RTP May₹21)

Answer 6

Amount that can be drawn from reserves for (10% dividend on Rs. 80,00,000 i.e. Rs. 8,00,000)

Profits available

Current year profit — Rs. 1,42,500

Amount which can be utilized from reserves (Rs. 8,00,000 – 1,42,500) — Rs.6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 2014:

Condition I

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

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid-up capital plus free reserves ie. Rs. 10,50,000 [10% of (80,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl Rs. 18,42,500 (Rs. 25,00,000 - Rs. 6,57,500) should not fall below 15 % of its paid-up capital ie. Rs. 12,00,000 (15% of Rs. 80,00,000]

Since all the three conditions are satisfied, the company can withdraw Rs. 6,57,500 from accumulated reserve (as per Declaration and Payment of Dividend Rules, 2014).

Question 7

From the following information, prepare extract of Balance Sheet of A Limited along with notes making necessary compliance of Schedule III to the Companies Act, 2013:

		Amount (₹)
Loan Funds		
(a) Secured Loans		**18,12,000**
(b) Unsecured Loan - Short term from bank		**2,25,000**
Other information is as under:		
Secured Loans		
Term Loans from:		
Banks		**8,95,000**

Others		9,17,000
		18,12,000
Current Maturities of long-term loan from Bank		1,24,000
Current Maturities of long- term loan from Others		85,000

There was no interest accrued / due as at the end of the year. Current maturities of long-term loans amounting ₹ 2,09,000 is included in the value of secured loans of ₹ 18,12,000. (MTP 5 Marks April 23 & MTP 5 Marks Nov 21)

Answer 7

Extract of Balance Sheet of A Ltd

Particulars	Note No.	Amount
Non - Current Liabilities **Long term borrowings**	**1**	**16,03,000**
Current Liabilities		
Short term borrowings	**2**	**4,34,000**

Notes to Accounts

1.	**Long-Term Borrowings**	
	Term loans — Secured	
	- From banks	8,95,000
	- From other parties	9,17,000
		18,12,000
	Less: Current maturities of long-term debt (Refer Note 3)	(2,09,000)
		16,03,000
2.	**Short-Term Borrowings**	
	(Unsecured loan)	
	- from bank	2,25,000
	Current maturities of long-term debt	
	- From banks	1,24,000
	- From others	85,000
		4,34,000

Question 8

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

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

(ii) Share option outstanding account.

(iii) Unpaid matured debenture and interest accrued thereon.

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

(v) Calls unpaid. (RTP Nov 21, Old & New SM)

Answer 8

(i) Current Liabilities/ Other Current Liabilities

(ii) Shareholders₹ Fund / Reserve & Surplus

(iii) Current liabilities/Other Current Liabilities

(iv) Contingent Liabilities and Commitments

(v) Shareholders₹ Fund / Share Capital

Question 9

Shweta Ltd. has the Authorized Capital of Rs. 15,00,000 consisting of 6,000 6% Preference shares of Rs. 100 each and 90,000 equity Shares of Rs.10 each. The following was the Trial Balance of the Company as on 31st March, 2018:

Particulars	**Dr.**	**Cr.**
Investment in Shares at cost	1,50,000	
Purchases	14,71,500	
Selling Expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and Wages	1,56,000	
Cash on Hand	36,000	
Interim Preference dividend for the half year to 30th September	18,000	
Bills Receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on Debentures upto 30th Sep (1st half year)	11,250	
Debtors	1,50,300	
Trade payables		2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of Rs. 45,000	1,05,000	
6% Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on Freehold properties		4,50,000
Income tax paid in advance for the current year	30,000	
Dividends		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft secured by hypothecation of stocks and receivables		4,50,000
Technical knowhow fees at cost paid during the year	4,50,000	
Audit fees	18,000	
Total	**44,72,850**	**44,72,850**

You are required to prepare the Profit and Loss Statement for the year ended 31st March, 2018 and the Balance Sheet as on 31st March, 2018 as per Schedule III of the Companies Act, 2013 after taking into account the following –

1. **Closing Stock was valued at Rs. 4,27,500.**
2. **Purchases include Rs. 15,000 worth of goods and articles distributed among valued customers.**
3. **Salaries and Wages include Rs. 6,000 being Wages incurred for installation of Electrical**

Fittings which were recorded under "Furniture".

4. **Bills Receivable include Rs. 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.**
5. **Bills Receivable of Rs. 6,000 maturing after 31st March were discounted.**
6. **Depreciation on Furniture to be charged at 10% on Written Down Value.**
7. **Investment in shares is to be treated as non-current investments.**
8. **Interest on Debentures for the half year ending on 31st March was due on that date.**
9. **Provide Provision for taxation Rs.12,000.**
10. **Technical Knowhow Fees is to be written off over a period of 10 years.**
11. **Salaries and Wages include Rs. 30,000 being Director₹s Remuneration.**
12. **Trade receivables include Rs. 18,000 due for more than six months.**

(RTP May 19) (Same concept different figures & lesser adjustments Nov 21)

Answer 9

(a) Statement of Profit and Loss of Shweta Ltd. for the year ended 31st March, 2018

	Particulars	**Note**	**Rs.**
I	Revenue from Operations		20,11,050
II	Other income (Divided income)		12,750
III	Total Revenue (I &+ II)		20,23,800
IV	Expenses:		
	(a) Purchases (14,71,500 – Advertisement Expenses 15,000)		14,56,500
	(b) Changes in Inventories of finished Goods / Work in progress (4,35,600 – 4,27,500)		8,100
	(c) Employee Benefits expense	**9**	1,20,000
	(d) Finance costs	**10**	51,900
	(e) Depreciation & Amortization Expenses [10% of (1,05,000 + 6,000)]		11,100
	(f) Other Expenses	**11**	3,47,550
	Total Expenses		19,95,150
V	Profit before exceptional, extraordinary items and tax (III-IV)		28,650
VI	Exceptional items		-
VII	Profit before extra ordinary items and tax (V-IV)		28,650
VIII	Extraordinary items		-
IX	Profit before tax (VII-VIII)		28,650
X	Tax expense: Current Tax		12,000
XI	Profit/Loss for the period (after tax)		16,650

Balance sheet of Shweta Ltd. as on 31st March, 2018

	Particulars as on 31st March	**Note**	
I			
(1)	**Shareholders₹ funds:**		
	(a) Share capital	**1**	12,00,000
	(b) Reserves and surplus	**2**	66,150

(2)	**Noncurrent liabilities:**		
	Long term borrowings	**3**	4,50,000
(3)	**Current liabilities:**		
	(a) Short term borrowings	**4**	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	**5**	29,250
	Total		24,58,950
II	**ASSETS**		
(1)	**Non-current Assets**		
	(a) Property, Plant & Equipment		
	(i) Tangible assets	6	11,49,900
	(ii) Intangible assets	7	4,05,000
	(b) Noncurrent investments (Shares at cost)		1,50,000
	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	8	2,72,550
	(c) Cash and Cash equivalents – Cash on hand		36,000
	(d) Short term loans and advances –Income tax (paid 30,000-Provision 12,000)		18,000
	Total		24,58,950

Note: There is a Contingent liability for Bills receivable discounted with Bank Rs. 6,000.

Notes to accounts

			(Rs.)
1.	**Share Capital**		
	Authorized		
	90,000 Equity Shares of Rs. 10 each	9,00,000	
	6,000 6% Preference shares of Rs. 100 each	6,00,000	15,00,000
	Issued, subscribed & called up		
	60,000, Equity Shares of Rs. 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	12,00,000
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2017	85,500	
	Add: Surplus for current year	16,650	1,02,150
	Less: Preference Dividend		36,000
	Balance as on 31st March, 2018		66,150
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		4,50,000
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		4,50,000
5.	**Other Current liabilities**		

	Interest Accrued and due on Borrowings (5% Debentures)	11,250	
	Unpaid Preference Dividends	18,000	29,250
6.	**Tangible Property, Plant & Equipment**		
	Furniture		
	Furniture at Cost Less depreciation Rs. 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Accumulated Depreciation Account: Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year: On Opening WDV at 10% i.e. (10% x 1,05,000) 10,500		
	On additional purchase during the year at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Fixed Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors (a) Debt outstanding for more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 -4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Amount as per Trial Balance	1,56,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors₹ Remuneration shown separately	30,000	
	Balance amount		1,20,000
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	51,900
11.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director₹s remuneration	30,000	
	Selling expenses	2,37,300	
	Technical knowhow written of (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x50%)	2,250	3,47,550

Working Note

Calculation of Sundry Debtors-Other Debts	
Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonored	4,500
	1,54,800
Less: Bad Debts written off – 50% Rs. 4,500	(2,250)
Adjusted Sundry Debtors	1,52,550
Less: Debts due for more than 6 months (as per information given)	(18,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550

Question 10

Kapil Ltd. has authorized capital of Rs. 50 lakhs divided into 5,00,000 equity shares of Rs. 10 each. Their books show the following balances as on 31st March, 2017:

	Rs.		**Rs.**
Inventory 1.4.2016	6,65,000	Bank Current Account	20,000
Discounts & Rebates allowed	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Interest (bank overdraft)	1,11,000
Patterns	3,75,000	Calls in Arrear @ Rs. 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of Rs. 10 each)	
Purchases	12,32,500	Bank Overdraft	12,67,000
Wages	13,68,000		
Freehold Land	16,25,000	Trade Payables (for goods)	2,40,500
Plant & Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rent (Cr.)	30,000
Trade Receivables	4,00,500	Transfer fees received	6,500
Advertisement	15,000	Profit & Loss A/c (Cr.)	67,000
Commission & Brokerage	67,500	Repairs to Building	56,500
Business Expenses	56,000	Bad debts	25,500

The inventory (valued at cost or market value, which is lower) as on 31st March, 2017 was Rs. 7,08,000. Outstanding liabilities for wages Rs. 25,000 and business expenses Rs. 36,000. Dividend declared @ 12% on paid-up capital and it was decided to transfer to reserve @ 2.5% of profits. Charge depreciation on closing written down amount of Plant & Machinery @ 5%, Engineering Tools @ 20%; Patterns @ 10%; and Furniture & Fixtures @10%. Provide 25,000 as doubtful debts after writing off Rs.16,000 as bad debts. Provide for income tax @ 30%. ~~Corporate Dividend Tax Rate @ 17.304 (wherein Base Rate is 15%).~~

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2017 and Balance Sheet as on that date. (RTP May 18)(Same concept different figures lesser adjustments RTP May₹21,MTP 16 Marks Oct 20, MTP 16 Marks Mar 22)

Answer 10

Kapil Ltd. Balance Sheet as at 31st March, 2017

		Particulars	Note No.	(Rs.)
I	**Equity and Liabilities**			
		(a)Share Capital	1	19,90,000
		(b) Reserves and Surplus **(as per amendment)**	2	**1,08,200**
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	13,28,000
		(c) Short-Term Provisions **(as per amendment)**	4	**3,58,800**
		Total		40,25,500
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) Property, Plant & Equipment		
		(i) Tangible Assets	5	29,30,000
	(2)	**Current Assets**		
		(a) Inventories		7,08,000
		(b) Trade Receivables	6	3,59,500
		(c) Cash and Cash Equivalents	7	28,000
		Total		40,25,500

Kapil Ltd.

Statement of Profit and Loss for the year ended 31st March, 2017

	Particulars	**Note No.**	**(Rs.)**
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,08,000]		(43,000)
	Employee Benefits Expenses	9	13,93,000
	Finance Costs	10	1,11,000
	Depreciation and Amortization Expenses		1,20,000
	Other Expenses	11	4,40,000
	Total Expenses		**32,53,500**
V	**Profit before Tax (III-IV)**		4,00,000
VI	**Tax Expenses @ 30%**		(1,20,000)
VII	**Profit for the period**		2,80,000

Notes to Accounts:

1. **Share Capital**

Authorized Capital	
5,00,000 Equity Shares of Rs. 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of Rs. 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of Rs.10 each	19,50,000

Subscribed Capital but not fully paid	
5,000 Equity Shares of Rs.10 each Rs. 8 paid	40,000
(Call unpaid Rs.10,000)	19,90,000

2. Reserves and Surplus

General Reserve		7,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	2,80,000	
Less: Transfer to Reserve @ 2.5%	(7,000)	
Less: Equity Dividend [12% of (20,00,000-10,000)]	(2,38,800)	
~~Less: **Corporate Dividend Tax (Working note) (as per amendment)**~~	~~(48,614)~~ ~~**(49,086)**~~	**101200**
		108200

3. Other Current Liabilities

Bank Overdraft	12,67,000
Outstanding Expenses [25,000+36,000]	61,000
	13,28,000

4. Short-term Provisions

Provision for Tax	1,20,000
Equity Dividend payable	2,38,800
~~**Corporate Dividend Tax (as per amendment)**~~	~~48,614~~ ~~**49,086**~~
	3,58,800

5. Tangible Assets

Particulars	**Value given (Rs.)**	**Depreciation rate**	**Depreciation Charged (Rs.)**	**Written down value at the end (Rs.)**
Land	16,25,000		-	16,25,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Patterns	3,75,000	10%	37,500	3,37,500
Engineering Tools	1,50,000	20%	30,000	1,20,000
	30,50,000		1,20,000	29,30,000

6. Trade Receivables

Trade receivables (4,00,500-16,000)	3,84,500
Less: Provision for doubtful debts	(25,000)
	3,59,500

7. Cash & Cash Equivalent

Cash Balance	8,000
Bank Balance in current A/c	20,000
	28,000

8. Other Income

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

9. Employee benefits expenses

Wages	13,68,000
Add: Outstanding wages	25,000
	13,93,000

10. Finance Cost

Interest on Bank overdraft	1,11,000

11. Other Expenses

Carriage Inward	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,000] (Business Expenses)	92,000
Bad Debts [25,500+16,000]	41,500
Provision for Doubtful Debts	25,000
	4,40,000

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Working Note

Calculation of grossing-up of dividend:

Particulars	Rs.
Dividend distributed by Company	2,38,800
~~Add: Increase for the purpose of grossing up of dividend 2,38,800 x [15/(100-15)]~~	~~42,141~~
~~Gross dividend~~	~~2,80,941~~
~~Dividend distribution tax @ 17.304%~~ ~~***(as per amendment @ 17.472%)***~~	~~48,614~~ ~~***49,086***~~

Question 11

(a) Following is the trial balance of Delta limited as on 31.3.2021. (Figures in ₹ ₹000)

Particulars	Debit	Particulars	Credit
Land at cost	**800**	**Equity share capital (shares of ₹ 10 each)**	**500**
Calls in arrears	**5**	**10% Debentures**	**300**
Cash in hand	**2**	**General reserve**	**150**
Plant & Machinery at cost	**824**	**Profit & Loss A/c (balance on 1.4.20)**	**75**
Trade receivables	**120**	**Securities premium**	**40**
Inventories (31-3-21)	**96**	**Sales**	**1200**
Cash at Bank	**28**	**Trade payables**	**30**

Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information:

(i) The authorized share capital of the company is 80,000 shares of ₹ 10 each.

(ii) The company revalued the land at ₹ 9,60,000.

(iii) Equity share capital includes shares of ₹ 50,000 issued for consideration other than cash.

(iv) Suspense account of ₹ 10,000 represents cash received from the sale of some of the machinery on 1.4.2020. The cost of the machinery was ₹ 24,000 and the accumulated depreciation thereon being ₹ 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.

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

(vi) Balance at bank includes ₹ 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.

(vii) Make provision for income tax @30%.

(viii) Trade receivables of ₹ 50,000 are due for more than six months.

You are required to prepare Delta Limited₹s Balance Sheet as at 31.3.2021 and Statement of Profit and Loss with notes to accounts for the year ended 31.3. 2021 as per Schedule III. Ignore previous year₹s figures & taxation.

(b) "Current maturities of long-term borrowing are disclosed separately under the head Other current liabilities in the balance sheet of a company." You are required to comment in line with schedule III to the Companies Act 2013. (RTP May ₹22) (Same concept different figures- Old & New SM)

Answer 11

(a)

Delta Limited
Balance Sheet as at 31st March 2021

Particulars	Note No.	(₹ in ₹000)
A. Equity and Liabilities		
1. Shareholders₹ funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00
(b) Short- term provision	4	163.80
Total		1,796.00
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00

(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 2021

	Particulars	Note No.	(₹ in ₹000)
I.	Revenue from Operations		1200.00
II.	Other Income	8	6.00
III.	Total Income (I +II)		1,206.00
IV.	Expenses:		
	Purchases (adjusted)		400.00
	Finance Costs	9	30.00
	Depreciation (10% of 800)	10	80.00
	Other expenses		150.00
	Total Expenses		660.00
V.	Profit / (Loss) for the period before tax (III – IV)		546.00
VI.	Tax expenses @30%		163.80
VII	Profit for the period		382.20

Notes to Accounts

	Particulars		(₹ in ₹000)
1	Share Capital		
	Equity Share Capital		
	Authorised		
	80,000 Shares of ₹ 10/- each		800
	Issued, Subscribed and Called-up		
	50,000 Shares of ₹ 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve ₹ (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance		
	Opening Balance	75.00	
	Add: Profit for the period	382.20	457.20
			807.20
3	Long-Term Borrowings		
	10% Debentures		300
4.	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960

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	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	
		800	
	Less: Depreciation ₹ (150 – 20 + 80)	(210)	
	Closing Balance		590
	Total		1,550
6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less: Book value of machinery (24 – 20)	(4)	6
9	Finance Costs		
	Debenture Interest		30
10	Other Expenses:		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	45	150

(b) Current maturities of loan term borrowing are shown under ₹short term borrowings₹ and not under ₹Other current liabilities₹ as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Hence the statement given in the question is not valid.

Question 12

The following balance appeared in the books of Oliva Ltd. as on 31-03-2022.

Particulars		**₹**	**Particulars**		**₹**
Inventory 01-04-2021			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		21,000
Purchases of raw material		12,60,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	**Secured Loans**:		
			Short–term	4,500	
			Long-term	21,000	25,500
			Fixed Deposits (unsecured)		
Salaries and wages		40,200	Short -term	1,500	
General Charges		16,500	Long - term	3,300	4,800

Building		1,01,000	Trade payables		3,27,000
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Investments: Current	4,500				
Non-Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,07,200			24,07,200

From the above balance and the following information, prepare the company₹s statement of Profit and Loss for the year ended 31st March, 2022 and company₹s Balance Sheet as on that date:

1. Inventory on 31st March,2022- Raw material ₹ 25,800 and finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. Current maturity of long-term loan is ₹ 1,000.
7. The Taxation provision of 40% on net profit is considered. **(RTP Nov₹19, Nov₹22)**

Answer 12

Oliva Ltd.
Balance Sheet as at 31.03.2022

	Particulars		**Note**	**Amount**
(1)	Equity and Liabilities			
	(i) Shareholders₹ funds			
	(a) Share Capital			3,15,000
	(b) Reserves and surplus		1	50,430
(2)	Non-current liabilities			
	(a) Long-term borrowings		2	23,300
(3)	Current Liabilities			
	(a) Short -term borrowings		3	7,000
	(b) Trade payables			3,27,000
	(c) Other current liability		4	72,000
	(d) Short term provision		5	19,620
II	ASSETS			8,14,350
(1)	Non-current assets			
	(a) Property, Plant & equipment		6	2,04,160
	(b) Non-current investments			7,500
(2)	Current assets			
	(a) Current investments			4,500
	(b) Inventories		7	85,800

	(c) Trade receivables			2,38,500
	(d) Cash and cash equivalents			2,71,100
	(e) Short-term loans and advances		8	2,490
	(f) Other current assets		9	300
				8,14,350

Oliva Ltd.
Statement of Profit and loss for the year ended 31.03.2022

(₹)

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200
III	Total income (I +II)		17,14,200
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	3,51,510
	Total Expenses		16,65,150
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Notes to accounts

No.	Particulars		Amount	Amount
1.	Reserve & Surplus			
	Profit & Loss Account: Balance b/f		21,000	
	Net Profit for the year		29,430	50,430
2.	Long term borrowings			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits: Unsecured		3,300	23,300
3.	Short term borrowings			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	
	Current maturities of long term borrowings		1,000	7,000
4.	Other current liabilities			
	Expenses Payable (67,500 + 4,500)		72,000	72,000
5.	Short term provisions			

	Provision for Income tax			19,620
6.	Property, plant and equipment			
	Building	1,01,000		
	Less: Depreciation @ 2%	(2,020)	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation @10%	(7,040)	63,360	
	Furniture	10,200		
	Less: Depreciation @10%	(1,020)	9,180	
	Motor vehicles	40,800		
	Less: Depreciation @20%	(8,160)	32,640	2,04,160
7	Inventory			
	Raw Material		25,800	
	Finished goods		60,000	85,800
8.	Short term Loans & Advances			
	General Charges prepaid			2,490
9.	Other Current Assets			
	Interest accrued			300
10.	Cost of material consumed			
	Opening inventory of raw Material	30,000		
	Add: Purchases	12,60,000	12,90,000	
	Less: Closing inventory		(25,800)	12,64,200
11.	Changes in inventory of Finished Goods & WIP			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		(46,500)	13,500
12.	Employee Benefit expenses			
	Salary & Wages (40,200 + 4,500)			44,700
13.	Other Expenses:			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	3,51,510

Question 13

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

	Dr.	**Cr.**
Equity Capital (Shares of ₹ 100 each)		**8,05,000**
5,000, 6% preference shares of ₹ 100 each		**5,00,000**
9% Debentures		**4,00,000**
General Reserve		**40,00,000**
Profit & Loss A/c (of previous year)		**72,000**
Sales		**60,00,000**
Trade Payables		**10,40,000**
Provision for Depreciation on Plant & Machinery		**1,72,000**
Suspense Account		**40,000**
Land at cost	**24,00,000**	
Plant & Machinery at cost	**7,70,000**	
Trade Receivables	**19,60,000**	

Inventories (31-03-2020?)	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	1,30,29,000

Additional Information:

(i) The authorized share capital of the company is:
5,000, 6% preference shares of ₹ 100 each 5,00,000
10,000, equity shares of ₹ 100 each 10,00,000
Issued equity capital as on 1st April 2020 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 2020. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid.

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

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

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

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

(vi) Amortize 1/5th of Goodwill.
You are required to prepare H Limited ₹ s Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years₹ figures & taxation. (PYP July₹21,20 Marks)

Answer 13

H Ltd Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in ₹
Equity and Liabilities		
I. Shareholders₹ Funds		
a. Share Capital	1	13,00,000
b. Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
a. Long Term Borrowings	3	4,00,000
III. Current Liabilities		
a. Trade Payables	4	10,40,000
b. Other Current Liabilities	5	70,000
Total		82,01,900
Assets		
I. Non-Current Assets		
a. Property, Plant and Equipment	6	40,61,000

	b. Intangible Assets	7	10,00,000
II.	**Current Assets**		
	a. Inventories		9,50,000
	b. Trade Receivables		19,60,000
	c. Cash and Cash equivalents		2,30,900
	Total		82,01,900

Statement of Profit and Loss for the year ended 31st March 2021

	Particulars	Note No	Amount in ₹
I.	**Revenue from operations**		60,00,000
	Total Revenue		60,00,000
II.	**Expenses**		
	Purchases (adjusted)		22,32,100
	Finance Costs	8	36,000
	Depreciation and Amortization	9	3,17,000
	Other Expenses	10	32,30,000
	Total Expenses		58,15,100
III.	**Profit/(Loss) for the period**		1,84,900

Notes to Accounts **(Amount in ₹)**

1	**Share Capital**		
	a. Authorized Capital		
	5,000, 6% Preference shares of ₹ 100/- each		5,00,000
	10,000 Equity Shares of ₹100/- each		10,00,000
			15,00,000
	b. Issued & Subscribed Capital		
	5,000, 6% Preference shares of ₹100/- each		5,00,000
	8,000, Equity shares of ₹100/- each		8,00,000
	Total		13,00,000
2	**Reserves & Surplus**		
	Capital Reserve (100 X (90-40))		5,000
	Revaluation Reserve (36,00,000-24,00,000)		12,00,000
	General Reserve		40,00,000
	Surplus	1,84,900	
	Add: Balance from previous year	72,000	
	Less:		
	Dividends declared	(70,000)	
	Profit/(Loss) carried forward to Balance Sheet		1,86,900
	Total		53,91,900
3	**Long-Term Borrowings**		
	Secured		
	9% Debentures		4,00,000
4	**Trade Payables**		10,40,000
5	**Other Current Liabilities**		
	Dividend Payable		
	Preference Dividend	30,000	
	Equity Dividend	40,000	
	Total		70,000

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6	**Property, Plant and Equipment**		
	Land		
	Opening balance	24,00,000	
	Add: Revaluation Adjustment	12,00,000	
	Closing Balance		36,00,000
	Plant and Machinery		
	Opening Balance	7,70,000	
	Less: Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	
	Closing Balance		4,61,000
	Total		40,61,000
7	**Intangible Assets**		
	Goodwill	12,50,000	
	Less: Amortized (1/5the)	(2,50,000)	
	Total		10,00,000
8	**Finance Costs**		
	Debenture Interest		36,000
9	**Depreciation and Amortization**		
	Plant and Machinery	67,000	
	Goodwill	2,50,000	
	Total		3,17,000
10	**Other Expenses**		
	Factory Expenses	15,00,000	
	Selling Expenses	14,00,000	
	Administrative Expenses	3,00,000	
	Loss on sale of Plant and Machinery		
	Book Value (1,00,000-30,000) 70,000		
	Less: Sale Value (40,000)	30,000	
	Total		32,30,000

Note

1. The inventories (31.3.20) amounting ₹ 9, 50,000 (given in the trial balance of the Question) should have been as closing inventory i.e. as on 31.3.21. In the above solution, this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on 31.3.21 and in that case, the balance sheet will not tally without using suspense account amounting ₹ 9,50,000.
2. The financial statements given in the above Answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the Question. However, practically dividends are declared in the annual general meetings which take place after the reporting date.

Question 14

A company sold 20% of the Goods on Cash Basis and the balance on Credit basis.
Debtors are allowed 1.5 month₹s credit and their balance as on 31st March, 2021 is ₹ 1,50,000. Assume that sale is evenly spread throughout the year.
Purchases during the year ₹ 9,50,000 Closing stock is ₹ 10,000 less than the Opening Stock. Average stock maintained during the year ₹ 60,000. Direct Expenses amounted to ₹ 35,000 Calculate Credit sales, Total sales and Gross profit for the year ended 31 st March, 2021. (PYP 5 Marks , Dec ₹21)

Answer 14

Calculation of Credit Sales, Total Sales and Gross Profit

Credit Sales for the year ended 31st March, 2021 = Debtors X $\frac{12\ Months}{1.5\ months}$

= 1,50,000 X $\frac{12\ Months}{1.5\ months}$

= Rs. 12,00,000

Total Sales for the year ended 2020-21 = Credit Sales X $\frac{100\%}{80\%}$

= Rs. 12,00,000 X $\frac{100\%}{80\%}$

= Rs. 15,00,000

Trading Account for the year ended 31st March, 2021

	₹		₹
To Opening stock	65,000	By Sales	15,00,000
To Direct expenses	35,000	By Closing Stock	55,000
To Purchases	9,50,000		
To Gross profit	5,05,000		
	15,55,000		15,55,000

Working Note:

Calculation of opening stock and closing stock

If closing stock is x then opening stock is x+10,000

Average stock ₹ 60,000

Average stock = Opening stock + Closing stock /2

Thus, opening stock is ₹ 65,000 and closing stock is ₹ 55,000.

Question 15

Debit Balance	Amount (₹)	Credit Balances	Amount (₹)
Purchases	82,95,000	Sales	1,25,87,000
Wages and Salaries	12,72,000	Commission	72,500
Rent	2,20,000	Equity Share Capital	10,00,000
Rates and Taxes	50,000	General Reserve	10,00,000
Selling & Distribution Expenses	4,36,000	Surplus (P&L A/c) 01.04.2021	8,75,500
Directors Fees	32,000	Securities Premium	2,50,000
Bad Debts	38,500	Term Loan from Public Sector Bank	1,02,00,000
Interest on Term Loan	8,05,000		
Land	24,00,000	Trade Payables	55,08,875
Factory Building Plant	36,80,000	Provision for Depreciation:	
and Machinery	62,50,000	On Plant & Machinery	9,37,500
			82,500

Furniture and Fittings Trade Receivables	8,25,000 64,75,000	On Furniture and Fittings On Factory Building	1,84,000
Advance Income Tax Paid Stock (1st April,2021) Bank Balances Cash on Hand	37,500 9,25,000 9,75,000 1,31,875	Provision for Doubtful Debts Bills Payable	25,000 1,25,000
Total	3,28,47,875	Total	3,28,47,875

Following information is provided:

(1) **The Authorized Share Capital of the Company is 2,00,000 Equity Shares of ₹ 10 each. The Company has issued 1,00,000 Equity Shares of ₹ 10 each.**

(2) **Rent of ₹ 20,000 and Wages of ₹ 1,56,500 are outstanding as on 31st March, 2022.**

(3) **Provide Depreciation @ 10% per annum on Plant and Machinery, 10% on Furniture and Fittings and 5% on Factory Building on written down value basis.**

(4) **Closing Stock as on 31st March, 2022 is ₹ 11,37,500.**

(5) **Make a provision for Doubtful Debt @ 5% on Debtors.**

(6) **Make a provision of 25% for Corporate Income Tax.**

(7) **Transfer ₹ 1,00,000 to General Reserve.**

(8) **Term Loan from Public Sector Bank is secured against Hypothecation of Plant and Machinery. Installment of Term Loan falling due within one year is ₹ 17,00,000.**

(9) **Trade Receivables of ₹ 85,600 are outstanding for more than six months.**

(10) **The Board declared a dividend @10% on Paid up Share Capital on 5 th April, 2022.**

You are required to prepare Balance Sheet as on 31st March 2022 and Statement of Profit and Loss with Note to Accounts for the year ending 31st March, 2022 as per Schedule III of the Companies Act, 2013. Ignore previous years₹ figures. (PYP 20 Marks Nov ₹22)

Answer 15

Balance Sheet of Anmol Ltd. as at 31st March, 2022

		Particulars	Note No	₹
Equity and Liabilities				
1	Shareholders₹ funds			
	a	Share capital	1	10,00,000
	b	Reserves and Surplus	2	24,76,462
2	Non-current liabilities			
	a	Long-term borrowings	3	85,00,000
3	Current liabilities			
	a	short-term borrowing (Installment of term loan falling due in one year)		17,00,000
	b	Trade Payables	4	56,33,875
	c	Other current liabilities	5	1,76,500
	d	Short term provisions (provision for tax)		1,16,988

		Total		1,96,03,825
ASSETS				
1	Non-current assets			
	a	PPE	6	1,11,70,700
2	Current assets			
	a	Inventories		11,37,500
	b	Trade receivables	7	61,51,250
	c	Cash and bank balances	8	11,06,875
	d	Short term loans & advances (Advance tax paid)		37,500
				1,96,03,825

Statement of Profit and Loss of Anmol Ltd. for the year ended 31st March, 2022

	Particulars	Notes	Amount
I.	Revenue from operations		1,25,87,000
II.	Other income (Commission income)		72,500
III.	Total Income (I + II)		1,26,59,500
IV.	Expenses:		
	Purchases of Inventory-in-Trade		82,95,000
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	9	(2,12,500)
	Employee benefits expense	10	14,28,500
	Finance costs (interest on term loan)		8,05,000
	Depreciation		7,80,300
	Other operating expenses	11	10,95,250
	Total expenses		1,21,91,550
V.	Profit (Loss) for the period (III - IV)		4,67,950
VI.	(-) Tax (25%)		(1,16,988)
VII.	PAT		3,50,962

Notes to accounts

			₹
1	Share Capital		20,00,000
	Equity share capital		
	Authorized		
	2,00,000 equity shares of ₹ 10 each		
	Issued & subscribed		
	1,00,000 equity shares of ₹ 10 each		10,00,000
2	Reserves and Surplus		
	General Reserve	10,00,000	
	Add: current year transfer	1,00,000	11,00,000
	Profit & Loss balance		

	Opening balance: Surplus P & L A/c	8,75,500	
	Profit for the year	3,50,962	
	Less: Appropriations:		
	Transfer to General reserve	(1,00,000)	11,26,462
	Securities premium		2,50,000
3	Long-term borrowings		24,76,462
	Term loan from public sector bank (Secured by hypothecation)		1,02,00,000
	Less: Installment of Term loan falling due within one year		(17,00,000)
	Total		85,00,000
4	Trade payables		
	Trade payables	55,08,875	
	Bills payable	1,25,000	56,33,875
5	Other current liabilities		
	Rent outstanding	20,000	
	Wages and Salaries Outstanding	1,56,500	1,76,500
6	PPE (Note 2)		
	Land		24,00,000
	Factory Buildings		33,21,200
	Plant & Machinery		47,81,250
	Furniture & Fittings		6,68,250
	Total		1,11,70,700
7	Trade receivables		
	Debtors Outstanding for period exceeding 6 months	85,600	
	Other debts	63,89,400	
	Less: Provision for doubtful debt	(3,23,750)	61,51,250
8	Cash and bank balances		
	Cash and cash equivalents		
	Bank balance	9,75,000	
	Cash on hand	1,31,875	11,06,875
9	Changes in Inventories		
	Opening Inventory	9,25,000	
	Less: Closing Inventory	(11,37,500)	
	Change		(2,12,500)
10	Employee benefit expense		
	Wages and Salaries	12,72,000	
	Add: Wages and Salaries Outstanding	1,56,500	14,28,500
11	Other operating expenses		
	Rent	2,20,000	
	Add: outstanding	20,000	2,40,000
	Rates and Taxes		50,000
	Selling & Distribution expenses		4,36,000
	Bad debts		38,500

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	Provision for Doubtful Debts (3,23,750-25,000) Director ₹ s fee		2,98,750 32,000
	Total		10,95,250

Note:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2022. Such dividends will be disclosed in notes only.

2. Calculation of depreciation:

	Book value	Accumulated depreciation	WDV	Current year Depreciation	Current year WDV
Land	24,00,000	-	24,00,000	-	24,00,000
Factory building	36,80,000	1,84,000	34,96,000	1,74,800	33,21,200
Plant & Machinery	62,50,000	9,37,500	53,12,500	5,31,250	47,81,250
Furniture & Fittings	8,25,000	82,500	7,42,500	74,250	6,68,250
Total				7,80,300	1,11,70,700

Question 16

The following balances are extracted from the books of Travese Limited as on 31st March 2023:

Particulars	**Amount (₹)**	
	Debit	**Credit**
7% Debentures		**48,45,000**
Plant & Machinery (at cost)	**37,43,400**	
Trade Receivable	**35,70,000**	
Land	**97,37,000**	
Debenture Interest	**3,39,150**	
Bank Interest	**13,260**	
Sales		**47,22,600**
Transfer Fees		**38,250**
Discount received		**66,300**
Purchases	**28,86,600**	
Inventories 1.04.2022	**4,97,250**	

Factory Expenses	**2,58,060**	
Rates, Taxes and Insurance	**65,025**	
Repairs	**1,49,685**	
Sundry Expenses	**1,27,500**	
Selling Expenses	**26,520**	
Directors Fees	**38,250**	
Interest on Investment for the year 2022-2023		**55,000**
Provision for depreciation		**5,96,700**
Miscellaneous receipts		**1,42,800**

Additional information:

(i) Closing inventory on 31.03.2023 is ₹ 4,76,850,

(ii) Miscellaneous receipts represent cash received from the sale of the Plant on 01.04.2022. The cost of the Plant was₹ 1,65,750 and the accumulated depreciation thereon is ₹ 24865.

(iii) The Land is re-valued at 1,08,63,000.

(iv) Depreciation is to be provided on Plant & Machinery at 10% p.a. on cost.

(v) Make a provision for income tax @ 25%.

(vi) The Board of Directors declared a dividend of 10% on Equity shares on 4th April, 2023.

You are required to prepare a Statement of Profit and Loss as per Schedule III of the Companies Act, 2013 for the year ended 31.03.2023. (Ignore previous year figures) (PYP 10 Marks May ₹23)

Answer 16

Statement of Profit and Loss of Travese Limited. for the year ended 31st March, 2023

	Particulars	Notes	Amount
I.	Revenue from operations	1	47,22,600
II.	Other income Total	2	1,61,465
III.	Income (I + II)		48,84,065
IV.	Expenses:		
	Purchases of Inventory-in-Trade		28,86,600
	Changes in inventories of finished goods, work-in progress and Inventory-in-Trade	3	20,400
	Finance costs	4	3,52,410

	Depreciation and amortization expenses	5	3,57,765
	Other expenses	6	6,65,040
	Total expenses		42,82,215
V.	Profit (Loss) for the period (III - IV) before tax		6,01,850
VI	Provision for tax		(1,50,463)
VII	Profit for the period		4,51,387

Notes to accounts

			₹
1	Revenue from operations Sale		47,22,600
2	Other Income Transfer fees		38,250
	Discount received		66,300
	Interest on Investment		55,000
	Profit on sale of plant		1,915
	Total		1,61,465
3	Changes in inventories of finished goods, work-InProgress and Inventory-in-Trade Opening Inventory	4,97,250	
	Less: Closing Inventory	(4,76,850)	20,400
	Total		20,400
4	Finance costs Interest on Debentures		3,39,150
	Bank Interest		13,260
	Total		3,52,410
5	Depreciation and Amortization expenses Depreciation on Plant & Machinery (10% x 37,43,400 - 1,65,750)		3,57,765
6	Other expenses		2,58,060

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	Factory expense		
	Rent, Taxes and Insurance		65,025
	Repairs		1,49,685
	Sundry expenses		1,27,500
	Selling expenses		26,520
	Directors fees		38,250
Total			**6,65,040**

Note:
The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of financial statements) as per accounting standards. Hence, it is not recognized in the financial statement for the year ending 31st March 2023. Such dividend will be disclosed in notes only.

Question 17

From the following particulars furnished by Ambience Ltd., prepare the Balance Sheet as on 31st March 2023 as required by Division I of Schedule III of the Companies Act, 2013.

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			25,00,000
Call in Arrears		2,500	
Land & Building		13,75,000	
Plant & Machinery		13,12,500	
Furniture		1,25,000	
General Reserve			5,25,000
Loan from State Financial Corporation			3,75,000
Inventories: Raw Materials	1,25,000		
Finished Goods	5,00,000	6,25,000	
Provision for Taxation			3,20,000
Trade receivables		5,00,000	
Advances		1,06,750	
Profit & Loss Account			2,16,750
Cash in Hand		75,000	
Cash at Bank		6,17,500	
Unsecured Loan			3,02,500
Trade creditors (for Goods and Expenses)			5,00,000
		47,39,250	47,39,250

The following additional information is also provided:

(i) 5,000 Equity shares were issued for consideration other than cash.

(ii) Trade receivables of ₹ 1,30,000 are due for more than 6 months.

(iii) The cost of the Assets was:

Building ₹ 15,00,000, Plant & Machinery ₹ 17,50,000 and Furniture ₹ 1,56,250

(iv) The balance of ₹ 3,75,000 in the Loan Account with State Finance Corporation is inclusive of ₹ 18,750 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

(v) Balance at Bank includes ₹ 5,000 with Global Bank Ltd., which is not a Scheduled Bank.

(vi) Bills Receivable for 1,60,000 maturing on 15th June, 2023 has been discounted.

(vii) Provide to doubtful debts @ 5% on trade receivables. (Nov ₹23)

Answer 17

Ambience Ltd.

Balance Sheet as on 31st March, 2023

	Particulars	**Notes**	**₹**
	Equity and Liabilities		
1	Shareholders₹ funds		
a	Share capital	1	24,97,500
b	Reserves and Surplus	2	7,16,750
2	Non-current liabilities		
	Long-term borrowings	3	6,58,750
3	Current liabilities		
a	Trade Payables		5,00,000
b	Other current liabilities	4	18,750
c	Short-term provisions	5	3,20,000
		Total	**47,11,750**
	Assets		
1	Non-current assets		
	Property, Plant and Equipment	6	28,12,500
2	Current assets		
a	Inventories	7	6,25,000
b	Trade receivables	8	4,75,000
c	Cash and cash equivalents	9	6,92,500
d	Short-term loans and advances		1,06,750
	Total		**47,11,750**
Contingent Liabilities and Commitments (to the extent not provided for) Contingent Liabilities: Bills discounted but not matured			**1,60,000**

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Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up & paid-up		

	25,000 Equity Shares of ₹ 100 each (of the above 5,000 shares have been issued for consideration other than cash)	**25,00,000**	
	Less: Calls in arrears	**(2,500)**	**24,97,500**
	Total		**24,97,500**
2	**Reserves and Surplus**		
	General Reserve		5,25,000
	Surplus (Profit & Loss A/c 2,16,750		
	Less: provision for debtors 25,000		1,91,750
	Total		**7,16,750**
3	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan (3,75,000-18,750) (Secured by hypothecation of Plant and Machinery)		3,56,250
	Unsecured Loan		3,02,500
	Total		**6,58,750**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		**18,750**
5	**Short-term provisions**		
	Provision for taxation		**3,20,000**
6	**Property, Plant and Equipment**		
	Land and Building	15,00,000	
	Less: Depreciation	(1,25,000)	13,75,000
	Plant & Machinery	17,50,000	
	Less: Depreciation	(4,37,500)	13,12,500
	Furniture & Fittings	1,56,250	
	Less: Depreciation	(31,250)	1,25,000
	Total		**28,12,500**
7	**Inventories**		
	Raw Materials		1,25,000
	Finished goods		5,00,000
	Total		**6,25,000**
8	**Trade receivables**		
	Outstanding for a period exceeding six months		1,30,000
	Other Amounts Less: Provision for doubtful debts		3,70,000 (25,000)
	Total		**4,75,000**
9	**Cash and cash equivalents**		
	Cash at bank		
	with Scheduled Banks	6,12,500	
	with others (Global Bank Ltd.)	5,000	6,17,500
	Cash in hand		75,000
	Total		**6,92,500**

VIVITSU STRIVING TOWARDS KNOWLEDGE

Chapter 11.2
Cash Flow Statement

Question 1

J Ltd. presents you the following information for the year ended 31st March, 2019:

		(Rs. in lacs)
(i)	Net profit before tax provision	36,000
(ii)	Dividend paid	10,202
(iii)	Income-tax paid	5,100
(iv)	Book value of assets sold	222
	Loss on sale of asset	48
(v)	Depreciation debited to P & L account	24,000
(vi)	Capital grant received - amortized to P & L A/c	10
(vii)	Book value of investment sold	33,318
	Profit on sale of investment	120
(viii)	Interest income from investment credited to P & L A/c	3,000
(ix)	Interest expenditure debited to P & L A/c	12,000
(x)	Interest actually paid (Financing activity)	13,042
(xi)	Increase in working capital	67,290
	[Excluding cash and bank balance]	
(xii)	Purchase of Property, Plant & Equipment	22,092
(xiii)	Expenditure on construction work	41,688
(xiv)	Grant received for capital projects	18
(xv)	Long term borrowings from banks	55,866
(xvi)	Provision for Income-tax debited to P & L A/c	6,000
	Cash and bank balance on 1.4.2018	6,000
	Cash and bank balance on 31.3.2019	8,000

You are required to prepare a cash flow statement as per AS-3 (Revised). (MTP Oct'19 12 Marks, RTP May 19)(Same concept lesser adjustments MTP 12 Marks Oct'22)

Answer 1

Cash Flow Statement as per AS 3

		Rs. in lacs
Cash flows from operating activities:		36,000
Net profit before tax provision		
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048
		72,048
Less: Non cash income		
Amortization of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Sale of assets (222 . 48)	174	

Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of Property, Plant & Equipment	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,168)
Cash flows from financing activities:		
Grants for capital projects	18	
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,640
Net increase in cash		2,000
Add: Cash and bank balance as on 1.4.2018		6,000
Cash and bank balance as on 31.3.2019		8,000

Question 2

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 were summarised as follows:

	2018 (₹)	2017 (₹)
Equity share capital	1,20,000	1,00,000
Reserves:		
Profit and Loss Account	9,000	8,000
Current Liabilities:		
Trade Payables	8,000	5,000
Income tax payable	3,000	2,000
Declared Dividends	4,000	2,000
	1,44,000	**1,17,000**
Property, Plant & Equipment (at W.D.V) :		
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	25,000	16,000
Long Term Investments	32,000	28,000
Current Assets:		
Inventory	14,000	8,000
Trade Receivables	8,000	6,000
Cash & Bank	12,000	17,000
	1,44,000	**1,17,000**

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

	₹
Profit before tax	8,000
Income Tax	(3,000)
Profit after tax	5,000
Declared Dividends	(4,000)
Retained Profit	1,000

Further Information is available:

1. **Depreciation on Building ₹ 1,000.**
2. **Depreciation on Furniture & Fixtures for the year ₹ 2,000.**
3. **Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.**
4. **Purchase investments for ₹ 6,000.**
5. **Sold investments for ₹ 10,000, these investments cost ₹ 2,000.**
6. **You are required to prepare Cash Flow Statement as per AS-3 (revised) using indirect method. (RTP Nov 18) (Same concept fewer adjustments MTP 15 Marks March '23, RTP Nov'22, Old & New SM)**

Answer 2

Harry Ltd.

Cash Flow Statement for the year ended 31st March, 2018

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation (1,000 + 2,000 +5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(2,000)	
Net cash generated from operating activities (A)		(400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	
Dividends paid*	(2,000)	
Net cash from financing activities(C)		18,000
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		12,000

* Dividend declared for the year ended 31st March, 2017 amounting ₹ 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

Working Notes:

1. Calculation of Income taxes paid

	₹
Income tax expense for the year	3,000
Add: Income tax liability at the beginning of the year	2,000
	5,000
Less: Income tax liability at the end of the year	(3,000)
	2,000

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (₹)	Car (₹)
W.D.V. at 31.3.2018	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	–	2,000
	36,000	32,000
Less: W.D.V. at 31. 3. 2017	(22,000)	(16,000)
Acquisitions during 2016-2018	14,000	16,000

Question 3

The following figures have been extracted from the books of Manan Limited for the year ended on 31.3.2022. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs:

(a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.

(b) Discount on issue of Debentures written off ₹ 45,000.

(c) Interest on Debentures paid ₹ 5,25,000.

(d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).

(e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹ 1,35,000 by the company in a suit filed.

(iii) Income tax paid during the year ₹ 15,75,000.

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2021 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹ 10 each at a premium of 20% on 30.3.2022 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2020-21 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2022 for the year 2020-2021 ₹ 7.50 lakhs and interim dividend paid ₹ 2.50 lakhs for the year 2021-2022.

(viii) Land was purchased on 02.4.2021 for ₹ 3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

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

	As on 01.04.2021	As on 31.3.2022
	₹	₹
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

(MTP 10 Marks April 23 & Nov ’21 & Sep ’23 , PYP 10 Marks Nov ’20, RTP May 20)(Similar to Jan’21 but different figures)

Answer 3

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

	Rs.	Rs.
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments		12,00,000
Operating profit before working capital changes		42,00,000
Adjustments for:		
Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities;		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	36,000	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2021		3,94,450
Cash and cash equivalents as on 31.3.2022		16,950

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Question 4

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

Extract of Balance Sheet

		Particulars	Notes	2021(Rs.'000)	2020(Rs.'000)
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	Share capital	1	500	200
2		**Non- current liabilities**			
	(a)	Long term loan from bank		---	250
3		**Current liabilities**			
	(a)	Trade Payables		1,000	3,047
		Assets			
1		**Non-current assets**			
	(a)	Property, Plant and Equipment		230	128
2		**Current assets**			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	Notes	2021 (Rs.'000)	2020 (Rs.'000)
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			
	Current tax (paid during year)		243	140

Notes to accounts

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

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting Rs. 80,000 was paid during the year ended 31st March, 2021. (RTP May '21)

Answer 4

Supriya Ltd.

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

(Using direct method)

		(Rs. '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	

Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of Property, Plant and Equipment	(102)	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Question 5

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

Balance Sheets

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

Note 1: Share Capital

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

Note 2: Reserves and Surplus

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000
Capital Reserve	25,000	
Total	82,000	38,000

Note 3: Current Liabilities

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

Note 4: Tangible Assets

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

Additional Information:

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

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

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

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

(v) An interim dividend of Rs.10,000 including Dividend Distribution Tax has been paid.

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

(vii) Amount of provision for tax existing on 31 3.2018 was paid during the year 2018 -19. (RTP Nov 19)

Answer 5

Cash flow Statement for the year ending 31st March, 2019

		Particulars	₹	₹
1.		**Cash flow from Operating Activities**		
	A.	**Closing balance as per Profit and Loss Account**		27,000
		Less: Opening balance as per Profit and Loss Account		(18,000)
		Add: Dividend declared during the year		37,000
		Add: Interim dividend paid during the year		10,000
		Add: Transfer to reserve		10,000
		Add: Provision for Tax		32,000
	B.	**Net profit before taxation, and extra-ordinary item**		98,000
	C.	**Add: Items to be added**		
		Depreciation	18,000	
		Loss on sale of Plant	3,000	
		Goodwill written off	13,000	34,000
	D.	**Less: Dividend Income**		(1,500)
	E.	Operating profit before working capital changes [B + C - D]		1,30,500

	F.	Add: Decrease in Current Assets and Increase in Current Liabilitie s		
		Decrease in Inventories	7,000	
		Increase in Trade Payables	21,000	28,000
	G.	Less: Increase in Trade Receivables		(33,000)
	H	Cash generated from operations (E+F-G)		1,25,500
	I	Less: Income taxes paid		(28,000)
	J	Net Cash from (used in) operating activities		97,500
II.		**Cash Flows from investing activities:**		
		Purchase of Plant		(1,34,000)
		Sale of Land		50,000
		Sale of plant		12,000
		Purchase of investments		(25,600)
		Dividend Received		2,100
		Net cash used in investing activities		(95,500)
III.		**Cash Flows from Financing Activities:**		
		Proceeds from issue of equity share capital		1,00,000
		Redemption of preference shares		(50,000)
		Interim Dividend (inclusive of DDT) paid		(10,000)
		Final dividend (inclusive of DDT) paid		(27,000)
		Net cash from financing activities		13,000
IV.		**Net increase in cash and cash equivalents (I+II+III)**		15,000
V.		**Cash and cash equivalents at beginning of period**		17,000
VI.		**Cash and cash equivalents at end of period (IV+V)**		32,000

1. Land and Building Account

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

Plant and Machinery Account

Particulars	₹	Particulars	₹
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss on sale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

2. Investments Account

Particulars	**₹**	**Particulars**	**₹**
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To bank A/c (Purchase	25,600	By Balance c/d	35,000
	35,600		35,600

Question 6

A company provides you the following information:

(i) Total sales for the year were Rs. 398 crores out of which cash sales amounted to Rs. 262 crores.

(ii) Receipts from credit customers during the year, aggregated Rs. 134 crores.

(iii) Purchases for the year amounted to Rs. 220 crores out of which credit purchase was 80%.

Balance in creditors as on

1.4.2020	₹ 84 crores
31.3.2021	₹ 92 crores

(iv) Suppliers of other consumables and services were paid Rs. 19 crores in cash.

(v) Employees of the enterprises were paid 20 crores in cash.

(vi) Fully paid preference shares of the face value of Rs. 32 crores were redeemed. Equity shares of the face value of Rs. 20 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of Rs. 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) Rs. 26 crores were paid by way of income tax.

(ix) A new machinery costing Rs. 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was Rs. 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of
Rs. 15 crores. The balance was paid in cash to the vendor.

(x) Investment costing Rs. 18 cores were sold at a loss of Rs. 2 crores.

(xi) Dividends amounting Rs. 15 crores (including dividend distribution tax of Rs. 2.7 crores) was also paid.

(xii) Debenture interest amounting Rs. 2 crore was paid.

(xiii) On 31st March 2016, Balance with Bank and Cash on hand was Rs. 2 crores.

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method). (RTP May 18) (Same concepts fewer adjustments RTP Nov 21)

Answer 6

Cash flow statement (using direct method) for the year ended 31 st March, 2017

	(Rs. in crores)	(Rs. in crores)
Cash flow from operating activities		
Cash sales	262	
Cash collected from credit customers	134	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(251)	
Cash from operations	145	
Less: Income tax paid	(26)	
Net cash generated from operating activities		119
Cash flow from investing activities		
Net Payment for purchase of Machine (25 – 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities		
Redemption of Preference shares	(32)	

Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net cash used in financing activities		(25)
Net increase in cash and cash equivalents		100
Add: Cash and cash equivalents as on 1.04.2016		2
Cash and cash equivalents as on 31.3.2017		102

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(Rs. in crores)
Opening Balance in creditors Account	84
Add: Purchases (220x .8)	176
Total	260
Less: Closing balance in Creditors Account	92
Cash paid to suppliers of goods	168
Add: Cash purchases (220x .2)	44
Total cash paid for purchases to suppliers (a)	212
Add: Cash paid to suppliers of other consumables and services (b)	19
Add: Payment to employees (c)	20
Total cash paid to suppliers of goods & services and to employees [(a)+(b) + (c)]	251

VIVITSU STRIVING TOWARDS KNOWLEDGE

Question 7

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement for the year ended 31st March, 2021:

	31.03.2021(₹)	**31.03.2020 (₹)**
Share Capital	**14,00,000**	**11,20,000**
General Reserve	**5,60,000**	**3,50,000**
Profit and Loss Account	**1,40,000**	**84,000**
Debentures	**2,80,000**	**-**
Provision for taxation	**1,40,000**	**98,000**
Trade payables	**9,80,000**	**11,48,000**
Plant and Machinery	**9,80,000**	**7,00,000**
Land and Building	**8,40,000**	**5,60,000**
Investments	**1,40,000**	**-**
Trade receivables	**7,00,000**	**9,80,000**
Inventories	**5,60,000**	**2,80,000**
Cash in hand and at Bank	**2,80,000**	**2,80,000**

(i) **Depreciation @ 20% was charged on the opening value of Plant and Machinery.**

(ii) **At the year end, one old machine costing 70,000 (WDV 28,000) was sold for ₹ 49,000. Purchase of machinery was also made at the year end.**

(iii) **₹ 70,000 was paid towards Income tax during the year.**

(iv) **Land & Building is not subject to any depreciation. Expenses on renovation of building amount ₹ 2,80,000 were incurred during the year. Prepare Cash Flow Statement. (RTP May '22)**

Answer 7

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

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account	56,000	
Provision for taxation	1,12,000	
Transfer to General Reserve	2,10,000	
Depreciation	1,40,000	
Profit on sale of Plant and Machinery	(21,000)	
Operating Profit before Working Capital changes	4,97,000	
Increase in Inventories	(2,80,000)	
Decrease in Trade receivables	2,80,000	
Decrease in Trade payables	(1,68,000)	
Cash generated from operations	3,29,000	
Income tax paid	(70,000)	
Net Cash from operating activities		2,59,000
Cash Flow from Investing Activities		
Purchase of plant & machinery	(4,48,000)	
Expenses on building	(2,80,000)	
Increase in investments	(1,40,000)	
Sale of old machine	49,000	
Net Cash used in investing activities		(8,19,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	2,80,000	
Proceeds from issue of debentures	2,80,000	
Net cash from financing activities		5,60,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,80,000
Cash and Cash equivalents at the end of the year		2,80,000

Working Notes: Provision for taxation account

	₹		₹
To Cash (Tax Paid)	70,000	By Balance b/d	98,000
To Balance c/d	1,40,000	By Profit and Loss A/c (Balancing figure)	1,12,000
	2,10,000		2,10,000

Plant and Machinery account

	₹		₹
To Balance b/d	7,00,000	By Depreciation	1,40,000
To Profit and Loss A/c (profit on sale of machine)	21,000	By Cash (sale of machine)	49,000
		By Balance c/d	9,80,000
To Cash (Balancing figure)	4,48,000		
	11,69,000		11,69,000

Question 8

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

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

Notes to Accounts

Particulars	31st March,2021 (₹)	31st March,2020 (₹)
1. Share capital		
(a) Equity share capital	**4,10,000**	**2,00,000**
(b) Preference share capital	**1,50,000**	**1,00,000**
	5,60,000	**3,00,000**
2. Reserve and surplus		
Surplus in statement of profit and loss at the beginning of the year	**25,000**	
Add: Profit of the year	**20,000**	
Less: Dividend	**(10,000)**	
Surplus in statement of profit and loss at the end of the year	**35,000**	**25,000**

Additional Information:

1. **Dividend paid during the year ₹ 10,000**
2. **Depreciation charges during the year ₹ 40,000. (RTP May 23)**

Answer 8

Fox Ltd.
Cash Flow Statement for the year ended 31st March 2021

	₹	₹
Cash flows from operating activities		

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

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

Working Note:

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

Question 9

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

(1) Gross Profit Ratio was 25% for the year, which amounts to Rs. 3,75,000.

(2) Company sold goods for cash only.

(3) Opening inventory was lesser than closing inventory by Rs. 25,000.

(4) Wages paid during the year Rs. 5,55,000.

(5) Office expenses paid during the year Rs. 35,000.

(6) Selling expenses paid during the year Rs. 15,000.

(7) Dividend paid during the year Rs. 40,000 (including dividend distribution tax).

(8) Bank Loan repaid during the year Rs. 2,05,000 (included interest Rs. 5,000)
(9) Trade Payables on 31st March, 2018 were Rs. 50,000 and on 31st March, 2019 were Rs. 35,000.
(10) Amount paid to Trade payables during the year Rs.6,10,000
(11) Income Tax paid during the year amounts to Rs. 55,000 (Provision for taxation as on 31st March, 2019 Rs. 30,000).
(12) Investments of Rs. 8,20,000 sold during the year at a profit of Rs. 20,000.
(13) Depreciation on furniture amounts to Rs. 40,000.
(14) Depreciation on other tangible assets amounts to Rs. 20,000.
(15) Plant and Machinery purchased on 15th November, 2018 for Rs. 3,50,000.
(16) On 31st March, 2019 Rs. 2,00,000, 7% Debentures were issued at face value in an exchange for a plant.
(17) Cash and Cash equivalents on 31st March, 2018 Rs. 2,25,000.
(A) Prepare cash flow statement for the year ended 31st March, 2019, using direct method.
(B) Calculate cash flow from operating activities, using indirect method. (PYP May '19, 10 Marks)

Answer 9

(i) PQR Ltd. Cash Flow Statement for the year ended 31st March, 2019 (Using direct method)

Particulars	₹	₹
Cash flows from Operating Activities		
Cash sales (₹ 3,75,000/25%)		15,00,000
Less: Cash payments for trade payables	(6,10,000)	
Wages Paid	(5,55,000)	
Office and selling expenses ₹ (35,000 + 15,000)	(50,000)	(12,15,000)
Cash generated from operations before taxes		2,85,000
Income tax paid		(55,000)
Net cash generated from operating activities (A)		2,30,000
Cash flows from Investing activities		
Sale of investments ₹ (8,20,000 + 20,000)	8,40,000	
Payments for purchase of Plant & machinery	(3,50,000)	
Net cash used in investing activities (B)		4,90,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,05,000)	
Dividend paid (including dividend distribution tax)	(40,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,75,000
Cash and cash equivalents at beginning of the period		2,25,000
Cash and cash equivalents at end of the period		7,00,000

(ii) 'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year before tax and extraordinary items		2,80,000
Add: Non-Cash and Non-Operating Expenses:		
Depreciation		60,000
Interest Paid		5,000
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Investments		(20,000)
Net Profit after Adjustment for Non-Cash Items		3,25,000
Less: Decrease in trade payables Increase in inventory	15,000 25,000	(40,000)
Cash generated from operations before taxes		2,85,000

Working Note:

Calculation of net profit earned during the year

	Rs.	**Rs.**
Gross profit		3,75,000
Less: Office expenses, selling expenses	50,000	
Depreciation	60,000	
Interest paid	5,000	(1,15,000)
		2,60,000
Add: Profit on sale of investments		20,000
Net profit before tax		2,80,000

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Chapter 12
Buy back of securities

Question 1

What are the conditions to be fulfilled by a Joint Stock Company to buy-back itsequity shares as per Companies Act, 2013? Explain in brief. (Old & New SM) (PYP 5 Marks May '23)

Answer 1

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. The Companies Act, 2013 under Section 68 (1) permits companies to buy-back theirown shares and other specified securities out of:

(i) Its free reserves; or

(ii) The securities premium account; or

(iii) The proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. For example, if equity shares are to be bought-back, then, preference shares may be used for the purpose. The other important provisions relating to the buy-back are:

(1) Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back; However, the above provisions do not apply where the buy-back is ten percent or less of the paid-up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(e) the ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test) **Note:** Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.

(f) all the shares or other specified securities for buy-back are fully paid-up;

(g) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations madeby the Securities and Exchange Board of India in this behalf;

(h) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed. Provided that no offer of the buy-back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy-back if any. This means that there cannot be more than one buy- back in one year.

(2) The notice of meeting at which special resolution is supposed to be passed must be accompanied by an explanatory statement stating-

(a) a full and complete disclosure of all material facts;

(b) the necessity of the buy-back;

   - **(c)** the class of security intended to be purchased under the buy-back;
   - **(d)** the amount to be invested under the buy-back;
   - **(e)** the time limit for completion of the buy-back.

(3) Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors.

(4) The buy-back may be—

   - **(a)** from the existing
   - **(b)** security holders on a proportionate basis; or
   - **(c)** from the open market; or
   - **(d)** by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(5) Where a company has passed a special resolution under clause (b) of Sub- section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board of Directors has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board of Directors. It must be signed by at least two directorsof the company, one of whom shall be the managing director, if any:

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(6) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

(7) Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(8) Where a company buy-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(9) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(10) If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakh but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but which may extend to three lakh rupees or with both.

(11) Section 69 (1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

(12) The shares or other specified securities which are proposed to be bought- back must be fully paid-up.

(13) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares

of the company to be issued to members of the company as fully paid bonus shares.

(14) Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against free reserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buy-back of securities.

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default is subsisting, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank. Provided that the buy–back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.

(2) In accordance with schedule III, no company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (filling of annual return), 123 (payment of dividend within 30 days of declaration), 127 (failure to distribute dividend) and 129 (preparation of financial statement of the company).

Question 2

The following was the summarized balance sheet of Bhoomi Ltd. as on 31st March, 2020:

Equity & liability	Rs (in lakhs)	Assets	Rs (in lakhs)
Authorised Capital:		Property, plant and equipment	1,12,000
Equity shares of Rs 10 each	80,000	Investments	24,000
Issued Capital		Cash at Bank	13,200
Equity Shares of Rs10 each Fully Paid up	64,000	Trade Receivables	66,000
10% Redeemable Preference Shares of 10 each, Fully Paid Up	20,000		
Reserves & Surplus:			
Capital Redemption Reserve	8,000		
Securities Premium	6,400		
General Reserve	48,000		
Profit & Loss Account	2,400		
9% Debentures	40,000		
Trade Payables	26,400		
	2,15,200		2,15,200

On 1st April,2020 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 25% of its Equity Shares at Rs20 per Share. In order to make Cash available, the Company sold all the Investments for Rs25,000 Lakhs and raised a Bank Loan amounting to Rs16,000 lakh on the Security of the Company's Plant. Give the necessary Journal Entries considering that the buy back is authorised by the articles of company and necessary resolution is passed by the company for this. The amount of Securities premium may be utilized to the maximum extent allowed by law. (MTP 8 Marks Oct '20, Oct'21 & Oct '23, MTP 12 Marks Oct'19)(Same concept different figures RTP May'20)

Answer 2

Journal entries In the books of Bhoomi Ltd.

			Dr.	Cr.
				Rs in lakhs
1	Bank A/c	Dr.	25,000	
	To Investments A/c			24,000
	To Profit and Loss A/c			1,000
	(Being Investments sold and, profit being credited to Profit and Loss Account)			
2	10% Redeemable Preference Share Capital A/c	Dr.	20,000	
	Premium payable on Redemption of Preference Shares A/c	Dr.	2,000	
	To Preference Shareholders A/c			22,000
	(Being amount payable on redemption of Preference shares, at a Premium of 10%)			
3	Securities Premium A/c	Dr.	2,000	
	To Premium payable on Redemption of Preference Shares A/c			2,000
	(Being Securities Premium utilised to provide Premium on Redemption of Preference Shares)			
4	Equity Share Capital A/c	Dr.	16,000	
	Premium payable on Buyback A/c	Dr.	16,000	
	To Equity Share buy back A/c			32,000
	(Being the amount due on buy-back)			
5	Securities Premium A/c (6,400 – 2,000)	Dr.	4,400	
	General Reserve A/c (balancing figure)	Dr.	11,600	
	To Premium payable on Buyback A/c			16,000
	(Being premium on buyback provided first out of Securities Premium and the balance out of General Reserves.)			
6	Bank A/c	Dr.	16,000	
	To Bank Loan A/c			16,000
	(Being Loan taken from Bank to finance Buyback)			
7	Preference Shareholders A/c	Dr.	22,000	
	Equity Shares buy back A/c	Dr.	32,000	
	To Bank A/c			54,000
	(Being payment made to Preference Shareholders and Equity Shareholders)			
8	General Reserve Account	Dr.	36,000	
	To Capital Redemption Reserve Account			36,000
	(Being amount transferred to Capital Redemption Reserve Account to the extent of face value of preference shares redeemed and equity Shares bought back) (20,000 + 16,000)			

Question 3

SMM Ltd. has the following capital structure as on 31st March, 2017: Rs. in crore

Particulars	Situation	Situation
(i) Equity share capital (shares of Rs. 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 Rs. 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. (MTP 10 Marks, Apr 19 & Mar 18, MTP 12 Marks Aug 18, Mar 19) (Same concept different figures PYP 15 Marks July'21)

Answer 3

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	**When loan fund is crores**	
	Rs.3,200crores	Rs. 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 Rs. 3,200 crores)

		Rs. in crores	
		Debit	**Credit**
(a) Equity Share buyback account	Dr.	720	
To Bank Account (Being payment for buy back of 24 crores equity shares of 10 each @ Rs. 30 per share)			720
(b) Equity share capital account	Dr.	**240**	
Premium Payable on buyback account	Dr.	**480**	
To Equity Share buyback account (Being cancellation of shares bought back)			720
Securities Premium account		**400**	
General Reserve / Profit & Loss A/c	Dr.	**80**	
To Premium Payable on buyback account (Being Premium Payable on buyback account charged tosecurities premium and general reserve/Profit & Loss A/c			**480**
(C). General Reserve / Profit & Loss A/c	Dr.	**240**	
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)			**240**

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	**(Rs. in crores)**
Paid up capital	1,200
Free reserves (Rs. in crores) (1,080 + 400 +200)	1,680

Shareholders' funds (Rs. in crores)	2,880
25% of Shareholders fund (Rs. in crores)	Rs. 720 crores
Buy back price per share	Rs. 30
Number of shares that can be bought back	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	
	Rs. 3,200 crores	**Rs. 6,000 crores**
(a) Loan funds (Rs.)	3,200	6,000
(b) Minimum equity to be maintained after buy back in the ratio of 2:1 (Rs.) (a/2)	1,600	3,000
(c) Present equity shareholders fund (Rs.)	2,880	2,880
(d) Future equity shareholders fund (Rs.) (see W.N.4)	2,560 (2,880-320)	N.A.
(e) Maximum permitted buy back of Equity (Rs.) [(d) – (b)]	960	Nil
(f) Maximum number of shares that can be bought back @ Rs. 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

$= \left(\frac{y}{30} \times 10\right) = X$ or $3x = y$ (2)

by solving the above two equations we get

x= Rs. 320 y = Rs. 960

Question 4

Following is the summarized Balance Sheet of Complicated Ltd. as on 31st March, 2016:

Liabilities	Amount (Rs.)
Equity shares of Rs. 10 each, fully paid up	12,50,000
Bonus shares of Rs. 10 each, fully paid up	1,00,000
Share option outstanding Account	4,00,000
Revenue Reserve	15,00,000
Securities Premium	2,50,000
Profit & Loss Account	1,25,000
Capital Reserve	2,00,000
Unpaid dividends	1,00,000
12% Debentures (Secured)	18,75,000
Advance from related parties (Unsecured)	10,00,000
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000
	86,50,000
Property, Plant & Equipment	46,50,000
Current Assets	40,00,000
	86,50,000

The Company wants to buy back 25,000 equity shares of Rs. 10 each, on 1st April, 2016 at Rs. 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 buy -back of shares by the Company is also within the provisions of the Companies Act, 2013. The payment for buy back of shares will be made by the Company out of sufficientbank balance available shown as part of Current Assets. You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back of shares. (MTP 15 Marks Oct 18)(Same amount different figures RTP May'18, May'22, Old & New SM)

Answer 4

As per the information given in the Question, buy -back of 25,000 shares @ Rs. 20, as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

		Debit	**Credit**
(a) Equity Share buyback account	Dr.	5,00,000	
To Bank Account (Being buy back of 25,000 equity shares of Rs. 10 each @ Rs. 20 per share)			5,00,000
(b) Equity shares capital account	Dr.	2,50,000	
Securities premium account		2,50,000	
To Equity shares buy-back account (Being cancellation of shares bought back)			5,00,000
(c) Revenue reserve account		2,50,000	
To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought backthrough free reserves)			2,50,000

Balance Sheet of Complicated Ltd.as on 1st April, 2016

Particulars	**Note No**	**Amount Rs.**
EQUITY AND LIABILITIES		
1 Shareholders' funds		
(a) Share capital	1	11,00,000
(a) Reserves and Surplus	2	22,25,000
2 Non-current liabilities		
(a) Long-term borrowings	3	28,75,000
3 Current liabilities		
(a) Other current liabilities	4	19,50,000
Total		81,50,000
ASSETS		
1 Non-current assets		
(a) Property, Plant & Equipment		46,50,000
2 **Current** assets (40,00,000-5,00,000)		35,00,000
Total		81,50,000

Notes to Accounts

			Rs.	Rs.
1.	Share Capital			
	Equity share capital			
	1,10,000 Equity shares of Rs.10 each			11,00,000
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	2,50,000		
	Less: Utilization for share buy-back	(2,50,000)	-	
	Share Option Outstanding Account		4,00,000	
	Capital Reserve		2,00,000	
	Capital Redemption Reserve		2,50,000	22,25,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		10,00,000	28,75,000
4.	Other Current Liabilities			
	Current maturities of long term borrowings		16,50,000	
	Unpaid dividend		1,00,000	
	Application money received for allotment due for refund		2,00,000	19,50,000

Question 5

SM Limited gives the following information as on 31st March, 2023:

		Rs
Share capital		
(60,000 Equity Shares of Rs 10 Each)		**6,00,000**
Reserve & Surplus:		
Security premium	**Rs 70,000**	
General reserve	**Rs 63,000**	
Profit and Loss	**Rs 1,40,000**	**2,73,000**
Non-current liability:		
9% debentures (secured)		**3,00,000**
Current Liabilities:		
Term loan		**40,000**
Creditors		**65,000**
Provision for taxation		**15,000**
Property plant and equipment		**6,00,000**
Non-current investment		**1,50,000**
Current assets:		
Stock	**Rs 2,00,000**	
Debtors	**Rs 2,60,000**	
Bank	**Rs 83,000**	**5,43,000**

The shareholders adopted the resolution on 31st March, 2020 to:

(i) Buy back 25% of the paid up capital @ Rs 15 each.

(ii) Issue 10% debentures of Rs 60,000 at a premium of 10% to finance the buyback of shares.

(iii) Maintain a balance of Rs 20,000 in General Reserve.

(iv) Sell investments worth Rs 1,00,000 for Rs 80,000.

(v) Buy back expenses were Rs 2,000.

You are required to pass necessary journal entries to record the above transactions and prepare Ledger account of Bank. (MTP 8 Marks Nov '21 & April '23)

Answer 5

In the books of SM Limited Journal Entries

	Particulars		**Dr.**	**Cr.**
			Rs	Rs
1.	Equity share capital A/c (15,000 x Rs10)	Dr.	1,50,000	
	Premium on buyback A/c (15,000 x Rs5)	Dr.	75,000	
	ity shares buy back or Equity Shareholders A/c (15,000 x Rs15) (Being the amount due to equity shareholders on buy back)			2,25,000
2.	Equity shares buy back/Equity shareholders A/c Dr.	Dr.	2,25,000	
	To Bank A/c			2,25,000
	(Being the payment made on account of buy back of 15,000 Equity Shares as per the Companies Act)			
3.	Bank A/c	Dr.	66,000	
	To 10 % Debentures A/c			60,000
	To Securities Premium A/c			6,000
	(Being 14 % debentures issued to finance buy back)			
4.	Buyback Expenses A/c	Dr.	2,000	
	To Bank A/c			2,000
	(Buyback expenses paid)			
5.	Bank A/c	Dr.	80,000	
	Profit and Loss A/c (Loss on sale of investment)		20,000	
	To Investment A/c			1,00,000
	(Being investment sold at loss)			
6.	General reserve	Dr.	43,000	
	Profit and Loss A/c	Dr.	1,07,000	
	To Capital redemption reserve A/c			1,50,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)			
7.	Securities Premium	Dr.	75,000	
	Profit and Loss A/c	Dr.	2,000	
	To Premium on buyback			75,000
	To Buyback Expenses A/c			2,000
	(Being premium on buyback and buyback expenses charged to securities premium and profit and loss account)			

Bank Account

Particulars	**Amount (Rs)**	**Particulars**	**Amount (Rs)**
To Balance b/d To	83,000	By Equity Shareholders A/c	2,25,000
Investment A/c	80,000	By Expenses on buy back of shares	2,000
To 10% Debentures and Securities premium	66,000	By Balance c/d	2,000
Total	2,29,000	Total	2,29,000

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of Rs 1,50,000 has been credited to CRR while solving the Question.

Question 6

Alpha Ltd. furnishes the following information as at 31st March, 2021:

	Rs In lakhs	Rs In lakhs
Shareholders' Funds		
Equity share capital (fully paid up shares of Rs 10 each)		**2,400**
Reserves and Surplus		
Securities Premium	**350**	
General Reserve	**530**	
Capital Redemption Reserve	**400**	
Profit & Loss Account	**340**	**1,620**
Non-current Liabilities		
12% Debentures		**1,500**
Current Liabilities		
Trade Payables	**1,490**	
Other Current Liabilities	**390**	**1,880**
Non-current Assets		
Property, plant and equipment		**4,052**
Current Assets		
Current Investments	**148**	
Inventories	**1,200**	
Trade Receivables	**520**	
Cash and Bank	**1,480**	**3,348**

(i) On 1st April, 2021, the company announced buy-back of 25% of its equity shares @ Rs 15 per share. For this purpose, it sold all its investment for Rs 150 lakhs.

(ii) On 10th April, 2021 the company achieved the target of buy-back.

(iii) On 30th April, 2021, the company issued one fully paid up equity share of Rs 10 each by way of bonus for every four equity shares held by the equity shareholders by capitalization of Capital Redemption Reserve. Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against securities premium account. You are required to pass necessary journal entries and prepare the Balance Sheet of Alpha Ltd. after bonus issue. (MTP 12 Marks Mar'22, PYP 10 Marks May '18) (Same concept different figures RTP May'21, RTP May'19, PYP 5 Marks Nov'22)

Answer 6

In the books of Alpha Limited Journal Entries

Date	Particulars		Dr.	Cr.
2021			**(Rs in lakhs)**	
April 1	Bank A/c	Dr.	150	
	To Investment A/c			148
	To Profit on sale of investment			2
	(Being investment sold on profit)			
April 10	Equity share capital A/c	Dr.	600	
	Securities premium A/c	Dr.	300	
	To Equity shares buy back A/c			900
	(Being the amount due to equity shareholders on buy back)			
	Equity shares buy back A/c	Dr.	900	
	To Bank A/c			900
	(Being the payment made on account of buy back of Rs 60 Lakh Equity Shares)			

April 10	General reserve A/c	Dr.	530	
	Profit and Loss A/c	Dr.	70	
	To Capital redemption reserve (CRR) A/c			600
	(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.	450	
	To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)			450
	Bonus shares A/c	Dr.	450	
	To Equity share capital A/c			450
	(Being issue of one bonus equity share for every four equity shares held)			
	Profit on sale of Investment To Profit and Loss A/c	Dr.	2	2
	(Profit on sale transfer to Profit and Loss A/c)			

Note: For transferring amount equal to nominal value of buy back shares from free reserves to capital redemption reserve account, the amount of Rs 340 lakhs from P & L A/c and the balance from general reserve may also be utilized. The combination of different set of amounts (from General Reserve and Profit and Loss Account) aggregating Rs 600 lakhs may also be considered for the purpose of transfer to CRR.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	**Note No**	**Amount (Rs in Lakhs)**
I. Equity and Liabilities		
(1) Shareholder's Funds	1	2,250
(a) Share Capital		
(b) Reserves and Surplus	2	872
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		1,500
(3) Current Liabilities		
(a) Trade payables		1,490
(b) Other current liabilities		390
Total		6,502
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		4,052
(2) Current assets		
(a) Current investments		
(b) Inventory		1,200
(c) Trade receivables		520
(d) Cash and cash equivalents (W.N. 2)		730
Total		6,502

Notes to Accounts

				Rs In lakhs
1.	Share Capital			
	Equity share capital (225 lakh fully paid up shares of Rs 10 each)			2,250
2.	Reserves and Surplus			
	General Reserve	530		
	Less: Transfer to CRR	(530)	-	
	Capital Redemption Reserve	400		
	Add: Transfer due to buy-back of shares from P/L	70		
	Add: Transfer due to buy-back of shares from Gen. res. 530			
	Less: Utilisation for issue of bonus shares	(450)	550	
	Securities premium	350		
	Less: Adjustment for premium paid on buy back	(300)	50	
	Profit & Loss A/c	340		
	Add: Profit on sale of investment	2		
	Less: Transfer to CRR	(70)	272	872

Working Notes:

1. Amount of equity share capital = 2,400 - 600 (buyback) + 450 (Bonus shares) = 2,250
2. Cash at bank after issue of bonus shares

	Rs in lakhs
Cash balance as on 1st April, 2021	1480
Add: Sale of investments	150
	1630
Less: Payment for buy back of shares	(900)
	730

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Question 7

Super Ltd. gives the following information as on 31st March, 2022.

Liabilities	In ₹
Equity Shares of ₹ 10 each fully paid up	17,00,000
Revenue Reserve	23,50,000
Securities Premium	2,50,000
Profit & Loss Account	2,00,000
Infrastructure Development Reserve	1,50,000
9% Debentures	38,00,000
Unsecured Loan	8,50,000
Property, plant & equipment	58,50,000
Current Assets	34,50,000

Super Limited wants to buy back 35,000 equity shares of ₹ 10 each fully paid up on 1st April, 2022 at ₹ 30 per share.

Buy Back of shares is fully authorised by its articles and necessary resolutions have 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 as part of the Current Assets. Comment with calculations, whether the Buy Back of shares by the company is within the provisions of the Companies Act, 2013. (MTP 10 Marks Oct'22, PYP 10 Marks May '19)

Answer 7

Determination of maximum no. of shares that can be bought back as per the Companies Act, 2013

1. **Shares Outstanding Test**

Particulars	(Shares)
Number of shares outstanding	1,70,000
25% of the shares outstanding	42,500

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	17,00,000
Free reserves (₹) (23,50,000 + 2,50,000 + 2,00,000)	28,00,000
Shareholders' funds (₹)	45,00,000
25% of Shareholders fund (₹)	11,25,000
Buy back price per share	₹ 30
Number of shares that can be bought back (shares) Actual Number of shares proposed for buy back	37,500 35,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Shareholder's Funds post Buy Back

	Particulars	₹
(a)	Loan funds (₹) (38,00,000+8,50,000)	46,50,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	23,25,000
(c)	Present equity/shareholders fund (₹)	45,00,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (45,00,000 – 5,43,750)	39,56,250
(e)	Maximum permitted buy back of Equity (₹) [(d) – (b)]	16,31,250
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	54,375 shares
(g)	Actual Buy Back Proposed	35,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	**Number of shares**
Shares Outstanding Test	42,500
Resources Test	37,500
Debt Equity Ratio Test	54,375
Maximum number of shares that can be bought back [least of the above]	37,500

Company qualifies all tests for buy-back of shares and it can buy back maximum 37,500 shares on 1st April, 2022.

However, company wants to buy-back only 35,000 equity shares @ ₹ 30. Therefore, buy-back of 35,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

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

(45,00,000 – x) – 23,25,000 = y (1)

$(\frac{y}{30} \times 10) = x$ Or $3x = y$ (2)

by solving the above equation, we get

x = ₹ 5,43,750

y = ₹ 16,31,250

Question 8

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 2022:

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. .(MTP 15 Marks March '23, Old & New SM, RTP Nov 20)(MTP 10 Marks Sep '23)

Answer 8

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 (1)

Since 51,80,000 – x = y

Equation 2 : $\left(\frac{\text{Maximum buy−back}}{\text{Offer price for buy−back}} \text{ X Nominal Value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

X = $\left(\frac{y}{30} X10\right)$ = X

3x = y (2)

x = ₹ 12,95,000 crores and y = ₹ 38,85,000 crores

Question 9

Umesh Ltd. resolves to buy back 4 lakhs of its fully paid equity shares of Rs. 10 each at Rs. 22 per share. This buyback is in compliance with the provisions of the Companies Act and does not exceed 25% of Company's paid up capital in the financial year. For the purpose, it issues 1 lakh 11 % preference shares of Rs. 10 each at par, the entire amount being payable with applications. The company uses Rs. 16 lakhs of its balance in Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back. Give necessary journal entries to record the above transactions. (RTP Nov 19, Nov'22)

Answer 9

Journal Entries in the books of Umesh Ltd.

			Rs.	Rs.
1.	Bank A/c	Dr.	10,00,000	
	11% Preference share application & allotment A/c			10,00,000
	(Being receipt of application money on preference shares)			
2.	11% Preference share application & allotment A/c	Dr.	10,00,000	
	To 11% Preference share capital A/c			10,00,000
	(Being allotment of 1 lakh preference shares)			
3.	General reserve A/c	Dr.	**30,00,000**	
	To Capital redemption reserve A/c			**30,00,000**
	(Being creation of capital redemption reserve for buy back of shares)			
4.	Equity share capital A/c	Dr.	**40,00,000**	
	Premium payable on buyback A/c	Dr.	**48,00,000**	
	To Equity shareholders/Equity shares buy back A/c			**88,00,000**
	(Amount payable to equity shareholder on buy back)			
5.	Equity shareholders/ Equity shares buy back A/c	Dr.	**88,00,000**	
	To Bank A/c			**88,00,000**
	(Being payment made for buy back of shares)			
6.	Securities Premium A/c	Dr.	**16,00,000**	
	General reserve A/c		**32,00,000**	
	To Premium payable on buyback A/c			**48,00,000**
	(Being premium on buyback charged from securities premium and general reserve)			

Working Notes:

1. Calculation of amount used from General Reserve Account

		Rs.Rs.
Amount paid for buy back of shares (4,00,000 shares x Rs. 22)		88,00,000
Less: Proceeds from issue of Preference Shares (1,00,000 shares x Rs.10)		(10,00,000)
Less: Utilization of Securities Premium Account		(16,00,000)
Balance used from General Reserve Account		62,00,000

* Used under Section 68 for buy back	32,00,000	
Used under Section 69 for transfer to CRR (W.N 2)	30,00,000	
	62,00,000	

2. Amount to be transferred to Capital Redemption Reserve account

	Rs.
Nominal value of shares bought back (4,00,000 shares x Rs.10)	40,00,000
Less: Nominal value of Preference Shares issued for such buy back (1,00,000 shares x Rs.10)	(10,00,000)
Amount transferred to Capital Redemption Reserve Account	30,00,000

Question 10

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

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

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

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

(a) **Give necessary journal entries and**

(b) **Give the Balance Sheet of the company after buy back of shares. (RTP Nov 18, Old & New SM)**

Answer 10

Journal Entries in the books of Pee Limited

	Particulars		Dr.	Cr.
(i)	Bank Account	Dr.	25,00,000	
	Profit and Loss Account	Dr.	5,00,000	
	To Investment Account			30,00,000
	(Being the investments sold at loss for the purpose of buy back)			
(ii)	Equity Share capital account	Dr.	4,80,000	
	Premium payable on buy back Account	Dr.	24,00,000	
	To Equity shares buy back Account			28,80,000
	(Being the amount due on buy back)			
(iii)	Securities Premium Account	Dr.	24,00,000	
	To Premium payable on buy back Account			24,00,000
	(Being the premium payable on buy back adjusted against			
	securities premium account)			
(iv)	Revenue Reserve Account	Dr.	1,80,000	
	To Capital Redemption Reserve Account			1,80,000
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital			
	redemption reserve account (4,80,000-3,00,000)			
(v)	Equity shares buy-back Account	Dr.	28,80,000	
	To Bank Account			28,80,000
	(Being the payment made on buy back)			

Balance Sheet of Pee Limited as on 1st April, 2017(After buy back of shares)

	Particulars	Note No	(Rs.)
I.	Equity and Liabilities		
(1)	Shareholder's Funds		
	(a) Share Capital	1	22,20,000
	(b) Reserves and Surplus	2	68,00,000
(2)	Current Liabilities		16,00,000
	Total		1,06,20,000
II.	Assets		
(1)	Non-current assets		
	(a) Fixed assets		76,00,000
(2)	Current assets		30,20,000
	Total		1,06,20,000

Notes to Accounts

1	**Share Capital**		**(Rs.)**
	Authorised capital:		30,00,000
	Issued and subscribed capital:		
	1,92,000 Equity shares of Rs. 10 each fully paid up	1,92,0000	

	3,000 10% Preference shares of Rs. 100 each fully paid up		3,00,000	22,20,000
	Reconciliation of share capital			
	Opening no. of shares		2,40,000	
	Buy back of shares during the year		48,000	1,92,000
	During the year the company has buy back of 48,000 shares			
2	Reserves and Surplus			
	Capital reserve		10,00,000	
	Capital redemption reserve		1,80,000	
	Securities Premium	27,00,000		
	Less: Premium payable on buy back of shares	24,00,000	3,00,000	
	Revenue reserve	25,00,000		
	Less: Transfer to Capital redemption reserve	1,80,000	23,20,000	
	Profit and loss A/c	35,00,000		
	Less: Loss on investment	5,00,000	30,00,000	68,00,000

Question 11

Pay Limited provides you with the following information as at 31st March, 2022:

	(₹ in Lakhs)	
Share Capital:		**300**
Authorized		
Issued:		
11% Redeemable preference shares of ₹ 100 each fully paid	**125**	
Equity shares of ₹ 10 each fully paid	**175**	**300**
Reserves and surplus:		
Capital reserve	**35**	
Securities premium	**105**	
Revenue reserves	**460**	
Profit and loss account	**50**	**650**
Current liabilities and provisions		**50**
Fixed assets: cost	**100**	
Less: Accumulated depreciation	**(90)**	**10**
Non-current investments at cost (Market value₹ 400 Lakhs)		**200**
Current assets		**790**

(i) **The company redeemed preference shares at a premium of 4% on 1st April, 2022.**

(ii) **It also bought back 2.5 lakhs equity shares of ₹ 10 each at ₹ 40 per share. The payments for the above were made out of the bank balances, which appeared as a part of current assets.**

You are asked to:

(1) **Pass journal entries to record the above.**

(2) **Prepare balance sheet as at 01.04.2022. (RTP May '23)**

Answer 11

(i) **Journal entries in the books of Pay Ltd.** **₹ in lakhs**

	Particulars		Debit	Credit
1st	11% Preference share capital A/c	Dr.	125	

April, 2022	Premium payable on Redemption of Preference Shares	Dr.	5	
	To Preference shareholders A/c (Being preference share capital account transferred to shareholders account)			130
	Preference shareholders A/c	Dr.	130	
	To Bank A/c (Being payment made to shareholders)			130
	Shares buy back A/c	Dr.	100	
	To Bank A/c			100
	(Being 2.5 lakhs equity shares bought back @ ₹ 40 per share)			
	Equity share capital A/c (2.5 lakh x ₹ 10)	Dr.	25	
	Premium payable on buy- back A/c (2.5 lakh x₹ 30)	Dr.	75	
	To Shares buy back A/c (Being cancellation of shares bought back)			100
	Revenue reserve A/c	Dr.	150	
	To Capital Redemption Reserve A/c (125 + 25)			150
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			
	Securities Premium	Dr.	80	
	To Premium payable on Redemption of Pref. Shares			5
	To Premium payable on buy- back A/c			75
	(Being premium on preference shares redeemed* and equity shares bought back charged to securities premium account)			

*Securities premium utilized for premium on preference shares redeemed assuming that the company is not governed under section 133 of the Companies Act. Alternatively, it may not be utilized assuming otherwise.

(ii) **Balance Sheet of Pay Ltd as at 1.4.2022**

Particulars	**Note No**	**₹ In lakhs**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	150
(b) Reserves and Surplus	2	570
(2) Current Liabilities		50
Total		770
II. Assets		
(1) Non-current assets		

(a) Property, plant and Equipment	3	10
(b) Non-current investments -Investment at cost Market value ₹ 400 crores)		200
(2) Current assets	4	560
Total		770

Notes to Accounts

1.	Share Capital			₹ In lakhs
	Authorised, Issued and Subscribed:			
	Equity shares of ₹ 10 each			150
2.	Reserves and Surplus			
	Capital reserve		35	
	Capital redemption reserve		150	
	Securities premium	105		
	Less: Utilisation for buy back and redemption of shares	(80)	25	
	Revenue Reserve	460		
	Less: transfer to Capital redemption reserve	(150)	310	
	Profit and Loss Account balance		50	570
3.	Property, plant and equipment			
	Cost		100	
	Less: Provision for depreciation		(90)	10
4.	Current assets			
	Current assets as on 31.3.2022		790	
	Less: Bank payment for redemption and buy back		(230)	560

Question 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. (PYP 5 Marks Jan 21)

Answer 12

Journal Entries in the books of Umang Ltd.

			Dr. ₹	Cr. ₹
1.	Bank A/c	Dr.	25,00,000	

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

Question 13

X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2018.

Liabilities	(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	20,00,000	
Dividend Equalization Fund	5,50,000	43,50,000
Non-Current Liabilities		
12% Debenture		12,50,000
Current Liabilities and Provisions		5,50,000
Total		1,21,50,000
Assets		
Fixed Assets		
Tangible Assets		1,00,75,000

Current Assets		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	15,75,000	20,75,000
Total		1,21,50,000

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

(1) **Buy back 25% of the paid up capital and i was decided to offer a price of 20% over market price. The prevailing market value of the company's share is Rs. 30 per share.**

(2) **To finance the buy back of share company :**

(a) **Issue 3000, 14 % debenture of 100 each at a premium of 20%**

(b) **Issue 2500, 10 % preference share of Rs. 100 each**

(3) **Sell investment worth Rs. 1,00,000 for Rs. 1,50,000.**

(4) **Maintain a balance of Rs. 2,00,000 in Revenue Reserve.**

(5) **Later the company issue three fully paid up equity share of Rs. 20 each by way of bonus share forevery 15 equity share held by the equity shareholder.**

You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back. (PYP 15 Marks, Nov'19, RTP Nov'21)

Answer 13

In the books of X 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 (Being 10% preference share issued to finance buy back)			2,50,000
3.	Bank A/c	Dr.	1,50,000	
	To Investment A/c			1,00,000
	To Profit on sale of investment (Being investment sold on profit)			50,000
4.	Equity share capital A/c (62,500 x ₹20)	Dr.	12,50,000	
	Securities premium A/c(62,500 x ₹16)	Dr.	10,00,000	
	To Equity shares buy back A/c (62,500 x ₹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 buy back of 62,500 Equity Shares as per the Companies Act)			
6.	Revenue reserve	Dr.	3,00,000	
	Securities premium	Dr.	2,60,000	
	Profit and Loss A/c	Dr.	4,40,000	
	To Capital redemption reserve A/c*			10,00,000

	(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]			
7.	Capital redemption reserve A/c	Dr.	7,50,000	
	To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue 37,500 bonus shares)			7,50,000
8.	Bonus shares A/c	Dr.	7,50,000	
	To Equity share capital A/c			7,50,000
	(Being issue of 3 bonus equity share for every 15equity shares held)			

*Alternatively, entry for combination of different amounts (from Revenue reserve, Securities premium and profit and Loss account.) may be passed for transferring the required amount to CRR.

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other **specified securities**. Issue of debentures has been excluded for the purpose of "**specified securities**" and the entire amount of Rs. 10,00,000 (after deducting only pref. share capital) has been credited to CRR while solving the question.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	57,50,000
(b) Reserves and Surplus	2	27,10,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	15,50,000
(3) Current Liabilities		
(a) Trade payables		-
(b) current liabilities & Provisions		5,50,000
Total		1,05,60,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		1,00,75,000
(2) Current assets		
(a) Investments		2,00,000
(b) Inventory		2,00,000
(c) Cash and cash equivalents (W.N. 2)		85,000
Total		1,05,60,000

Notes to Accounts

				₹
1.	Share Capital			
	Equity share capital (Fully paid up shares of ₹ 20 each)			
	(2,50,000-62,500+37,500 shares)		45,00,000	

	10% preference shares @ ₹ 100 each (10,00,000 + 2,50,000)		12,50,000	57,50,000
2.	Reserves and Surplus			
	Capital Reserve		1,00,000	
	Revenue reserve		2,00,000	
	Securities premium	12,00,000		
	Add: Premium on debenture	60,000		
	Less: Adjustment for premium paid on buy back	(10,00,000)		
	Less: Transfer to CRR	(2,60,000)	Nil	
	Capital Redemption Reserve			
	Transfer due to buy-back of shares from P&L			
3		10,00,000		
	Less: Utilisation for issue of bonus shares	(7,50,000)	2,50,000	
	Profit & Loss A/c	20,00,000		
	Add: Profit on sale of investment	50,000		
	Less: Transfer to CRR	(4,40,000)	16,10,000	
	Dividend equalization reserve	(5,50,000)	5,50,000	27,10,000
	Long-term borrowings - 12% Debentures 12,50,000			
	- 14% Debentures	3,00,000		15,50,000

Working Notes:

1. Amount of bonus shares = [(2,50,000 -25%)3/15] x 20 = 37,500 x 20=7,50,000
2. Cash at bank after issue of bonus shares

	Rs.
Cash balance as on 30.3.2018	15,75,000
Add: Issue of debenture	3,60,000
Add: issue of preference shares	2,50,000
Add: Sale of investments	1,50,000
	23,35,000
Less: Payment for buy back of shares	(22,50,000)
	85,000

Question 14

Mohan Ltd. furnishes the following summarised Balance Sheet on 31st March 2021. (₹ in Lakhs)

	Amount
Equity and Liabilities:	

Shareholders' fund	
Share Capital	
Equity Shares of ₹ 10 each fully paid up 6% Redeemable Preference shares of ₹ 50 each fully Paid up	780 240
Reserves and Surplus	
Capital Reserves	58
General Reserve	625
Securities Premium	52
Profit & Loss	148
Revaluation Reserve	34
Infrastructure Development Reserve	16
Non-current liabilities	
7% Debentures	268
Unsecured Loans	36
Current Liabilities	395
	2652
Assets:	
Non-current Assets	
Plant and Equipment less depreciation	725
Investment at cost	720
Current Assets	1207
	2652

Other Information:

(1) The company redeemed preference shares at a premium of 10% on 1st April,2021.

(2) It also offered to buy back the maximum permissible number of equity shares of ₹ 10 each at ₹ 30 per share on 2nd April 2021.

(3) The payment for the above was made out of available bank balance, which appeared as a part of the current assets.

(4) The company had investment in own debentures costing ₹ 60 lakhs (face value ₹ 75 lakhs). These debentures were cancelled on 2nd April 2021.

(5) On 4th April 2021 company issued one fully paid-up equity share of ₹ 10 each by way of bonus for every five equity shares held by the shareholders.

You are required to:

(a) Calculate maximum possible number of equity shares that can be bought back as per the Companies Act, 2013 and

(b) Record the Journal Entries for the above-mentioned information. (PYP 10 Marks Dec'21)

Answer 14

(a) (i) **Statement determining the maximum number of shares to be bought back**

Number of shares (in lakhs)

Particulars	When loan fund is ₹ 304 lakhs'
Shares Outstanding Test (W.N.1)	19.5
Resources Test (W.N.2)	11.175
Debt Equity Ratio Test (W.N.3)	29.725

Maximum number of shares that can be bought back [least of the above]	11.175

Thus, the company can buy 11,17,500 Equity shares at ₹ 30 each.

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in lakh)
Number of shares outstanding	78
25% of the shares outstanding	19.5

2. Resources Test

Particulars	
Paid up capital (₹ in lakh)	780
Free reserves (₹ in lakh) (625+52+148-24-240*)	561
Shareholders' funds (₹ in lakh)	1341
25% of Shareholders fund (₹ in lakh)	335.25
Buy-back price per share	30
Number of shares that can be bought back	11.175
*Amount transferred to CRR is excluded from free reserves. Premium on redemption also reduced.	

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	₹ In lakh
(a)	Loan funds (₹)	304
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	152
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1043.75 (1341-297.25)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	891.75
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	29.725
	As per the provisions of the Companies Act, 2013, company	Qualifies

Alternatively, when current liabilities are considered as part of loan funds, in that case Debt Equity Ratio Test will be done as follows:

	Particulars	₹ in lakh
(a)	Loan funds (₹)	699
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	349.5
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1093.125 (1341-247.875)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	743.625
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	24.7875
	As per the provisions of the Companies Act, 2013, company	Qualifies

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

= (1341 – x) – 152 = y

= 1189 – x =y (1)

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

y/30 x 10 = x or 3x = y (2)

by solving the above two equations we get x = ₹ 297.25 and y = ₹ 891.75

Alternatively, when current liabilities are considered as part of loan funds, in that case

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

= (1341 – x) – 349.5 = y

= 991.5 – x =y (1)

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

y/30 x 10 = x or 3x = y (2)

by solving the above two equations we get x = 247.875 and y = 743.625

(ii) Journal Entries for Buy Back (₹ in lakhs)

Date	Particulars		Debit	Credit
2021 1st April	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c	Dr.	24	
	To Preference shareholders A/c			264
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	264	
	To Bank A/c			264
	(Being payment made to shareholders)			
	General Reserve or P&L A/c*	Dr.	24	
	To Premium on redemption of preference shares A/c			24
	(Being premium on redemption of preference shares adjusted through securities premium)			
2nd April	Equity shares buy-back A/c	Dr.	335.25	
	To Bank A/c			335.25
	(Being 11.175 lakhs equity shares of ₹ 10 each bought back @ ₹ 30 per share)			
	Equity share capital A/c	Dr.	111.75	
	Securities Premium A/c	Dr.	52	
	General Reserve or P&L A/c	Dr.	171.50	
	To Equity Shares buy-back A/c			335.25
	(Being cancellation of shares bought back)			
	General reserve A/c	Dr.	351.75	

	To Capital redemption reserve A/c			351.75
	(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 ie. 240+ 111.75 lakhs)			
2nd April	7% Debentures A/c	Dr.	75	
	To Investment (own debentures) A/c			60
	To Profit on cancellation of own debentures A/c			15
	(Being cancellation of own debentures costing ₹ 60 lakhs, face value being ₹ 75 lakhs and the balance being profit on cancellation of debentures)			
4th April	Capital Redemption Reserve	Dr.	133.65	
	To Bonus Shares A/c			133.65
	(Being issue of one bonus equity share for every five equity shares held)			
	Bonus shares A/c	Dr.	133.65	
	To Equity share capital A/c			133.65
	(Being bonus shares issued)			

Working Note: Bonus Share to be issued =66.825 (78 - 11.175) lakh shares divided by 5 = 13.365 lakh shares.

Note: *Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and complies with the Accounting Standards prescribed for them. Alternative entry considering otherwise is also possible by utilizing securities premium amount.

Question 15

Quick Ltd. has the following capital structure as on 31st March,2021:

		₹ in Crores	
(1)	**Share Capital:**		**462**
	(Equity Shares of ₹ 10 each, fully paid)		
(2)	**Reserves and Surplus:**		
	General Reserve	**336**	
	Securities Premium Account	**126**	
	Profit and Loss Account	**126**	
	Statutory Reserve	**180**	
	Capital Redemption Reserve	**87**	
	Plant Revaluation Reserve	**33**	**888**
(3)	**Loan Funds:**		
	Secured	**2,200**	
	Unsecured	**320**	**2,520**

On the recommendations of the Board of Directors, on 16th September, 2021, the shareholders of the company have approved a proposal to buy-back of equity shares. The prevailing market value of the company's share is ₹ 20 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 50% over market value. The company had sufficient balance in its bank account for the buy-back of shares.

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 ₹

1,680 Crores or ₹ 2,100 Crores.

Assuming that the entire buy-back is completed by 31st December,2021, Pass the necessary accounting entries (narrations not required) in the books of the company in each situation (PYP 10 Marks May'22)

Answer 15

Statement determining the maximum number of shares to be bought back Number of shares

Particulars	When loan fund is		
	₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
Shares Outstanding Test (W.N.1)	11.55	11.55	11.55
Resources Test (W.N.2)	8.75	8.75	8.75
Debt Equity Ratio Test (W.N.3)	Nil	5.25	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	5.25	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 1,680 crores)

₹ in crores

	Particulars		Debit	Credit
(a)	Equity share buy-back account	Dr.	157.5	
	To Bank account			157.5
(b)	Equity share capital account (5.25 x ₹ 10)	Dr.	52.5	
	Securities premium account (5.25 x ₹ 20)	Dr.	105	
	To Equity share buy-back account			157.5
(c)	General reserve account	Dr.	52.5	
	To Capital redemption reserve account			52.5

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Working Notes:

1. **Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	46.2
25% of the shares outstanding	11.55

2. **Resources Test**

Particulars	
Paid up capital (₹ in crores)	462
Free reserves (₹ in crores) (336+126+126)	588
Shareholders' funds (₹ in crores)	1,050
25% of Shareholders fund (₹ in crores)	₹ 262.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	8.75 crores shares

3. **Debt Equity Ratio Test**

	Particulars	When loan fund is		
		₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
(a)	Loan funds (₹ in crores)	2,520	1,680	2,100
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹ in crores)	1,260	840	1,050
(c)	Present equity shareholders fund (₹ in crores)	1,050	1,050	1,050

(d)	Futureequity shareholder fund (₹ in crores) (See Note 2)	N.A.	997.5 (1,050-52.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	Nil	157.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	Nil	5.25 (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.

   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

   (1,050 –x)-840 = y

   Since 210 – x = y

   Equation 2= $\left[\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \text{x Nominal Value}\right]$

   = Nominal value of the shares bought –back to be transferred to CRR

   $= \frac{y}{30} \times \mathbf{10}$

   Or 3x = y (2)

   by solving the above two equations we get

   x = ₹ 52.5 crores y = ₹ 157.5 crores

3. Statutory reserves, capital redemption reserve and plant revaluation reserves are not free reserves.
4. For calculation of debt -equity ratio both secured and unsecured loans have been considered.

Question 16

The following information from Balance Sheet of Z Ltd. as on 31st March ,2023:

	₹ Lakhs
Share Capital:	
Equity shares of ₹ 10 each Fully Paid Up	**16,000**
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	**5,000**
Reserves & Surplus	
Capital Redemption Reserve	**2,000**
Securities Premium	**1,600**
General Reserve	**12,000**
Profit & Loss Account	**600**
Secured Loans:	
9% Debentures	**10,000**

Current Liabilities:	
Trade payables	4,600
Sundry Provisions	2,000
Fixed Assets	28,000
Investments	4,700
Cash at Bank	4,600
Other Current Assets	16,500

On 1st April, 2023 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 10% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 5,000 lakhs.

You are required to pass journal entries for the above and prepare the Company's Balance sheet immediately after buyback of equity shares and redemption of preference shares.(Nov '23)

Answer 16

(i) Journal Entries in the books of Z Ltd. (₹ in lakhs)

	Particulars			
1	Bank A/c To Investments A/c To Profit and Loss A/c (Being investment sold on profit for the purpose of buy-back)	Dr.	5,000	4,700 300
2	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being redemption of preference share capital at premium of 10%)	Dr. Dr.	5,000 500	5,500
3	Profit and Loss A/c To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	Dr.	500	500
4	Equity Share Capital A/c Premium on buyback To Equity buy-back A/c (Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)	Dr. Dr.	1,600 1,600	3,200
5	Securities Premium A/c (1,600) To Premium on Buyback A/c (Being premium on buyback provided out of securities premium)	Dr.	1,600	1,600
6	Preference Shareholders A/c Equity buy-back A/c To Bank A/c (Being payment made to preference shareholders and equity shareholders)		5,500 3,200	8,700

7	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)		6,600	6,600

(ii) Balance Sheet of C Ltd. (after Redemption and Buyback)

(₹ Lakhs)

	Particulars	**Note No**	**Amount**
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	14,400
	(b) Reserves and Surplus	2	14,400
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	10,000
(3)	Current Liabilities:		
	(a) Trade payables		4,600
	(b) Short Term Provisions		2,000
	Total		45,400
(II)	ASSETS		
(1)	Non-Current Assets		
	PPE		28,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		900
	(b) Other Current Assets		16,500
			45,400

Notes to Accounts

		₹ in Lakhs		
1.	Share Capital			
	1,440 lakh Equity Shares of ₹ 10 each Fully Paid up (160 lakh Equity Shares bought back)			14,400
2.	Reserves and Surplus			
	General Reserve	12,000		
	Less: Transfer to CRR	(6,600)	5,400	
	Capital Redemption Reserve	2,000		
	Add: Transfer due to buy-back of shares from Gen. res.	6,600	8,600	
	Securities premium	1,600		
	Less: Adjustment for premium paid on buy back	(1,600)		
	Profit & Loss A/c	600		
	Add: Profit on sale of investment	300		
	Less: Adjustment for premium paid on redemption of preference shares	(500)	400	14,400

3.	Long-term borrowings			
	Secured			
	9 % Debentures			10,000

Working Note:

Bank Account

	Amount (₹ Lakhs)		Amount (₹ Lakhs)
To balance b/d	4,600	By Preference Shareholders A/c	5,500
To Investment A/c (sale Proceeds)	5,000	By Equity buy back A/c	3,200
		By Balance c/d (Balancing figure)	900
	9,600		9,600

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Chapter 13
Amalgamation of Companies

Question 1 (Illustration)

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

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

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of10% 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 bookvalue by P Ltd.

Prepare:

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

(b) Statement of consideration payable by P Ltd. (Old & New SM) (Same concept different figures RTP May '23, PYP 10 Marks May '19)

Answer 1

(a) 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 overfrom 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 ofnet 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 holdersof Q Ltd. at a discount of 10%)			
Sundry Creditors of Q Ltd.	Dr.	10,000	
To Sundry Debtors of P Ltd.			10,000
(Cancellation of mutual owing)			
Goodwill	Dr.	30,000	
To Bank			30,000
(Being liquidation expenses reimbursed to Q Ltd.)			
Capital Reserve	Dr.	30,000	
To Goodwill			30,000
(Being goodwill set off)			

(b) Statement of Consideration payable by P Ltd. for 30,000 shares (paymentmethod)

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

Rs. $\frac{1,00,000 \times 90}{100}$ ₹ 90,000 (ii)

Consideration amount [(i) + (ii)] ₹ 4,90,000

Question 2

The following is the summarized Balance Sheet of 'A' Ltd. as on 31.3.2019:

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

	18,00,000		18,00,000

B Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis: Market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is an unrecorded liability of Rs. 25,000. (MTP 5 Marks Oct 19)

Answer 2

Calculation of Purchase Consideration under Net Assets Method

		Rs.	Rs.
Sundry assets			
	$18,00,000 \times \frac{75}{100} \times \frac{112}{100} =$	15,12,000	
	$18,00,000 \times \frac{75}{100} \times \frac{112}{100} =$	4,14,000	19,26,000
Less:	Liabilities:		
	10% Debentures	2,00,000	
	Trade payables	1,40,000	
	Bank overdraft	50,000	
	Unrecorded liability	25,000	(4,15,000)
Purchase consideration			15,11,000

Question 3

P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2016 Their summarized Balance Sheets as on31.03.2016 were as follows:

(Rs.in '000)

Particulars	P Ltd.	Q Ltd.
Source of Funds:		
Equity share capital (Rs.10 each)	**300**	**280**
9% preference share Capital (Rs.100 each)	**60**	**40**
Investment allowance Reserve	**70**	**60**
Profit and Loss Account	**8**	**12**
10 % Debentures	**100**	**60**
Trade Payables	**50**	**30**
Tax provision	**14**	**8**
Total	**602**	**490**
Application of Funds:		
Building	**120**	**100**
Plant and Machinery	**160**	**140**
Investments	**80**	**50**
Trade receivables	**90**	**70**
Inventories	**72**	**80**
Cash and Bank	**80**	**50**
Total	**602**	**490**

From the following information, you are required to prepare the Balance Sheet as on 01.04.2016 of a new company, R Ltd., which was formed to take over the business of both the companies and took overall the assets and liabilities:

(i) 50 % Debenture are to be converted into Equity Shares of the New Company.

(ii) Investments are non - current in nature.

(iii) Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.

(iv) 10 % of trade receivables were doubtful for both the companies. Inventories to be carried at cost.

(v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.

(vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of Rs.10 each of the new company at a premium of Rs. 5 per share.

Give your Answer on the basis that amalgamation is in the nature of purchase. (MTP 15 Marks Oct'18, RTP May 19)

Answer 3

M/s R Ltd. Balance Sheet as at 1.4.2016

		Particulars	Notes	Rs. in'000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	6,55,980
	b	Reserves and Surplus	2	2,77,990
2		**Non-current liabilities**		
	a	Long-term borrowings	3	80,000
3		**Current liabilities**		
	a	Trade Payables	4	80,000
	b	Short term provision	5	22,000
		Total		11,15,970
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	6	5,60,000
	b	Non-current investments	7	1,30,000
2		**Current assets**		
	a	Inventory	8	1,52,000
	b	Trade receivables	9	1,44,000
	c	Cash and cash equivalents	10	1,29,970
		Total		11,15,970

Note to accounts

		Rs. in'000
1.	**Share Capital**	
	Equity share capital	
	55,598 Equity shares of Rs.10 each, fully paid up (W.N.2)	5,55,980
	Preference share capital	
	9% Preference share capital (Share of Rs.100 each) (W.N.2)	1,00,000
		6,55,980
2.	**Reserves and Surplus**	
	Securities premium (W.N.2)	2,77,990
	Investment allowance reserve (Rs.70,000+ Rs.60,000)	1,30,000
	Amalgamation adjustment reserve	(1,30,000)
		2,77,990
3.	**Long-term borrowings**	
	Secured	
	10% Debentures (50% of Rs.1,60,000)	80,000
4.	**Trade Payables** (Rs.50,000+ Rs.30,000)	80,000

5.	**Short term provisions**	
	Provision for tax (Rs.14,000+ Rs.8,000)	22,000
6.	**Tangible assets**	
	Building (Rs.1,32,000+Rs.1,05,000)	2,37,000
	Plant and machinery (Rs.1,76,000+Rs.1,47,000)	3,23,000
		5,60,000
7.	Non – current Investments (Rs.80,000+ Rs.50,000)	1,30,000
8.	**Inventory**	
	Stock (Rs. 72,000+ Rs. 80,000)	1,52,000
9.	**Trade receivables**	
	Trade receivables (90% of (Rs.90,000+ Rs.70,000)	1,44,000
10.	**Cash and cash equivalents**	
	Cash and Bank (Rs. 80,000+ Rs. 50,000 – Rs. 30)	1,29,970

Working Notes:

1. Calculation of value of equity shares issued to transferor companies

	P Ltd. (Rs.)		Q Ltd. (Rs.)	
Assets taken over:				
Building		1,32,000		1,05,000
Plant and machinery		1,76,000		1,47,000
Investments		80,000		50,000
Inventories		72,000		80,000
Trade receivables		81,000		63,000
Cash & Bank		80,000		50,000
		6,21,000		4,95,000
Less: Liabilities:				
10% Debentures	1,00,000		60,000	
Trade payables	50,000		30,000	
Tax Provision	14,000	1,64,000	8,000	98,000
		4,57,000		3,97,000
Less: Preference Share Capital		60,000		40,000
		3,97,000		**3,57,000**

2. Number of shares issued to equity shareholders, debenture holders and preference shareholders

	P Ltd.	Q Ltd.	Total
Equity shares issued @ Rs.15 per			
share (including Rs.5 premium)			
Rs.3,97,000/15	26,466 shares		
Rs.3,57,000/15		23,800 shares	50,266 shares
Equity share capital @ Rs.10	Rs.2,64,660	Rs.2,38,000	Rs.5,02,660
Securities premium @ Rs.5	Rs.1,32,330	Rs.1,19,000	Rs.2,51,330
	Rs.3,96,990	Rs.3,57,000	Rs.7,53,990

50% of Debentures are converted into equity shares @ Rs. 15 per share

1,00,000/2 = 50,000/15 60,000/2 = 30,000/15	3,332 shares	2,000 shares	5,332 shares
Equity share capital @ Rs.10	Rs.33,320	Rs.20,000	Rs.53,320
Security premium@ Rs.5	Rs.16,660 Rs.49,980	Rs.10,000 Rs.30,000	Rs.26,660 Rs. 79,980

9% Preference share capital issued	Rs.60,000	Rs.40,000	Rs.1,00,000

Question 4

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

	Robert Ltd. (Rs. in lakhs)	Diamond Ltd. (Rs. in lakhs)
Equity Share Capital (Fully paid shares of Rs. 10 each)	22,500	9,000
Securities Premium	4,500	-
Foreign Project Reserve	-	465
General Reserve	14,250	4,800
Profit and Loss Account	4,305	1,162.5
12% Debentures	-	1,500
Trade payables	1,800	694.5
Provisions	2,745	1,053
Land and Buildings	9,000	-
Plant and Machinery	21,000	7,500
Furniture, Fixtures and Fittings	3,456	2,550
Inventory	11,793	6,061.5
Trade receivables	3,180	1,650
Cash at Bank	1,671	913.5

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

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

Details of trade receivables and trade payables are as under:

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

Expenses of amalgamation amounting to Rs. 1.5 lakhs were borne by Robert Ltd. You are required to:

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

(ii) Prepare Robert Ltd.'s Balance Sheet immediately after the merger. (MTP 16 Marks Apr'22, MTP 20 Marks March 21 & May '20)(Same concept different figures MTP 20 Marks Apr'19, MTP 15 Marks Aug 18, Old & New SM)

Answer 4

Books of Robert Ltd. Journal Entries

		(Rs. in Lacs)	(Rs. in Lacs)
Business Purchase A/c	Dr.	13,500	
To Liquidator of Diamond Ltd.			13,500
(Being business of Diamond Ltd. taken over for consideration settled as per agreement)			
Plant and Machinery	Dr.	7,500	
Furniture & Fittings	Dr.	2,550	
Inventory	Dr.	6,061.5	
Debtors	Dr.	1,530	
Cash at Bank	Dr.	913.5	
Bills Receivable	Dr.	120	
To Foreign Project Reserve			465
To General Reserve Rs. (4,800 - 4,500)			300
To Profit and Loss A/c			1,162.5
To Liability for 12% Debentures			1,500
To Creditors			694.5
To Provisions			1,053
To Business Purchase A/c			13,500
(Being assets & liabilities taken over from Diamond Ltd.)			
Liquidator of Diamond Ltd. A/c	Dr.	13,500	
To Equity Share Capital A/c			13,500
(Purchase consideration discharged in the form of equity shares)			
Profit & Loss A/c	Dr.	1.5	
To Bank A/c			1.5
(Liquidation expenses paid and charged to P& L A/c)			
Liability for 12% Debentures A/c	Dr.	1,500	
To 13% Debentures A/c			1500
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	120	
To Bills Receivable A/c			120
(Cancellation of mutual owing on account of bills)			

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

	Particulars	Notes	Rs. (in lakhs)
	Equity and Liabilities		
1	Shareholders' funds		
A	Share capital	1	36,000
B	Reserves and Surplus	2	24,981
2	Non-current liabilities		
A	Long-term borrowings	3	1,500
3	Current liabilities		
A	Trade Payables (1,800+694.5-120)		2,374.5
B	Short-term provisions (2,745+1,053)		3,798
	Total		68,653.5
	Assets		

1	Non-current assets		
A	Property, Plant & Equipment	4	43,506
2	Current assets		
A	Inventories (11,793+6,061.5)		17,854.5
B	Trade receivables (3,180+1,650-120)		4,710
C	Cash and cash equivalents (1,671+913.5-1.5)		2,583
	Total		68,653.5

Notes to Accounts

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

Working Note:

Computation of purchase consideration

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

Purchase consideration = Rs. 9,000 lacs × 3/2 = Rs. 13,500 lacs

Question 5

Two companies named Alex Ltd. and Beta Ltd. provide you the following summary of ledger balances as on 31st March, 2020:

	Alex Ltd. (Rs.)	Beta Ltd. (Rs.)
Goodwill	**1,40,000**	**70,000**
Building	**8,40,000**	**2,80,000**
Machinery	**14,00,000**	**4,20,000**
Inventory	**7,00,000**	**4,90,000**
Trade receivables	**5,60,000**	**2,80,000**
Cash at Bank	**1,40,000**	**56,000**
Equity Shares of Rs. 10 each	**28,00,000**	**8,40,000**
8% Preference Shares of Rs. 100 each	**2,80,000**	**–**

10% Preference Shares of Rs. 100 each	–	2,80,000
General Reserve	1,96,000	1,96,000
Retirement Gratuity fund	1,40,000	56,000
Trade payables	3,64,000	2,24,000

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

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 8% Preference Shares of Alex Ltd.

(b) Goodwill of Beta Ltd. is valued at Rs. 1,40,000, Buildings are valued at Rs. 4,20,000 and the Machinery at Rs. 4,48,000.

(c) Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.

(d) Equity Shareholders of Beta Ltd. will be issued Equity Shares of Alex Ltd. @ 5% premium. You are required to:

(i) Prepare necessary Ledger Accounts to close the books of Beta Ltd.

(ii) Show the acquisition entries in the books of Alex Ltd.

(iii) Also draft the Balance Sheet after absorption as at 31st March, 2020. (MTP 16 Marks Oct 20, Mar 22 & Oct '23, RTP Nov 18) (Same concept different figures Old & New SM)

Answer 5

(i) In the Books of Beta Ltd. Realization Account

	Rs.		Rs.
To Sundry Assets	15,96,000	By Retirement Gratuity Fund	56,000
To Preference Shareholders (Premium on Redemption)	28,000	By Trade payables (Purchase Consideration)	2,24,000
To Equity Shareholders (Profit on Realisation)	1,40,000	By Alex Ltd.	14,84,000
	17,64,000		17,64,000

Equity Shareholders Account

	Rs.		Rs.
To Equity Shares of Alex Ltd.	11,76,000	By Share Capital	8,40,000
		By General Reserve	1,96,000
		By Realisation Account (Profit on Realisation)	1,40,000
	11,76,000		11,76,000

Preference Shareholders Account

	Rs.		Rs.
To 8% Preference Shares of Alex Ltd.	3,08,000	By Preference Share Capital	2,80,000
		By Realisation Account (Premium on Redemption of Preference Shares)	28,000
	3,08,000		3,08,000

Alex Ltd. Account

	Rs.		Rs.
To Realization Account	14,84,000	By 8% Preference Shares	3,08,000
		By Equity Shares	11,76,000
	14,84,000		14,84,000

(ii) In the Books of Alex Ltd. Journal Entries

		Dr.	Cr.
		Rs.	Rs.
Business Purchase A/c	Dr.	14,84,000	
To Liquidators of Beta Ltd. Account			14,84,000
(Being business of Beta Ltd. taken over)			
Goodwill Account	Dr.	1,40,000	
Building Account	Dr.	4,20,000	
Machinery Account	Dr.	4,48,000	
Inventory Account	Dr.	4,41,000	
Trade receivables Account	Dr.	2,80,000	
Bank Account	Dr.	56,000	
To Retirement Gratuity Fund Account			56,000
To Trade payables Account			2,24,000
To Provision for Doubtful Debts Account			21,000
To Business Purchase A/c			14,84,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Beta Ltd. A/c	Dr.	14,84,000	
To 8% Preference Share Capital A/c			3,08,000
To Equity Share Capital A/c			11,20,000
To Securities Premium A/c			56,000
(Being Purchase Consideration satisfied as above).			

(iii) Balance Sheet of Alex Ltd. (after absorption) as at 31st March, 2020

	Particulars	Notes	Rs.
	Equity and Liabilities		
1	**Shareholders' funds**		
A	Share capital	1	45,08,000
B	Reserves and Surplus	2	2,52,000
2	**Non-current liabilities**		
A	Long-term provisions		1,96,000
3	**Current liabilities**		
A	Trade Payables		5,88,000
B	Short term provision		21,000
	Total		55,65,000
	Assets		
1	**Non-current assets**		
A	Property, Plant and Equipment (PPE)	3	31,08,000
B	Intangible assets		2,80,000

2	**Current assets**		
A	Inventories		11,41,000
B	Trade receivables		8,40,000
C	Cash and cash equivalents		1,96,000
	Total		55,65,000

Notes to accounts:

		Rs.
1	**Share Capital**	
	Equity share capital	
	3,92,000 Equity Shares of Rs. 10 each fully paid (Out of above 1,12,000 Equity Shares were issued in consideration other than for cash)	39,20,000
	Preference share capital	
	5,880 8% Preference Shares of Rs. 100 each (Out of above 3,080 Preference Shares were issued in consideration other than for cash)	5,88,000
	Total	45,08,000
2	**Reserves and Surplus**	
	Securities Premium	56,000
	General Reserve	1,96,000
	Total	2,52,000
3	**PPE**	
	Buildings	12,60,000
	Machinery	18,48,000
	Total	31,08,000

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Working Notes:

Purchase Consideration:	**Rs.**
Goodwill	1,40,000
Building	4,20,000
Machinery	4,48,000
Inventory	4,41,000
Trade receivables	2,59,000
Cash at Bank	56,000
Less: Liabilities:	
Retirement Gratuity	(56,000)
Trade payables	(2,24,000)
Net Assets/ Purchase Consideration	14,84,000
To be satisfied as under:	
Preference Shareholders of Beta Ltd.	2,80,000
Add: 10% Premium	28,000
Satisfied by issue of 3,080 no. of 8% Preference Shares of Alex Ltd.	3,08,000
Equity Shareholders of Beta Ltd. to be satisfied by issue of 1,12,000 Equity Shares of Alex Ltd. at 5% Premium	11,76,000
Total	14,84,000

Question 6

Sun and Neptune (both companies) had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of Rs. 4,00,000 divided into 80,000 equity shares of Rs. 5 each. On 31st March, 2021 Sun and Neptune provide the following information:

	Sun (Rs.)	Neptune (Rs.)
Property, Plant & Equipment	6,35,000	3,65,000
Current Assets	3,27,000	1,67,750
	9,62,000	5,32,750
Less: Current Liabilities	(5,97,000)	(1,80,250)
Representing Capital	3,65,000	3,52,500

Additional Information:

(a) Revalued figures of Property, Plant & Equipment and Current assets were as follows:

	Sun (Rs.)	Neptune (Rs.)
Property, Plant & Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

(b) The debtors and creditors include Rs. 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 (Rs.)	Neptune (Rs.)
2019 Profit	4,49,576	2,73,900
2020 (Loss)/Profit	(2,500)	3,42,100
2021 Profit	3,77,924	3,59,000

(ii) 15% debentures in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31 st March, 2021 after revaluation of assets.

You are required to :

(1) Compute the amount of debentures and shares to be issued to Sun and Neptune.

(2) A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.(MTP 16 Marks Oct '21 & April '23, Old & New SM)(PYP 20 Marks May '23)

Answer 6

(1) **Computation of Amount of Debentures and Shares to be issued:**

		Sun	Neptune
		Rs.	Rs.
(i)	Average Net Profit		
	Rs. (4,49,576-2,500+3,77,924)/3	= 2,75,000	
	Rs. (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

		Sun	Neptune
		Rs.	Rs.
	27,500 shares of Rs. 5 each	1,37,500	
	32,500 shares of Rs. 5 each		1,62,500
(iii)	**Capital Employed (after revaluation of assets)**	**Rs.**	**Rs.**
	Property, Plant & 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 × 100/15	2,20,000	
	Neptune: 29,400 × 100/15		1,96,000

(2) **Balance Sheet of Jupiter Ltd. As at 31st March 2021 (after amalgamation)**

Particulars	Note No	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(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) Property, Plant & Equipment		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		**15,13,900**

Notes to Accounts

		Rs.
1	Share Capital	
	Authorized	
	80,000 Equity Shares of Rs. 5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of Rs. 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
		Rs.	Rs.	Rs.
(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
(b)	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

Question 7

A Ltd. gives the following information on 31st March, 2022:

	Rs.
8,000 Equity shares of Rs. 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 Rs. 6,00,000 and the balance in fully paid equity shares of Rs. 100 each at Rs. 125 per share.

The average profit is Rs. 1,24,400. The liquidation expenses amounted to Rs. 16,000. B Ltd. sold prior to 31st March, 2021 goods costing Rs. 1,20,000 to A Ltd. for Rs. 1,60,000. Rs. 1,00,000 worth of goods are still in Inventory of A Ltd. on 31st March, 2021. Trade payables of A Ltd. include Rs. 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, 2021 after the takeover from the available information. (MTP 16 Marks Nov '21 & March '23, RTP Nov'19)

Answer 7

Books of A Limited Realization Account

	Rs.		Rs.
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.		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 Rs. 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 Realization Account	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, 2021 (An extract)[1]

	Particulars	Notes	Rs.
	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 Balance Sheet of B Ltd. after takeover cannot be prepared.

Notes to Accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	4,880 Equity shares of Rs. 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: Intercompany transaction cancelled upon amalgamation	(40,000)	1,94,000

Working Notes:

1. **Valuation of Goodwill**	Rs.
Average profit	1,24,400
Less: 8% of Rs. 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 Rs. 6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) Rs. 6,10,000 in shares of Rs. 125. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. Unrealized Profit on Inventory	Rs.
The Inventory of A Ltd. includes goods worth Rs. 1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this Inventory will be 40,000 / 1,60,000 X 10,000	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 Rs. 1,00,000.	(10,000)
Amount of unrealized profit	15,000

Question 8

Black Limited and White Limited have been carrying their business independently from 01/04/2022. Because of synergy in business, they amalgamated on and from 1 st April, 2022 and formed a new company Grey Limited to take over the business of Black Limited and White Limited. The information of Black Limited and White Limited as on 31st March, 2022 are as follows:

	Black Ltd. (₹)	**White Ltd. (₹)**
Share Capital:		
Equity share of ₹ 10 each	**15,00,000**	**14,50,000**
10% Preference shares of ₹ 100 each	**2,00,000**	**1,40,000**
Revaluation Reserve	**1,00,000**	**2,00,000**
General Reserve	**1,65,000**	**85,000**
Profit & Loss Account:		
Opening balance (Credit balance)	**1,50,000**	**1,20,000**
Profit for the Year	**2,00,000**	**1,30,000**
15% Debentures of ₹ 100 each (Secured)	**4,00,000**	**5,00,000**
Trade payables	**3,10,000**	**1,20,000**
Land and Buildings	**3,20,000**	**7,40,000**
Plant and Machinery	**18,00,000**	**14,00,000**
Investments	**1,00,000**	**60,000**
Inventory	**2,20,000**	**1,50,000**
Trade Receivables	**4,25,000**	**2,65,000**
Cash at Bank	**1,60,000**	**1,30,000**

Additional Information:

(i) The authorized capital of the new company will be ₹ 54,00,000 divided into 2,00,000 equity shares of ₹ 25 each, and 4,000 preference shares of ₹ 100 each.

(ii) Trade payables of Black Limited includes ₹ 15,000 due to White Limited and trade receivables of White Limited shows ₹ 15,000 receivable from Black Limited.

(iii) Land & Buildings and inventory of Black Limited and White Limited are to be revalued as under:

	Black Ltd. (₹)	White Ltd. (₹)
Land and Buildings	5,20,000	10,40,000
Inventory	1,80,000	1,25,000

(iv) The purchase consideration is to be discharged as under:

(a) Issue 1,80,000 equity shares of ₹ 25 each fully paid up in proportion of their profitability in the preceding two financial years.

(b) Preference shareholders of two companies are issued equivalent number of 12% preference shares of Grey Limited at a price of ₹ 120 per share (face value ₹ 100).

(c) 15% Debenture holders of Black Limited and White Limited are discharged by Grey Limited issuing such number of its 18% Debentures of ₹ 100 each so as to maintain the same amount of interest.

You are required to prepare the Balance Sheet of Grey Limited after amalgamation. The amalgamation took place in the nature of purchase. (MTP 15 Marks Sep'22)

Answer 8

Balance Sheet of Grey Ltd. as at 1st April, 2022

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	48,40,000
(b) Reserves and Surplus	2	1,85,000
(2) Non-Current Liabilities		
Long-term borrowings	3	7,50,000
(3) Current Liabilities		
Trade payables		4,15,000
Total		**61,90,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	47,60,000
(b) Non-current investments		1,60,000
(2) Current assets		
(a) Inventory		3,05,000
(b) Trade receivables		6,75,000
(c) Cash and bank balances		2,90,000
Total		**61,90,000**

Notes to Accounts:

		(₹)	(₹)
1.	**Share Capital**		
	Authorized: 2,00,000 equity shares of ₹ 25 each		50,00,000
	4,000 preference share of ₹ 100 each		4,00,000
	Issued, subscribed, and paid up share capital:		
	1,80,000 Equity shares of ₹ 25 each	45,00,000	
	3,400 Preference shares of ₹ 100 each	3,40,000	

	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		48,40,000
2.	**Reserves and surplus**		
	Securities Premium (3,400 x ₹ 20)	68,000	
	Capital Reserve	1,17,000	1,85,000
3.	**Long-term borrowings**		
	18% Debentures		7,50,000
4.	**Property, plant and equipment**		
	Land and Building	15,60,000	
	Plant and Machinery	32,00,000	47,60,000

Working Notes:

		(₹)		
		Black Ltd.	**Grey Ltd.**	
1.	**Computation of Purchase consideration**			
	(a) **Preference shares:**			
	Shares at ₹ 120 each	2,40,000		1,68,000
	(b) **Equity shares:**			
	Preceding 2 years profitability			
	Year 1	1,50,000		1,20,000
	Year 2	2,00,000		1,30,000
		3,50,000		2,50,000
	Shares (in ratio 35: 25)			
	1,05,000 shares at ₹ 25	26,25,000		
	75,000 shares at ₹ 25			18,75,000
	Amount of purchase consideration (a + b)	28,65,000		20,43,000
2.	**Net Assets Taken Over**			
	Assets taken over:			
	Land and Building	5,20,000		10,40,000
	Plant and Machinery	18,00,000		14,00,000
	Investments	1,00,000		60,000
	Inventory	1,80,000		1, 25,000
	Trade receivables	4,25,000		2,50,000
	Cash and bank	1,60,000		1,30,000
		31,85,000		30,05,000
	Less: Liabilities taken over:			
	Debentures 3,33,333		4,16,667	
	Trade payables 2,95,000		1,20,000	
		6,28,333		5,36,667
	Net assets taken over	25,56,667		24,68,333
	Purchase consideration	28,65,000		20,43,000
	Goodwill	3,08,333		
	Capital reserve			4,25,333
	Net amount of capital reserve			₹ 1,17,000
3.		**Black Limited**	**White Limited**	
	Existing Debentures	₹ 4,00,000 x 15%	₹ 5,00,000 x 15%	
		= ₹ 60,000	= ₹ 75,000	

	Debentures to be issued in Grey Limited @	₹ 60,000 x 100/18	₹ 75,000x100/18
	18% to maintain the same amount of interest	= ₹ 3,33,333	= ₹ 4,16,667

Question 9

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

	A Ltd.(₹)	B Ltd. (₹)
Share Capital		
- **Equity Shares 10 each (Fully Paid)**	**12,00,000**	**7,20,000**
- **10% Preference Shares of ₹ 100 each**	**6,00,000**	**-**
- **8% Preference Shares of ₹ 100 each**	**-**	**5,00,000**
General Reserve	**3,00,000**	**2,50,000**
Investment Allowance Reserve	**-**	**60,000**
Security Premium	**2,40,000**	**-**
Export Profit Reserve	**1,80,000**	**1,20,000**
Profit & Loss Account	**2,16,000**	**1,92,000**
9% Debentures (₹ 10 each)	**3,00,000**	**2,00,000**
Secured Loan	**-**	**3,60,000**
Sundry Creditors	**3,12,000**	**2,04,000**
Bills Payable	**75,000**	**1,00,000**
Other Current Liabilities	**50,000**	**75,000**
Land and Building	**10,80,000**	**8,40,000**
Plant and Machinery	**6,00,000**	**5,60,000**
Office Equipment	**3,45,000**	**2,10,000**
Investments	**96,000**	**3,00,000**
Stock in Trade	**6,30,000**	**4,20,000**
Sundry Debtors	**4,90,000**	**3,20,000**
Bills Receivables	**60,000**	**70,000**
Cash at Bank	**1,72,000**	**61,000**

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

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

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

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

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

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

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

You are required to pass opening Journal Entries in the books of A Limited and prepare the opening Balance Sheet of A Limited as on 1st April, 2021 after amalgamation, assuming that the amalgamation is in the nature of Merger.(MTP 20 Marks Oct'22)

VIVITSU STRIVING TOWARDS KNOWLEDGE

Answer 9

Journal Entries in the books of A Ltd.

Particulars		Debit ₹	Credit ₹
Business purchase A/c (W.N.1)	Dr.	13,75,000	
To Liquidator of B Ltd.			13,75,000
(Being business of B Ltd. taken over)			
Land & Building A/c	Dr.	8,40,000	
Plant and machinery A/c	Dr.	5,60,000	
Office equipment A/c	Dr.	2,10,000	
Investments A/c	Dr.	3,00,000	
Inventory A/c	Dr.	4,20,000	
Debtors A/c	Dr.	3,20,000	
Bills receivables A/c	Dr.	70,000	
Bank A/c	Dr.	61,000	
To General reserve A/c (W.N.2) (2,50,000-1,55,000)			95,000
To Export profit reserve A/c			1,20,000
To Investment allowance reserve A/c			60,000
To Profit and loss A/c			1,20,000
To Liability for 9% Debentures A/c (₹ 100 each)			2,00,000
To Secured Loan			3,60,000
To Trade creditors A/c			2,76,000
To Bills payables A/c			1,00,000
To Other current liabilities A/c			75,000
To Business purchase A/c			13,75,000
(Being assets and liabilities taken over)			
Liquidator of B Ltd.	Dr.	13,75,000	
To Equity share capital A/c			8,00,000
To 10% Preference share capital A/c			4,00,000
To Securities premium A/c			1,75,000
(Being purchase consideration discharged)			
General Reserve* A/c	Dr.	12,000	
To Cash at bank			12,000
(Being expenses of amalgamation paid)			
Liability for 9% Debentures in B Ltd. A/c	Dr.	2,00,000	
To 9% Debentures A/c			2,00,000
(Being debentures in B ltd. discharged by issuing own 9% debentures)			
Bills payables A/c	Dr.	60,000	
To Bill receivables A/c			60,000
(Cancellation of mutual owing on account of bills of exchange)			

*Alternatively, profit & loss A/c may be debited in place of general reserve A/c.

Opening Balance Sheet of A Ltd. (after absorption) as at 1st April, 2021

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		

a	Share capital	1	30,00,000
b	Reserves and Surplus	2	14,94,000
2	Non-current liabilities		
a	Long-term borrowings	3	8,60,000
3	Current liabilities		
a	Trade Payables	4	7,03,000
b	Other current liabilities	5	1,25,000
	Total		61,82,000
	Assets		
1	Non-current assets		
a	PPE	6	36,35,000
b	Investments	7	3,96,000
2	Current assets		
a	Inventories	8	10,50,000
b	Trade receivables	9	8,80,000
c	Cash and cash equivalents	10	2,21,000
	Total		61,82,000

Notes to accounts

			₹
1	Share Capital		
	Equity share capital		
	2,00,000 Equity shares of ₹ 10 each (Out of above, 80,000 shares were issued for consideration other than cash)		20,00,000
	Preference share capital		
	10,000 10% Preference shares of ₹ 100 each (Out of above, 4,000 shares were issued for consideration other than cash)		10,00,000
	Total		30,00,000
2	Reserves and Surplus		
	General Reserve		
	Opening balance	3,00,000	
	Add: Adjustment under scheme of amalgamation	95,000	
	Less: Amalgamation expense paid	(12,000)	3,83,000
	Securities premium (2,40,000+1,75,000)		4,15,000
	Export profit reserve		
	Opening balance	1,80,000	
	Add: Adjustment under scheme of amalgamation	1,20,000	3,00,000
	Investment allowance reserve		60,000
	Profit and loss account		
	Opening balance	2,16,000	
	Add: Adjustment under scheme of amalgamation	1,20,000	3,36,000
	Total		14,94,000
3	Long-term borrowings		
	Secured		

	9% Debentures	3,00,000	
	Add: Adjustment under scheme of amalgamation	2,00,000	
	Secured loan	3,60,000	8,60,000
4	Trade payables		
	Creditors: Opening balance	3,12,000	
	Add: Adjustment under scheme of amalgamation	2,76,000	5,88,000
	Bills Payables: Opening balance	75,000	
	Add: Adjustment under scheme of amalgamation	1,00,000	
	Less: Cancellation of mutual owning upon amalgamation	(60,000)	1,15,000
			7,03,000
5	Other current liabilities		
	Opening balance	50,000	
	Add: Adjustment under scheme of amalgamation	75,000	1,25,000
6	PPE		
	Land & Building- Opening balance	10,80,000	
	Add: Adjustment under scheme of amalgamation	8,40,000	19,20,000
	Plant and machinery- Opening balance	6,00,000	
	Add: Adjustment under scheme of amalgamation	5,60,000	11,60,000
	Office equipment- Opening balance	3,45,000	
	Add: Adjustment under scheme of amalgamation	2,10,000	5,55,000
	Total		36,35,000
7	Investments		
	Opening balance	96,000	
	Add: Adjustment under scheme of amalgamation	3,00,000	3,96,000
8	Inventories		
	Opening balance	6,30,000	
	Add: Adjustment under scheme of amalgamation	4,20,000	10,50,000
9	Trade receivables		
	Debtors: Opening balance	4,90,000	
	Add: Adjustment under scheme of amalgamation	3,20,000	8,10,000
	Bills Payables: Opening balance	60,000	
	Add: Adjustment under scheme of amalgamation	70,000	
	Less: Cancellation of mutual owning upon amalgamation	(60,000)	70,000
	Total		8,80,000
10	Cash and cash equivalents		
	Opening balance	1,72,000	
	Add: Adjustment under scheme of amalgamation	61,000	
	Less: Amalgamation expense paid	(12,000)	2,21,000

Working Notes:

1. **Calculation of purchase consideration**

	₹
Equity shareholders of B Ltd. (80,000 x ₹ 10)	8,00,000
Preference shareholders of B Ltd. (5,00,000 x 115%)	5,75,000
Purchase consideration would be	13,75,000

2. **Amount to be adjusted from general reserve**

The difference between the amount recorded as share capital issued and the amount of share capital of transferor company should be adjusted in General Reserve.

Thus, General reserve will be adjusted as follows:

	₹
Purchase consideration	13,75,000
Less: Share capital issued (₹ 7,20,000 + ₹ 5,00,000)	(12,20,000)
Amount to be adjusted from general reserve	1,55,000

3. **Calculation of balances of Profit & Loss and Sundry Creditors of B Limited to be taken over by A Limited**

	P&L (₹)	Creditors (₹)
Balance as per Balance Sheet of B Limited	1,92,000	2,04,000
Less / Add: Contingent Trade Payable treated as Actual Liability	(72,000)	72,000
Taken by A Limited	1,20,000	2,76,000

Question 10

Mohan Ltd. gives you the following information as on 31st March, 2020:

	Rs.
<u>**Share capital**</u>: **Equity shares of Rs. 10 each**	**3,00,000**
6,000, 9% cumulative preference shares of Rs. 10 each	**60,000**
Profit and Loss Account (Dr. balance)	**1,70,000**
10% Debentures of Rs. 100 each	**2,00,000**
Interest payable on Debentures	**20,000**
Trade Payables	**1,50,000**
Property, Plant and Equipment	**3,40,000**
Goodwill	**10,000**
Inventory	**80,000**
Trade Receivables	**1,10,000**
Bank Balance	**20,000**

A new company Ravi Ltd. is formed with authorised share capital of Rs. 4,00,000 divided into 40,000 Equity Shares of Rs. 10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following terms:

(i) (a) Mohan Ltd.'s debentures are paid by similar debentures in new company and for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.

(b) The trade payables are paid by issue of 12,000 equity shares at par in full and final settlement of their claims.

(c) Preference shareholders are to get equal number of equity shares issued at par. Dividend on

preference shares is in arrears for three years. Preference shareholders to forgo dividend for two years. For balance dividend, equity shares of equal amount are issued at par.

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

(ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%). Goodwill is to be eliminated. The Property, plant and equipment is taken over at Rs. 3,08,400.

(iii) Remaining equity shares of the new company are issued to public at par fully paid up.

(iv) Expenses of Rs. 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 21)

Answer 10

In the books of Mohan Ltd.

(i) Realisation Account

	Rs.		Rs.
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

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

*Alternatively, expenses may be routed through Realization account.

In the books of Ravi Ltd.

(iii) Bank Account

	Rs.		Rs.
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

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

Particulars	Note No.	Rs.
I. Equity and Liabilities		
(1) Shareholder's Funds		

Share Capital	1	4,00,000
(2) Non-Current Liabilities		
Long-term borrowings	2	2,00,000
Total		6,00,000
II. Assets		
(1) Non-current assets		
(a) Property, plant 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

		Rs.
1.	Share Capital	
	Authorised share capital	
	40,000 equity shares of Rs. 10 each	4,00,000
	Issued and Subscribed	
	40,000 shares of Rs. 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**

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

2. **Preference shareholders' Account in books of Mohan Ltd.**

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

3. **Calculation of number of Equity shares issued to 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 public at par for cash		9,460

Question 11

X Ltd. and Y Ltd. give the following information of assets, equity and liabilities as on 31st March, 2018:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
Equity and Liabilities		
Equity Shares of Rs. 10 each	**30,00,000**	**9,00,000**
9% Preference Shares of Rs. 100 each	**3,00,000**	**-**
10% Preference Shares of Rs. 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 preceding three financial years (2016-17 : Rs. 90,000; 2015-16 : Rs. 78,000 and 2014-15: Rs. 72,000). The profits of 2014 -15 included credit of an insurance claim of Rs. 25,000 (fire occurred in 2013-14 and loss by fire Rs. 30,000 was booked in Profit and Loss Account of that year). In the year 2015 -16, there was an embezzlement of cash by an employee amounting to Rs. 10,000.

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

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

(v) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to Rs. 15,000 and such asset was also taken over by X Ltd.

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

(vii) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium. You are required to:

(i) Prepare Realizations 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,2018. (RTP Nov 20, PYP 20 Marks May 18)

Answer 11

In the Books of Y Ltd.
Realization Account

		Rs.		Rs.
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		30,000		
(Premium on Redemption)				
To Equity Shareholders				
(Profit on Realization)		1,50,000		
		18,90,000		18,90,000

In the Books of X Ltd.
Journal Entries

		Dr. Rs.	Cr. Rs.
Business Purchase A/c	Dr.	15,90,000	15,90,000
To Liquidators of Y Ltd. Account			
(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	Rs.
	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

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Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	4,20,000 Equity Shares of Rs. 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 Rs. 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

	Rs.
Profit of 2016-17	90,000
Profit of 2015-16 adjusted (Rs. 78,000 + 10,000)	88,000
Profit of 2014-15 adjusted (Rs. 72,000 – 25,000)	47,000
	2,25,000
Average profit	75,000

2. Goodwill to be valued at 2 times of average profits = Rs. 75,000 x 2 = Rs. 1,50,000

Purchase Consideration:		Rs.
Goodwill		1,50,000
Land & Building		5,00,000
Plant & Machinery		4,00,000
Inventory		4,72,500
Trade receivables		3,00,000
Unrecorded assets		15,000
Cash at Bank		60,000
		18,97,500
Less: Liabilities:		
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**

Question 12

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

Liabilities	P Ltd. Rs.	Q Ltd. Rs.	Assets	P Ltd. Rs.	Q Ltd. Rs.
Equity Shares	**8,20,000**	**3,20,000**	**Land & Building**	**4,50,000**	**3,40,000**
(Rs. 100 each)					

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

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

PQ Ltd. will issue:

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

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

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

(iv) 20,000 new equity shares of Rs. 20 each for cash @ Rs.18 paid up at a premium of Rs.4 per share. PQ Ltd. will pay cash to equity shareholders of both the companies in order to adjust their rights as per the intrinsic value of the shares of both the companies.

You are required to prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books. (RTP May 20)

Answer 12

In the Books of P Ltd. Realization Account

	Rs.		Rs.
To Land & Building	4,50,000	By 8% Debentures	2,00,000
To Plant & Machinery	6,20,000	By Trade Payables	88,000
To Furniture & Fitting	1,00,000	By PQ Ltd.	16,02,100
To Trade receivables	3,25,000	(Purchase consideration)	
To Inventory/Stock	2,33,000	By Equity Shareholders A/c	1,37,900
To Cash at Bank	2,08,000	(loss)	
To Cash in Hand	54,000		
To Preference shareholders	38,000		
(excess payment)			
	20,28,000		**20,28,000**

Equity Shareholders Account

	Rs.		Rs.
To Realization A/c (loss)	1,37,900	By Share capital	8,20,000
To Equity Shares in PQ Ltd.	10,82,400	By Profit & Loss A/c	3,52,000
To Cash	1,01,700	By General Reserve	1,50,000
	13,22,000		**13,22,000**

9% Preference Shareholders Account

To Preference Shares in PQ Ltd.	4,18,000	By Pref. Share capital	3,80,000
		By Realization A/c	38,000
	4,18,000		**4,18,000**

PQ Ltd. Account

To Realization A/c	16,02,100	By Shares in PQ Ltd.		
		For Equity	10,82,400	15,00,400
		For Pref.	4,18,000	

		By Cash		
				1,01,700
	16,02,100			**16,02,100**

8% Debentures holders Account

	Rs.		Rs.
To 6% Debentures	2,00,000	By 8% Debentures	2,00,000

Books of Q Ltd.

Realization Account

	Rs.		Rs.
To Land & Building	3,40,000	By 8% Debentures	1,00,000
To Plant & Machinery	4,50,000	By Trade payables	1,60,000
To Furniture & Fittings	50,000	By Unsecured loan	1,75,000
To Trade receivables	1,50,000	By PQ Ltd. (Purchase consideration)	
To Inventory	1,05,000		7,92,250
To Cash at bank	1,75,000	By Equity Shareholders A/c	90,750
To Cash in hand	20,000	Loss	
To Pref. shareholders	28,000		
	13,18,000		13,18,000

Equity Shareholders Account

	Rs.		Rs.
To Equity shares in PQ Ltd.	4,22,400	By Share Capital	3,20,000
To Realization	90,750	By Profit & Loss A/c	2,05,000
To Cash	61,850	By General Reserve	50,000
	5,75,000		**5,75,000**

9% Preference Shareholders Account

	Rs.		Rs.
To Preference Shares in PQ Ltd.	3,08,000	By Share capital	2,80,000
		By Realization A/c	28,000
	3,08,000		**3,08,000**

Q Ltd. Account

	Rs.			Rs.
To Realization A/c	7,92,250	By Equity shares in PQ Ltd.		
		For Equity	4,22,400	
		Preference	3,08,000	7,30,400
		By Cash		61,850
	7,92,250			**7,92,250**

8% Debentures holders Account

	Rs.		Rs.
To 6% Debentures	1,00,000	By 8% Debentures	1,00,000

Working Notes:

(i) Purchase consideration

	P Ltd. Rs.	Q Ltd. Rs.
Payable to preference shareholders:		
Preference shares at Rs. 22 per share	4,18,000	3,08,000
Equity Shares at Rs. 22 per share	10,82,400	4,22,400
Cash [See W.N. (ii)]	1,01,700	61,850
	16,02,100	**7,92,250**

(ii) Value of Net Assets

		P Ltd. Rs.		Q Ltd. Rs.
Land & Building		4,50,000		3,40,000
Plant & Machinery less 10% Depreciation		5,58,000		4,05,000
Furniture & Fittings less 10% Depreciation		90,000		45,000
Trade receivables less 5%		3,08,750		1,42,500
Inventory less 5%		2,21,350		99,750
Cash at Bank		2,08,000		1,75,000
Cash in hand		54,000		20,000
		18,90,100		12,27,250
Less: Debentures	2,00,000		1,00,000	
Trade payables	88,000		1,60,000	
Secured Loans	–	(2,88,000)	1,75,000	(4,35,000)
			16,02,100	7,92,250
Payable in shares			15,00,400	7,30,400
Payable in cash*			1,01,700	(61,850)

(iii)

	P	Q
Plant & Machinery	6,20,000	4,50,000
Less: Depreciation 10%	62,000	45,000
	5,58,000	4,05,000
Furniture & Fixtures	1,00,000	50,000
Less: Depreciation 10%	10,000	5,000
	90,000	45,000

*This cash is paid to equity shareholders of both the companies for adjustment of their rights as per intrinsic value of both companies.

Question 13

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

Summarized balance sheets as at 31-03-2017

Liabilities	P Ltd. Rs.	Q Ltd. Rs.	Assets	P Ltd. Rs.	Q Ltd. Rs.
Equity & liabilities:			**Assets:**		
Shareholders Fund			**Non-current Assets:**		
a. Share Capital	**6,00,000**	**8,40,000**	**Property, Plant &**		

			Equipment		
b. Reserves	10,20,000	6,00,000	(excluding Goodwill)	7,20,000	10,80,000
Current Liabilities			Current Assets		
Bank Overdraft	-	5,40,000	a. Inventories	3,60,000	6,60,000
Trade payables	2,40,000	5,40,000	b. Trade receivables	4,80,000	7,80,000
			c. Cash at Bank	3,00,000	-
	18,60,000	25,20,000		18,60,000	25,20,000

The consideration was to be based on the net assets of the companies as shown in the above Balance Sheets, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March, 2017. The weights for this purpose for the years 2014-15, 2015-16 and 2016-17 were agreed as 1, 2 and 3 respectively. The profit had been: 2014-15 Rs. 3,00,000; 2015-16 Rs. 5,25,000 and 2016-17 Rs. 6,30,000. The shares of PQ Ltd. were to be issued to P Ltd. and Q Ltd. at a premium and in proportion to the agreed net assets value of these companies. In order to raise working capital, PQ Ltd proceeded to issue 72,000 shares of Rs. 10 each at the same rate of premium as issued for discharging purchase consideration to P Ltd. and Q Ltd. You are required to :

(i) Calculate the number of shares issued to P Ltd. and Q Ltd; and

(ii) Prepare required journal entries in the books of PQ Ltd.; and

(iii) Prepare the Balance Sheet of PQ Ltd. as per Schedule III after recording the necessary journal entries. (RTP May 18, Nov 21)

Answer 13

(i) Calculation of number of shares issued to P Ltd. and Q Ltd.:

Amount of Share Capital as per balance sheet		**Rs.**
P Ltd.		6,00,000
Q Ltd.		8,40,000
		14,40,000

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

= Rs. 8,64,000 or 86,400 shares

Securities premium = Rs. 21,60,000 – Rs. 8,64,000 = Rs. 12,96,000Premium

per share = Rs. 12,96,000 / Rs. 86,400 = Rs. 15

Issued 86,400 shares @ Rs. 10 each at a premium of Rs.15 per share Share of Q Ltd.

= Rs. 14,40,000 x [14,40,000/ (21,60,000 + 14,40,000)]

= Rs. 5,76,000 or 57,600 shares

Securities premium = Rs. 14,40,000 – Rs. 5,76,000 = Rs. 8,64,000Premium

per share = Rs. 8,64,000 / Rs. 57,600 = Rs. 15

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

(ii) Journal Entries in the books of PQ Ltd.

Particulars		**Dr. Amount (Rs.)**	**Cr. Amount (Rs.)**
Business purchase account	Dr.	36,00,000	
To Liquidator of P Ltd. account			21,60,000
To Liquidator of Q Ltd. account			14,40,000
(Being the amount of purchase consideration payable			
to liquidator of P Ltd. and Q Ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	

Particulars		Dr. (₹)	Cr. (₹)
Property, Plant & Equipment 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 P Ltd. taken over)			
Property, Plant & Equipment 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 Q Ltd. taken over)			
Liquidator of P Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 x Rs. 10)			8,64,000
To Securities premium (86,400 x Rs. 15)			12,96,000
(Being the allotment of shares as per agreement for			
discharge of purchase consideration)			
Liquidator of Q Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 x Rs. 10)			5,76,000
To Securities premium (57,600 x Rs. 15)			8,64,000
(Being the allotment of shares as per agreement for discharge			
of purchase consideration)			
Bank A/c		18,00,000	
To Equity share capital account			7,20,000
To Securities premium(Equity share capital issued to raise working capital)			10,80,000

(iii) Balance Sheet of PQ Ltd. on 31st March, 2017 after amalgamation

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	21,60,000
	b	Reserves and Surplus	2	32,40,000
2		Current liabilities		
	a	Trade payables (2,40,000 + 5,40,000)		7,80,000
		Total		61,80,000
		Assets		
1		Non-current assets		
	a	Fixed assets		
2		Tangible assets (7,20,000 + 10,80,000)		18,00,000
		Intangible assets (goodwill)	4	5,40,000
		Current assets		

	a	Inventories (3,60,000 + 6,60,000)		10,20,000
	b	Trade receivables (4,80,000 +7,80,000)		12,60,000
	c	Cash and cash equivalents	3	15,60,000
		Total		61,80,000

Notes to accounts

		Rs.
1	**Share Capital**	
	Issued, subscribed and paid up share capital	
	2,16,000 Equity shares of Rs. 10 each	21,60,000
	(Out of the above 1,44,000 shares issued for non-cash consideration	
	under scheme of amalgamation)	
2	**Reserves and Surplus**	
	Securities premium	32,40,000
	(@ Rs. 15 for 2,16,000 shares)	
3	**Cash and cash equivalents**	
	Cash at Bank	15,60,000
4	**Intangible Assets**	
	Goodwill	5,40,000

Working Notes:

1. **Calculation of goodwill of P Ltd.**

Particulars	**Amount Rs.**	**Weight**	**Weighted amount Rs.**
2014-15	3,00,000	1	3,00,000
2015-16	5,25,000	2	10,50,000
2016-17	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][Rs. 32,40,000/6]Goodwill			5,40,000

2. **Calculation of Net assets**

	P Ltd. Rs.	**Q Ltd. Rs.**
Assets		
Goodwill	5,40,000	
Property, Plant & Equipment	7,20,000	10,80,000
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft	5,40,000	
Trade payables	2,40,000	5,40,000
Net assets or Purchase consideration	21,60,000	14,40,000
New authorized capital		
= Rs. 14,40,000 + Rs. 12,00 000 = Rs. 26,40,000		
Cash and Cash equivalents **Rs.**		
P Ltd. Balance 3,00,000		

Cash received from Fresh issue (72,000 X Rs.25)18,00,000		
21,00,000		
Less: Bank Overdraft 5,40,000		
15,60,000*		

*The balance of cash and equivalents has been shown after setting off overdraft amount.

Question 14

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

Particulars	Note No.	Aakash Limited (Rs.)	Ganga Limited (Rs.)
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	**1**	**80,00,000**	**20,00,000**
(b) Reserves and Surplus	**2**	**(3,24,00,000)**	**56,00,000**
(2) Non-Current Liabilities:			
(a) Secured Loans	**3**	**3,20,00,000**	**1,60,00,000**
(b) Unsecured Loans	**4**	**1,72,00,000**	**-**
(3) Current Liabilities:			
(a) Trade Payables		**56,00,000**	**36,00,000**
(b) Other Current Liabilities	**5**	**2,04,00,000**	**56,00,000**
Total		**5,08,00,000**	**3,28,00,000**
II. Assets:			
(1) Non-Current Assets:			
Property, Plant & Equipment		**68,00,000**	**1,36,00,000**
(2) Current Assets:			
(a) Inventories		**3,68,00,000**	**-**
(b) Other Current Assets		**72,00,000**	**1,92,00,000**
Total		**5,08,00,000**	**3,28,00,000**

Notes to Accounts:

		Aakash Limited (Rs.)	Ganga Limited (Rs.)
1.	**Share Capital**		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of Rs.10 each	**60,00,000**	**-**
	20,000 Preference Shares of Rs. 100 each	**20,00,000**	**-**
	2,00,000 Equity Shares of Rs. 10 each	**-**	**20,00,000**
		80,00,000	**20,00,000**
2.	**Reserves and Surplus**		
	General Reserve	**8,00,000**	**56,00,000**
	Surplus	**(3,32,00,000)**	**-**
		(3,24,00,000)	**56,00,000**
3.	**Secured Loans** (Secured Loans of Aakash Limited are secured against pledge of Inventories)	**3,20,00,000**	**1,60,00,000**
4.	**Unsecured Loans**	**1,72,00,000**	**-**

5.	Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000
	Liability to Employees	60,00,000	36,00,000
		2,04,00,000	56,00,000

Both the companies go into liquidation and a new company 'AakashGanga Limited' is formed to take over their business. The following information is given:

(i) All Current Assets of two companies, except pledged inventory are taken over by Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.

(ii) Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.

(iii) Secured Loans include Rs. 32,00,000 accured interest in case of Ganga Limited.

(iv) 4,00,000 Equity Shares of Rs. 10 each are allotted by AakashGanga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.

(v) Preference Shareholders in Aakash Limited are issued Equity Shares in AakashGanga Ltd. worth Rs. 4,00,000 in lieu of their present holdings.

(vi) Secured Loan agree to continue the balance amount of their loans to AakashGanga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.

(vii) Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.

(viii) Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.

(ix) Statutory Liabilities are taken over by AakashGanga Limited at full value and Trade Payables are taken over at 80% of the book value.

You are required to prepare the opening Balance Sheet of AakashGanga Limited as at 1.4.2021. (RTP May 22)

Answer 14

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

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

Notes to Accounts

			(Rs.)
1.	Share Capital		
	Issued, subscribed & Paid up:		
	14,00,000 equity shares of Rs. 10 each, fully paid up (W.N.4) (of the above 10,00,000 shares have been issued for consideration other than cash)		1,40,00,000
2.	Long Term borrowings		
	Secured Loans		
	Aakash Limited 25,60,000		
	Ganga Limited 1,44,00,000	1,69,60,000	
	Unsecured Loans	43,00,000	2,12,60,000
3.	Trade Payables (W.N.1)		
	Aakash Limited	44,80,000	
	Ganga Limited	28,80,000	73,60,000
4.	Other current liabilities		
	Statutory Liabilities		
	Aakash Limited	1,44,00,000	
	Ganga Limited	20,00,000	1,64,00,000
5.	Property, Plant & Equipment		
	Aakash Limited	68,00,000	
	Ganga Limited	1,36,00,000	2,04,00,000
6.	Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7.	Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

1. Value of total liabilities taken over by Aakash Ganga Ltd. **(Rs.)**

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

2. Assets taken over by AakashGanga Ltd. **(Rs.)**

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

3. Goodwill / Capital Reserve on amalgamation **(Rs.)**

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

4. Equity shares issued by AakashGanga Ltd.

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

5. Journal Entries in the Books of Z Ltd.

			Rs.	Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs. 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs. 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 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 payable A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000

	To Reconstruction A/c			5,78,000
	(Being Rs. 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 payable 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 Rs. 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 (Rs. 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 8,000 equity shares of Rs. 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 Rs. 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 full 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			11,00,000
	To Patent A/c			5,00,000

	To Profit and Loss A/c			14,60,000
	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

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

Reconstruction Account

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

Question 15

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

Particulars	Note No.	Truth Ltd. (₹)	Myth Ltd. (₹)
(1) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share Capital	**1**	**10,00,000**	**4,00,000**

(b) Reserves and Surplus	2	11,35,000	4,13,000
2. Non -Current Liabilities	3	-	1,50,000
3. Current Liabilities	4	1,40,000	1,82,000
Total		22,75,000	11,45,000
(2) Assets			
1. Non -Current Assets			
(a) Property, Plant & Equipment		15,75,000	6,80,000
(b) Investments		1,87,500	1,00,000
2. Current Assets	5	5,12,500	3,65,000
Total		22,75,000	11,45,000

Note No.	Particulars	Truth Limited (₹)	Myth Limited (₹)
1	Share Capital	10,00,000	4,00,000
	Equity shares of ₹ 10 each		
2	Reserves & Surplus		
	General Reserve	5,05,000	2,30,000
	Profit & Loss A/c	4,45,000	1,58,000
	Export Profit Reserve	1,85,000	25,000
3	Non- Current Liabilities	11,35,000	4,13,000
	14% Debentures	---	1,50,000
4	Current Liabilities		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
5	Current Assets	1,40,000	1,82,000
	Inventory	2,15,000	85,000
	Trade Receivables	2,02,500	1,75,000
	Cash and Cash equivalents	95,000	1,05,000
		5,12,500	3,65,000

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

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

Goodwill is to be calculated on the basis of simple average of three years profit by using Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the amalgamation. (RTP Nov'22)

Answer 15

Balance Sheet of Truth Ltd. (after amalgamated with Myth Ltd.) as at 1.4.2021

Particulars	Note No.	(₹)
I. Equity and liabilities		
(1) Shareholder's funds		
(a) Share capital	1	13,13,750
(b) Reserves and surplus	2	20,76,250
(2) Non-current liabilities		
12% Debentures	3	1,75,000
(3) Current liabilities		
(a) Trade payables	4	2,32,000
(b) Other current liabilities	5	90,000
Total		38,87,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	22,55,000
(b) Intangible assets (Goodwill) [WN 1]		4,67,000
(c) Non-current investments	7	2,87,500
(2) Current assets		
(a) Inventories (2,15,000 + 85,000)		3,00,000
(b) Trade receivables (2,02,500 + 1,75,000)		3,77,500
(c) Cash & cash equivalents (95,000 + 1,05,000)		2,00,000
Total		38,87,000

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	1,31,375 Equity Shares of ₹ 10 each [1,00,000 + 31,375]		13,13,750
	(of the above shares, 31,375 shares were issued to the vendors otherwise than for cash)		
2.	Reserves and surplus		
	General Reserve	5,05,000	
	Profit and Loss A/c	4,45,000	
	Securities Premium [31,375 x 30]	9,41,250	
	Export profit reserve 1,85,000		
	Add: Balance of Myth Ltd. 25,000	2,10,000	
	Amalgamation Adjustment Reserve	(25,000)	20,76,250
3.	Long Term Borrowings		
	12% Debentures issued to Myth Ltd.		1,75,000
4.	Trade payables		
	Trade payables	90,000	
	Add: Taken over	1,42,000	2,32,000
5	Other Current Liabilities		
	Truth Ltd.	50,000	
	Myth Ltd.	40,000	90,000

6.	Property, Plant & Equipment		
	Truth Ltd.	15,75,000	
	Myth Ltd.	6,80,000	22,55,000
7.	Investment		2,87,500
	Truth Ltd.	1,87,500	
	Myth Ltd.	1,00,000	

Working Notes:

(1) Valuation of Goodwill

(i) Capital Employed

	Truth Ltd.		Myth Ltd.	
	₹	₹	₹	₹
Assets as per Balance Sheet		22,75,000		11,45,000
Less: Non-trade Investment		(1,50,000)		(80,000)
		21,25,000		10,65,000
Less: Liabilities:				
14% Debentures	-		1,50,000	
Trade payables	90,000		1,42,000	
Other current liabilities	50,000	(1,40,000)	40,000	(3,32,000)
Capital Employed		19,85,000		7,33,000

(ii) Average Profit before Tax

	Truth Ltd.		Myth Ltd.	
2018-2019		8,20,000		2,55,000
2019-2020		7,45,000		2,15,000
2020- 2021		6,04,000		2,14,000
Total profit of 3 years (a)		21,69,000		6,84,000
Simple Average [(a)/3]		7,23,000		2,28,000
Less: Non-trading income*		(30,000)		(12,000)
(iii) Goodwill		6,93,000		2,16,000
Capitalized value of average profit	[(6,93,000 / 18) x 100]	38,50,000	[(2,16,000 / 18) x 100]	12,00,000
Less: Capital Employed [From (i) above]		(19,85,000)		(7,33,000)
Goodwill		18,65,000		4,67,000

* For Truth Ltd. = 1,87,500 x 80% x 20% = 30,000; and

Myth Ltd. = 1,00,000 x 80% x 15% = 12,000

(2) Intrinsic Value per Share

	Truth Ltd.		Myth Ltd.	
		₹		₹
Goodwill [W.N. 1]	18,65,000		4,67,000	
Other Assets	22,75,000	41,40,000	11,45,000	16,12,000
Less: Liabilities				
12% Debentures	-		1,75,000**	
Trade payables	90,000		1,42,000	
Provision for Tax	50,000	(1,40,000)	40,000	(3,57,000)
Net Assets		40,00,000		12,55,000

Intrinsic value per share [Net Assets / No. of Shares]		40,00,000 / 1,00,000		12,55,000 / 40,000
		= ₹ 40		= ₹ 31.375

** $1,50,000 \times \frac{14\%}{12\%} = 1,75,000$

(3) Purchase Consideration & manner of its discharge

Intrinsic Value of Myth Ltd. [a]	₹ 31.375 per share
No. of shares [b]	40,000 shares
Purchase Consideration c= [a x b]	₹ 12,55,000
Intrinsic Value of Truth Ltd. [d]	₹ 40 per share
No. of shares to be issued [c / d]	31,375 shares

Question 16

The summarized Balance Sheets of Black Limited and White Limited as on 31st March, 2020 is as follows:

Particulars	Notes	Black Limited (₹ In 000)	White Limited (₹ In 000)
Equity and Liabilities			
Shareholders' Funds			
(a) Share Capital	1	6,000	3,600
(b) Reserves and Surplus	2	1,080	660
Current Liabilities			
Trade payables		600	360
Total		7,680	4,620
Assets			
Non-current assets			
Property, Plant and Equipment		3,600	2,400
Current assets			
(a) Inventories		960	720
(b) Trade receivables		1,680	1,080
(c) Cash and Cash Equivalents		1,440	420
Total		7,680	4,620

Note No.	**Particulars**	**Black Limited (₹ in 000)**	**White Limited (₹ in 000)**
1.	Share Capital Equity Shares of ₹ 100 each	6,000	3,600
	Reserves and Surplus		
2.	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

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

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

Estimated profit of Black Limited during these 3 months was ₹ 4,80,000 after charging proportionate deprecation @ 10% p.a. on Property Plant and Equipment

Both the companies have declared and paid 10% dividend within this 3 months' period.

Goodwill of White Limited is valued at ₹ 2,40,000 and Property Plant and Equipment are valued at ₹ 1,20,000 above the depreciated book value on the date of takeover.

Purchase consideration is to be satisfied by Black Limited by issuing shares at par. Ignore income tax.

You are required to:

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

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

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

(iv) Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover. (PYP 10 Marks July 21)

Answer 16

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

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

(ii) Calculation of Net Current Assets as on 01.07.2020

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

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

	₹
P & L A/c balance as on 31.03.2020	7,20,000
Less: Dividend paid	(6,00,000)
	1,20,000
Add: Estimated profit for 3 months after charging depreciation	4,80,000
	6,00,000

(iv) Property, plant and equipment as on 01.07.2020

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

Question 17

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigate competition, a new company Glorious Ltd, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. The summarized Balance Sheet of Galaxy Ltd. and Glory Ltd. as at 31st March, 2020 are as follows:

			Galaxy Ltd.	Glory Ltd.
			₹	₹
(I)	**Equity & Liabilities** **(1) Shareholders' fund**			
	Share Capital Equity shares of ₹ 10 each		8,40,000	4,55,000
	Reserves & Surplus			
	General Reserve		4,48,000	40,000
	Profit & Loss A/c		1,12,000	72,000
	(1) Non-current Liabilities Secured Loan			
	6% Debentures		-	3,30,000
	(1) Current Liabilities Trade Payables		4,20,000	1,83,000
		Total	18,20,000	10,80,000

(II) Assets (1) Non-current assets Property, Plant & Equipment			
Freehold property, at cost		5,88,000	3,36,000
Plant & Machinery, at cost less depreciation		1,40,000	84,000
Motor vehicles, at cost less depreciation		56,000	-
(2) Current Assets			
Inventories		3,36,000	4,38,000
Trade Receivables		4,62,000	1,18,000
Cash at Bank		2,38,000	1,04,000
	Total	18,20,000	10,80,000

Assets and Liabilities are to be taken at book value, with the following exceptions:

(i) The Debentures of Glory Ltd. are to be discharged, by the issue of 8% Debentures of Glorious Ltd. at a premium of 10%.

(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. and Glory Ltd, assuming the nominal value of each share in Glorious Ltd. is ₹ 10.

(2) Prepare Balance Sheet of Glorious Ltd., as on 1st April, 2020 and also prepare notes to the accounts as per Schedule III of the Companies Act, 2013. (PYP 20 Marks , Jan 21)

Answer 17

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

	Galaxy Ltd.	**Glory Ltd.**
Purchase Consideration:	₹	₹
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36,000
Plant and Machinery	2,52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000

Less: Liabilities:		
6% Debentures (3,00,000 x 110%)	- (4,20,000)	(3,30,000)
Trade payables	19,60,000	
Net Assets taken over	1,96,000	7,20,000
To be satisfied by issue of shares of Glorious. Ltd. @ ₹ 10 each		72,000

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

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

Notes to accounts:

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

	Secured 8% 3,000 Debentures of ₹100 each		
4.	Property Plant and Equipment		
	Freehold property		
	Galaxy Ltd.	5,88,000	
	Glory Ltd.	3,36,000	9,24,000
	Plant and Machinery		
	Galaxy Ltd.	2,52,000	
	Glory Ltd.	84,000	3,36,000
	Motor vehicles - Galaxy Ltd.		56,000
			13,16,000
5	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	4,38,000	7,74,000
7	Cash and cash equivalents		
	Galaxy Ltd.	2,38,000	
	Glory Ltd.(As per working note)	24,000	2,62,000

Question 18

Dark Ltd. and Fair Ltd. were amalgamated on and from 1st April, 2021. A new company Bright Ltd. was formed to take over the business of the existing companies. The balance Sheets of Dark Ltd. and Fair Ltd. as at 31st March, 2021 are given below:

(₹ In Lakhs)

	Particulars	Note No.	Dark Ltd.	Fair Ltd.
1	**Equity and Liabilities**			
	(1) **Shareholders' Funds**			
	Share Capital	**1**	**1,650**	**1,425**
	Reserves and Surplus	**2**	**630**	**495**
	(2) **Non-Current Liabilities Long Term Borrowings:** **10% Debentures of 100 ₹ each**		**90**	**45**
	(3) **Current Liabilities Trade Payables**		**630**	**285**
	Total		**3,000**	**2,250**
II	**Assets**			
	(1) **Non Current Assets** (a) **Property, Plant and Equipment**		**1,350**	**975**

	(b) Non Current Investments		225	75
	(2) Current Assets			
	(a) Inventories		525	375
	(b) Trade Receivables		450	525
	(c) Cash and Cash Equivalents		450	300
	Total		3,000	2,250

Notes to Accounts

		Dark Ltd. (₹ in Lakh)	Fair Ltd. (₹ in Lakh)
1	Share Capital Equity Shares of ₹ 100 each 14% Preference Shares of ₹ 100 each	 1, 200 450 1,650	 1,125 300 1,425
2	Reserves and Surplus		
	Revaluation Reserve	225	150
	General Reserve	255	225
	Investment Allowance Reserve	75	75
	Profit and Loss Account	75	45
		630	495

Additional Information:

(i) Bright Limited will issue 5 equity shares for each equity share of Dark Limited and 4 equity shares for each equity share of Fair Limited. The shares are to be issued @ ₹ 35 each having a face value of ₹ 10 per share.

(ii) Preference shareholders of the two companies are issued equivalent number of 16% preference shares of Bright Limited at a price of ₹ 160 per share (face value ₹ 100).

(iii) 10% Debenture holders of Dark Limited and Fair Limited are discharged by Bright Limited, issuing such number of its 16% Debentures of ₹ 100 each so as to maintain the interest.

(iv) Investment allowance reserve is to be maintained for 4 more years.

(v) Liquidation expenses are for Dark Limited ₹ 6,00,000 and for Fair Limited ₹ 3,00,000. It is decided that these expenses would be borne by Bright Limited.

(vi) All the assets and liabilities of Dark Limited and Fair Limited are taken over at book value.

(vii) Authorized equity share capital of Bright Limited is ₹ 15,00,00,000 divided into equity share of ₹ 10 each. After issuing required number of shares to the liquidators of Dark Limited and Fair Limited, Bright Limited issued balance shares to public. The issue was fully subscribed.

You are required to prepare Balance Sheet of Bright Limited as at 1st April, 2021 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase (PYP 15 Marks Dec'21) (Same concept different figures PYP 15 Marks Nov'20)(MTP 15 Marks Sep '23)

Answer 18

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

Particulars	Note No.	(₹ in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,250
(b) Reserves and Surplus	2	4,200
(2) Non-Current Liabilities		

Long-term borrowings	3	84.375
(3) Current Liabilities		
Trade payables	4	915
Total		7449.375
II. Assets		
(1) Non-current assets		
(a) i. Property, plant and equipment	5	2,325
ii. Intangible assets	6	633.375
(b) Non-current investments	7	300
(2) Current assets		
(a) Inventories	8	900
(b) Trade receivables	9	975
(c) Cash and cash equivalents	10	2316
Total		7449.375

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	Authorized Share Capital		
	1,50,00,000 Equity shares of ₹10 each	1500	
	7,50,000 16% Preference Share of 100 each	750	
	Issued: 1,50,00,000 Equity shares of ₹ 10 each (Out of which 1,05,00,000 Shares were Issued for consideration other than cash)	1500	
	7,50,000 16% Preference Shares of 100 each (Issued for consideration other than cash)	750	2,250
2.	Reserves and surplus		
	Securities Premium Account (1,50,00,000 shares ×₹ 25) 3750		
	(7,50,000 shares × ₹ 60) 450	4,200	
	Investment Allowance Reserve	150	
	Amalgamation Adjustment Reserve	(150)	4,200
3.	Long-term borrowings		
	16% Debentures (56,25,000+28,12,500) (W.N. 3)		84.375
4.	Trade payables		
	Dark Ltd.	630	
	Fair Ltd.	285	915
5.	Property, plant & equipment		
	Land and Building	1350	
	Plant and Machinery	975	2,325
6.	Intangible assets		
	Goodwill [W.N. 2] 624.375		
	Add: liquidation exp. (6+3) 9.00		633.375
7.	Non-current Investments		
	Investments (225+75)		300

8.	Inventories		
	Dark Ltd.	525	
	Fair Ltd.	375	900
9	Trade receivables		
	Dark Ltd.	450	
	Fair Ltd.	525	975
10	Cash & cash equivalents		
	Dark Ltd.	450	
	Fair Ltd.	300	
	Liquidation Expenses (6+3)	(9)	
	Shares issued for cash (45 lakh shares x ₹35)	1575	2316

Working Notes:

		(₹ in lakhs)		
		Dark Ltd.		Fair Ltd.
(1)	Computation of Purchase consideration (a) Preference shareholders: $\left(\frac{4,50,00,000}{100}\right)$			
	i.e. 4,50,000 shares × ₹ 160 each $\left(\frac{3,00,00,000}{100}\right)$	720		
	i.e. 3,00,000 shares × ₹ 160 each			480
	(b) Equity shareholders: $\left(\frac{12,00,00,000X\ 5}{100}\right)$	2,100		
	i.e. 60,00,000 shares x ₹ 35 each $\left(\frac{11,25,00,000X4}{100}\right)$ i.e. 45,00,000 shares × ₹ 35 each			
	Amount of Purchase Consideration Net	2,820		1,575
	Assets Taken Over			2,055
(2)	Assets taken over: Property Plant & Equity	1,350		975
	Non-Current Investments	225		75
	Inventory	525		375
	Trade receivables	450		525
	Cash and bank	450		300
		3,000		2,250
	Less: Liabilities taken over:			
	10% Debentures 56.25		28.125	

	Trade payables	630	(686.25)	285	(313.125)
	Net assets taken over		2,313.75		1936.875
	Purchase consideration		2,820		2055.00
	Goodwill		506.25		118.125
	Total goodwill				624.375

(3) Issue of Debentures

Debentures	₹ 90,00,000	₹ 45,00,000
Interest 10%	₹ 9,00,000	₹ 4,50,000
	$\left(\frac{9{,}00{,}000 \times 100}{16}\right) = 56{,}25{,}000$	$\left(\frac{4{,}50{,}000 \times 100}{16}\right) = 28{,}12{,}500$

NOTE: In the above solution ₹ 35 has been considered as the issue price of Equity shares for public issue also. Alternative considering this as ₹ 10 also possible. In that case, the balance of cash and cash equivalents will be ₹ 1,191 lakhs and securities premium will be ₹ 3,075 lakhs in place of the balances given in the balance sheet in the above solution.

Question 19

The summarized Balance Sheet of A Ltd. and B Ltd. as at 31st March,2022 are as under:

	A Ltd. (in ₹)	B Ltd. (in ₹)
Equity shares of ₹10 each, fully paid up	30,00,000	24,00,000
Securities Premium Account	4,00,000	
General Reserve	6,20,000	5,00,000
Profit and Loss Account	3,60,000	3,20,000
Retirement Gratuity Fund Account	1,00,000	
10% Debentures	20,00,000	
Unsecured Loan (including loan from A Ltd.)	6,00,000	8,20,000
Trade Payables	1,00,000	3,40,000
	71,80,000	43,80,000
Land and Buildings	28,00,000	21,00,000
Plant and Machinery	20,00,000	7,60,000
Long term advance to B Ltd.	2,20,000	7,00,000
Inventories	10,40,000	5,20,000
Trade Receivables	8,20,000	3,00,000
Cash and Bank	3,00,000	
	71,80,000	43,80,000

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B Ltd. is to declare and pay ₹ 1 per equity share as dividend, before the following amalgamation takes place with Z Ltd.

Z Ltd. was incorporated to take over the business of both A Ltd. and B Ltd.

(a) **The authorized share capital of Z Ltd. is ₹ 60 lakhs divided into ₹ 6 lakhs equity shares of ₹ 10 each.**

(b) **As per Registered Valuer the value of equity shares of A Ltd. is ₹ 18 per share and of B Ltd. is ₹ 12 per share respectively and agreed by respective shareholders of the companies.**

(c) **10% Debentures of A Ltd. to be issued 12% Debentures of Z Ltd. at par in consideration of their holdings.**

(d) **A contingent liability of A Ltd. of ₹ 2,00,000 is to be treated as actual liability.**

(e) **Liquidation expenses including Registered Valuer fees of A Ltd.₹ 50,000 and B Ltd.₹ 30,000 respectively to be borne by Z Ltd.**

(f) **The shareholders of A Ltd. and B Ltd. is to be paid by issuing sufficient number of fully paid up**

equity shares of ₹ 10 each at a premium of ₹ 10 per share.

Assuming amalgamation in the nature of purchase, you are required to pass the necessary journal entries (narrations not required) in the books of Z Ltd. and Prepare Balance Sheet of Z Ltd. immediately after amalgamation of both the companies.(PYP 20 Marks May'22)

Answer 19

Journal Entries in the books of Z Ltd.

		₹	₹
Business Purchase A/c	Dr.	54,00,000	
To Liquidator of A Ltd. A/c			54,00,000
Land & Building A/c	Dr.	28,00,000	
Plant & Machinery A/c	Dr.	20,00,000	
Long term advance to B Ltd. A/c	Dr.	2,20,000	
Inventories A/c	Dr.	10,40,000	
Trade Receivables A/c	Dr.	8,20,000	
Cash and Bank A/c	Dr.	3,00,000	
Goodwill A/c	Dr.	12,20,000	
To Retirement Gratuity Fund A/c			1,00,000
To 10% Debentures A/c			20,00,000
To Unsecured Loan A/c			6,00,000
To Trade Payables A/c			1,00,000
To Other liabilities A/c			2,00,000
To Business Purchase A/c			54,00,000
10% Debentures A/c	Dr.	20,00,000	
To 12% Debentures A/c			20,00,000
Liquidator of A Ltd. A/c	Dr.	54,00,000	
To Equity Share Capital A/c			27,00,000
To Securities Premium A/c			27,00,000
Business Purchase A/c	Dr.	28,80,000	
To Liquidator of B Ltd. A/c			28,80,000
Land and Building A/c	Dr.	21,00,000	
Plant & Machinery A/c	Dr.	7,60,000	
Inventories A/c	Dr.	7,00,000	
Trade Receivables A/c	Dr.	5,20,000	
Cash and Bank (less dividend) A/c	Dr.	60,000	
To Unsecured Loan A/c			8,20,000
To Trade Payables A/c			3,40,000
To Business Purchase A/c			28,80,000
To Capital Reserve A/c			1,00,000
Liquidators of B Ltd. A/c	Dr.	28,80,000	
To Equity Share Capital A/c			14,40,000
To Securities Premium A/c			14,40,000
Unsecured Loans A/c	Dr.	2,20,000	
To Long term Advance to B Ltd. A/c			2,20,000
*Capital Reserve A/c	Dr.	1,00,000	
To Cash and Bank A/c (Liquidation expenses)			80,000

To Goodwill A/c			20,000

Note:

1. The journal entries for A Ltd. and B Ltd. have been given separately in the above solution. Alternatively, the entries may be given as combined for both companies.
2. Alternatively, following set of entries may be given in place of the last entry given in the above solution:

Goodwill A/c	Dr.	50,000	
To Cash & Bank A/c (Liquidation expenses of A Ltd.)			50,000
Capital Reserve A/c	Dr.	30,000	
To Cash and Bank A/c (Liquidation expenses of B Ltd.)			30,000
Capital Reserve A/c	Dr.	70,000	
To Goodwill A/c			70,000

Balance Sheet of Z Ltd. as at 31st March, 2022

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	41,40,000
(b) Reserves and Surplus	2	41,40,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	20,00,000
(b) Long term provisions	4	1,00,000
(3) Current Liabilities		
(a) Short-term borrowings1	5	12,00,000
(b) Trade payables	6	4,40,000
(a) Other liability		2,00,000
Total		1,22,20,000
II. Assets		
(1) Non-current assets		
(a) i. Property, plant and equipment	7	76,60,000
ii. Intangible assets (Goodwill 12,20,000-20,000)		12,00,000
(2) Current assets		
(a) Inventories	8	17,40,000
(b) Trade receivables	9	13,40,000
(c) Cash and cash equivalents	10	2,80,000
Total		1,22,20,000
ii. Intangible assets (Goodwill 12,20,000-20,000)		12,00,000
(2) Current assets		
(a) Inventories	8	17,40,000
(b) Trade receivables	9	13,40,000

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(c) Cash and cash equivalents	10	2,80,000
Total		1,22,20,000

[1] Unsecured loans have been considered as short-term borrowings. Alternatively, it may be considered as long-term borrowings and presented accordingly

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	Authorized Share Capital		
	6,00,000 Equity shares of ₹ 10 each		60,00,000
	Issued: 4,14,000 Equity shares of ₹ 10 each (all these shares were Issued for consideration other than cash)		41,40,000
2.	Reserves and surplus		
	Securities Premium Account (4,14,000 shares × ₹ 10)		41,40,000
3.	Long-term borrowings		
	12% Debentures		20,00,000
4	Long term Provisions		
	Retirement gratuity fund		1,00,000
5.	Short-term borrowings		
	Unsecured loans		
	A Ltd. 6,00,000		
	B Ltd. 8,20,000	14,20,000	
	Less: Mutual	(2,20,000)	12,00,000
6.	Trade payables		
	A Ltd.	1,00,000	
	B Ltd.	3,40,000	4,40,000
7.	Property, plant & equipment		
	Land and Building		
	A Ltd.	28,00,000	
	B Ltd.	21,00,000	49,00,000
	Plant and Machinery		
	A Ltd.	20,00,000	
	B Ltd.	7,60,000	27,60,000
8.	Inventories		76,60,000
	A Ltd.	10,40,000	
	B Ltd.	7,00,000	17,40,000
9	Trade receivables		
	A Ltd.	8,20,000	
	B Ltd.	5,20,000	13,40,000
10	Cash & cash equivalents		
	A Ltd.	3,00,000	
	B Ltd. [3,00,000-2,40,000(dividend)]	60,000	
		3,60,000	

	Less: Liquidation Expenses	(80,000)	2,80,000

Working Note:

Calculation of amount of Purchase Consideration

	A Ltd.	B Ltd.
Existing shares	3,00,000	2,40,000
Agreed value per share	₹ 18	₹ 12
Purchase consideration	54,00,000	28,80,000
No. of shares to be issued of ₹ 20 each (including ₹ 10 premium)	2,70,000	1,44,000
Face value of shares at ₹ 10	27,00,000	14,40,000
Premium of shares at ₹ 10	27,00,000	14,40,000

Question 20

What are the conditions, which, according to AS 14 on Accounting forAmalgamations, must be satisfied for an amalgamation in the nature of merger? (Old & New SM, MTP 4 Marks Apr'21, Mar'22, Old & New SM, PYP 5 Marks Jan 21)

Answer 20

Amalgamation in the nature of merger is an amalgamation where there is a genuine pooling not only of assets and liabilities of the transferor and transferee companies but also of the shareholders' interests and of the businesses of thecompanies. The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the respective figures of the transferor and transferee companies.

Amalgamation in the nature of merger is an amalgamation, as per para 3(e) of AS-14, which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity sharesof the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company,except that cash may be paid in respect of any fractional shares.

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

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformityof accounting policies. For example, if transferor company is following weighted average method for inventory valuation, the book value of the inventory of the transferor company will be revised by applying the FIFOmethod (if the transferee company follows FIFO method for inventory valuation).

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

Question 21

Distinguish between (i) the pooling of interest's method and (ii) the purchase method of recording transactions relating to amalgamation. (Old & New SM, MTP 4 Marks Oct 20, Oct'21)

Answer 21

Pooling of Interest Method

Under pooling of interest's method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policiesfollowed by these companies. As a result, the difference between the amount recorded as share capital issued(plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in the reservesof the financial statements of Transferee company (recorded as deduction from the reserves where the capital issued is more than the capital of the transferor company).

In simple terms, where in case of pooling method- the amount to be adjustedagainst the reserves- can be computed in the following 3 steps-

Step I- Equity Share capital + Preference share capital issued+ any other additionalconsideration in form of cash and other assets by the Transferee Company.

Step II- Existing Equity share capital + Existing Preference share capital in the booksof Transferor Company.

Step III- Step I- Step II= amount to be adjusted from the reserves of Transfereecompany.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized as goodwill in the financial statement of the transferee company. Any short fall should be shown as capital reserve. Goodwill should be amortized over period of five years unless a somewhat longer period can be justified.

In simple terms, where in case of purchase method- the amount to be transferredto capital reserve or to be recorded as Goodwill- can be computed in the following 3 steps-

Step I- Find out the **Net assets** amount using the following formula- Total assets- Outside liabilities (Non-current liabilities + Current Liabilities)

Step II- Compute the purchase consideration using any of the methods as given under Purchase consideration computation.

Step III- (a) If Step I- Step II= Positive amount- then it is capital reserve- since the assets received more than the amount paid as purchase consideration to acquire them.

(b) If Step I- Step II= Negative amount- then it is to be recorded as Goodwill (intangible asset) - since the amount paid for acquiring business is more than the Net assets, which is technically due to its goodwill.

Question 22

On 1st April, 2021, Bimal Ltd. take over the business of Vimal Ltd. and discharged purchase consideration as follows:

(a) Issued 50,000 fully paid Equity shares of Rs. 10 each at a premium of Rs. 5 per share to the equity shareholders of Vimal Ltd.

(b) Cash payment of Rs. 50,000 was made to equity shareholders of Vimal Ltd.

(c) Issued 2,000 fully paid 12% Preference shares of Rs. 100 each at par to discharge the preference shareholders of Vimal Ltd.

(d) Debentures of Vimal Ltd. (Rs.1,20,000) will be converted into equal number and amount of 10% debentures of Bimal Ltd.

Calculate the amount of Purchase consideration as per AS 14 and pass Journal Entry relating to discharge of purchase consideration in the books of Bimal Ltd. (MTP 5 Marks April 21, PYP 5 Marks Nov '18)

Answer 22

Particulars	Rs.
Equity Shares (50,000 x 15)	7,50,000
Cash payment	50,000

12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Journal entry relating to discharge of consideration in the books of Bimal Ltd.

Liquidation of Vimal Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Discharge of purchase consideration)		

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Few examinees were not able to compute correct amount of purchase consideration as per AS 14 "Accounting for Amalgamation of Companies" and failed to pass journal entry relating to discharge of purchase consideration.

Question 23

Moon Limited is absorbed by Sun Limited; the consideration, being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9000); the payment of 9% Debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value; the payment of ₹ 18 per share in cash; allotment of two 11% preference shares of ₹ 10/- each and one equity share of ₹ 10/- each at a premium of 30% fully paid for every three shares in Moon Limited respectively. The number of shares of the vendor company is 1,50,000 of ₹ 10/- each fully paid. Calculate purchase consideration as per AS-14. (PYP 5 Marks Dec '21) (Same concept different figures RTP May'21)

Answer 23

As per AS 14 "Accounting for Amalgamations", the term consideration has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Purchase consideration will be:		
	₹	Form
Equity shareholders: 1,50,000 × ₹ 18	27,00,000	Cash
1,50,000 × 2/3 × ₹ 10	10,00,000	11% Pref. shares
1,50,000 × 1/3 × ₹ 13	6,50,000	Equity shares
	43,50,000	
Note:		

1. According to AS 14, 'consideration' excludes the any amount payable to debenture- holders. The liability in respect of debentures of vendor company will be taken by transferee company, which will then be settled by issuing new debentures.
2. Liquidation expenses will also not form part of purchase consideration.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This part of the question required calculation of purchase consideration. Few examinees wrongly included amount payable to debenture-holders and cost of absorption expenses as part of purchase consideration.

Question 24

Star Limited agreed to take over Moon Limited on 1st April,2022. The terms and conditions of takeover were as follows:

(i) Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Moon Limited.

(ii) Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.

(iii) 25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Moon Limited.

You are required:

(i) to give the meaning of "consideration for the amalgamation' as per AS-14, and
(ii) Calculate the amount of purchase consideration. (PYP 5 Marks Nov 22) (Same concept different figures MTP 5 Marks March '23, RTP Nov '20)

Answer 24

Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase consideration	**(₹)**	**Form**
For Preference Shareholders of Moon Ltd. (25,000 × ₹ 70)	17,50,000	25,000 Preference
For equity shareholders of Moon Ltd. (70,000 × ₹ 110)	77,00,000	70,000 Equity shares of Star Ltd.
	1,25,000	Cash
Total Purchase consideration	95,75,000	

Question 25

The following information from Balance Sheet of X Ltd. as at 31st March, 2023:

	₹
4,000 Equity shares of ₹ 100 each	**4,00,000**
10% Debentures	**2,00,000**
Loans	**80,000**
Trade payables	**1,60,000**
General Reserve	**40,000**
Building	**1,70,000**
Machinery	**3,20,000**
Inventory	**1,10,000**
Trade receivables	**1,30,000**
Bank	**68,000**
Patent	**65,000**
Share issue Expenses	**17,000**

Y Ltd. agreed to absorb X Ltd. on the following terms and conditions:

(1) Y 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) Y Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹ 3,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 62,200. The liquidation expenses amounted to ₹ 8,000. Y Ltd. sold prior to 31st March, 2023 goods costing ₹ 60,000 to X Ltd. for ₹ 80,000. ₹ 50,000 worth of goods are still in Inventory of X Ltd. on 31st March, 2023. Trade payables of X Ltd. include ₹ 20,000 still due to Y Ltd.

Show the necessary Ledger Accounts to close the books of X Ltd. and prepare the Balance Sheet of Y Ltd. as at 1st April, 2023 after the takeover.(Nov '23)

Answer 25

Books of X Limited Realization Account

	₹		₹
To Building	1,70,000	By Trade payables	1,60,000
To Machinery	3,20,000	By Y Ltd.	6,05,000
To Inventory	1,10,000	By Equity Shareholders (Loss)	38,000
To Trade receivables	1,30,000		
To Patent	65,000		
To Bank (Exp.)	8,000		
	8,03,000		8,03,000

Bank Account

To Balance b/d	68,000	By Realization (Exp.)	8,000
To Y Ltd.	3,00,000	By 10% Debentures	2,00,000
		By Loan	80,000
		By Equity shareholders	80,000
	3,68,000		3,68,000

10% Debentures Account

To Bank	2,00,000	By Balance b/d	2,00,000
	2,00,000		2,00,000

Loan Account

To Bank	80,000	By Balance b/d	80,000
	80,000		80,000

Share Issue Expenses Account

To Balance b/d	17,000	By Equity shareholders	17,000
	17,000		17,000

General Reserve Account

To Equity shareholders	40,000	By Balance b/d	40,000
	40,000		40,000

Y Ltd. Account

To Realization A/c	6,05,000	By Bank	3,00,000
		By Equity share in Y Ltd. (2,440 shares at ₹ 125 each)	3,05,000
	6,05,000		6,05,000

Equity Shares in Y Ltd. Account

To Y Ltd.	3,05,000	By Equity shareholders	3,05,000

	3,05,000		3,05,000

Equity Share Holders Account

To Realization	38,000	By Equity share capital	4,00,000
To Share issue Expenses	17,000	By General reserve	40,000
To Equity shares in B Ltd.	3,05,000		
To Bank	80,000		
			4,40,000

Y Ltd

Balance Sheet as on 1st April, 2023 (An extract) *

	Particulars	Notes	₹
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	2,44,000
b	Reserves and Surplus	2	53,500
2	Current liabilities		
a	Trade Payables	3	1,40,000
b	Bank overdraft		3,00,000
	Total		7,37,500
	Assets		
1	Non-current assets		
a	Property, Plant and Equipment	4	4,41,000
	Intangible assets	5	1,08,000
2	Current assets		
a	Inventories	6	91,500
b	Trade receivables	7	97,000
			7,37,500

Notes to Accounts

			₹
1	Share Capital		
	Equity share capital		
	2,440 Equity shares of ₹ 100 each (Shares have been issued for consideration other than cash)		2,44,000
	Total		2,44,000
2	Reserves and Surplus (an extract)		
	Securities Premium		61,000
	Profit and loss account	.....	
	Less: Unrealised profit	(7,500)	(7,500)
	Total		53,500
3	Trade payables		
	Opening balance	1,60,000	
	Less: Inter-company transaction cancelled upon amalgamation	(20,000)	1,40,000
4	Property, Plant and Equipments		

	Buildings		1,53,000
	Machinery		2,88,000
	Total		4,41,000
5	Intangible assets		
	Goodwill		1,08,000
6	Inventories		
	Opening balance	99,000	
	Less: Cancellation of profit upon amalgamation	(7,500)	91,500
7	Trade receivables		
	Opening balance	1,17,000	
	Less: Intercompany transaction cancelled upon amalgamation	(20,000)	97,000

Working Notes:

1.	Valuation of Goodwill	₹
	Average profit	62,200
	Less: 8% of ₹ 4,40,000	(35,200)
	Super profit	27,000
	Value of Goodwill = 27,000 x 4	1,08,000
2.	Net Assets for purchase consideration	
	Goodwill as valued in W.N.1	1,08,000
	Building	1,53,000
	Machinery	2,88,000
	Inventory	99,000
	Trade receivables (1,30,000-13,000)	1,17,000
	Total Assets	7,65,000
	Less: Trade payables	(1,60,000)
	Net Assets	6,05,000
	Out of this ₹ 3,00,000 is to be paid in cash and remaining i.e., (6,05,000 – 3,00,000) ₹ 3,05,000 in shares of ₹ 125. Thus, the number of shares to be allotted 3,05,000/125 = 2,440 shares.	
3.	Unrealised Profit on Inventory	₹
	The Inventory of X Ltd. includes goods worth ₹ 50,000 which was sold by Y Ltd. on profit. Unrealized profit on this Inventory will be [20,000/80,000 x 50,000]	12,500
	As Y Ltd purchased assets of X Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 50,000.	(5,000)
	Amount of unrealized profit	7,500

*In the absence of the particulars of assets and liabilities (other than those of X Ltd.), the complete Balance Sheet of Y Ltd. after takeover cannot be prepared.

Chapter 14
Accounting for Reconstruction of Companies

Question 1

M/s Xylem Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital		Land & Building	42,70,000
50,000 shares of Rs. 50		Machinery	8,50,000
each fully paid up	25,00,000	Computers	5,20,000
1,00,000 shares of Rs. 50		Inventories	3,20,000
each Rs. 40 paid up	40,00,000	Trade receivables	10,90,000
Capital Reserve	5,00,000	Cash at Bank	2,68,000
8% Debentures of Rs. 100 each	4,00,000	Profit & Loss Account	29,82,000
12% Debentures of Rs. 100 each	6,00,000		
Trade payables	12,40,000		
Outstanding Expenses	10,60,000		
	1,03,00,000		1,03,00,000

Following is the interest of Mr. A and Mr. B in M/s Xylem Limited:

	Mr. A	Mr. B
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	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 Rs. 40 each.

(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for Rs. 12,50,000.

(3) Trade payables are given option of either to accept fully paid equity shares of Rs. 40 each for theamount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade payables for Rs. 7,50,000 accept equity shares and rest of them opted for cashtowards full and final settlement of their claim.

(4) Mr. A agrees to cancel debentures amounting to Rs. 2,00,000 out of total debentures due to himand agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to Rs. 1,00,000.

(5) Mr. B agrees to cancel debentures amounting to Rs. 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

(6) Land & Building to be revalued at Rs. 51,84,000, Machinery at Rs. 7,20,000, Computers at Rs. 4,00,000, Inventories at Rs. 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.

(7) Outstanding Expenses are fully paid in cash.

(8) 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.

(b) A Liquidator is entitled to receive remuneration at 2% on the assets realized, 3% on the amount distributed to Preferential Creditors and 3% on the payment made to Unsecured Creditors. The assets were realized for Rs. 25,00,000 against which payment was made as follows:

Liquidation expenses	Rs. 25,000
Secured Creditors	Rs. 10,00,000
Preferential Creditors	Rs. 75,000

The amount due to Unsecured Creditors was Rs. 15,00,000. You are asked to calculate the total Remuneration payable to Liquidator. Calculation shall be made to the nearest multiple of a rupee. (MTP October 2019 15 Marks, RTP May 18, RTP Nov'19)

Answer 1

Journal Entries

		Rs.	Rs.
Bank A/c	Dr	10,00,000	
To Equity share capital A/c (Being money on final call received)			10,00,000
Equity share capital (Rs. 50) A/c	Dr	75,00,000	
To Equity share capital (Rs. 40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of Rs. 50 each into Rs. 40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at Rs. 40 each)			
Trade payables A/c	Dr.	12,40,000	
To Equity share capital A/c			7,50,000
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to trade payables in shares or cash to			
the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To A A/c			7,00,000
(Being cancellation of 8% and 12% debentures of A)			
A A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance			
Transferred to capital reduction account as			
per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To A A/c			1,00,000
(Being new debentures subscribed by A)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c Dr.		2,00,000	
To B A/c			3,00,000
(Being cancellation of 8% and 12% debentures of B)			
B A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and balance			
Transferred to capital reduction account as			
per reconstruction scheme)			
Land and Building	Dr		
.(51,84,000 – 42,70,000)		9,14,000	
Inventories Dr.		30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000

(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Profit and Loss A/c			29,82,000
(Being amount of Capital Reduction utilized in writing			
off P & L A/c (Dr.) balance and downfall in value of other assets)			
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 of Xylem Ltd. (as reduced) as on 31.3.2019

Particulars		Notes	Rs.
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	80,00,000
2	**Non-current liabilities**		
a	Long-term borrowings	2	8,50,000
	Total		**88,50,000**
	Assets	3	
1	**Non-current assets**		
a	**Property, Plant and Equipment**		
	Tangible assets		**63,04,000**
2	**Current assets**		
a	**Inventories**		**3,50,000**
b	**Trade receivables**		**9,81,000**
c	**Cash and cash equivalents**		**12,15,000**
	Total		**88,50,000**

Notes to accounts

			Rs.
1.	**Share Capital**		
	2,00,000 Equity shares of Rs. 40		80,00,000
2.	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3.	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. Cash at Bank Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2,68,000	By Trade payables A/c	3,43,000
To Equity Share capital A/c	10,00,000	By Outstanding expenses, A/c	10,60,000
To Equity Share Capital A/c	12,50,000	By Balance c/d (bal. fig.)	12,15,000
To A A/c	1,00,000		
	26,18,000		26,18,000

2. Capital Reduction Account

Particulars	Rs.	Particulars	Rs.
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 payables A/c	1,47,000
To Trade receivables A/c	1,09,000	By A A/c	2,00,000
To Profit and Loss A/c	29,82,000	By B A/c	50,000
By Land & Building	9,14,000		
By Inventories	30,000		
		By Capital Reserve A/c	5,00,000
	33,41,000		**33,41,000**

(b) Calculation of Total Remuneration payable to Liquidator

Amount in Rs.

2% on Assets realised	25,00,000 x 2%	50,000
3% on payment made to Preferential creditors	75,000 x 3%	2,250
3% on payment made to Unsecured creditors (Refer W.N)		39,255
Total Remuneration payable to Liquidator		91,505

Working Note:

Liquidator's remuneration on payment to unsecured creditors = Cash available for unsecured creditors after all payments including liquidation expenses, payment to secured creditors, preferential creditors & liquidator's remuneration

= Rs. 25,00,000 – Rs. 25,000 – Rs. 10,00,000 – Rs. 75,000 – Rs. 50,000 – Rs. 2,250 = Rs. 13,47,750.

Liquidator's remuneration on payment to unsecured creditors = 3/103 x Rs. 13,47,750 = Rs. 39,255.

Question 2

The shareholders of Lili Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2017 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Lili Ltd.

Summarized Balance Sheet of Lili Ltd. as on 31.3.2017

Liabilities	Rs.	Assets	Rs.
Share Capital		**Property, Plant & Equipment**	
30,000 Equity shares of Rs. 10 each	**3,00,000**	**Trademarks and Patents**	**1,10,000**
40,000 8% Cumulative Preference		**Goodwill at cost**	**36,100**
shares Rs. 10 each	**4,00,000**	**Freehold Land**	**1,20,000**
Reserves and Surplus		**Freehold Premises**	**2,44,000**
Securities Premium Account	**10,000**	**Plant and Equipment Investment**	**3,20,000**
Profit and Loss Account	**(1,38,400)**	**Investment (marked to market)**	**64,000**

Secured Borrowings		Current Assets	
9% Debentures (Rs. 100) 1,20,000		Inventories:	
Accrued Interest 5,400	1,25,400	Raw materials and packing materials 60,000	
Current liabilities Trade payables	1,20,000	Finished goods 16,000	76,000
Tax payable	50,000		
Temporary bank overdraft	2,23,100	Trade receivables	1,20,000
	10,90,100		10,90,100

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

(1) The authorized capital of the Company to be re-fixed at Rs. 10 lakhs (preference capital of Rs. 3 lakhs and equity capital of Rs. 7 lakhs). Both classes of shares are of Rs. 10 each.

(2) The preference shares are to be reduced to Rs. 5 each and equity shares reduced by Rs. 3 per share. Post reduction, both classes of shares to be re-consolidated into Rs. 10 shares.

(3) Trade Investments are to be liquidated in open market.

(4) One fresh equity shares of Rs.10 to be issued for every Rs.40 of preference dividends in arrears (ignore taxation).

(5) Expenses for the scheme were Rs. 10,000.

(6) The debenture holders took over freehold land at Rs. 2,10,000 and settled the balance after adjusting their dues.

(7) Unprovided contingent liabilities were settled at Rs. 54,000 and a pending insurance claim receivable settled at Rs. 12,500.

(8) The intangible assets were all to be written off along with Rs. 10,000 worth obsolete packing material and 10% of the receivables.

(9) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.

(10) The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.

(MTP 15 Marks Mar 19)

Answer 2

(i) In the books of Lili Ltd. Journal Entries

				Dr.	Cr.
	2017			Rs.	Rs.
1.	March 31	Equity Share Capital A/c (Rs.10)	Dr.	3,00,000	
		To Capital Reduction A/c			90,000
		To Equity Share Capital A/c (Rs.7)			2,10,000
		(Being reduction of equity shares of Rs.10 each to shares of Rs. 7 each as per Reconstruction Scheme dated...)			
2		8% Cum. Preference Share Capital A/c (Rs. 10)	Dr.	4,00,000	
		To Capital Reduction A/c			2,00,000
		To Preference Share Capital A/c (Rs. 5)			2,00,000
		(Being reduction of preference shares of Rs.10 each to shares of Rs.5 each as per reconstruction scheme)			

3.		Equity Share Capital A/c (30,000 x Rs.7)	Dr.	2,10,000	
		Preference Share Capital A/c (40,000 x Rs.5)	Dr.	2,00,000	
		To Equity Share Capital A/c (21,000 x Rs. 10)			2,10,000
		To Preference Share Capital A/c (20,000 x Rs.10) (Being post reduction, both classes of shares reconsolidated into Rs.10 each) s			2,00,000
4.		Cash Account	Dr.	64,000	
		To Trade Investments (Being trade investments liquidated in the open market)			64,000
5.		Capital Reduction Account	Dr.	32,000	
		To Equity Share Capital Account			32,000
		(Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of Rs.10 each)			
6.		Capital Reduction Account	Dr.	10,000	
		To Cash Account			10,000
		(Being expenses of reconstruction scheme paid in cash)			
7.		9% Debentures Account	Dr.	1,20,000	
		Accrued Interest Account	Dr.	5,400	
		To Debenture holders Account			1,25,400
		(Being amount due to debenture holders)			
8.		Debenture holders Account	Dr.	1,25,400	
		Cash Account (2,10,000 – 1,25,400)	Dr.	84,600	
		To Freehold Land			1,20,000
		To Capital Reduction Account (2,10,000 – 1,20,000)			90,000
		(Being Debenture holders took over freehold land at Rs.2,10,000 and settled the balance)			
9.		Capital Reduction Account	Dr.	54,000	
		To Cash Account			54,000
		(Being contingent liability of Rs.54,000 paid)			
10		Cash Account	Dr.	12,500	
		To Capital Reduction Account			12,500
		(Being pending insurance claim received)			
11		Capital Reduction Account	Dr.	1,68,100	
		To Trademarks and Patents			1,10,000
		To Goodwill			36,100
		To Raw materials & Packing materials			10,000
		To Trade receivables			12,000
		(Being intangible assets written off along with raw materials and packing materials worth Rs.10,000 and 10% of trade receivables)			
12		Cash Account	Dr.	1,26,000	
		To Equity Share Capital Account			1,26,000
		(Being 12,600 shares issued to existing shareholders)			

13		Bank Overdraft Account	Dr.	2,23,100	
		To Cash Account			2,23,100
		(Being cash balance utilized to pay off bank overdraft)			
14		Capital Reduction Account	Dr.	1,28,400	
		To Capital reserve Account			1,28,400
		(Being balance of capital reduction account transferred to capital reserve account)			

(ii) Capital Reduction Account

Particulars	Rs.	Particulars	Rs.
To Equity share capital	32,000	By Preference share capital	2,00,000
To Cash (contingent liability settled)	54,000	By Equity share capital	90,000
To Trademarks and Patents	1,10,000	By Freehold land	90,000
To Goodwill	36,100	By Cash	
To Raw material and		(insurance claim)	12,500
Packing materials	10,000		
To Trade receivables	12,000		
To Cash account	10,000		
To Capital reserve account	1,28,400		
	3,92,500		**3,92,500**

(iii) Cash Account

Particulars	Rs.	Particulars	Rs.
To Investment	64,000	By Capital reduction	
To 9% Debenture holders		(Contingent liability)	54,000
(2,10,000-1,25,400)	84,600	By Expenses	10,000
To Capital reduction (insurance claim)	12,500	By Temporary bank overdraft	
		- From available cash	
		(64,000+84,600+12,500	
		-54,000-10,000)	97,100
To Equity share capital 12,600		- From proceeds of equity	
shares @ Rs. 10 each	1,26,000	share capital	
		(2,23,100–97,100) 1,26,000	2,23,100
	2,87,100		**2,87,100**

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft = Rs. 2,23,100 – Rs. 97,100 = Rs. 1,26,000

Question 3

The Balance Sheet of Lion Limited as on 31-03-2018 is given below:

Particulars	Note No.	Amount (₹ in lakh)
Equity & Liabilities		
Shareholders' Funds		
Shares' Capital	**1**	**1,400**
Reserves & Surplus	**2**	**(522)**
Non-Current Liabilities		
Long term Borrowings	**3**	**700**
Current Liabilities		

Trade Payables	4	102
Other Liabilities	5	24
Total		1704
Assets		
Non-Current Assets		
Fixed Assets		
Tangible Assets	6	750
Current Assets		
Current Investments	7	200
Inventories	8	300
Trade Receivables	9	450
Cash & Cash Equivalents	10	4
Total		1704

Notes to Accounts:

		₹ in Lakhs
(1) Share Capital		
Authorised :		
200 lakh shares of ₹ 10 each		2,000
8 lakh, 8% Preference Shares of ₹ 100 each		800
		2,800
Issued, Subscribed and paid up:		
100 lakh Equity Shares of ₹ 10 each, full paid up		1,000
4 lakh 8% Preference Shares of ₹ 100 each, fully paid up		400
	Total	1400
(2) Reserves and Surplus		
Debit balance of Profit & Loss A/c		(522)
(3) Long Term Borrowings		
6% Debentures (Secured by Freehold Property)		400
Directors' Loan		300
		700
(4) Trade Payables		
Trade payables for Goods		102
(5) Other Current Liabilities		
Interest Accrued and Due on 6% Debentures		24
(6) Tangible Assets		
Freehold Property		550
Plant & Machinery		200
		750
(7) Current Investment		
Investment in Equity Instruments		200
(8) Inventories		
Finished Goods		300
(9) Trade Receivables		
Trade receivables for Goods		450
(10) Cash and Cash Equivalents		
Balance with Bank		4

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) **Preference Shares are to be written down to Rs. 80 each and Equity Shares to Rs. 2 each.**

(2) **Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of Rs. 2 each to be allotted.**

(3) **Debenture holders agreed to take one Freehold Property at its book value of Rs. 300 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.**

(4) **Interest accrued and due on Debentures to be paid in cash.**

(5) **Remaining Freehold Property to be valued at Rs. 400 lakh.**

(6) **All investments sold out for Rs. 250 lakh.**

(7) **70% of Directors' loan to be waived and for the balance, Equity Shares of Rs. 2 each to be allowed.**

(8) **40% of Trade receivables and 80% of Inventories to be written off.**

(9) **Company's contractual commitments amounting to Rs. 600 lakh have been settled by paying 5% penalty of contract value.**

You are required to :

(a) **Pass Journal Entries for all the transactions related to internal reconstruction;**

(b) **Prepare Reconstruction Account; and**

(c) **Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction.**

(MTP 15 Marks Mar 18, MTP 16 Marks Apr 21, RTP May 19)

Answer 3

Journal Entries in the books of Lion Ltd.

Particulars		**Debit (Rs. in lakhs)**	**Credit (Rs. in lakhs)**
8% Preference share capital A/c (Rs. 100 each)	Dr.	400	
To 8% Preference share capital A/c (Rs. 80 each)			320
To Capital Reduction A/c			80
(Being the preference shares of Rs. 100 each reduced to			
Rs. 80 each as per the approved scheme)			
Equity share capital A/c (Rs. 10 each)	Dr.	1,000	
To Equity share capital A/c (Rs. 2 each)			200
To Capital Reduction A/c			800
(Being the equity shares of Rs. 10 each reduced to Rs. 2 each)			
Capital Reduction A/c	Dr.	32	
To Equity share capital A/c (Rs. 2 each)			32
(Being 1/3rd arrears of preference share dividend of 3 years to			
be satisfied by issue of 16 lakhs equity shares of Rs. 2 each)			
6% Debentures A/c	Dr.	300	
To Freehold property A/c			300
(Being claim of Debenture holders settled in part			
by transfer of freehold property)			
Accrued debenture interest A/c	Dr.	24	
To Bank A/c			24
(Being accrued debenture interest paid)			
Freehold property A/c	Dr.	150	
To Capital Reduction A/c			150
(Being appreciation in the value of freehold property)			
Bank A/c	Dr.	250	
To Investments A/c			200

To Capital Reduction A/c			50
(Being investment sold at profit)			
Director's loan A/c	Dr.	300	
To Equity share capital A/c (Rs. 2 each)			90
To Capital Reduction A/c			210
(Being director's loan waived by 70% and balance being			
discharged by issue of 45 lakhs equity shares of Rs. 2 each)			
Capital Reduction A/c	Dr.	972	
To Profit and loss A/c			522
To Trade receivables A/c (450 x 40%)			180
To Inventories-in-trade A/c (300x 80%)			240
To Bank A/c (600 x 5%)			30
(Being certain value of various assets, penalty on cancellation			
of contract, profit and loss account debit balance written of			
through Capital Reduction Account)			

(x)

Capital Reduction A/c To Capital reserve A/c (Being balance transferred to capital reserve account as per the scheme)	286	 286

Capital Reduction Account

Dr.	(Rs. in lakhs)		Cr. (Rs. in lakhs)
To Equity Share Capital	32	By Preference Share Capital	80
To Trade receivables	180	By Equity Share Capital	800
To Finished Goods	240	By Freehold Property	150
To Profit & Loss A/c	522	By Bank	50
To Bank A/c To Capital Reserve	30 286	By Director's Loan	210
	1,290		**1,290**

Notes to Balance Sheet

	(Rs. in lakhs)	(Rs. in lakhs)
1. Share Capital		
Authorized:		
200 lakhs Equity shares of Rs. 2 each		400
8 lakhs 8% Preference shares of Rs. 80 each		640
		1,040
Issued:		
161 lakhs equity shares of Rs. 2 each		322
4 lakhs Preference Shares of Rs. 80 each		320
		642
2. Tangible Assets		
Freehold Property	550	
Less: Utilized to pay Debenture holders	(300) 250	
Add: Appreciation	150	400
Plant and Machinery		200
		600

Question 4

The Paid-up capital of S Limited amounted to Rs. 5,00,000 Equity Shares of Rs. 10 each. Due to continuous losses incurred by the company, the following scheme of reconstruction has been approved for S Limited on 1st April, 2020:

(i) In lieu of present holding the Equity Shareholders are to receive:

(a) Fully Paid Equity Shares equal to 3/5th of their holding.

(b) 8% Preference Shares fully paid to the extent of 20% of the above new Equity Shares.

(c) 10% Second Debentures of Rs. 40,000.

(ii) An issue of 8% Debentures First Debentures of Rs. 1,00,000 was made and fully subscribed for cash,

(iii) The Assets were reduced as follows: -

(a) Building from Rs. 2,00,000 to Rs. 1,50,000

(b) Plant & Machinery from Rs. 1,50,000 to Rs. 1,30,000

(c) Goodwill from Rs. 30,000 to Nil.

Show the Journal Entries in the books of S Limited to give effect of the scheme of Reconstruction. (MTP 5 Marks March 21, May 20, Apr 22) (Same concept different figures MTP 5 Marks Sep'22, Old & New SM)

Answer 4

Journal Entries in the books of S Ltd.

2020			Dr. Rs.	Cr. Rs.
April 1	Equity Share Capital A/c (Rs. 10)	Dr.	5,00,000	
	To Equity Share Capital A/c			3,00,000
	To 8% Preference Equity Share Capital A/c			60,000
	To 10% Second Debentures A/c			40,000
	To Capital Reduction /Reconstruction A/c			1,00,000
	(Being reduction of equity shares to 3/5 shares, issue of preference shares and debentures as per Reconstruction Scheme dated...)			
	Capital Reduction / Reconstruction A/c	Dr.	1,00,000	
	To Building A/c			50,000
	To Plant and Machinery A/c			20,000
	To Goodwill A/c			30,000
	(Being value of building and plant and machinery reduced and goodwill written off completely.)			
	Bank A/c	Dr.	1,00,000	
	To 8% First Debentures A/c			1,00,000
	(Being Rs. 1,00,000 debentures issued)			

Question 5

The summarised Balance Sheet of Preeti Limited as on 31st March 2019, was as follows:

Liabilities	(₹)	Assets	(₹)
Authorized and subscribed capital:		**Property, plant and equipment:**	
20,000 Equity shares of ₹ 100 each fully paid	**20,00,000**	**Machineries**	**7,00,000**
Unsecured loans:		**Current Assets:**	

15% Debentures	6,00,000	Inventory	5,06,000
Interest payable thereon	90,000	Trade receivables	4,60,000
Current Liabilities:		Bank	40,000
Trade payables	1,04,000	Profit & loss A/c	11,60,000
Provision for income tax	72,000		
	28,66,000		28,66,000

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

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

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

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

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

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

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

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

Pass Journal Entries giving effect to the above. (MTP 8 Marks Oct 20, MTP 5 Marks Mar 22) (Same concept different figures Old & New SM)

Answer 5

In the books of Preeti Limited Journal Entries

			₹	₹
(i)	Equity Share Capital (₹ 100) A/c	Dr.	20,00,000	
	To Share Surrender A/c			10,00,000
	To Equity Share Capital (₹ 10) A/c			10,00,000
	(Sub-division of 20,000 equity shares of ₹ 100 each into 2,00,000 equity shares of ₹ 10 each and surrender of 1,00,000 of such sub-divided shares as per capital reduction scheme)			
(ii)	15% Debentures A/c	Dr.	3,00,000	
	Interest payable A/c (proportionate 50%)	Dr.	45,000	
	To Reconstruction A/c			3,45,000
	(Transferred 50% of the claims of the debenture holders to Reconstruction A/c in consideration of which 10% Preference shares are being issued, out of share surrender A/c as per capital reduction scheme)			
(iii)	Trade payables A/c	Dr.	1,04,000	
	To Reconstruction A/c			1,04,000
	(Transferred claims of the trade payables to Reconstruction A/c, 25% of which is reduction and equity shares are issued in consideration of the balance amount)			
(iv)	Share Surrender A/c	Dr.	10,00,000	

	To 10% Preference Share Capital A/c			2,00,000
	To Equity Share Capital A/c			78,000
	To Reconstruction A/c			7,22,000
	(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as per scheme and the balance in share surrender account is transferred to reconstruction account)			
(v)	Reconstruction A/c	Dr.	11,71,000	
	To Profit & Loss A/c			11,60,000
	To Capital Reserve A/c			11,000
	(Adjusted debit balance of profit and loss account against reconstruction account and the balance is transferred to Capital Reserve account)			

Note: Alternative set of correct journal entries may be given for transfer of surrendered shares to trade payables and debenture holders.

Question 6

Shine Ltd. provides the following information as on 31st March, 2021: (Rs.in '000)

	Amount
Equity Shares of Rs. 10 each	**35,000**
8%, Cumulative Preference Shares of Rs. 100 each	**17,500**
6% Debentures of Rs. 100 each	**14,000**
Sundry Creditors	**17,500**
Provision for taxation	**350**
Property, Plant and Equipment	**43,750**
Investments (Market value Rs. 3325 thousand)	**3,500**
Current Assets (Including Bank Balance)	**35,000**
Profit and Loss Account (Dr. balance)	**2,100**

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

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

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

(iii) The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of Rs. 100 each and exchange them for fresh debentures of Rs. 80 each. Each old debenture is exchanged for one new debenture.

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

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

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

(vii) One of the creditors of the Company for Rs. 70,00,000 gives up 50% of his claim. He is allotted 8,75,000 equity shares of Rs. 4 each in full and final settlement of his claim.

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

You are required to give journal entries for the above transactions and prepare capital reduction account. (RTP Nov 21) (Same concept different figures PYP 10 Marks Nov'18, Old & New SM)

Answer 6

Journal Entries in the books of Shine Ltd.

			Rs. '000	Rs. '000
(i)	Equity share capital (Rs. 10) A/c	Dr.	35,000	
	To Equity Share Capital (Rs. 4) A/c			14,000
	To Capital Reduction A/c			21,000
	(Being conversion of equity share capital of Rs. 10 each into Rs. 4 each as per reconstruction scheme)			
(ii)	8% Cumulative Preference Share capital (Rs. 100) A/c Dr.		17,500	
	To 8% Cumulative Preference Share Capital (Rs. 60) A/c			10,500
	To Capital Reduction A/c			7,000
	(Being conversion of 6% cumulative preference shares capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)			
(iii)	6% Debentures (Rs. 100) A/c	Dr.	14,000	
	To 9% Debentures (Rs. 80) A/c			11,200
	To Capital Reduction A/c			2,800
	(Being 9% debentures of Rs. 80 each issued to existing 6% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Sundry Creditors A/c	Dr.	7,000	
	To Equity Share Capital (Rs. 4) A/c			3,500
	To Capital Reduction A/c			3,500
	(Being a creditor of Rs. 70,00,000 agreed to surrender his claim by 50% and was allotted 8,75,000 equity shares of Rs. 4 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	350	
	Capital Reduction A/c	Dr.	175	
	To Liability for Taxation A/c			525
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
(vi)	Liability for Taxation A/c	Dr.	525	
	To Current Assets (Bank A/c)			525
	(Being the payment of tax liability)			
(vii)	Capital Reduction A/c	Dr.	34,125	
	To P & L A/c			2,100
	To PPE A/c			8,750
	To Current Assets A/c			18,725
	To Investments A/c			175
	To Capital Reserve A/c (Bal. fig.)			4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, Plant & Equipment, Current Assets, Investments and the Balance transferred to Capital Reserve)			

Capital Reduction Account

To Liability for taxation A/c	175	By Equity share capital	21,000
To P & L A/c	2,100	By 8% Cumulative preferences Share capital	7,000
To Property, Plant & Equipment	8,750		
To Current assets	18,725	By 6% Debentures	2,800

To Investment	175	By Sundry creditors	3,500
To Capital Reserve (Bal. fig.)	4,375		
	34,300		34,300

Question 7

Recover Ltd decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 2020 is as follows-

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	**Share capital**	1	**3,50,000**
	B	**Reserves and surplus**	2	**(70,000)**
2		**Non-current liabilities**		
	A	**Long-term borrowings**	3	**55,000**
3		**Current liabilities**		
	A	**Trade Payables**		**80,000**
	B	**Short term Borrowings – Bank overdraft**		**90,000**
				5,05,000
		Assets		
1		**Non-current assets**		
	A	**Property, Plant Equipment**	4	**3,35,000**
	B	**Intangible assets**	5	**50,000**
	C	**Non-current investments**	6	**40,000**
2		**Current assets**		
	A	**Inventories**		**30,000**
	B	**Trade receivables**		**50,000**
				5,05,000

Notes to accounts:

		Rs.
1	**Share Capital**	
	Equity share capital:	
	20,000 Equity Shares of Rs. 10 each	**2,00,000**
	Preference share capital:	
	15,000 8% Cumulative Preference Shares of Rs. 10 each (preference dividend has been in arrears for 4 years)	**1,50,000**
2	**Reserves and surplus**	**3,50,000**
	Securities premium	**10,000**
	Profit and loss account (debit balance)	**(80,000)**
3	**Long-term borrowings**	**(70,000)**
	Secured	
	9% Debentures (secured on the freehold property	**50,000**
	Accrued interest on 9% debentures	**5,000**
4	**Property, Plant and Equipment**	**55,000**
	Freehold property	**1,20,000**
	Leasehold property	**85,000**
	Plant and machinery	**1,30,000**
		3,35,000

5	Intangible assets		
	Goodwill		50,000
6	Non-current investments		50,000
	Non-Trade investments at cost		40,000
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

i. **The preference shares were reduced to Rs. 2.5 per share, and the equity shares to Rs. 1 per share.**

ii. **One new equity share of Rs. 1 was issued for the arrears of preferred dividend for past 4 years.**

iii. **The balance on Securities Premium Account was utilized and was transferred to capital reduction account.**

iv. **The debenture holders took over the freehold property at an agreed figure of Rs. 75,000 and paid the balance to the company after deducting the amount due to them.**

v. **Plant and Machinery was written down to Rs. 1,00,000.**

vi. **Non-trade Investments were sold for Rs. 32,000.**

vii. **Goodwill and obsolete stock (included in the value of inventories) of Rs. 10,000 were written off.**

viii. **A contingent liability of which no provision had been made was settled at Rs. 7,000 and of this amount, Rs. 6,300 was recovered from the insurance.**

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme. (RTP May 21) (New SM)

Answer 7

In the books of Recover Ltd
Journal entries

Particulars		Dr.	Cr.
		Rs.	Rs.
8% Cumulative Preference share capital (Rs. 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (Rs.2.5) A/c			37,500
To Capital reduction (Rs. 7.5) A/c			1,12,500
(Preference shares being reduced to shares of Rs. 2.5 per share and remaining transferred to capital reduction account as per capital reduction scheme)			
Equity share capital A/c (Rs.10)	Dr.	2,00,000	
To Equity Share capital A/c (Rs. 1)			20,000
To Capital reduction A/c (Rs. 9)			1,80,000
(Equity shares reduced to Rs. 1 per share with the remaining amount transferred to capital reduction ac as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of Rs. 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
Securities Premium A/c	Dr.	10,000	
To Capital reduction A/c			10,000

(Amount from the securities premium utilized towards the capital reduction a/c as a part of the internal reconstruction scheme)			
9% Debentures A/c	Dr.	50,000	
Accrued interest on debentures A/c	Dr	5,000	
Bank A/c	Dr.	20,000	
Capital reduction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the capital reduction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Capital reduction A/c	Dr.	8,000	
To Investments A/c			40,000
(Investments sold at a loss debited to capital reduction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Capital reduction A/c	Dr.	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingency payment amount)			
Capital reduction A/c	Dr.	80,000	
To Profit and loss A/c			80,000
(Accumulated losses written off to capital reduction account as a part of the internal reconstruction scheme).			
Capital reduction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in capital reduction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 2020 (and reduced)

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		

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	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		**Non-current liabilities**		
	A	Long-term borrowings		-
3		**Current liabilities**		
	A	Trade Payables		80,000
	B	Bank Overdraft		90,000
		Total		**3,06,300**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	1,85,000
2		**Current assets**		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	51,300
		Total		**3,06,300**

Notes to accounts:

1	**Share Capital**	**Rs.**
	Equity share capital	
	68,000 Equity Shares of Rs. 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of Rs. 2.5 each	37,500
2	**Reserves and surplus**	1,05,500
	Capital reserve	30,800
3	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
4	**Cash and cash equivalents**	1,85,000
	Bank A/c (20,000+32,000-7000+6,300)	

Question 8

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

				Rs.
A.	**Equity & Liabilities**			
	1.	**Shareholders' Fund:**		
		(a)	**Share Capital:**	
			9,000 7% Preference Shares of Rs. 100 each fully paid	9,00,000
			10,000 Equity Shares of Rs. 100 each fully paid	10,00,000
		(b)	**Reserve & Surplus:**	
			Profit & Loss Account	(2,00,000)
	2.	**Non-current liabilities:**		
			"A" 6% Debentures (Secured on Bombay Works)	3,00,000
			"B" 6% Debentures (Secured on Chennai Works)	3,50,000
	3.	**Current Liabilities and Provisions:**		
		(a)	Workmen's Compensation Fund:	
			Bombay Works	10,000

			Chennai Works	5,000
		(b)	Trade Payables	1,25,000
			Total	24,90,000
B.	**Assets:**			
	Non- current Assets:			
	1.	**PPE**:		
			Bombay Works	9,50,000
			Chennai Works	7,75,000
	2.	**Investment:**		
			Investments for Workman's Compensation Fund	15,000
	3.	**Current Assets:**		
		(a)	Inventories	4,50,000
		(b)	Trade Receivables	2,50,000
		(c)	Cash at Bank	50,000
				24,90,000

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

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

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

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

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

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

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

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

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

(ix) **Chennai works completely written off.**

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

Pass necessary Journal Entries in the books of Star Ltd. after the scheme has been carried into effect. (RTP May 20)

Answer 8

In the books of Star Ltd. Journal Entries

Particulars		**Amount**	**Amount**
		Rs.	**Rs.**
(i) 7% Preference share capital (Rs. 100)	Dr.	9,00,000	
To 9% Preference share capital (Rs. 80)			7,20,000
To Capital reduction A/c			1,80,000
(Being preference shares reduced to Rs.80 and also			
rate of dividend raised from 7% to 9%)			
(ii) Equity share capital A/c (Rs. 100 each)	Dr.	10,00,000	
To Equity share capital A/c (Rs. 10 each)			1,00,000

	To Capital reduction A/c			9,00,000
	(Being reduction of nominal value of one share of			
	Rs. 100 each to Rs. 10 each)			
(iii)	Bank A/c	Dr.	50,000	
	To Capital reduction A/c			50,000
	(Being directors refunded the fee amount)			
(iv)	Trade payables A/c (Interest on debentures)	Dr.	26,000	
	To Capital reduction A/c			26,000
	(Being interest forgone by the debenture holders)			
(v)	No entry required			
(vi) a	'B' 6% Debentures A/c	Dr.	3,50,000	
	To Debentures holders A/c			3,50,000
	(Being amount due to Debentures holders)			
b	Debentures holders A/c	Dr.	4,40,000	
	To Chennai Works A/c			4,25,000
	To Equity share capital A/c			15,000
	(Being Chennai works taken over and equity shares			
	issued to 'B' 6% Debenture holders)			
c	Equity share of Zia ltd. A/c	Dr.	90,000	
	To Debentures holders A/c			90,000
	(Being 9,000 equity shares of Zia Ltd. issued by			
	Debentures holders)			
(vii) a	Chennai Works – Workmen Compensation Fund	Dr.	4,000	
	To Capital reduction A/c			4,000
	(Being difference due to reduced amount of			
	actual liability transferred to capital reduction			
	account)			
b	Bank A/c	Dr.	15,400	
	To Investment for Workmen			
	Compensation Fund			14,000
	To Capital reduction A/c			1,400
	(Being investment for Workmen Compensation			
	Fund sold @ 10% profit)			
c	Trade Payables A/c	Dr.	15,400	
	To Bank A/c			15,400
	(Being part payment made to trade payables)			
(viii)	Capital reduction A/c	Dr.	2,10,000	
	To Provision for Doubtful Debts A/c			20,000
	To Inventory A/c			1,90,000
	(Being assets revalued)			
(ix)	Capital reduction A/c	Dr.	5,50,000	
	To Profit & Loss A/c			2,00,000
	To PPE – Chennai Works			3,50,000
	(Being assets revalued and losses written off)			
(x)	Capital reduction A/c	Dr.	4,01,400	
	To PPE – Bombay Works			2,67,600
	To Capital reserve A/c			1,33,800
	(Being assets revalued and remaining amount			
	transferred to capital reserve account)			

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Question 9

The summarized balance sheet of Z Limited as on 31st March, 2017 is as under:

Liabilities **Share Capital:**	**Amount in Rs.**
5,00,000 Equity shares of Rs. 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of Rs. 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 & Equipment:	
(a) Tangible Assets:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
(b) 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 debentures	1,00,000
Total	**81,00,000**

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover Rs. 1,00,000 and Rs. 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.

(xi) **All the equity shares to be converted into fully paid equity shares of Rs. 5.00 each.**

(xii) **The Preference shares be reduced to Rs. 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.**

(xiii) **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 Rs. 1,00,000 and Rs. 60,000 respectively in cash and to receive new 12% debentures for the balance amount.**

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

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

(xvi) **Capital commitments of Rs. 3.00 lacs were cancelled on payment of Rs. 15,000 as penalty.**

(xvii) **Directors refunded Rs. 1,00,000 of the fees previously received by them.**

(xviii) **Reconstruction expenses paid Rs. 15,000.**

(xix) **The taxation liability of the company was settled for Rs 75,000 and was paid immediately.**

(x) The Assets were revalued as under:	
Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to prepare necessary journal entries for all the above-mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit and Loss account arid Discount on issue of debentures. And also, prepare Bank Account and Reconstruction Account. (RTP Nov 18) (Same concept different figures- RTP May'22 & Nov'20)

Answer 9

Journal Entries in the Books of Z Ltd.

			Dr. Rs.	Cr. Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs. 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs. 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 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			5,78,000
	(Being Rs. 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	Dr.	60,000	
	Interest on debentures outstanding A/c	Dr.	64,000	
	Bank A/c	Dr.	60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000

	(Being Rs. 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 (Rs. 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 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 Rs. 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 full 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			

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	as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

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

Reconstruction Account

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

Question 10

Planet 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 31 st March, 2022 before reconstruction:

Particulars	Note No.	Amount (₹ In lakh)
Equity & Liabilities		
Shareholders' Funds		
Share Capital	**1**	**2,100**
Reserves & Surplus	**2**	**(783)**
Non-Current Liabilities		
Long term Borrowings	**3**	**1,050**
Current Liabilities		
Trade Payables	**4**	**153**
Other Liabilities	**5**	**36**
Total		**2,556**
Assets		
Non-Current Assets:		
PPE	**6**	**1,125**
Current Investments	**7**	**300**
Inventories	**8**	**450**

Trade Receivables	9	675
Cash & Cash Equivalents	10	6
Total		2,556

Notes to Accounts:

		₹ In lakh
(1)	Share capital	
	Authorised:	
	300 lakh Equity shares of ₹ 10 each	3,000
	12 lakh, 8% preference Shares of ₹ 100 each	1,200
		4,200
	Issued, Subscribed and Paid up:	
	150 Lakh Equity Shares of ₹ 10 each, fully paid up	1,500
	6 lakh 8% Preference Shares of ₹ 100 each, fully paid up	600
(2)	Reserves and Surplus	2,100
	Debit balance of Profit & Loss A/c	(783)
(3)	Long term borrowings	
	6% Debentures (Secured by freehold property)	600
	Director's Loan	450
(4)	Trade payables	1,050
	Trade payables for Goods	153
(5)	Other Liabilities	
	Interest Accrued and Due on 6% Debentures	36
(6)	PPE	
	Freehold Property	825
	Plant & machinery	300
(7)	Current Investment	1,125
	Investment in Equity Instruments	300
(8)	Inventories	
	Finished Goods	450
(9)	Trade Receivables	
	Trade receivables for Goods	675
(10)	Cash and Cash equivalents	
	Balance with bank	6

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.

(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹ 2 each to be allotted.

(3) Debenture holders agreed to take one Freehold Property at its book value of ₹ 450 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.

(4) Interest accrued and due on Debentures to be paid in cash.

(5) Remaining Freehold Property to be valued at ₹ 550 lakh.

(6) All investments sold out for ₹ 425 lakh.

(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹ 2 each to be alloted.

(8) 40% of Trade receivables and 80% of Inventories to be written off.

(9) **Company's contractual commitments amounting to ₹ 900 lakh have been settled by paying penalty of ₹ 72 lakhs.**

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;

(b) Prepare Capital Reduction Account, Bank Account; and

Prepare Notes to Accounts on Share Capital and PPE, immediately after the implementation of internal reconstruction. (RTP Nov'22)

Answer 10

a) Journal Entries related to internal reconstruction in the books of Planet Ltd.

(₹ in lakhs)

	Particulars		Debit ₹	Credit ₹
i	8% Preference share capital A/c (₹ 100 each)	Dr.	600	
	To 8% Preference share capital A/c (₹ 75 each)			450
	To Capital reduction A/c			150
	(Being the preference shares of ₹ 100 each reduced to ₹ 75 each as per the approved scheme)			
ii	Equity share capital A/c (₹ 10 each)	Dr.	1,500	
	To Equity share capital A/c (₹ 2 each)			300
	To Capital reduction A/c			1,200
	(Being the equity shares of ₹ 10 each reduced to ₹ 2 each)			
iii	Capital reduction A/c	Dr.	48	
	To Equity share capital A/c (₹ 2 each)			48
	(Being 1/3rd of arrears of preference share dividend of three years to be satisfied by issue of 24 lakh equity shares of ₹ 2 each)			
iv	6% Debentures A/c	Dr.	450	
	To Freehold property A/c			450
	(Being claim settled in part by transfer of freehold property)			
v	Accrued debenture interest A/c	Dr.	36	
	To Bank A/c			36
	(Being accrued debenture interest paid)			
vi	Freehold property A/c	Dr.	175	
	To Capital reduction A/c			175
	(Being appreciation (550-375) in the value of freehold property)			
vii	Bank A/c	Dr.	425	
	To Investment A/c			300
	To Capital reduction A/c			125
	(Being investment sold on profit)			
viii	Director's loan A/c	Dr.	450	
	To Equity share capital A/c (₹ 2 each)			135
	To Capital reduction A/c			315
	(Being director's loan waived by 70% and balance being discharged by issue of 67.5 lakh equity shares of ₹ 2 each)			
ix	Capital Reduction A/c	Dr.	1,485	
	To Profit and loss A/c			783
	To Trade receivables A/c (675 x 40%)			270

	To Inventories-in-trade A/c (450 x 80%)			360
	To Bank A/c			72
	(Being various assets, penalty on cancellation of contract, profit and loss account debit balance written off through capital reduction account)			
x	Capital Reduction A/c	Dr.	432	
	To Capital reserve A/c			432
	(Being balance transferred to capital reserve account as per the scheme)			

b) Capital Reduction Account

(₹ in lakhs)

To Equity Share Capital	48	By 8% Pref. Share Capital	150
To P & L A/c	783	By Equity Share Capital	1,200
To Trade Receivables	270	By Freehold property	175
To Inventories	360	By Bank (profit on sale of investment)	125
To Bank	72	By Director's loan	315
To Capital Reserve	432		
	1,965		1,965

Bank Account (₹ in lakhs)

To Balance b/d	6	By Accrued debenture interest	36
To Investments	300	By Capital Reduction Account (Penalty on cancellation of contract)	72
To Capital reduction	125	By Balance c/d	323
	431		431

c) Note to Accounts on Share Capital and PPE after implementation of internal reconstruction

Share Capital	(₹ in lakhs)
Authorised:	
300 lakh shares of ₹ 2 each	600
12 lakh, 8% Preference shares of ₹ 75 each	900
Issued, subscribed and paid up:	1,500
241.5 lakh Equity shares of ₹ 2 each	483
(out of which 91.5 lakh shares have been issued for consideration other than cash)	450
6 lakh, 8% Preference shares of ₹75 each fully paid up	
Total	933
PPE	
Freehold property 825	
Less: Utilised to pay Debenture holders (450)	
Add: Appreciation 175	550
Plant and machinery	300
Total	850

Working Note:

Calculation of number of equity shares issued	
To equity shareholders	150 Lakh
To Preference shareholders (in lieu of arrear of preference dividend)	24 Lakh
To Directors	67.5 Lakh
	241.5 Lakh

Question 11

The following information is being provided by Fortunate Ltd. as on 31st March, 2022.

Particulars	Amount (₹)
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	7,50,000
(b) 18,750 Equity shares of ₹ 50 each	9,37,500
Profit and Loss Account (Dr. balance)	5,63,750
Loan	7,16,250
Trade Payables	2,58,750
Other Liabilities	43,750
Building at cost less depreciation	5,00,000
Plant at cost less depreciation	3,35,000
Trademarks and goodwill at cost	3,97,500
Inventory	5,00,000
Trade Receivables	4,10,000

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(Note: Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and not earnings profits. A scheme of reconstruction has been approved by both the classes of shareholders. The summarized scheme of reconstruction is as follows:

(i) **The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 5 by cancellation of ₹ 45.00 per share. They have also agreed to subscribe for three new equity shares of ₹ 5.00 each for each equity share held.**

(ii) **The preference shareholders have agreed to forego the arrears of dividends and to accept for each ₹ 50 preference share, 4 new 6% preference shares of ₹ 10 each, plus 3 new equity shares of ₹ 5.00 each, all credited as fully paid.**

(iii) **Lenders to the company for ₹ 1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of ₹ 10 each and 7,500 new equity shares of ₹ 5.00 each.**

(iv) **The directors have agreed to subscribe in cash for 25,000 new equity shares of**

₹ 5.00 each in addition to any shares to be subscribed by them under (i) above.

(v) **Of the cash received by the issue of new shares, ₹ 2,50,000 is to be used to reduce the loan due by the company.**

(vi) **The equity share capital cancelled is to be applied:**

  (a) **To write off the debit balance in the Profit and Loss A/c, and**

  (b) **To write off ₹ 43,750 from the value of plant.**

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital, as reduced, is to be increased to ₹ 8,12,500 for preference share capital and ₹ 9,37,500 for

equity share capital.

You are required to pass journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction. (RTP May '23, PYP 15 Marks Nov '19) (Same concept different figures Old & New SM)

Answer 11

In the books of Fortunate Ltd. Journal Entries

	Particulars		Debit (₹)	Credit (₹)
1.	Equity share capital A/c (₹ 50)	Dr.	9,37,500	
	To Equity share capital A/c (₹ 5)			93,750
	To Capital reduction A/c*			8,43,750
	(Being equity capital reduced to nominal value of ₹ 5 each)			
2.	Bank A/c	Dr.	2,81,250	
	To Equity share capital			2,81,250
	(Being 3 right shares against each share was issued and subscribed)			
3.	8% Preference share capital A/c (₹ 50)	Dr.	7,50,000	
	Capital reduction A/c	Dr.	75,000	
	To 6% Preference share capital (₹ 10)			6,00,000
	To equity share capital (₹ 50)			2,25,000
	(Being 8% preference shares of ₹ 50 each converted to 6% preference shares of ₹ 10 each and also given to them 3 equity shares for every share held)			
4.	Loan A/c	Dr.	1,87,500	
	To 6% Preference share capital A/c (15,000 x ₹ 10)			1,50,000
	To Equity share capital A/c (7,500 x ₹ 5)			37,500
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c (25,000 x ₹5)	Dr.	1,25,000	
	To Equity share application A/c			1,25,000
	(Being shares subscribed by the directors)			
6.	Equity share application A/c	Dr.	1,25,000	
	To Equity share capital A/c			1,25,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,50,000	
	To Bank A/c			2,50,000
	(Being loan repaid)			
8.	Capital reduction A/c	Dr.	7,68,750	
	To Profit and loss A/c			5,63,750
	To Plant A/c			43,750
	To Trademarks and Goodwill A/c (Bal. fig.)			1,61,250

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	(Being losses and assets written off to the extent required)			

Balance sheet of Fortunate Ltd. (and reduced) as on 31.3.2022

		Particulars	Notes	₹
1.		Equity and Liabilities		
		Shareholders' funds		
	a	Share capital	1	15,12,500
2.		Non-current liabilities		
	a	Long-term borrowings (7,16,250 – 1,87,500 – 2,50,000)		2,78,750
3.		Current liabilities		
	a	Trade Payables		2,58,750
	b	Other current liabilities		43,750
		Total		20,93,750
		Assets		
1.		Non-current assets		
	a	Property, Plant and Equipment	2	7,91,250
	b	Intangible assets	3	2,36,250
2.		Current assets		
	a	Inventories		5,00,000
	b	Trade receivables		4,10,000
	c	Cash and cash equivalents	4	1,56,250
		Total		20,93,750

Notes to accounts:

			₹
1.	Share Capital		
	Authorized capital:		
	81,250 Preference shares of ₹ 10 each	8,12,500	
	1,87,500 Equity shares of ₹ 5 each	9,37,500	17,50,000
	Issued, subscribed and paid up:		
	1,52,500 equity shares of ₹ 5 each	7,62,500	
	75,000, 6% Preference shares of ₹ 10 each	7,50,000	15,12,500
2.	Property, Plant and Equipment		
	Building at cost less depreciation	5,00,000	
	Plant at cost less depreciation	2,91,250	7,91,250
3.	Intangible assets		
	Trademarks and goodwill		2,36,250
4.	Cash and cash equivalents		
	Bank (2,81,250+1,25,000-2,50,000)		1,56,250

Note: *In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used.

Question 12

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

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

following:

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

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

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

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

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

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

You are required to show the necessary Journal Entries in the books of Sapra Limited of the above reconstruction scheme considering that balance in General Reserve is utilized to write off the losses. (PYP 5 Marks July 21)

Answer 12

Journal Entries

		₹	₹
Equity Share Capital (old) A/c	Dr.	75,00,000	
To Equity Share Capital (₹ 10) A/c			45,00,000
To 6% Preference Share Capital (₹ 10) A/c			18,00,000
To 7% Debentures A/c			2,50,000
To Capital Reduction A/c			9,50,000
(Being new equity shares, 6% Preference Shares, 7% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
Building A/c	Dr.	1,50,000	
Capital Reduction A/c	Dr.	9,53,000	
To Goodwill Account			2,70,000
To Plant and Machinery Account			1,00,000
To Furniture Account			88,000
To Investment A/c			4,20,000
To Profit & Loss A/c			2,25,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery, furniture, investment and Profit & Loss as per the scheme)			
General reserve A/c	Dr.	3,000	
To Capital Reduction A/c			3,000
(Being general reserve utilized to write off the balance in Capital reduction A/c)			

Note: In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used in the above journal entries.

Question 13

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

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	**1**	**15,00,000**

(b) Reserves & Surplus	2	(3,00,000)
(2) Current Liabilities		
(a) Trade Payables		2,20,000
(b) Short Term Borrowings – Bank Overdraft		2,00,000
Total		16,20,000
II. Assets		
(1) Non-Current Assets		
(a) Property, Plant and Equipment	3	10,20,000
(b) Intangible Assets	4	1,20,600
(2) Current Assets		
(a) Inventories		1,70,000
(b) Trade Receivables		3,01,800
(c) Cash and cash equivalents		7,600
Total		16,20,000

Notes to Accounts

	₹	₹
(1) Share Capital		
90,000 Equity Shares of ₹ 10 each fully paid	9,00,000	
6% Preference Share Capital	6,00,000	15,00,000
(2) Reserves & Surplus		
Profit & Loss account		(3,00,000)
(3) Property, Plant and Equipment		
Land and Building	5,40,000	
Plant and Machinery	4,80,000	10,20,000
(4) Intangible Assets		
Goodwill	84,600	
Patents	36,000	1,20,600

Dividends on preference shares are in arrears for 3 years.

On the above date, the company adopted the following scheme of reconstruction:

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

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

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

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

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

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

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

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

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

capital.

You are required to give journal entries incorporating the above scheme of reconstruction, capital reduction account and prepare the reconstructed Balance Sheet. (PYP 20 Marks Nov '22)

Answer 13

	Particulars		Debit (₹)	Credit (₹)
1.	6% Preference share capital A/c	Dr.	6,00,000	
	To 8% Preference share capital A/c			4,50,000
	To Capital reduction A/c			1,50,000
	(Being 6% preference shares converted to 8% preference shares so that return to pref. shareholders remains unaffected)			
2.	Equity share capital A/c (₹ 10)	Dr.	9,00,000	
	To Equity share capital A/c (₹ 8)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being equity capital reduced to nominal value of ₹ 8 each)			
3.	Capital Reduction A/c	Dr.	3,30,000	
	To Goodwill A/c			84,600
	To Land and Building A/c			81,000
	To Plant and Machinery A/c			96,000
	To Trade Receivables A/c (Book debts)			14,400
	To Patents A/c (Bal. fig.)			24,000
	To Profit and loss A/c			30,000
	(Being losses and assets written off to the extent required)			
4.	Bank A/c	Dr.	4,80,000	
	To Bank Loan A/c			4,80,000
	(Being Loan taken)			
5.	Bank overdraft A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being Bank overdraft repaid)			

Capital Reduction Account

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

Balance Sheet of Purple Ltd. (and reduced) as at 31.3.2022

		Particulars	Notes	₹
		Equity and Liabilities		

1		Shareholders' funds		
	a	Share capital	1	11,70,000
	b	Reserves and surplus	2	(2,70,000)
2		Current liabilities		
	a	Short term borrowings (Secured Bank Loan)		4,80,000
	b	Trade Payables		2,20,000
		Total		16,00,000
		Assets		
1		Non-current assets		
	a	Property, plant and equipment	3	8,43,000
	b	Intangible assets	4	12,000
2		Current Assets		
	a	Inventory		1,70,000
	b	Trade receivables	5	2,87,400
	c	Cash and cash equivalents (7,600+4,80,000-2,00,000)		2,87,600
		Total		16,00,000

Notes to Accounts:

			₹
1.	Share Capital		
	Authorized		
	Issued, subscribed and paid up:		
	90,000 equity shares of ₹ 8 each fully paid	7,20,000	
	8% Preference share capital*	4,50,000	11,70,000
2.	Reserves and Surplus		
	Profit and Loss Account (Dr. balance)		(2,70,000)
3.	Property plant and equipment		
	Land and Building	4,59,000	
	Plant and Machinery	3,84,000	8,43,000
4.	Intangible assets		
	Patent ₹ (36,000 - 24,000)		12,000
5.	Trade Receivables		
	Sundry Debtors	3,01,800	
	Less: Bad debts	(14,400)	2,87,400

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

Working Notes:

1. Calculation of new Preference Shares

Rate of return : 6% on Preference Shares

Dividend Rate of return	: :	(6/100) x ₹ 6,00,000 8% on Preference Shares	= ₹ 36,000

Dividend :	(8/100) x X =	₹ 36,000
	X = (36,000/8) x 100 =	₹ 4,50,000
New Preference Share Capital	=	₹ 4,50,000
Old Preference Share Capital	=	₹ 6,00,000
(6,00,000 – 4,50,000)	=	₹ 1,50,000 Amount taken to Capital Reduction A/c.

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

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

Land & Building	= (85/100) x 5,40,000	= ₹ 4,59,000
Plant & Machinery	= (80/100) x 4,80,000	= ₹ 3,84,000
Reduced by:		
Land & Building	= (5,40,000 - 4,59,000)	= ₹ 81,000
Plant & Machinery	= (4,80,000 - 3,84,000)	= ₹ 96,000

Question 14

X Ltd. had ₹ 1,00,000 equity share capital divided into 1,000 shares of ₹ 100 each out of which ₹ 80 per share was called up and paid up. It has 1,500 cumulative preference shares of ₹ 100 each fully paid up. Intangible assets include Goodwill of ₹ 80,000 and patents of ₹ 27,800. Preference dividends are in arrears of ₹ 33,000.

You are required to show the entries (Ignore dates) under each of the following conditions:

(i) If X Ltd. resolves to subdivide the equity shares into 10,000 equity shares of ₹ 10 each of which ₹ 8 per share is called up and paid up.

(ii) If X Ltd. resolves to convert its 1,000 equity shares of ₹ 100 each (assume fully - paid) into ₹ 1,00,000 worth of stock.

(iii) The preference shares are to be converted into 11% unsecured debentures of ₹ 100 each (including arrears of dividends).

(iv) Patents and Goodwill to be written-off. (PYP 5 Marks May '23)

Answer 14

Journal Entries in the books of X Ltd.

			₹	₹
(i)	Equity Share Capital (₹ 100) A/c	Dr.	80,000	
	To Equity Share Capital (₹ 10) A/c			80,000
	(Being the sub-division of 1,000 shares of ₹ 100 each with ₹ 80 paid up into 10,000 shares ₹ 10 each with ₹ 8 paid up by resolution in general meeting dated....)			
(ii)	Equity Share Capital (₹ 100) A/c	Dr.	1,00,000	
	To Equity Stock A/c			1,00,000

	(Being conversion of 1,000 fully paid Equity Shares of ₹ 100 into ₹ 1,00,000 Equity Stock as per resolution in general meeting dated…)			
(iii)	Cumulative Preference Share Capital A/c	Dr.	1,50,000	
	Capital Reduction (Reconstruction) A/c	Dr.	33,000	
	To 11% Debentures (Unsecured)			1,83,000
(iv)	(Being 1,500 cumulative preference shares of ₹ 100 each fully paid up converted into 11% debentures of ₹ 100 each (including arrears of dividends amounting ₹ 33,000)			
	Capital Reduction (Reconstruction) A/c	Dr.	1,07,800	
	To Goodwill			80,000
	To Patents			27,800
	(Writing off patents, goodwill)			

Question 15

Following information from Balance Sheet of Ruby Limited as on 31st March, 2023.

	Amount ₹
Authorised and Issued equity share capital:	
60,000 shares of ₹ 100 each fully paid	**60,00,000**
40,000 7% cumulative preference shares of ₹ 100 each fully paid	**40,00,000**
General Reserve	**12,00,000**
Loan from Director	**8,80,000**
Trade Payables	**49,20,000**
Outstanding expenses	**6,40,000**
Bank loan	**6,00,000**
Patent	**8,00,000**
Plant & machinery	**60,00,000**
Building	**11,00,000**
Trade receivables	**47,00,000**
Inventory	**32,60,000**
Cash	**2,40,000**
Bank Balance	**4,60,000**
Profit and Loss account	**16,80,000**

Note: The arrears of preference dividend amount to ₹ 5,60,000.

The company had suffered losses since last 3 years due to bad market conditions and hope for a better position in the future.

The following scheme of reconstruction has been agreed upon and duly approved by all concerned:

(1) **Equity shares to be converted into 6,00,000 shares of ₹ 10 each.**

(2) **Equity shareholders to surrender to the company 80 percent of their holdings.**

(3) **Preference shareholders agree to forgo their right on arrears of dividends in consideration of which 7% preference shares are to be converted into 8% preference shares.**

(4) Trade payables agree to reduce their claim by one fourth in consideration of their getting shares of ₹ 10,00,000 out of the surrendered equity shares.

(5) Directors agree to forego the amounts due on account of loan.

(6) Surrendered shares not otherwise utilized to be cancelled.

(7) Assets to be reduced as under:

	₹
Patent to	Nil
Plant & Machinery by	8,00,000
Inventory by	6,80,000

(8) Trade receivables to the extent of ₹ 34,00,000 are considered good.

(9) Revalued figures for building is accepted at ₹ 14,00,000.

(10) Bank loan is paid.

(11) Any surplus after meeting the losses should be utilized in writing down the value of the plant further.

(12) Expenses of reconstruction amounted to ₹ 1,20,000.

(13) Further 80,000 equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid up.

You are required to pass the Journal Entries for giving effect to the above arrangement and also to draw up the resultant Balance Sheet of the Company.(RTP Nov '23)

Answer 15

Books of Ruby Ltd.

Journal Entries

Particulars		Debit (₹)	Credit (₹)
Equity Share Capital (₹ 100 each) a/c	Dr	60,00,000	
To Equity share capital (₹ 10 each) A/c			60,00,000
(Sub division of equity share into ₹ 10 each)			
Equity Share Capital (₹ 10) A/c	Dr.	48,00,000	
To Share surrendered A/c			48,00,000
(Surrender of 80% of share holding by equity share holders)			
7% Cumulative preference share capital A/c	Dr.	40,00,000	
To 8% cumulative preference share capital A/c			40,00,000
(Conversion of 7% Cumulative Preference share capital into 8% Cumulative Preference share capital. They also forgo their right to arrears of dividends)			
Shares Surrendered A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Surrendered share issued against trade payables under reconstruction scheme)			
Bank loan A/c	Dr.	6,00,000	

Expenses of reconstruction A/c	Dr.	1,20,000	
To Bank A/c			7,20,000
(Bank loan and reconstruction expenses paid)			
Share surrendered A/c	Dr.	38,00,000	
To Capital Reduction A/c			38,00,000
(Cancellation of unissued surrendered shares) (48,00,000-10,00,000)			
Loan from Director A/c	Dr.	8,80,000	
Trade Payables A/c	Dr.	12,30,000	
Building A/c	Dr.	3,00,000	
To Capital reduction A/c			24,10,000
(Amount sacrificed by directors and trade payables and appreciation in value of building)			
Capital reduction A/c	Dr.	62,10,000	
To Patent A/c			8,00,000
To Trade receivables A/c			13,00,000
To Inventory A/c			6,80,000
To Profit and Loss A/c			16,80,000
To Expenses on Reconstruction A/c			1,20,000
To Plant A/c (bal. fig) (8,00,000+8,30,000)			16,30,000
(Various assets and expenses written off)			
Bank A/c	Dr.	8,00,000	
To Share application money A/c			8,00,000
(Application money received on full and final payment)			
Share application money A/c	Dr.	8,00,000	
To Share capital A/c			8,00,000
(Being 80,000 equity shares of ₹ 10 each issued and fully paid up)			

Note: Cancellation of preference dividend need not be journalised. On cancellation, it ceases to be contingent liability and hence no further disclosure required.

Balance Sheet of Ruby Ltd. (and Reduced) as at 31st March, 2023

	Particulars	Note	Amount (₹)
I.	EQUITY AND LIABILITIES		
	1. Shareholders' funds		
	a. Share capital	1	70,00 000
	b. General reserve		12,00 000
	2. Current liabilities		
	a. Trade payables (49,20,000-12,30,000)		36,90,000
	b. Other current liabilities (outstanding expenses)		6,40,000
	Total		125,30,000

II.	ASSETS		
	1. Non-current assets		
	i. Property, Plant and Equipments	2	57,70,000
	ii. Intangible assets	3	-
	2. Current assets		
	a. Inventories (32,60,000- 6,80,000)		25,80,000
	b. Trade receivables (47,00,000 - 13,00,000)		34,00,000
	c. Cash and cash equivalents	4	7,80,000
	Total		125,30,000

Notes to the financial statements

(1) Share capital

	Particulars	Amount (₹)
a.	Authorised • 6,00,000 equity shares of ₹ 10 each • 40,000 8% cumulative preference shares of ₹ 100 each	 60,00,000 40,00,000
b.	Issued, subscribed and fully paid up • 3,00,000 equity shares of ₹ 10 each (of the above, 1,00,000 shares were issued as fully paid up for consideration other than cash under the scheme of reconstruction) • 40,000 8% cumulative preference shares of ₹ 100 each	 30,00,000 40,00,000
	Total	70,00,000

(2) Property, Plant and Equipments

Particulars	**₹**
Plant (60,00,000-16,30,000)	43,70,000
Building (11,00,000 + 3,00,000)	14,00,000
Total	57,70,000

(3) Intangible assets

Particulars	**₹**
Patent (8,00,000-8,00,000)	-

(4) Cash and cash equivalents

	Particulars	**₹**
a.	Balance with bank (4,60,000-6,00,000-1,20,000+8,00,000)	5,40,000
b.	Cash on hand	2,40,000
	Total	7,80,000

Chapter 15
Accounting for Branches including Foreign Branches

Question 1

M & S Co. of Lucknow has a branch in Canberra, Australia (as an integral foreign operation of M & S Co.). At the end of 31st March 2019, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

	Lucknow office (Rs. In thousand)		Canberra Branch (Aust. Dollars in thousand)	
	Dr.	Cr.	Dr.	Cr.
Capital		2,000		
Reserves & Surplus		1,000		
Land	500			
Buildings (Cost)	1,000			
Buildings Dep. Reserves		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery Dep. Reserves		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1- 4-2018	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salary	75		45	
Rent			12	
Office Expenses	25		18	
Commission Receipts		256		100
Branch/HO Current Account	120			7
	4,880	4,880	390	390

The following information is also available:

(i) Stock as at 31st March, 2019
Lucknow Rs. 1,50,000
Canberra A$ 3125 (all stock is out of purchases made at Abroad)

(ii) Head Office always sent goods to the Branch at cost plus 25%

(iii) Provision is to be made for doubtful debts at 5%

(iv) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written downvalue.

You are required to:

(1) Convert the Branch Trial Balance into rupees by using the following exchange rates:

Opening rate	1 A $ = Rs. 50
Closing rate	1 A $ = Rs. 53
Average rate	1 A $ = Rs. 51.00
For Property, Plant & Equipment	1 A $ = Rs. 46.00

(2) Prepare Trading and Profit and Loss Account for the year ended 31st March 2019 showing to the extent possible H.O. results and Branch results separately. [MTP Oct.'19, 12 Marks, RTP Nov '22, Old & New SM) (Same concept fewer adjustments RTP Nov'20)

Answer 1

M & S Co. Ltd. Canberra, Australia Branch Trial Balance As on 31st Mar 2019

	($ 'thousands)			(Rs. 'thousands)	
	Dr.	Cr.	Conversion	Dr.	Cr.
			rate per $		
Plant & Machinery (cost)	200		Rs. 46	9,200	
Plant & Machinery Dep. Reserve		130	Rs. 46		5,980
Trade receivable/payable	60	30	Rs. 53	3,180	1,590
Stock (1.4.2018)	20		Rs. 50	1,000	
Cash & Bank Balances	10		Rs. 53	530	
Purchase / Sales	20	123	Rs. 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		Rs. 51	2,295	
Rent	12		Rs. 51	612	
Office expenses	18		Rs. 51	918	
Commission Receipts		100	Rs. 51		5,100
H.O. Current A/c		7	Actual		120
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				208	
	390	**390**		**19,063**	**19,063**
Closing stock	3.125		53	165.625	

Trading and Profit & Loss Account for the year ended 31st March, 2019 (Rs.'000)

	H.O.	Branch	Total		H.O.	Branch	Total
To Opening Stock	100	1,000.000	1,100.000	By Sales	520	6,273.000	6,793.000
To Purchases	240	1,020.000	1,260.000	By Goods sent to Branch	100	-	100.000
To Goods received from Head Office	-	100.000	100.000	By Closing Stock	150	165.625	315.625
To Wages & Salaries	75	2,295.000	2,370.000				
To Gross profit c/d	355	2,023.625	2,378.625				
	770	6,438.625	7,208.625		770	6,438.625	7,208.625
To Rent	-	612.000	612.000	By Gross profit b/d	355	2,023.625	2,378.625
To Office expenses	25	918.000	943.000	By Commission receipts	256	5,100.000	5,356.000
To Provision for doubtful debts@ 5%	14	159.000	173.000				
To Depreciation	460	644.000	1,104.000				
To (W. N.) Balance c/d	112	4,790.625	4,902.625				
	611	**7,123.625**	**7,734.625**		**611**	**7,123.625**	**7,734.625**
To Managing Partner's Salary		30.000		By Balance b/d		4,902.625	
To Exchange Loss		208.000		By Branch stock reserve		4,000	
To Balance c/d		4,668.625					
		4,906.625				**4,906.625**	

Working Note: Calculation of Depreciation		
	H. O	Branch
	Rs. '000	Rs. '000
Building. Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,500	9,200
Less: Dep. Reserve	(600)	(5,980)
	1,900	3,220
Depreciation @ 20% (B)	380	644
Total Depreciation (A+B)	460	644

Note: As the closing stock of Branch does not consist any stock transferred from M& S Co., there is no needto create closing stock reserve. But the opening branch stock reserve has to be reversed in the P&L A/c.

Question 2

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars, you are required to prepare branch account in the books of Head Office.

	Rs.		Rs.
Stock on 1st April 2017 (invoice price)	**30,000**	**Discount allowed to debtors**	**160**
Sundry Debtors on 1st April, 201 7	**18,000**	**Expenses paid by head office:**	
Cash in hand as on 1st April, 2017	**-**	**Rent**	**1,800**
Office furniture on 1st April, 2017	**3,000**	**Salary**	**3,200**
Goods invoiced from the head		**Stationery & Printing**	**800**
office (invoice price)	**1,60,000**		
Goods returned to Head Office	**2,000**	**Petty expenses paid by the branch**	**600**
(invoice price)			
Goods returned by debtors	**960**	**Depreciation to be provided on branch**	
Cash received from debtors	**60,000**	**furniture at 10% p. a.**	
Cash Sales	**1,00,000**	**Stock on 31st March, 2018**	
Credit sales	**60,000**	**(at invoice price)**	**28,000**

(MTP March '19 8 Marks, MTP March '18 10 Marks)

Answer 2

In the books of Head Office – Kolkata Branch Account (at invoice)

	Rs.			Rs.
To Balance b/d		By Stock reserve (opening)		6,000
Stock	30,000	By Remittances:		
Debtors	18,000	Cash Sales	1,00,000	
Furniture	3,000	Cash from Debtors	60,000	
To Goods sent to	1,60,000	Less: Petty expenses	(600)	1,59,400

branch			By Goods sent to branch (loading)	32,000
To Goods returned by branch (loading)		400	By Goods returned by branch (Return to H.O.)	2,000
To Bank (expenses			By Balance c/d	
paid by H.O.)			Stock	28,000
Rent	1,800		Debtors	16,880
Salary	3,200		Furniture (3,000-300)	2,700
Stationary &				
printing	800	5,800		
To Stock reserve (closing)		5,600		
To Profit transferred to				
General Profit & Loss A/c		24,180		
		2,46,980		2,46,980

Working Note:

Debtors Account

	Rs.		**Rs.**
To Balance c/d	**18,000**	**By Cash account**	**60,000**
To Sales account (credit)	**60,000**	**By Sales return account**	**960**
		By Discount allowed account	**160**
		By Balance c/d	**16,880**
	78,000		**78,000**

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Note: In the absence of opening cash balance, remittance to Head Office has been made after payment of petty expenses.

Question 3

On 31st December, 2016 the following balances appeared in the books of Kolkata Branch of an English firm having its HO office in New York:

	Amount in Rs.	**Amount in Rs.**
Stock on 1st Jan, 2016	**2,34,000**	
Purchases and Sales	**15,62,500**	**23,43,750**
Debtors and Creditors	**7,65,000**	**5,10,000**
Bills Receivable and Payable	**2,04,000**	**1,78,500**
Salaries and Wages	**1,00,000**	**-**
Rent, Rates and Taxes	**1,06,250**	**-**
Furniture	**91,000**	**-**
Bank A/c	**5,68,650**	
New York Account	**_**	**5,99,150**
	36,31,400	**36,31,400**

Stock on 31st December, 2016 was Rs. 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 2016 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange on 31st December, 2015 was Rs. 52 and on 31st December, 2016 was Rs. 51. The average rate for the year was Rs. 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch. (MTP April '19 Oct'18 ,10 Marks, Old & New SM)

Answer 3

In the books of English Firm (Head Office in New York) Kolkata Branch Profit and Loss Account for the year ended 31st December, 2016

	$		$
To Opening Stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To salaries	2,000		23,625
To Rent, rates and taxes	2,125	By Gross profit b/d	
To exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		**23,625**

Balance Sheet of Kolkata Branch as on 31st December, 2016

Liabilities		**$**		**$**
Head office A/c	13,400		Furniture Closing Stock Trade	**1,750**
Add: Net profit	17,500	30,900	DebtorsBill ReceivableCash at Bank	**12,500**
Trade creditors		10,000		**15,000**
Bills Payable		3,500		**4,000**
				11,150
		44,400		**44,400**

Working Note: Require for calculation of Exchange Translation Loss
Kalkata Branch Trail Balance (converted in $) as on 31st December, 2016

	Dr.	**Cr.**	**Conversion**	**Dr.**	**Cr.**
	Rs.	**Rs.**	**rate**	**$**	**$**
Stock on 1st Jan., 2016	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	**36,31,400**		**73,775**	**73,775**

Question 4

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

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

(ii) **Sale price is cost plus 40%.**

(iii) **Invoice price is cost plus 15%.**

(iv) **Other information from accounts of branch:**

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

(MTP 4 Marks Oct'21, May '20)

Answer 4

Branch Stock Reserve in respect of unrealized profit on opening stock = Rs. 3,45,000 x (15/115) = Rs. 45,000

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

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

Question 5

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

Particulars	**Pune Branch ₹**	**Goa Branch ₹**
Opening Stock	**40,000**	**30,000**
Purchases (Including Inter Branch transfers)	**2,00,000**	**2,50,000**
Sales	**2,80,000**	**2,95,625**
Chargeable Expenses	**15,000**	**27,500**
Closing Stock	**30,000**	**43,500**
Office and Administration Expenses	**13,250**	**7,000**
Selling and Distribution Expenses	**15,000**	**10,000**

Information:

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

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

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

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

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

(vi) Closing stock at Goa Branch includes goods of ₹ 4,000 (invoice price).(MTP 6 Marks Mar 22,Oct 20)

Answer 5

Pune Branch Trading and Profit and Loss Account

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

Question 6

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

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

The rates of exchange may be taken as follows:

- **on 1.4.2019 @ ₹ 40 per US $**

- on 31.3.2020 @ ₹ 42 per US $
- average exchange rate for the year @ ₹ 41 per US $.

New York branch account showed a debit balance of ₹ 44,380 on 31.3.2020 in Delhi books and there were no items pending reconciliation. You are asked to prepare trial balance of New York in ₹ in the books of Ganesh Ltd. (MTP 4 Marks Mar'22, Oct 20)

Answer 6

In the books of Ganesh Ltd. New York Branch Trial Balance in (₹) as on 31st March, 2020

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

Question 7

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

Particulars	**£**	**£**
	Dr.	**Cr.**
Property, Plant & Equipment (Acquired on 1st April, 2017)	**24,000**	
Stock as on 1st April, 2020	**11,200**	
Goods from head Office	**64,000**	
Expenses	**4,800**	
Debtors	**4,800**	
Creditors		**3,200**
Cash at bank	**1,200**	
Head Office Account		**22,800**
Purchases	**12,000**	
Sales		**96,000**
	1,22,000	**1,22,000**

In head office books, the branch account stood as shown below:

London Branch A/c

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

The following further information is given:

(a) Property, Plant & Equipment are to be depreciated @ 10% p.a. on WDV.

(b) On 31st March, 2021:

Expenses outstanding	**-**	**£ 400**
Prepaid expenses	**-**	**£ 200**
Closing stock	**-**	**£ 8,000**
(c) Rate of Exchange:		

1st April, 2017 - Rs. 70 to £ 1

1st April, 2020 - Rs. 76 to £ 1

31st March, 2021 - Rs. 77 to £ 1

Average - Rs. 75 to £ 1

You are required to prepare: (1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees; and (2) Trading and profit and loss account for the year ended 31st March, 2021 of London branch as would appear in the books of Delhi head office of DM. (MTP 8 Marks April 22, April 21)

Answer 7

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

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

Closing stock will be (8,000 × 77) = Rs. 6,16,000 Trading and Profit & Loss A/c for the year ended 31st March, 2021

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

To Depreciation	1,68,000			
To Net Profit	6,08,200			
	11,51,200			11,51,200

Working Note:

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

Question 8

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

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

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

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

(iv) Branch paid ₹ 2,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.(MTP 4 Marks , Nov '21 & April '23)

Answer 8

Journal Entries in Books of Branch

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

Question 9

Moon Star has a branch at Virginia (USA). The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2022 is as follows:

Particulars	**US $**	
	Dr.	**Cr.**
Office equipments	**48,000**	
Furniture and Fixtures	**3,200**	

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Stock (April 1, 2021)	22,400	
Purchases	96,000	
Sales	---	1,66,400
Goods sent from H.O	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rates & Taxes	800	
Insurance	400	
Trade Expenses	400	
Head Office Account	---	45,600
Sundry Debtors	9,600	
Sundry Creditors	---	6,800
Cash at Bank	2,000	
Cash in Hand	400	
	2,18,800	2,18,800

The following further information is given:

(1) **Salaries outstanding $ 400.**

(2) **Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.**

(3) **The Head Office sent goods to Branch for ₹15,80,000.**

(4) **The Head Office shows an amount of ₹ 20,50,000 due from Branch.**

(5) **Stock on 31st March, 2022 -$21,500.**

(6) **There were no transit items either at the start or at the end of the year.**

(7) **On April 1, 2020 when the fixed assets were purchased the rate of exchange was**

(8) **₹ 43 to one $. On April 1, 2021, the rate was 47 per $. On March 31, 2022 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.**

Prepare Trial balance incorporating adjustments given converting dollars into rupees and Trading, Profit and Loss Account for the year ended 31st March, 2022 of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet. (MTP 8 Marks March 21 & Oct '23, MTP 12 Marks Sep '22)

Answer 9

In the books of Moon Star Trial Balance (in Rupees) of Virginia (USA) Branch as on 31st March, 2022

	Dr.	Cr.	Conversion	Dr.	Cr.
	US $	US $	rate	₹	₹
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2021)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	

Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange difference (bal. fig.) transferred to foreign currency translation reserve account					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Trading and Profit and Loss Account of Virginia Branch for the year ended 31st March, 2022

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US $ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		15,92,200

Question 10

M/s Heera & Co. has head office at U.S.A. and branch in Patna(India). Patna branch is an integral foreign operation of Heera & Co.

Patna branch furnishes you with its trial balance as on 31st March, 2022 and the additional information given thereafter:

	Dr.	**Cr.**
	(Rupees in thousands)	
Stock on 1st April, 2021	**300**	
Purchases and Sales	**800**	**1,200**
Sundry Debtors & Creditors	**400**	**300**
Bills of Exchange	**120**	**240**
Wages & Salaries	**560**	**-**

Rent, Rates & Taxes	360	-
Sundry Charges	160	-
Plant	240	-
Bank Balance	420	-
U.S.A. Office A/c	-	1,620
	3,360	3,360

Information:

(a) **Plant was acquired from a remittance of US $ 6,000 received from USA head office and paid to the suppliers. Depreciate Plant at 60% for the year.**

(b) **Unsold stock of Patna branch was worth ₹ 4,20,000 on 31st March, 2022.**

(c) **The rates of exchange may be taken as follows:**

- **On 01.04.2021 @ ₹ 55 per US $**
- **On 31.03.2022 @ ₹ 60 per US $**
- **Average exchange rate for the year @ ₹ 58 per US $**
- **Conversion in $ shall be made up to two decimal accuracy.**

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2022 and the balance sheet as on that date of Patna branch as would appear in the books of USA head office of Heera & Co. You are informed that Patna branch account showed a debit balance of US $ 29845.35 on 31.3.2022 in USA books and there were no items pending reconciliation. (MTP 12 Marks Oct '22 & Aug. '18, 12 Marks) (Same concept different figures PYP May'19 8 Marks, Old & New SM)

Answer 10

M/s Heera & Co. Patna Branch Trial Balance in (US $) as on 31st March, 2022

	Conversion rate per US $ (₹)	Dr. US $	Cr. US $
Stock on 1.4.21	55	5,454.55	–
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	-
Rent, rates and taxes	58	6,206.90	-
Sundry charges	58	2,758.62	-
Plant	–	6,000.00	-
Bank balance	60	7,000.00	-
USA office A/c	–	-	29,845.35
		59,535.01	59,535.01

Trading and Profit & Loss Account for the year ended 31st March,2022

	US $		US $
To Opening Stock	5,454.55	By Sales	20,689.66

To Purchases To Wages and salaries	13,793.10 9,655.17	By Closing stock (₹ 4,20,000/60)	7,000.00
		By Gross Loss c/d	1,213.16
	28,902.82		28,902.82
To Gross Loss b/d	1,213.16	By Net Loss	13,778.68
To Rent, rates and taxes	6,206.90		
To Sundry charges	2,758.62		
To Depreciation on Plant	3,600.00		
(US $ 6,000 × 0.6)			
	13,778.68		13,778.68

Balance Sheet of Patna Branch as on 31st March, 2022

Liabilities		US $	Assets	US $	US $
USA Office A/c	29,845.35		Plant	6,000.00	
Less: Net Loss	(13,778.68)	16,066.67	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		5,000.00	Closing stock		7,000.00
Bills payable		4,000.00	Sundry debtors		6,666.67
			Bills receivable		2,000.00
			Bank balance		7,000.00
		25,066.67			25,066.67

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Question 11

On 31st March, 2022 Chennai Branch submits the following Trial Balance to its Head Office at Lucknow:

Debit Balances	**₹ in lacs**
Furniture and Equipment	**18**
Depreciation on furniture	**2**
Salaries	**25**
Rent	**10**
Advertising	**6**
Telephone, Postage and Stationery	**3**
Sundry Office Expenses	**1**
Stock on 1st April, 2021	**60**
Goods Received from Head Office	**288**
Debtors	**20**
Cash at bank and in hand	**8**
Carriage Inwards	**7**
Credit Balances	**448**
Outstanding Expenses	**3**
Goods Returned to Head Office	**5**
Sales	**360**
Head Office	**80**
	448

Additional Information:

Stock on 31st March, 2022 was valued at ₹ 62 lacs. On 29th March, 2022 the Head Office dispatched goods costing ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 2022. Hence, the figure of goods received from Head Office does not include these goods. Also the head office has charged the branch ₹ 1 lac for centralized services for which the branch has not passed the entry. You are required to :(i) pass Journal Entries in the books of the Branch to make the necessary adjustments and (ii) prepare Final Accounts of the Branch including Balance Sheet. (MTP 12 Marks March '23, RTP May '19, RTP May'20, Old & New SM)

Answer 11

(i) Books of Branch

Journal Entries

			(₹ in lacs)
		Dr.	Cr.
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 2022)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 2022

	₹ in lacs		₹ in lacs
To Opening Stock	60	By Sales	360
To Goods received from		By Closing Stock	62
Head Office 288			
Less : Returns (5)	283		
To Carriage Inwards	7		
To Gross Profit c/d	72		
	422		422
To Salaries	25	By Gross Profit b/d	72
To Depreciation on Furniture	2		
To Rent	10		
To Advertising	6		
To Telephone, Postage & Stationery	3		
To Sundry Office Expenses	1		
To Head Office Expenses	1		
To Net Profit Transferred to			
Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 2022

Liabilities	₹ in lacs		Assets	₹ in lacs	
Head Office	80		Furniture & Equipment	20	

Add : Goods in transit	10		Less : Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24		Goods in Transit		10
		115	Debtors		20
Outstanding Expenses		3	Cash at bank and in hand		8
		118			118

Question 12

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

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

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

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit. (RTP Nov 21, PYP 10 Marks Nov 20)

Answer 12

Branch Stock Account

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

		5,03,000				5,03,000
1.4.20	To Balance b/d	75,000				

Branch Debtors Account

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

Branch Expenses Account

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

Branch Profit & Loss Account for year ended 31.3.20

		₹			₹
31.3.20	To Branch Expenses A/c	59,100	31.3.20	By Branch stock	47,000
	To Net Profit transferred to General P & L A/c	46,900		By Branch Stock Adjustment account	58,500
				By Baddebts recovered	500
		1,06,000			106,000

Branch Stock Adjustment Account for year ended 31.3.20

		₹			₹
31.3.20	To Goods sent to branch (30,000x1/6) -returns	5,000	31.3.20	By Balance b/d (36,000x1/6)	6,000
	To Branch P & L A/c	58,500		By Goods sent to branch (4,20,000x1/6)	70,000
	To Balance c/d (75,000x1/6)	12,500			
		76,000			76,000

Question 13

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31 st March, 2020.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated

before charging his commission but subject to a deduction from such commission equal to 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch from head office. The following details for the year ended 31st March, 2020 are given as follows:

	Rs.		Rs.
Opening Stock (at cost)	**74,736**	**Chargeable expenses**	**49,120**
Goods sent to branch (at cost)	**2,89,680**	**Closing Stock (Selling Price)**	**1,23,328**
Sales	**3,61,280**		
Manager's commission paid on account	**2,400**		

From the above details, you are required to calculate the commission due to manager for the year ended 31st March, 2020. (RTP May'21, May 18)

Answer 13

In the books of Alpha Ltd.

Step 1: Calculation of Deficiency Branch stock account (at invoice price)

Particulars	Rs.	Particulars	Rs.
To Opening Stock (Rs. 74,736 + 1/3 of Rs. 74,736)	99,648	By Sales	3,61,280
To Goods sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Deficiency at sale price [Balancing figure]	1,280
	4,85,888		4,85,888

Step 2: Calculation of Net Profit before Commission

Branch account

Particulars	Rs.	Particulars	Rs.
To Opening Stock [Rs.74,736 + 1/3 of Rs. 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
To Expenses	49,120	By Stock Reserve A/c	24,912
To Stock Reserve A/c [Rs. 1,23,328 x 25/100]	30,832	By Goods sent to Branch A/c	96,560
To Net Profit – subject to manager's commission	40,240		
	6,06,080		6,06,080

Step 3: Calculation of Commission still due to manager

		Rs.
A	Calculation at 10% profit before charging his commission [Rs. 40,240 x 10/100]	4,024
B	Less: 25% of cost of deficiency in stock [25% of (75% of Rs. 1,280)]	(240)
C	Commission for the year [A-B]	3,784
D	Less: Paid on account	(2,400)
E	Balance due (C-D)	1,384

Question 14

From the following particulars relating to Pune branch for the year ending December 31, 2018, prepare

Branch Account in the books of Head office.

		₹
Stock at Branch on January 1, 2018		10,000
Branch Debtors on January 1, 2018		4,000
Branch Debtors on Dec. 31, 2018		4,900
Petty cash at branch on January 1, 2018		500
Furniture at branch on January 1, 2018		2,000
Prepaid fire insurance premium on January 1, 2018		150
Salaries outstanding at branch on January 1, 2018		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Annual Insurance up to March 31, 2019	600	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2018		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs.1,200 were destroyed due to fire and a sum of Rs.1,000 was received from the Insurance Company (RTP Nov 19)

Answer 14

Pune Branch Account

Particulars		**₹**	**Particulars**	**₹**	**₹**
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash paid by debtors directly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received from Insurance Company	1,000	1,68,000
To Bank (expenses)			By Goods sent to branch		1,000
Rent	2,000		(return of goods by		
Salaries	2,400		the branch to H.O.)		
Petty Cash	1,000		By Closing Balances:		
Insurance	600	6,000	Stock		5,000

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To Net Profit		78,950	Petty Cash		650
			Debtors		4,900
			Furniture (2,000 – 10% depreciation)		1,800
			Prepaid insurance (1/4 x Rs.600)		150
		1,81,600			1,81,600

Working Note:

Calculation of petty cash balance at the end:	₹
Opening balance	500
Add: Cash received form the Head Office	1,000
Total Cash with branch	1,500
Less: Spent by the branch	850
Closing balance	650

Question 15

Pass necessary Journal entries in the books of an independent Branch of M/s TPL Sons, wherever required, to rectify or adjust the following transactions:

(i) Branch paid ₹ 5,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.

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

(iii) Branch assets accounts retained at head office, depreciation charged for the year ₹ 15,000 not recorded by Branch.

(iv) Head Office expenses ₹ 75,000 allocated to the Branch, but not yet been recorded by the Branch.

(v) Head Office collected ₹ 60,000 directly from a Branch Customer. The intimation of the fact has not been received by the Branch.

(vi) Goods dispatched by the Head office amounting to ₹ 50,000, but not received by the Branch till date of reconciliation.

(vii) Branch incurred advertisement expenses of ₹ 10,000 on behalf of other Branches, but not recorded in the books of Branch.

(viii) Head office made payment of ₹ 16,000 for purchase of goods by branch, but not recorded in branch books. (RTP Nov 18, Old & New SM)

Answer 15

Books of Branch Journal Entries

			Amounts₹	
			Dr.	Cr.
(i)	Head Office Account	Dr.	5,000	
	To Salaries Account (Being rectification of salary paid on behalf of Head Office)			5,000
(ii)	No entry in Branch Books is required.			
(iii)	Depreciation A/c	Dr.	15,000	
	To Head Office Account			15,000
	(Being depreciation of assets accounted for)			
(iv)	Expenses Account	Dr.	75,000	

	To Head Office Account (Being allocated expenses of Head Office recorded)			75,000
(v)	Head Office Account	Dr.	60,000	
	To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)			60,000
(vi)	Goods in-transit Account	Dr.	50,000	
	To Head Office Account (Being goods sent by Head Office still in-transit)			50,000
(vii)	Head Office Account	Dr.	10,000	
	To expenses Account (Being expenditure incurred, wrongly recorded in books)			10,000
(vii)	Purchases account A/c	Dr.	16,000	
	To Head Office Account (Being purchases booked)			16,000

Question 16

Mr. Chena Swami of Chennai trades in Refined Oil and Ghee. It has a branch at Salem. He despatches 30 tins of Refined Oil @ ₹ 1,500 per tin and 20 tins of Ghee @ ₹ 5,000 per tin on 1st of every month. The Branch has incurred expenditure of ₹ 45,890 which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

	Chennai H.O.	Salem B.O.
	Amount (₹)	**Amount (₹)**
Purchases:		
Refined Oil	**27,50,000**	
Ghee	**48,28,000**	
Direct Expenses	**6,35,800**	
Expenses paid by H.O.		**76,800**
Sales:		
Refined Oil	**24,10,000**	**5,95,000**
Ghee	**38,40,500**	**14,50,000**
Collection during the year		**20,15,000**
Remittance by Branch to Head Office		**19,50,000**

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

Salem Brach Office		
Balance as on	01-04-2020 Amount (₹)	31-03-2021 Amount (₹)
Stock:		
Refined Oil	22,500	19,500
Ghee	40,000	90,000
Sundry Debtors	1,80,000	?
Cash in hand	25,690	?
Furniture & Fixtures	23,800	21,420

Additional information:

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

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

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

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

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

You are requested to prepare Branch Account in the Head Office books and also prepare Chena Swami's Trading and Profit & loss Account (excluding branch transactions) for the year ended 31st March, 2021. (RTP May '22) (Same concept different figures Old & New SM)

Answer 16

In the books of Mr. Chena Swami Salem Branch Account

		₹		₹
To	Balance b/d Opening stock:		By Bank (Remittance to H.O.)	19,50,000
	Ghee	40,000	By Balance c/d	
	Refined Oil	22,500	Closing stock:	
	Debtors	1,80,000	Refined oil	19,500
	Cash on hand	25,690	Ghee	90,000
	Furniture & fittings	23,800	Debtors (W.N. 1)	2,10,000
To	Goods sent to Branch A/c		Cash on hand (W.N. 2)	44,800
	Refined Oil (30 x ₹ 1,500x12)	5,40,000	Furniture & fittings	21,420
	Ghee (20 x ₹ 5,000 x12)	12,00,000		
To	Bank (Expenses paid by H.O.)	76,800		
To	Manager's commission in profits			
	10% (2,26,930x10/110)	20,630		
To	Net Profit transferred			
	to General P & L A/c	2,06,300		
		23,35,720		**23,35,720**

Mr. Chena Swami Trading and Profit and Loss account for the year ended 31st March, 2021 (Excluding branch transactions)

	₹		₹
To Opening Stock:		By Sales:	

Refined Oil	44,000	Refined Oil	24,10,000
Ghee	10,65,000	Ghee	38,40,500
To Purchases:		By Closing Stock:	
Refined Oil 27,50,000		Refined Oil	8,90,000
Less: Goods sent to Branch (5,40,000)	22,10,000	Ghee	15,70,000
Ghee 48,28,000			
Less: Goods sent to Branch (12,00,000)	36,28,000		
To Direct Expenses	6,35,800		
To Gross Profit	11,27,700		
	87,10,500		87,10,500
To Manager's Salary	2,40,000	By Gross Profit	11,27,700
To General Expenses	1,86,000	By Branch Profit transferred	2,06,300
To Depreciation			
Furniture (88,600 - 79,740)	8,860		
Building (5,10,800 + 2,41,600 - 7,14,780)	37,620		
To Net profit	8,61,520		
	13,34,000		**13,34,000**

Working Notes:

(1) Debtors Account

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

(2) Branch Cash Account

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

Question 17

PQR has a branch at Houston (USA). Business of the Branch is carried out substantially independent by way of accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. The trial balance of the Branch as at 31st March, 2022 is as follows:

	US$	
Particulars	**Debit**	**Credit**

Office equipment (Cost)	56,400	
Opening Accumulated Depreciation (Office equipment)		5,400
Furniture and Fixtures (Cost)	36,000	
Opening Accumulated Depreciation		6,840
(Furniture and Fixtures)		
Opening Stock as on 1st April, 2021	24,500	
Purchases	96,500	
Sales		1,76,250
Salaries	4,250	
Carriage inward	256	
Rent, Rates & Taxes	956	
Trade receivables	12,560	
Trade payables		8,650
Cash at bank	2,540	
Cash in hand	500	
Head office Account	______	37,322
Total	2,34,462	2,34,462

Following further information are given:

(i) Salaries outstanding as on 31st March, 2022 is US$ 600.

(ii) Depreciate office equipment and furniture & fixtures @ 10% at written down value.

(iii) Closing stock as on 31st March, 2022 is US $, 24,650.

(iv) You are informed that the Head office is showing receivable from the Branch as ₹ 23,75,614 as on 31st March, 2022. No transaction in respect of the Branch is pending in Head office.

(v) Office equipment (cost) includes one office equipment of US $ 2,400 purchased on 1/04/2021.

(vi) One furniture of carrying value of US $ 450 as on 01/04/2021 (cost: US $ 500 and Accumulated depreciation: US $ 50) has been sold for US $ 405 on 31/03/2022 to Mr. M at no profit no loss. Mr. M has not paid the amount till the finalization of branch account. No entry has been passed for this sale of furniture in the above trial balance.

(vii) The rate of exchange on different dates are:

Date	1 US $ is equivalent to
1st April, 2021	₹ 64
31st December, 2021	₹ 70
31st March, 2022	₹ 75
Average for the year	₹ 72

You are required to prepare the trial Balance after incorporating adjustments given and converting US $ into rupees. (RTP May 23)

Answer 17

In the books of PQR

Trial Balance (in Rupees) of Houston (USA) Branch – Non-Integral foreign operation as on 31st March, 2022

	Dr.	Cr.	Conversion	Dr.	Cr.
	US $	US $	rate	₹	₹
Office Equipment	56,400		75	42,30,000	

Depreciation on Office Equipment (Accumulated)		10,500	75		7,87,500
(5,400+5,100)					
Depreciation	8,016		75	6,01,200	
Furniture and fixtures (36,000-500)	35,500		75	26,62,500	
Depreciation on furniture and fixtures (Accumulated)		9,661	75		7,24,575
(6,840-50-45 +2,916)					
Stock (1st April, 2021)	24,500		64	15,68,000	
Purchases	96,500		72	69,48,000	
Sales		1,76,250	72		126,90,000
Carriage inward	256		72	18,432	
Salaries (4,250+600)	4,850		72	3,49,200	
Rent, rates and taxes	956		72	68,832	
Salaries payable		600	75		45,000
Head Office A/c		37,322			23,75,614
					(given)
Trade receivables	12,560		75	9,42,000	
Trade payables		8,650	75		6,48,750
Cash at bank	2,540		75	1,90,500	
Cash in hand	500		75	37,500	
Mr. M	405		75	30,375	
(Receivable for sale of					
furniture)					
Exchange gain (bal. fig.)					3,75,100
	2,42,983	**2,42,983**		**176,46,539**	**176,46,539**

Closing stock 24,650 US$ x ₹ 75 =₹18,48,750.

Question 18

Ayan Ltd. invoices goods to its branch at cost plus 33 % . From the following particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office.

	Rs.
Stock at commencement at Branch at invoice Price	**3,60,000**
Stock at close at Branch at Invoice Price	**2,88,000**
Goods sent to Branch during the year at invoice price (including goods invoiced at Rs. 48,000 to Branch on 31.03.2018 but not received by Branch before close o f the year).	**24,00,000**
Return of goods to head office (invoice Price)	**1,20,000**
Credit Sales at Branch	**1,20,000**
Invoice value of goods pilfered	**24,000**
Normal loss at Branch due to wastage and deterioration of stock (at invoice price)	**36,000**
Cash Sales at Branch	**21,60,000**

Ayan closes its books on 31st March, 2018. (PYP May '18, 10 Marks)

Answer 18

In the books of Head Office Branch Stock Account

Particular	Rs.	Particular	Rs.
To Balance b/d	3,60,000	By Bank A/c (cash Sales)	21,60,000
To Goods sent to Branch A/c	24,00,000	By Branch Debtors A/c (Credit Sales)	1,20,000
To Branch Adjustment	36,000	By Goods sent to Branch A/c (Returns to H.O.)	1,20,000
A/c balancing fig. (Surplus)***		By Branch Adjustment A/c*(Rs.24,000 x 25/100)	6,000
		By Branch P&L A/c* (Cost of Abnormal Loss)	18,000
		By Branch Adjustment A/c**(invoice price of normal loss	36,000
		By Balance c/d:	
		In hand	2,88,000
		In transit	48,000
	27,96,000		**27,96,000**

*Alternative, combined posting for the amount of Rs.24,000 may be passed through Goods preferred account.

** Alternatively, it may first be transferred to normal Loss account which may ultimately be closed bytransfer to Branch Adjustment account. The final amount of net profit will however remain same.

*** It has been considered that the surplus may be due to sale of goods by branch at price higher than invoice price.

Branch Stock Adjustment Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c	6,000	By Stock Reserve A/c	90,000
(Loading on Abnormal Loss)		(Rs. 3,60,000x25/100)	
To Branch Stock A/c	36,000	By Goods Sent to Branch A/c	5,70,000
(Normal Loss)		(Rs.24,00,000 - Rs.1,20,000) x 25/100	
To Stock Reserve A/c	84,000	By Branch Stock A/c (Surplus)	36,000
(Rs.3,36,000x25/100)			
To Gross Profit t/f to P & LA/c	5,70,000		
	6,96,000		**6,96,000**

Branch Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c	18,000	By Branch Adjustment A/c	5,70,000
(Cost of Abnormal Loss)		(Gross Profit)	
To Net Profit t/f to General P&LA/c	5,52,000		
	5,70,000		**5,70,000**

Question 19

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

(1) Branch paid ₹ 5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.

(2) Asset Purchased by branch for ₹ 25,000, but the Asset account was retained in H.O Books.

(3) A remittance of ₹8,000 sent by the branch has not been received by H.O.

(4) H.O collected ₹ 25,000 directly from the customer of Branch but fails to give the intimation to branch.

(5) Remittance of funds by H.O to branch ₹5,000 not entered in branch books. (PYP 5 Marks Jan 21)

Answer 19

Journal Entries in Books of Branch A

	Particulars	Dr. Amount ₹	Cr. Amount ₹
(i)	Head office account Dr.	5,000	
	To Salaries account (Being the rectification of salary paid on behalf of H.O.)		5,000
(ii)	Head office account Dr.	25,000	
	To Bank / Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)		25,000
(iii)	No Entry in Branch Books		
(iv)	Head office account Dr.	25,000	
	To Debtors account (Being the amount of branch debtors collected by H.O.)		25,000
(v)	Bank A/c Dr.	5,000	
	To Head Office (Remittance of Funds by H.O. to Branch)		5,000

Question 20

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

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

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

	₹		₹
Sales	2,78,000	Manager's salary	16,400
Purchases	64,500	Collections from debtors	2,57,000
Wages Paid	24,000	Discounts allowed	16,000
Salaries (inclusive of advance of 5,000)	15,600	Discount earned	4,600
General Expenses	7,800	Cash paid to creditors	88,500
Fire Insurance (Paid for one year)	11,200	Building Account (further payment)	14,000
Remittance to H.O.	52,900	Cash in Hand	5,600
		Cash at Bank	47,000

Set out the Head Office Account in Noida Books and the Branch Balance Sheet as on 30.09.2020. Also give journal entries in the Noida books. (PYP July '21,10 Marks) (Same concepts different figures Old & New SM)(MTP 10 Marks Sep '23)

Answer 20

Journal Entries in the Books of Noida Branch

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

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

Head Office Account

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

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

Balance Sheet of Noida Branch As at 30th Sept 2020

Liabilities	Amt (₹)	Assets	Amt (₹)
Creditors	33,400	Debtors	2,29,000
Head Office A/c	2,58,800	Salary Advance	5,000
		Prepaid Insurance	5,600
		Building Extension A/c transferred to HO	
		Cash in Hand	5,600
		Cash at Bank	47,000
Total	2,92,200	Total	2,92,200

Working Notes

Cash and Bank Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	26,000	By Wages	24,000
To Collection from debtors	2,57,000	By Salaries	15,600
		By Insurance	11,200

		By General Expenses	7,800
		By HO A/c	52,900
		By Manager's Salary	16,400
		By Creditors	88,500
		By Building A/c	14,000
		By Balance c/d	
Total		- Cash in Hand	5,600
		- Cash at bank	47,000
	2,83,000	Total	2,83,000

Debtors Account

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

Creditors Account

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

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

Question 21

Delta Ltd. Has a branch at Kanpur. Goods are invoiced from head office to Branch at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office. Prepare necessary Ledger accounts in the books of Delta Ltd. Under Stock and Debtors system to show profit earned at the branch for the year ending 31 st March, 2021.

Following information related to Branch is given:

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

(PYP 10 Marks, Dec '21)

Answer 21

Books of Delta Ltd. Kanpur Branch Stock Account

	₹		₹
To Balance b/d – Opening Stock	31,200	By Bank A/c – Cash Sales	20,000
To Branch Debtors A/c – Sales Return	3,000	By Branch Debtors A/c - Credit Sales	68,200

To Goods sent to Branch A/c (72,000 +50% of 72,000)	1,08,000	By Balance c/d - Closing stock	54,600
To Surplus in stock	600		
	1,42,800		1,42,800

Kanpur Branch Stock Adjustment Account

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

Goods Sent to Branch Account

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

Branch Debtors Account

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

Branch Expenses Account

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

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

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

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

Question 22

Walkaway Footwears has its head office at Nagpur and Branch at Patna. It invoiced goods to its branch at 20% less than the list price which is cost plus 100%, with instruction that cash sales were to be made at

invoice price and credit sales at catalogue price (i.e. list price).

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

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

You are required to prepare Branch Stock Account, Branch Adjustment Account, Branch Profit & Loss Account and Branch Debtors Account for the year ended 31st March,2022. (PYP 10 Marks May 22)

Answer 22

(a) In the books of walkaway footwears

Patna Branch Stock Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
1.1.21	To Balance b/d Goods sent to	12,000	31.12.21	By Bank A/c (Cash sales)	46,000
31.12.21	To branch A/c	1,32,000		By Branch debtors A/c (credit sales)	1,00,000
	To Branch adjustment A/c (Surplus over invoice price)	20,000	31.12.21	By Shortage in stock A/c	400
				By Balance c/d	17,600
		1,64,000			1,64,000

Patna Branch Adjustment Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
31.12.21	To Stock reserve - ₹17,600x 60/160 (closing stock)	6,600	31.12.21	By Stock reserve – ₹12,000x 60/160 (Opening stock)	4,500
	To Shortage (400x 60/160)	150		By Goods sent to branch A/c	49,500
	To Branch profit & loss A/c (Gross profit)	67,250		(₹1,32,000x 60/160)	
				By Branch stock A/c	20,000
		74,000			74,000

Branch Profit & Loss Account

Particulars	Amount (₹)	Particulars	Amount (₹)

To Branch expenses A/c	17,500	By Branch adjustment A/c (Gross Profit)	67,250
To Shortage in stock A/c	250		
To Net profit (transferred to Profit & Loss A/c)	49,500		
	67,250		67,250

Branch Debtors Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
1.1.21	To Balance b/d	10,000	31.12.21	By Bank A/c	85,000
31.12.21	To Branch stock A/c	1,00,000		By Balance c/d (bal. fig.)	25,000
		1,10,000			1,10,000

Question 23

Modern Stores of Delhi operates a branch at Nagpur. The Head office affects all purchases and the branch is charged at cost plus 60%. All the cash received by Nagpur Branch is remitted to Delhi. The Branch expenses are met by the Branch out of an Imprest Account which is reimbursed by the Delhi Head Office every month. The Branch maintains a Sales Ledger and certain essential subsidiary records, but otherwise all branch transactions are recorded at Delhi.

The following branch transactions took place during the year ended 31st March, 2022:

	₹
Goods received from Delhi at Selling Price	**1,50,000**
Cash Sales	**69,000**
Goods returned to Delhi at Selling Price	**3,000**
Credit Sales (Net of returns)	**63,000**
Authorized Reduction in Selling Price of Goods Sold	**1,500**
Cash Received from Debtors	**48,000**
Debtors written off as irrecoverable	**2,000**
Cash Discount allowed to Debtors	**1,500**

- **On 1st April, 2021 the Stock in trade at the Branch at Selling Price amounted to ₹ 60,000 and the Debtors were ₹ 40,000.**
- **A consignment of goods sent to the Branch on 27th March,2022 with a Selling Price of ₹ 1,800 was not received until 5th April,2022 and had not been accounted for in stock.**
- **The Closing Stock at Selling Price was ₹ 72,900.**
- **The expenses relating to the Branch for the year ended 31 st March,2022 amounted to 18,000.**

You are required to prepare the Branch Stock Account, Branch Debtors Account, Branch Adjustment Account and Branch Profit and Loss Account maintained at Delhi under Stock and Debtors method. Any stock unaccounted for is to be regarded as normal wastage.
(PYP 10 Marks Nov '22)

Answer 23

Books of Modern Store Delhi Nagpur Branch Stock A/c

Particulars	**₹**	**Particulars**	**₹**
To Opening stock	60,000	By Bank A/c (Cash Sales)	69,000

To Goods sent to branch A/c	1,50,000	By Branch Debtors A/c (Credit sales)	63,000
To Goods sent to branch A/c	1,800	By Goods sent to branch A/c (Return)	3,000
		By Branch adjustment A/c (Reduction in selling price)	1,500
		By Branch adjustment A/c (Normal Loss)	600
		By Closing stock (including stock in transit of ₹ 1,800)	74,700
	2,11,800		2,11,800

Branch Debtors A/c

Particulars	₹	Particulars	₹
To Bal. b/d	40,000	By Cash/Bank A/c	48,000
To Branch Stock (Sales)	63,000	By Branch P&L A/c (Bad debts)	2,000
		By Branch P&L A/c (Discount)	1,500
		By Bal. c/d	51,500
	103,000		103,000

Branch Adjustment A/c

Particulars	₹	Particulars	₹
To Branch Stock Account (Reduction in selling price)	1,500	By Stock reserve A/c (60,000 X 60/160)	22,500
To Branch Stock Account (Normal loss*)	600	By Goods sent to branch A/c (Loading) (1,51,800 X 60/160)	56,925
To Goods sent to branch A/c (loading on returns) (3,000 X 60/160)	1,125		
To Branch P&L A/c	48,187		
To Stock reserve A/c (74,700 X 60/160)	28,013**		
	79,425		79,425

Note: * Alternatively, the loading of ₹ 225 on normal loss may be charged to Branch Adjustment A/c and cost ₹375 thereof may be charged to Branch P&L A/c.

** rounded off. Alternatively may be rounded off as ₹ 28,012.

Branch P&L A/c

Particulars	₹	Particulars	₹
To Branch expenses A/c	18,000	By Branch Adjustment A/c	48,187
To Bad debts A/c	2,000		
To Discount A/c	1,500		

To Net Profit	26,687		
	48,187		**48,187**

Question 24

Artis Limited has a branch at Seattle USA. Its Trial Balance as on 31thDecember 2022 is as follows:

	Dr. in US $	Cr. In US $
Stock as on 01.01.2022	22,000	
Purchases	1,00,000	
Sales		1,30,500
Goods from H.O.	30,000	
Salaries	4,000	
Head Office A/c.		27,000
Sundry Debtors	2,200	
Sundry Creditors		1,500
Cash at Bank & Hand	800	
Total	1,59,000	1,59,000

The following information is given:

i) Salaries outstanding are $ 500.

ii) The Head Office sent goods to Branch for ₹ 24,00,000.

iii) The Head Office shows an amount of ₹ 21,90,000 due from Branch.

The exchange rates were as below:

- **On 1st January 2022 -₹ 79 to 1$**
- **On 31st December 2022-₹ 83 to 1 $**
- **Average rate during the year was ₹ 79.50 to 1 $**

You are required to prepare the Seattle Branch Trial Balance incorporating adjustments given above, converting dollars into rupees. (PYP 5 Marks May '23)

Answer 24

Seattle Branch Trial balance (in ₹)

Particulars	Rate as per ₹	Debit ₹	Credit ₹
Stock (01-01-2022)	79.00	17,38,000	
Purchases	79.50	79,50,000	
Sales	79.50		1,03,74,750
Goods from HO	Given	24,00,000	
Salaries ($ 4,000 + $ 500 = $ 4,500 x ₹	79.50	3,57,750	

79.50)1			
Head Office A/c	Given		21,90,000
Sundry Debtors	83.00	1,82,600	
Sundry Creditors	83.00		1,24,500
Cash at Bank & Hand	83.00	66,400	
Salaries Outstanding ($ 500 x ₹ 83)	83.00		41,500
Exchange gain		**36,000**	
Total		**1,27,30,750**	**1,27,30,750**

[1] The amount of outstanding salary amounting $ 500 (included in the salaries) may be converted at ₹ 83 and the salary paid during the year at ₹79.50. In that case the amount of salaries including outstanding salary debited in the trial balance will be for ₹ 3,59,500 [(4,000 X 79.5 =3,18,000) + (500 x 83= 41,500). In this case, the amount of exchange gain will be computed as ₹ 34,250.

Question 25

Treadmill invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding ₹ 20,000 necessary for meeting immediate requirements of cash. On 31st March, 2022 the assets at the branch were as follows:

	₹ ('000)
Cash in Hand	20
Trade Debtors	768
Stock, at Invoice Price	2,160
Furniture and Fittings	1,000

During the accounting year ended 31st March, 2023 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 2 crore 64 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at ₹ 1,44,000. Other transactions at the branch during the year were as follows:

	(₹ '000)
Cash Sales	19,400
Credit Sales	6,280
Cash collected by Branch from Credit Customers	5,684
Cash Discount allowed to Debtors	116
Returns by Customers direct to Head office (at invoice price)	204
Bad Debts written off	74
Expenses paid by Branch	1,684

On 1st January, 2023 the branch purchased new furniture for ₹ 2 lakh for which payment was made by head office through a cheque.

On 31st March, 2023 branch expenses amounting to ₹ 12,000 were outstanding and cash in hand was again ₹ 20,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 2023. (RTP Nov '23)

Answer 25

In the Head Office Books Branch Account for the year ended 31st March, 2023

	₹ '000		₹'000
To Balance b/d		By Balance b/d	
Cash in hand Trade debtors	20 768	Stock reserve ₹ 2,160 × $\frac{1}{6}$	360
Stock Furniture and fittings	2,160 1,000	By Goods sent to branch A/c (Returns to H.O.) {144 + [204 -34 (loading]}	314
To Goods sent to branch A/c	26,400	By Goods sent to branch A/c (Loading on net goods sent to branch – (26,256 x 1/6)	4,376
To Bank A/c (Payment for furniture)	200		
To Balance c/d Stock reserve (2,736 x 1/6)	456	By Bank A/c (Remittance from branch to H.O.)	23,400
To Outstanding expenses	12	By Balance c/d	
To Profit and loss A/c (Net Profit)	2,192	Cash in hand	20
		Trade debtors	970
		Stock	2,736
		Furniture and fittings	1,032
	33,208		33,208

Working Notes:

1. Invoice price and cost

Let cost be	100
So, invoice price	120
Loading	20
Loading: Invoice price	= 20: 120 = 1: 6

2. Invoice price of closing stock in branch

Branch Stock Account

	₹ '000		₹ '000
To Balance b/d	2,160	By Goods sent to branch	144
To Goods sent to branch	26,400	By Branch Cash	19,400
		By Branch debtors	6,280
		By Balance c/d (Bal fig)	2,736
	28,560		28,560

Note: adjustment regarding returns by Customers direct to Head office has not been made in branch stock account.

3. Closing balance of branch debtors

Branch Debtors Account

	₹ '000		₹ '000
To Balance b/d	768	By Branch cash	5,684
To Branch stock	6,280	By Branch expenses discount	116
		By Goods sent to Branch (Returns)	204
		By Branch expenses	
		(Bad debts)	74
		By Balance c/d (Bal fig)	970
	7,048		7,048

4. Closing balance of furniture and fittings

Branch Furniture and Fittings Account

	₹ '000		₹ '000
To Balance b/d	1,000	By Depreciation (160+8)	168
To Bank	200	By Balance c/d	1,032
	1,200		1,200

Note: Since the new furniture was purchased on 1st Jan 2023 depreciation will be for 3 months.

5. Remittance by branch to head office

Branch Cash Account

	₹ '000		₹ '000
To Balance b/d	20	By Branch expenses	1,684
To Branch stock	19,400	By Remittances to H.O.	23,400
To Branch debtors	5,684	By Balance b/d	20
	25,104		25,104

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