मेहनत अगर आदत बन जाए तो, कामयाबी मुकद्दर बन जाती है!

CA INTER

ADVANCED ACCOUNTING

BOOSTER BATCH

(IMPORTANT QUESTIONS + CONCEPTS)

BY

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Class 2! AS 10 AS 26 AS 28 and AS 17: https://youtu.be/lnyY5hATw48

Class 3! Internal Reconstruction, AS 7,AS 9& AS 25: https://youtu.be/G3aZKynoSME

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RTP Jan 25: https://youtu.be/OtOXpZIUj2k

MARATHON OF ICAI STUDY MATERIAL BATCH: https://youtu.be/cS5OkYCknVo

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Play list of all RTP and MTP https://www.youtube.com/watch?v=NrbplGgcWdE&list=PLqE5aHjZDY87bdP2tM6zKaK1K5wZRriZe

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Suggested Answer Sept. 24: https://youtu.be/LXdXjE-a1xw

CHAPTER 1 AS 16 - BORROWING COSTS

1. Capitalisation of Borrowing cost: Borrowing costs that are directly attributable
   - to the acquisition, construction or production of a qualifying asset
   - are capitalised as part of the cost of the qualifying asset.

   ⇨ Other borrowing costs are recognised as an expense (P&L A/c).

2. A qualifying asset: is an asset
   - that necessarily takes
   - a substantial period of time [a period of 12 months or more. (ASI-1)]

3. Commencement of capitalization: when all the following conditions are satisfied:
   (a) Expenditure on a qualifying asset is being incurred.
   (b) Borrowing costs are being incurred.
   (c) Necessary activities are in progress.

4. Suspension of capitalization: if active development is interrupted, then
   - Capitalization of borrowing costs is to be suspended, during extended periods in which it suspends active development of a qualifying asset.

5. Cessation of capitalisation: If any one condition is fulfilled out of following two:-
   (a) when the qualifying asset for its intended use or sale are complete; or
   (b) Borrowing has been repaid.

   Note: When an entity completes the construction of a Q.A. in parts & each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs on that part.

6. Calculation of amount of borrowing cost capitalized:

Particulars	Amount
Specific Borrowing Cost (Note 2)	XXX
(+) General borrowing cost	
{Weighted average of expenditure incurred on Q.A. from general borrowing} X {Capitalisation rate / general borrowing rate}	XXX
	XXX

Note 1: Expenditures on a qualifying asset include:

Those expenditures that have resulted in payments of cash	XXX
Transfers of other assets	XXX
Assumption of interest bearing liabilities	XXX
Amount of borrowing cost already capitalised	XXX
(-)Any progress payments received and grants received	(XXX)
	XXX

Note 2: Specific borrowing cost:

Actual borrowing cost incurred on specific borrowing	XXX
(-) Any income on temporary investment of borrowed funds	(XXX)
	XXX

Note 3: General Borrowing Rate/Capitalisation Rate

$$\frac{\text{Total general borrowing costs for the period(excluding specific borrowings)}}{\text{Weighted average total general borrowings(excluding specific borrowings)}} \times 100$$

Notes:
(1) Borrowing cost does not include notional cost of capital.
(2) Always use first specific borrowing then use general borrowing.

7. Meaning of Borrowing costs: It includes:
(i) interest and commitment charges.
(ii) amortisation of discounts or premiums relating to borrowings;
(iii) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
(iv) finance charges in respect of assets acquired under finance leases; and
(v) Foreign exchange loss: shall be capitalized at lower of two:
(a) Foreign exchange loss; or
(b) Local borrowing cost in excess of foreign borrowing cost.

8. No borrowing cost shall be capitalized once asset get ready for its intended use or sale.

9. Qualifying Assets may be any of the following: (Depending on the circumstances)
(a) PPE (b) inventories (c) intangible assets (d) investment properties

PRACTICAL QUESTIONS

1. M/s 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. Detailed of other outstanding non-specific loans were:

Amounts (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 loading construction were as follows:

Date	Amounts (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 constriction 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.

Solution: As per AS-16, "Borrowing Cost"

(1) Calculation of amount of borrowing cost capitalized

(Rs.)

Date	Amount	Nature of Borrowing	Amount of Borrowing Cost Capitalised (Periods used in Months)
01/04/2017	3,00,000	Specific Rs. 2,00,000 General Rs. 1,00,000	2,00,000 x 8% x 12/12 = Rs. 16,000 1,00,000 x 11.50% x 12/12=Rs. 11,500
31/05/2017	2,40,000	General	2,40,000 x 11.50% x 10/12=Rs. 23,000
01/08/2017	4,00,000	General	4,00,000 x 11.50% x 8/12=Rs. 30,667
31/12/2017	3,60,000	General	3,60,000 x 11.50% x 3/12=Rs. 10,350
Total	13,00,000		91,517

(2) **Journal Entry**

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.03.18	Building account	Dr.	13,91,517	
	To Bank account (13,00,000 + 91,517)			13,91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

Working Note: Calculation of average interest rate other than for specific borrowings

$$\frac{(4,00,000 \times 9\%) + (5,00,000 \times 12\%) + (3,00,000 \times 14\%)}{4,00,000 + 5,00,000 + 3,00,000}$$

= 11.50%

2. On 1st April, 2023, Green Limited started the construction of an Office Building (qualified asset). The land under the building is regarded as a separate asset and is not a part of qualifying asset.
For the purpose of construction of building, the company raised a specific loan of ₹14 lakhs from a Bank at an interest rate of 12% per annum. An interest income of ₹15,000 was earned on this loan while it was held in anticipation of payments. The company's other outstanding loans on 1 April, 2023 were as follows:

Amount of Loan	Rate of Interest per annum
₹ 20,00,000	15%
₹ 30,00,000	8%

The construction of building started on 1st April, 2023 and was completed on 31st January, 2024 when it was ready for its intended use. Up to the date of completion of the building, the following payments were made to the contractor:

Payment date	**Amount in (₹)**
1st April 2023	4,00,000
1st August, 2023	10,00,000
1st December, 2023	25,00,000
31st January, 2024	5,00,000

The life of building is estimated to be 20 years and depreciation is calculated on straight line method.
You are required to:

(i) Calculate the amount of borrowing cost to be capitalized.
(ii) Pass initial journal entry to recognise the cost of building.
(iii) Depreciation on building for the year ending 31st March, 2024.
(iv) Carrying value of building on 31st March, 2024.

Solution:

(i) Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses

Date of incurrence of expenditure	**Amount spent**	**Financed through**	**Calculation**	**₹**
1st April, 2023	4,00,000	Specific borrowing	4,00,000 X 12% X 10/12	40,000
1st August, 2023	10,00,000	Specific borrowing	10,00,000 X 12% X 10/12	1,00,000
1st December, 2023	25,00,000	General borrowing	25,00,000 X 10.80% x 2/12	45,000
31st January, 2024	5,00,000	General borrowing	5,00,000 X 10.80% x 0/12	0
Total				1,85,000
Less: Interest income on specific borrowings				(15,000)
Amount eligible for capitalization				1,70,000

(ii) **Journal Entry**

Date	Particulars		Rs.	Rs.
31.01.2024	Building account (WN 2)	Dr.	45,70,000	
	To Bank account			44,00,000
	To Interest payable (borrowing cost)			1,70,000
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization:

Date	Particulars		Rs.	Rs.
31.01.2024	Building account (WN 2)	Dr.	45,70,000	
	To Bank account			45,70,000
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

(iii) Calculation of amount of depreciation on Building for the year ended 31/03/2024

Depreciation from 1st February 24 to 31st March 24

= (45,70,000 / 20 Years) X 2/12

= Rs. 38,083

(iv) Calculation of carrying amount of Building as on 31/03/2024

Particulars	Amount (Rs.)
Capitalised amount of building as on 31st Jan 24	45,70,000
(-) Amount of depreciation	(38,083)
	45,31,917

Working Notes:

(1) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
20,00,000	15%	=	3,00,000
30,00,000	8%	=	2,40,000
50,00,000			5,40,000

Weighted average rate of interest (5,40,000/50,00,000) x 100 = 10.80%

(2) Total expenses to be capitalized for building

Cost of building (4,00,000 + 10,00,000 + 25,00,000 + 5,00,000)	44,00,000
Add: Amount of interest to be capitalized	1,70,000
	45,70,000

Note: Alternative way of Calculation of Amount of Borrowing cost Capitalised

(1) The costs incurred should first be allocated to the specific borrowings and then allocated to General Borrowing. Analysis of expenditure from general borrowings:

Date	Expenditure	Amount allocated in general borrowings	Weighted for period outstanding
1st April, 2023	4,00,000	0	0
1st August, 2023	10,00,000	0	0
1st December, 2023	25,00,000	25,00,000	25,00,000 X 2/12 = 4,16,667
31st January, 2024	5,00,000	5,00,000	5,00,000 × 0/12 = 0
Total			4,16,667

(2) Calculation of amount of borrowing cost to be capitalized:

		Amount (Rs.)
On specific borrowings (14,00,000 X 12% X 10/12)	1,40,000	
Less: interest income on specific borrowings	(15,000)	1,25,000
On General borrowing (4,16,667 × 10.80%)		45,000
Total		1,70,000

3. Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2019. Money raised from debentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:

(i) Interest on debentures for the Financial Year 2019-2020 was paid by the Company.

(ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

(iii) In March, 2020 construction of factory building was not completed (it is expected that it will take another 6 months).

(iv) In March 2020, Machinery was installed and ready for its intended use.

(v) Furniture was put to use at the end of March 2020.

(vi) Truck is going to be received in April, 2020.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2020 in the Books of Expert Limited.

Solution: According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As per the Standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = ₹10,00,000 (100 lakhs x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory building	Qualifying Asset	9,50,000x40/100 = ₹ 3,80,000	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100 = 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	9,50,000x2/100 =19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100 = 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100 = ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

4. Nikka Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ₹ 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 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, 20X2?

Solution: As per AS 16, Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

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

Accordingly, the treatment of Interest of ₹ 68.20 lacs occurred during the year 20X1-20X2 would be as follows:

(i) When construction of asset completed on 30th April, 20X2:

The treatment for total borrowing cost of ₹ 68.20 lakh will be as follows:

Purpose	Nature	Interest to be capitalised (₹ in lakh)	Interest to be charged to profit and loss account (₹ in lakh)
Modernisation and renovation of plant and machinery	Qualifying asset	[68.20 x (510/620)] = 56.10	
Advance to suppliers for additional assets	Qualifying asset	[68.20 x (54/620)] = 5.94	
Working Capital	Not a qualifying asset		[68.20 x (56/620)] = 6.16
		62.04	6.16

(ii) When construction of assets is completed by 28th February, 20X2

When the process of renovation gets completed in less than 12 months, the plant and machinery and the additional assets will not be considered as qualifying assets (until and unless the entity specifically considers that the assets took substantial period of time for completing their construction). Accordingly, the whole of interest will be required to be charged off / expensed off to Profit and loss account.

5. Take Ltd. has borrowed Rs. 30 lakhs from State Bank of India during the financial year 2013-14. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost Rs. 50 lakhs. As on 31st March, 2014, since the said project was not complete, the directors of Take Ltd. resolved to capitalize the interest accruing on borrowings amounting tò 4 lakhs and add it to the cost of investments. Comment.

   Solution: As per para 9 of AS 13 "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. Rs. 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

   Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2014.

6. Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

   Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I ₹	Phase II ₹	Phase III ₹	Phase IV ₹
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

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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.

Solution:

S.N.	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 = [(30,00,000 / 2,21,00,000) X 98,00,000]	13,30,317 (approx.)
7	Interest on loan used for Phases III & IV, based on proportionate Loan amount = [(30,00,000 / 2,21,00,000) X 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.

7. ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'.

Solution: Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding Balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest (₹)
	a	b	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		**2,26,000**

Weighted average cost of borrowings

= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest / Weighted average of general borrowings) x 100]

= [(2,26,000 / 24,33,334) x 100]

= 9.29% p.a.

CHAPTER 2 AS 12: ACCOUNTING FOR GOVERNMENT GRANTS

1. Accounting of Govt Grants: For accounting purpose Govt Grant shall be classified as follows:

(i) Grant for depreciable Assets (Grant for fixed Asset other than Land): There are two approaches to record the Govt. grant for depreciable Asset.

(A) Additive Approach: Under additive approach
- fixed asset shall be shown at cost price
- Govt grant shall be treated as deferred income (known as Deferred Govt. Grant).

Notes:
(1) DGG shall be amortised in the ratio of depreciation over the useful life of PPE.
(2) Both depreciation and amortisation of D.G.G. shall be transfer into P&L A/c.
(3) In case fixed asset is received in kind then such asset is recorded at nominal value with corresponding credit into Capital reserve A/c.

(B) Deductive Approach: Under deductive approach fixed asset has been shown at cost price as reduced by Govt. grant. Depreciation will be charged on such net amount.

In examination if question is silent regarding which approach is being followed then give the answer under both the approaches.

(ii) Grants related to revenue

A. Considered as income: Grant is in the nature of incentive, so it is credited into P&L.

For presented in SPL: There are 2 alternatives
- Either presented as a separate item; or
- Shown under the head 'Other income'.

B. For revenue expenses: Such grant is received for the purpose of incurred specific revenue expenditure. Such Grant shall be presented in SPL as follows:
- Either presented in credit side as a separate item; or shown under the head 'Other income'. or
- Can be reduced from respective expenditure.

Note: In case revenue expenditure incurred in more than one year then grant shall be recorded as deferred income and amortised in the ratio of expenditure incurred.

(iii) Grant received for reimbursement of losses / Bailout / Special Grant against losses: Such grant shall be shown as extra ordinary income.

(iv) Grant received as a promoters' contribution:
- This grant is of capital nature and shall be credited into capital reserve.
- This grant shall be used for specific purpose because it is received for specific purpose.
- This grant cannot be used for distribution of dividend.

(v) Grand received as non-monetary / in kind (like land received from Govt.): In such case assets shall be recorded at nominal value with credited into capital reserve.

2. Refund of Govt. Grants:
   (i) The repayment should be applied first against any unamortised deferred income / Deferred Govt. Grants as appeared in Balance Sheet.

   (ii) To the extent that the repayment exceeds any such deferred income / Deferred Govt. Grants as appeared in Balance Sheet or when no deferred income exists, the repayment should be recognised immediately in profit or loss as extra-ordinary item.

   (iii) In case of Refund of Govt. Grant for depreciable Asset

   A. Originally deferred:

Unamortized deferred Govt. Grant A/c	Dr.	XXX	
SPL A/c (As deferred Income)	Dr. (b/f)	XXX	
To Bank A/c			XXX

   B. Originally reduced from PPE:

PPE A/c	Dr.	XXX	
To Bank A/c			XXX

PRACTICAL QUESTIONS

1. 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 and 31st March, 2020.
   Darshan Ltd. follows straight line method for charging depreciation.
   Solution: 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 & 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.

2. 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.

Solution:

(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.

3. Santosh Ltd. has received a grant of Rs. 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed Rs. 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.
Solution: As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.
In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value.
The treatment of both the grants is incorrect as per AS 12.

4. Yogya Ltd. received a specific grant of Rs. 300 lakhs for acquiring the plant of Rs. 1,500 lakhs during 2013-14 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2016-2017, due to non -compliance of conditions laid down for the grant of Rs. 300 lakhs, the company had to refund the grant to the Government. Balance in the deferred income on that date was Rs. 210 lakhs and written down value of plant was Rs. 1,050lakhs.
(i) 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 2016-2017 in the Statement of Profit and Loss?
(ii) What should be the treatment of the refund if grant was deducted from the cost of the plant during 2013-14?
Assume depreciation is charged on assets as per Straight Line Method.
Solution: As per para 21 of AS 12, amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. 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 Rs. 300 lakhs and balance in deferred income is Rs. 210 lakhs, therefore, Rs. 90 lakhs shall be charged to the profit and loss account for the year 2016-2017. There will be no effect on the cost of the fixed asset and depreciation charge will be same as charged in the earlier years.

(ii) As per para 21 of AS 12, the amount refundable in respect of grant which was related 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 Rs. 300 lakhs. The increased cost of Rs. 300 lakhs of the plant should be amortised over 7 years (residual life). Depreciation charged during the year 2016-2017 shall be 1200/10 + 300/7 = Rs. 162.86 lakhs.

5. Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years & residual value ₹ 8 lakhs). Government grant received is ₹ 32 lakhs. 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
   (i) the grant is credited to Fixed A/c.
   (ii) the grant is credited to Deferred Grant A/c.

Solution:

(1) If the grant is credited to Fixed Assets Account:

1. Journal Entry (at the time of refund of grant)

		₹ in lakhs	**₹ in lakhs**
Fixed Assets	Dr.	32	
To Bank A/c			32
(Being grant refunded)			

2. Value of Fixed Assets after two years but before refund of grant

Fixed assets initially recorded in the books = ₹ 80 lakhs – ₹ 32 lakhs
= ₹ 48 lakhs

Depreciation p.a. = (₹ 48 lakhs – ₹8 lakhs)/4 years
= ₹ 10 lakhs per year for first two years.

Value of the assets before refund of grant = ₹ 48 lakhs - ₹ 20 lakhs = ₹ 28 lakhs

3. Value of Fixed Assets after refund of grant

Value of Fixed Assets before refund of grant	₹ 28 lakhs
Add: Refund of grant	₹ 32 lakhs
	₹ 60 lakhs

4. Amount of depreciation for remaining two years

Value of the fixed assets after refund of grant –residual value of the assets / No. of years
= ₹ 60 lakhs - ₹ 8 lakhs / 2
= ₹ 26 lakhs per annum will be charged for next two years.

(II) If the grant is credited to Deferred Grant Account: As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged.

Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹8 lakhs p.a. x 2 years = ₹ 16 lakhs will be credited to Profit and Loss Account and ₹ 16 lakhs will be the balance of Deferred Grant Account after two years.

Therefore, on refund of grant, following entry will be passed:

		₹	₹
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
To Bank A/c			32 lakhs
(Being Government grant refunded)			

1. Value of Fixed Assets after two years but before refund of grant

Fixed assets initially recorded in the books = ₹ 80 lakhs

Depreciation p.a. = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year

Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs

2. Value of Fixed Assets after refund of grant: On refund of grant the balance of deferred grant account will become nil. The Fixed assets will continue to be shown in the books at ₹ 44 lakhs.

3. Amount of depreciation for remaining two years: Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

CHAPTER 3 AS 2: VALUATION OF INVENTORIES

1. Measurement of Inventories: Initially measured at cost; and subsequently are measured as follows:

A. Finished goods and WIP shall be valued at Lower of:
(a) Cost Price
(b) Net realizable value
on item by item basis.

➢ Such items either can be on individual basis or group basis.
➢ The objective of such valuation is no adjustment of loss one item with the profit of another item.

(a) Cost: Cost of inventories comprises all

Costs of purchase	XXX
(+) Costs of conversion	XXX
(+) Other costs incurred in bringing the inventories to their present location and condition. (E.g. the costs of designing products for specific customers in the cost of inventories)	XXX
	XXX

Cost of Purchase: The costs of purchase of inventories comprise the

➢ purchase price, non-refundable taxes, transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services.
➢ Reduced by any trade discounts, rebates.

Conversion Cost: The costs of conversion of inventories include

➢ costs directly related to the units of production, such as direct labour

➢ Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

➢ Fixed overhead are allocated to each unit of production on the basis of recovery rate.

Recovery Rate = Fixed overhead / (normal or actual production whichever is higher)

Allocation of cost to joint products and by-products: Costs should be allocated on a consistent and rational basis in the case of joint products, whereas the net realizable value of by-products and the net proceeds from the sale of scrap should be deducted from the total cost of the main product.

Excluded in Cost:
(a) abnormal amounts of wasted materials, labour or other production costs;
(b) storage costs, unless the production process requires such storage; (e.g.: In case of wine, it has to be stored as a part of the production process)
(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and
(d) selling and distribution costs.

(b) Net Realisable Value: Expected selling price – expected selling expenses – expected cost of completion (In case of WIP).

➢ Estimates of NRV are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise.

B. Valuation of Raw Material
   (a) At CP: If Finished Goods SP ≥ Finished goods cost price.
   (b) At CP or Replacement Price whichever is lower: In other cases

2. Other Techniques for the measurement of cost: The standard cost method or the retail method, may be used for convenience if the results approximate cost.
   (i) Standard costs: take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. It is a predetermined cost.

   (ii) The retail inventory method: This method is used for where the inventories are generally large and volatile.
   Cost= Retail price - Gross Margin.

3. Other Relevant points
   (i) Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of PPE as per AS 10, PPE.
   (ii) Treatment of Borrowing Costs: on the basis of the requirement of AS 16.
   (iii) Treatment of Normal Loss and Abnormal Loss
      (A) Normal Loss – Part of the cost
      (B) Abnormal Loss – Charged into P & L Account at cost.
   (iv) Is Packing Material is a part of Cost of Inventory?
      (A) Primary packing material is one which is essential to bring an item of inventory to its saleable condition e.g. bottles, cans etc., in case of food and beverages industry.
      It is included in the cost as it is considered part of the production process.
      (A) Secondary packing and publicity material required for transporting and forwarding the material will normally be in the nature of secondary packing material. Therefore, they cannot be included in the cost of production.

PRACTICAL QUESTIONS

1. Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2017. His factory produces Product X using Raw Material A.
   (i) 600 units of Raw material A (purchased @ Rs. 120). Replacement cost of raw material A as on 31-3-2017 is Rs. 90 per unit.
   (ii) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs. 260 per unit. These units can be finished next year by incurring additional cost of Rs. 60 per unit.
   (iii) 1500 units of finished Product X and total cost incurred Rs. 320 per unit. Expected selling price of Product X is Rs. 300 per unit.

   Determine how each item of inventory will be valued as on 31-3-2017. Also calculate the value of total inventory as on 31-3-2017.

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

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Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.2017: **(Rs.)**

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

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

(a) 100 coats, which had cost Rs. 2,200 each and normally sold for Rs. 4,000 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal selling price.

(b) 200 skirts, which had cost Rs. 50 each. These too were found to be defective. Remedial work in April cost Rs. 2 per skirt, and selling expenses for the batch totalled Rs. 200. They were sold for Rs. 55 each.

(c) Shirts which had cost Rs. 50,000, their net realizable value at Balance sheet date was Rs. 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?

Solution:

Valuation of closing stock	**Rs.**
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 skirts and shirts as their NRV is more than their cost which was included in value of inventory.

3. A Ltd. purchased 1,00,000 MT for Rs. 100 each MT of raw material and introduced it in the production process to get 85,000 MT as output. Normal wastage is 5%. In the process, company incurred the following expenses:

Direct Labour	Rs. 10,00,000
Direct Variable Overheads	Rs. 1,00,000
Direct Fixed Overheads (Including interest Rs. 40,625)	Rs. 1,00,000

Of the above 80,000 MT was sold during the year and remaining 5,000 MT remained in closing stock. Due to fall in demand in market the selling price for the finished goods on the closing day was estimated to be Rs. 105 per MT. Calculate the value of closing stock.

Answer: **Calculation of cost for closing inventory**

Particulars		Rs.
Cost of Purchase (1,00,000 x 100)		1,00,00,000
Direct Labour		10,00,000
Variable Overhead		1,00,000
Fixed Overhead	(1,00,000 - 40,625)	59,375
Cost of Production for normal output i.e. 95,000 MT		1,11,59,375

Cost of closing inventory per unit (Rs. 1,11,59,375/95,000)	Rs. 117.47 (approx)
Net Realisable Value per unit	Rs. 105

Since, net realisable value is less than cost, closing inventory will be valued at Rs. 105. Therefore, closing inventory is Rs. 5,25,000 (5,000 x 105).

Note: Abnormal wastage of 10,000 MT i.e.10,000 MT x Rs. 117.47 = Rs. 11,74,670 will be separately accounted for in the books.

4. Calculate the value of raw materials and closing stock based on the following information:

Raw material X	
Closing balance	500 units
	Rs per unit
Cost price including excise duty	200
Excise duty (Cenvat credit is receivable on the excise duty paid)	10
Freight inward	20
Unloading charges	10
Replacement cost	150
Finished goods Y	
Closing Balance	1200 units
	Rs per unit
Material consumed	220
Direct Labour	60
Direct overhead	40

Total Fixed overhead for the year was Rs 2,00,000 on normal capacity of 20,000 units.

Calculate the value of the closing stock when:-

(i) Net Realizable value of the Finished Goods Y is Rs 400.

(ii) Net Realizable Value of the Finished Goods Y is Rs 300.

Solution:

Statement showing valuation of Raw Material and Finished Goods at cost

Raw Material X	**Rs.**
Cost Price	200
Less: CENVAT credit	(10)
	190
Add: Freight Inward	20
Unloading charges	10
Cost	220

Finished goods Y	**Rs.**
Materials consumed	220
Direct labour	60
Direct overhead	40
Fixed overheads (2,00,000/20,000)	10
Cost	330

(i) When Net Realisable Value (NRV) of the Finished Goods Y is Rs. 400

NRV is greater than the cost of Finished Goods Y i.e. Rs. 330

Hence, Raw Material and Finished Goods will be valued at cost

Accordingly, value of closing stock will be:

	Qty	Rate	Amount (Rs.)
Raw Material X	500	220	1,10,000
Finished Goods Y	1,200	330	3,96,000
Total cost of closing stock			5,06,000

(ii) When Net Realisable Value of the Finished Goods Y is Rs. 300

NRV is less than the cost of Finished Goods Y i.e. Rs. 330

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

Accordingly, value of closing stock will be:

		Qty	Rate	Amount (Rs.)
Raw Material	X	500	150	75,000
Finished Goods	Y	1,200	300	3,60,000
Total cost of closing stock				4,35,000

Note: It has been assumed that Raw Material X is used for production of Finished Goods Y.

5. Well Wear Limited is a Textile Manufacturing Company and engaged in the production of Polyester (P) and Nylon (N). While manufacturing the main products, a by-product Fiber (F) is also produced. Details of the cost of production are as under:

Purchase of Raw Material for manufacturing process of	
30,000 units	₹ 3,50,000
Wages paid	₹ 1,60,000
Fixed overheads	₹ 1,20,000
Variable overheads	₹ 60,000
Output:	
Polyester (P)	12,500 Units
Nylon (N)	10,000 Units
Fiber (F)	3,200 Units
Closing Inventory:	
Polyester (P)	1,600 Units
Nylon (N)	400 Units

Average market price of Polyester and Nylon is ₹ 100 and ₹ 60 per unit respectively, by-product Fiber is sold @ ₹ 40 per unit. There is a profit of ₹ 8,000 on sale of by-product after incurring separate processing expenses of ₹ 10,000 and packing charges of ₹ 9,000.₹ 5,000 was realized from sale of scrap.

On the basis of the above information, you are required to compute the value of closing inventory of Polyester and Nylon.

Solution: As per para 10 of AS 2 'Valuation of Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1. Calculation of net realizable value of by-product, Fiber (F)

	Rs.
Selling price of by-product BP (3,200 units X Rs. 40 per unit)	1,28,000
Less: Separate processing charges of by-product Fiber (F)	(10,000)
Packing charges	(9,000)
Net realizable value of by-product BP	1,09,000

2. Calculation of cost of conversion for allocation between joint products Polyester (P) and Nylon (N)

	Rs.	Rs.
Raw material (30,000 Units)		3,50,000
Wages		1,60,000
Fixed overhead		1,20,000
Variable overhead		60,000
		6,90,000
Less: NRV of by-product Fiber (F) (See calculation 1)	(1,09,000)	
Sale value of scrap	(5,000)	(1,14,000)
Joint cost to be allocated between Polyester (P) and Nylon (N)		5,76,000

3. Determination of basis for allocation and allocation of joint cost to Polyester (P) and Nylon (N)

	Polyester (P)	Nylon (N)
Output in units (a)	12,500 units	10,000 units
Sales price per unit (b)	Rs. 100	Rs. 60
Sales value (a x b)	Rs.12,50,000	Rs.6,00,000
Ratio of allocation	125	60
Joint cost of Rs. 5,76,000 allocated in the ratio of 125:60 (c)	Rs. 3,89,189	Rs. 1,86,811
Cost per unit [c/a]	Rs. 31.13512	Rs. 18.6811

4. Determination of value of closing inventory of Polyester (P) and Nylon (N)

	Polyester (P)	Nylon (N)
Closing inventory in units	1,600 units	400 units
Cost per unit	Rs. 31.13512	Rs. 18.6811
Value of closing inventory	Rs. 49,816	Rs. 7,472

6.

Particulars	Kg.	Rs.
Opening Stock: 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 Stock: Raw Materials	900	
Finished Goods	1200	

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

Solution: Calculation of cost for closing stock

Particulars	Rs.
Cost of Production {(1,100 + 10,000 – 900) X 10}	1,02,000
Direct Labour	76,500
Fixed Overhead [(75,000 / 15,000) X 10,200]	51,000
Cost of Production	2,29,500
Cost of closing stock per unit (2,29,500/10,200)	Rs. 22.50
Net Realisable Value per unit	Rs. 20.00

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

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

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

7. XYZ Limited is engaged in a business of manufacturing and supply of lubricants. For manufacturing of lubricant, company generally requires two types of raw material i.e. 1) Base Oil & 2) Additives.

For Base Oil procurement, the company's cost structure per litre is as follows:

(1) Material Cost (Base Oil) - Rs. 100 per Litre
(2) Custom Duty – 5% on Material Cost.
(3) Storage Tank Rent – Rs. 2 per litre.
(4) Custom House Agent charges – Rs. 1 per litre
(5) Inward Freight (i.e. Transportation cost for transferring the goods from Shore Tanks to Plants) – Rs. 3 per litre.

Costing manager informed you the following facts:

(1) We have purchased a 100 Litres of Base Oil from one of our Group Company situated in Singapore.
(2) Base Oil material is duly arrived at port and goods have been duly unloaded in storage tanks.

(3) Due to Covid 19 Lockdown, Base Oil is still lying in storage tanks as at 31.03.2020.
Costing Manager requires your assistance at what value Base Oil should be recorded as Inventory.
Solution:

Particulars	Amount	Remarks
Material Cost	10,000	(100 Quantity x Rs. 100)
Custom Duty	500	(5% of Material Value)
Storage Tank	200	(100 Quantity x Rs. 2)
CHA Charges	100	(100 Quantity x Rs. 1)
Inward Freight	0	<Not yet incurred>
Total	**10,800**	

As per AS 2, the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
As per AS 2, the costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
In above case, all the expenses (i.e. Custom duty, Storage Tank, CHA Charges) are directly attributable to the acquisition of material. Though, inward freight cost is directly attributable to the acquisition but it will be incurred once movement of goods happened between the Storage Tanks to plant, as at year end, the goods are still lying at Shore Tanks and hence such inward freight cost is not directly attributable to the acquisition of materials and hence considered as NIL.

8. Sun Ltd. has fabricated special equipment (solar power panel) during 2014-2015 as per drawing and design supplied by the customer. However due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.
As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-3-2016 are as follows:

(i)	Solar power panel (WIP)	Rs. 85 lakhs
(ii)	Solar power panel (finished products)	Rs. 55lakhs
(iii)	Sundry debtors (solar power panel)	Rs. 65 lakhs

The petition for winding up against the customer has been filled during 2015-2016 by Sun Ltd.
Comment with explanation on provision to be made of Rs. 205 lakhs included in sundry Debtors, finished goods and WIP in the financial statement of 2015-16.
Solution: From the fact given in question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per AS-2, "Valuation of Inventory" Inventories are assets (a) Held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials /supplies to be consumed in the production process/rendering of services. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.
As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in AS 2 i.e. lower of cost or NRV. Though, the goods were produced as per specifications of buyer of the company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such solar panel should be provided for in the books. In the absence of NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per AS 2 for Rs. 140 lakhs [i.e. solar power panel (WIP) Rs. 85 lakhs + Solar power panel (finished products) Rs. 55 lakhs].
Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.
As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 2015-16, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for Rs. 65 lakhs shall be made in the books against the debtors amount.

CHAPTER 4 AS 10 - PROPERTY, PLANT AND EQUIPMENT

1. Recognition Amount of PPE: PPE shall be recognized at two stages
   (a) Initial Recognition
   (b) Subsequent Recognition

2. Initial recognition of PPE: Initially all PPE shall be recognized at cost price either it is being acquired /purchase or self-generated.

   Notes:

   (i) Any expenses/cost incurred in relation to PPE shall be capitalized if such expenditure is necessary to bring the asset to the location and condition and it to be capable of operating in the manner as intended by the management;

   (ii) Cost includes following:
   (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
   (b) 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 e.g. Registration and stamp duty cost, employee benefits cost arising directly from construction or acquisition of PPE, Cost of Site Preparation, initial delivery and handling costs, installation and assembly costs, Professional Fees, Costs of testing/trial run (reduce by any sale of scrap from trial run) etc.
   (c) allocable cost
   (d) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. Such amount shall be recorded at PV.

   (iii) Cost does not include
   (a) administrative and general overhead
   (b) Costs incurred in introducing a new product or service
   (c) cost of opening a new facility or inauguration cost of new business
   (d) Cost of conducting business in a new location
   (e) Abnormal loss or operating loss.
   (f) Free sample distribution of product.

   (iv) Cost does not include any imputed cost / notional profit.
   Ex 1. Installment cost of the machinery in the market is Rs. 2,000 whereas actual cost incurred by x Ltd on installing Machine is Rs. 1,500. In this case installation cost is capitalized by Rs. 1,500.
   Ex. 2 X Ltd issue an instrument from selling dept. to constructed dept for Rs. 11, 000 whereas actual cost is Rs. 10,000. In this case amount is capitalized by Rs. 10,000

   (v) Any cost incurred on PPE after it is ready to use should not be capitalized.

   (vi) Any expenses incurred or any income earned during construction shall not be capitalized or decapitalized if such income or expenses are not related to constructed asset.

   (vii) Decommissioning restoration and other liabilities(DROL) / Cost of dismantling, removal and site restoration: If any DROL is aimed at the time of disposal of assets then provisions of such cost shall be capitalized at its present value.

(viii) Borrowing cost shall be treated as per the provisions of AS 16.

(ix) In case any payment is deferred then difference between actual amount paid and cash price shall be recognized as interest amount. Such interest expenses shall be treated as per AS 16.
E.g. X Ltd purchased an equipment for Rs. 30,000 as on 1/04/20X1 and amount is payable as on 1/04/20X2 whereas cash price is Rs. 28,000. Pass JE for acquisition Equipment.
Solution: Journal entry

		Dr (Rs.)	Cr (Rs.)
1. As on 1/04/20X1			
Equipment A/c	Dr	28,000	
To payable A/c			28,000
2. As on 1/04/20X2			
Payable A/c	Dr	28,000	
Interest expenses A/c	Dr	2,000	
To Bank A/c			30,000

Note: If there is a time gap between two payments is more than one year then IRR shall be calculated for the purpose of recording Interest Expenses.

(x) Calculation of cost price if assets are acquired in combined manner: In such case cost of each asset shall be calculated in the ratio of their fair value
Example: X Ltd purchased four plant and machinery for Rs. 10,000. Calculate cost price of each machine if the fair values of machineries are given below

Name of Machinery	Fair Value (Rs.)
A	1,500
B	2,500
C	3,500
D	5,000
Total	12,500

Solution: Calculation of cost price of each machinery.

Name of Machinery	Cost Price (Rs.)
A	(10,000/12500)X 1,500 = Rs. 1,200
B	(10,000/12500)X 2,500 = Rs. 2,000
C	(10,000/12500)X 3,500 = Rs. 2,800
D	(10,000/12500)X 5,000 = Rs. 4,000

(xi) In case any PPE is purchased and need to demolition of existing structure for the purpose of using the PPE, then any demolition expenses (Net of any recovery) shall be capitalised.

(xii) Treatment of discount received on PPE
(a) Trade Discount: Reduce from cost of PPE.
(b) Settlement Discount: Considered as other income(As followed by ICAI in CA Final)

(xiii) PPE acquired in an exchange for a non –monetary asset or a combination of monetary and non-monetary:
The cost of such an item of PPE is measured at fair value only if:
(a) the exchange transaction have commercial substance; and
(b) the fair value of either the asset received or the asset given up is reliably measurable.

*1 If none of conditions is fulfilled then acquired PPE shall be recorded at book value of asset surrendered.
*2 If any consideration is paid or received in cash, it shall be adjusted accordingly.
*3 Any difference between the recorded PPE and the de-capitalization of PPE shall be transferred to SPL.

*4 If the fair value of both the asset given up and the asset obtained can be reliably measured, the acquired PPE shall be valued at the fair value of the asset surrendered, unless the fair value of the acquired PPE is more reliably measured.

3. Subsequent recognition of PPE: There are 2 models used for subsequent recognition of PPE
   (a) Cost Model
   (b) Revaluation model

   Entity can use any one model as its accounting policy on the basis of class of asset.

4. Cost model under subsequent recognition: Under cost model asset shall subsequently recorded at historical cost as reduced by Accumulated Depreciation and Impairment loss as per AS 28.

5. Revaluation model under subsequent recognition: Under revaluation model asset shall be shown at fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

   Following points are relevant in case entity follow revaluation model:
   (i) In case entity follow revaluation model then it should be on the basis of class of asset and shall be shown as its accounting policy.

   (ii) A class of PPE is a grouping of assets of a similar nature and use in an entity's operations.

   (iii) Treatment of revaluation surplus or deficit arising on revaluation:

<table>
<tr><td rowspan="2">First time revaluation</td><td colspan="2">Gain</td><td>Transfer into Revaluation Reserve</td></tr>
<tr><td colspan="2">Loss</td><td>Transfer into P & L A/c</td></tr>
<tr><td rowspan="4">Subsequently Revaluation</td><td rowspan="2">Gain</td><td>Earlier Gain</td><td>Transfer into Revaluation Reserve</td></tr>
<tr><td>Earlier Loss</td><td>To the extent earlier loss gain shall be credited into P&L A/c and balance transfer into Revaluation Reserve</td></tr>
<tr><td rowspan="2">Loss</td><td>Earlier Gain</td><td>Adjust with Revaluation Reserve as appeared in Balance Sheet, balance charged into P&L A/c</td></tr>
<tr><td>Earlier Loss</td><td>Transfer into P & L A/c</td></tr>
</table>

   Note: The revaluation surplus included in equity in respect of an item of PPE may be transferred directly to revenue reserve when the asset is derecognized.

   (iv) Accounting treatment of revaluation reserve: There are 2 alternative

   Alternative 1: Depreciation elimination approach

   (a) Accumulated depreciation A/c Dr. (At B.V.) XXX
       TO PPE A/c XXX

   &

   (b) PPE A/c Dr. XXX
       To revaluation reserve A/c (With revaluation amount) XXX

   Alternative 2: Restatement approach: Following steps are followed

   Step 1: Calculate revaluation surplus by comparing Book value with fair value of PPE.
   Step2: Calculate % of revaluation surplus, in comparison with the book value of PPE.
   Step 3: Pass Journal entry.

   PPE A/c (At cost x % of surplus) Dr. XXX
       To Accumulated depreciation A/c (At BV X %of surplus) XXX
       To Revaluation Reserve A/c (With Revalued amount) XXX

(vii) Revaluation Reserve is not a free reserve & cannot be used for distribution of dividend.

(viii) Depreciation will be calculated on revalued amount and charged into P&L A/c.

(ix) Further treatment/Utilisation of Revaluation Reserve: There are two alternatives:
Alternative I: The amount of the surplus transferred into revenue reserve that would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost.
(Transfers from revaluation surplus to revenue reserve are not made through P&L)
Alternative 2: No changes in the balance of revaluation Reserve till the date of de-recognition of PPE
* Whatever alternative is being followed by the entity shall be shown as its accounting policy.

6. Depreciation: is a systematic allocation/amortization of depreciable amount (*1) of PPE over the useful life (*2) of the PPE.
*1 Depreciable amount = cost or other amount substituted for cost - Expected residual value.

*2 Useful life is:
(a) the period over which an asset is expected to be available for use by an entity; or
(b) the number of units expected to be obtained from the asset by an entity.

Relevant points for depreciation:

(i) Depreciating shall be charged on the basis of component of assets. From the point of view in calculation of depreciation on component basis following points are relevant:
   (a) Cost of each component shall be calculated in the ratio of fair value of each component.
   (b) For each component expected life and expected scrap value shall be identify separately.
   (c) Suppose, X Ltd purchased machinery which has 3 major components in such a case remainder part of the machinery shall be considered as another separate component.
   (d) A significant part of an item of PPE may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

(ii) Methods of charging deprecation: The depreciation method used reflects the pattern in which entity derive expected benefit from the asset. There is no specific method given by As 10, that simply specify it should be on the basis of systematic allocation of depreciable amount. Generally there are 3 methods used:
   (1) Production unit method (more appropriate method) – Usage Basis
   (2) WDV Method – Time Basis
   (3) SLM Method. – Time Basis

(iii) In case there is any change in the method of depreciation then such change shall be taken on prospective basis and it is considered as changes in accounting estimate as per AS 5.

(iv) At each reporting date entity shall reassessed its depreciable amount, estimated scrap value and useful life of asset. In case there is any change then such change shall be considered as change in accounting estimate and its impact shall be taken on prospective basis.

(v) Depreciation shall be charged irrespective of company follow either cost model or revaluation model.

(vi) The entity can use different methods of depreciation if either the nature or the use of the asset is different.

(vii) Deprecation shall be charged from the date when asset is ready to use/ available for use

(viii) Depreciation shall be ceased:

(1) From the date when asset is retired from active use and held for disposal; or
(2) If estimated scrap value $\geq$ the carrying amount of asset.

* The above case shall be reviewed at the end of each year and if it is held that any of the above condition does not exist on reporting date then depreciation shall be charged again.

Note 1: Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

Note 2: Under usage methods of depreciation (i.e. production of unit method), depreciation will be Nil during the periods when there is no production.

(ix) In case land and building are purchased together then for the purpose of charging of depreciation segregate total amount among land and building.

7. Retired Asset: Assets are not in active use. Such asset shall be shown at lower of:
   (a) Carrying Amount; or
   (b) Estimated net selling Price.

   If NSP $<$ Carrying Amount = Difference shall be charged into SPL

8. Disposal/Derecognition/Sale of asset: The carrying amount of PPE should be derecognised:
   (a) on disposal; or
   (b) when no future economic benefits are expected from its use or disposal.

   Any difference between sale value and book value shall be transferred into P&L A/c except in a case where PPE is sold and lease back under AS 19.

   #In case any profit on sale of PPE or sale price of PPE, shall not be considered as revenue from operations.

9. Replacement of any asset/component: In this case
   (a) New PPE shall be capitalized; and
   (b) Old PPE shall be de-capitalized: Any difference between proceeds amount and carrying amount shall be transferred into SPL.

   Note: In case the carrying amount or cost of the replaced part is not available:

   Step 1: Calculate the cost of the replaced part as the present value of its current cost.

   Step 2: Calculate the carrying amount on the date of replacement:
   = Cost calculated in Step 1 – Depreciation up to the replacement date

10. Subsequent costs

   (i) Repair & maintenance: day-to-day servicing cost is recognised in SPL as incurred.

   (ii) Replacement parts: An entity includes the cost of replacing a part of PPE in its carrying amount when the recognition criteria are met. The carrying amount of the replaced parts is derecognized according to this Standard's derecognition provisions

   (iii) Major inspections or overhauls: Where an asset requires regular overhauls or major inspection in order to continue to operate, the cost of the overhaul is treated as an additional component and depreciated over the period to the next overhaul.
   Any remaining carrying amount of the cost of the previous inspection is derecognized in accordance with the derecognition provisions of this Standard.

11. Any Change in expected amount of provision for DROL: once shall be credited/debited into provision for DROL A/c and other impact shall be given as follows:
Case-1 If asset is maintained at historical cost/using cost model:
   - Adjusted with the book value of PPE

   Case-2 If PPE is maintained by using revaluation model:
   - If balance of revaluation reserve is available then adjust with amount of revaluation reserve
   - In case balance of revaluation reserve is not available then another impact shall be given into P&L A/c

12. Compensation from third parties for items of PPE that were impaired, lost or given up:
Sometime assets is damaged or loss but compensated by 3rd Party e.g. Insurance Claim.
Accounting Treatment:
   - Impairments of items of PPE are recognized is - as per AS 28;
   - De-recognition of items of PPE retired or disposed is - as per AS 10;
   - Compensation from 3rd parties for items of PPE that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and
   - The cost of items of PPE restored, purchased or constructed as replacements is as per AS 10.

13. Spare parts, stand-by equipment and servicing equipment: are recognised as per AS 10 when they meet the definition of PPE. Otherwise, such items are classified as inventory as per AS 2.

14. Non-Applicability:
(a) Biological assets related to agricultural activity other than bearer plants.
(b) Wasting Assets including Mineral rights, Expenditure on the exploration for & extraction of minerals, oil, natural gas and similar non-regenerative resources.

    # However, this Standard applies to PPE used to develop or maintain above assets.

    *A bearer plant is a living plant that:
    (a) is used in the production or supply of agricultural produce;
    (b) is expected to bear produce for more than a period of 12 months; and
    (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

15. Some relevant issues/points under AS 10

(i) Are any criteria in AS 10 to identify Unit? AS 10 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.

(ii) To record PPE whether ownership is required or not? This issue is explained through this example:
X Ltd set up a factory in Uk and incurred cost of Rs. 10crores to build a road for the convenient of its transport. It is used by the company as well as by the general public. The estimated useful life of such factory is 15 years. Shall such road cost is to be capitalized by X Ltd? (Here issue is whether ownership is required or not)
Answer: The recognition criteria of PPE under AS 10, specify that PPE shall be recognized if following two conditions are fulfilled
(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.
On the basis of above 2 conditions road cost shall be capitalized by entity.
Further AS 10 does not explain the criteria of unit or component so it is a subjective matter. Further in each AS substance over form works. It means legal ownership is not required if asset is substantially used by the entity.
Conclusion: In the given case it is advisable to capitalize road expenditure as a separate PPE and amortize over the period of 15 years.

PRACTICAL QUESTIONS

1. 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 ₹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.
Solution: Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		Rs.
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

2. X Limited started construction on a building for its own use on April 1, 20X0. The following costs are incurred:

	₹
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Materials	10,00,000
Direct labour cost	4,00,000
General overheads	1,00,000

Other relevant information:
Other relevant information: Material costing ₹ 1,00,000 had been spoiled and therefore wasted and a further ₹ 1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 20X0 and it is estimated that ₹ 22,000 of the labour cost relate to that period. The building was completed on 1st January, 20X1 and brought in use 1st April, 20X1. X Limited had taken a loan of ₹ 40,00,000 on 1st April, 20X0 for construction of the building. The loan carried an interest rate of 8% per annum and is repayable on 1st April, 20X2. Assume that the entity did not considered the construction period as substantial period of time as per AS 16.
Calculate the cost of the building that will be included in tangible non-current asset as an addition?
Solution: Only those costs which are directly attributable to bringing the asset into working condition for its intended use should be included. Administration and general costs cannot be included. Cost of abnormal amount of wasted material/ labor or other resources is not included as per AS 10. Here, the cost of spoilt materials and faulty designs are assumed to be abnormal costs. Also, it is assumed that the wastages and labor charges incurred are abnormal in nature. Hence, same are also not included in the cost of PPE.

Amount to be included in Property, Plant and Equipment (PPE):

	₹
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Material (10,00,000 – 2,50,000)	7,50,000

Direct labour cost (4,00,000 – 22,000)	3,78,000
General overheads	Nil
Interest (In the given question Building is not a Qualify Asset)	Nil
Total to be capitalized	45,78,000

3. Skanda Ltd. acquired a machinery for ₹ 2,50,00,000 five years ago. Depreciation was charged at 10% p.a. on SLM basis, useful life being 10 years. At the beginning of Year 3, the machinery was revalued to ₹ 3,00,00,000 with the surplus on revaluation being credited to Revaluation Reserve. Depreciation was provided on the revalued amount over the balance useful life of 8 years. The machinery was sold in the current year for ₹ 1,12,50,000. Give the accounting treatment for the above in the Company's accounts. What will be the treatment if the machinery fetched only ₹ 42,50,000 now?

Solution:

Particulars	₹
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (₹ 2,50,00,000 x 10% x 2 years)	50,00,000
Book Value at the beginning of Year 3	2,00,00,000
Add: Revaluation Surplus (balancing figure)	1,00,00,000
Revalued Amount as given (= revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3-5 (₹ 3,00,00,000 ÷ 8 yrs x 3 yrs)	1,12,50,000
Carrying Amount at the end of Year 5	**1,87,50,000**

The treatment of Gain / Loss on Disposal / Revaluation is as below:

Particulars	Disposal Proceeds = ₹ 1,12,50,000	Disposal Proceeds = ₹ 42,50,000
Book Value Less Disposal Proceeds	₹ 1,87,50,000 – ₹ 1,12,50,000	₹ 1,87,50,000 – ₹ 42,50,000
= Loss recognized in Profit or Loss	= ₹ 75,00,000 (Loss)	= ₹ 1,45,00,000 (Loss)
Revaluation Surplus directly transferred to Retained Earnings	₹ 1,00,00,000	₹ 1,00,00,000

4. Entity A exchanges land with a book value of ₹ 10,00,000 for cash of ₹ 20,00,000 and plant and machinery valued at ₹ 25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

Solution: In the given case, Plant & Machinery is valued at ₹ 25,00,000, which is assumed to be fair value in absence of information. Further, since fair value of land (asset given up) is not given, the transaction will be recorded at fair value of assets acquired of ₹ 45,00,000 (₹ Cash 20,00,000 + ₹ Plant & Machinery 25,00,000). Since land of book value ₹ 10,00,000 is transferred in exchange of assets worth ₹ 45,00,000, a gain of ₹ 35,00,000 will be recognised in the books of Entity A.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	20,00,000	
Plant & Machinery A/c	Dr.	25,00,000	
To Land			10,00,000
To Profit on Sale of Land (balancing figure)			35,00,000

5. XYZ Ltd has acquired a heavy road transporter at a cost of Rs 1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10years. At the end of the sixth year, the Power train (one of its component) requires replacement, as further maintenance is uneconomical due to the off –road time required. The remainder of the vehicle is perfectly roadworthy and is expected to last for the next four years. The cost of a new power train is Rs 45,00,000. The discount rate assumed is 5%.
Can the cost of the new power train be recognized as an asset, and, if so, what treatment should be used?
Solution: The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset. The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement Rs. 45,00,000 can be used as an indication (usually by discounting) of the likely cost, six years previously.
If an appropriate discount rate is 5% per annum, Rs. 45,00,000 discounted back six years amounts to Rs. 33,57,900 [Rs. 45,00,000/(1.05)6], i.e., the approximate cost of turbine before 6 years.
The current carrying amount of the turbine which is required to be replaced of Rs. 13,43,160 would be derecognised from the books of account, (i.e., Original Cost Rs. 33,57,900 as reduced by accumulated depreciation for past 6 years Rs. 20,14,740, assuming depreciation is charged on straight-line basis.)
The cost of the new turbine, Rs. 45,00,000 would be added to the cost of machine, resulting in a revision of carrying amount of machine to Rs. 71,56,840. (i.e., Rs. 40,00,000* – Rs. 13,43,160 + Rs. 45,00,000).
*Original cost of machine Rs. 1,00,00,000 reduced by accumulated depreciation (till the end of 6 years) Rs. 60,00,000.

6. 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.
Solution: 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

7. On 1 April 20X1, Sun ltd purchased some land for ₹ 10 million (including legal costs of ₹ 1 million) in order to construct a new factory. Construction work commenced on 1 May 20X1. Sun ltd incurred the following costs in relation with its construction:
   - Preparation and levelling of the land – ₹ 3,00,000.
   - Purchase of materials for the construction – ₹ 6.08 million in total.
   - Employment costs of the construction workers – ₹ 2,00,000 per month.
   - Overhead costs incurred directly on the construction of the factory – ₹ 1,00,000 per month.
   - Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – ₹ 50,000 per month.
   - Income received during the temporary use of the factory premises as a car park during the construction period – ₹ 50,000.
   - Costs of relocating employees to work at the new factory – ₹ 300,000.
   - Costs of the opening ceremony on 31 January 20X1 – ₹ 150,000.

   The factory was completed on 30 November 20X1 and production began on 1 February 20X2. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

   At the end of the 40 -year period, Sun ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be ₹ 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of ₹ 1 payable in 40 years' time at an annual discount rate of 8% is Rs. 0.046.

   The construction of the factory was partly financed by a loan of ₹ 17.5 million taken out on 1 April 20X1. The loan was at an annual rate of interest of 6%. During the period 1 April 20X1 to 31 August 20X1 (when the loan proceeds had been fully utilised to finance the construction), Sun Ltd received investment income of ₹ 100,000 on the temporary investment of the proceeds.

   Required: Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31 March 20X2. You should explain your treatment of all the amounts referred to in this part in your answer.

   Solution: Computation of the cost of the factory

Description	**Included in PPE Rs 000**	**Explanation**
Purchase of land	10,000	Both the purchase of the land and the associated legal costs are direct costs of constructing the factory.
Preparation and leveling	300	A direct cost of constructing the factory
Materials	6,080	A direct cost of constructing the factory
Employment costs of construction workers	1,400	A direct cost of constructing the factory for a seven-month period
Direct overhead costs	700	A direct cost of constructing the factory for a seven-month period
Allocated overhead costs	Nil	Not a direct cost of construction
Income from use as a car park	Nil	Not essential to the construction so recognised directly in profit or loss
Relocation costs	Nil	Not a direct cost of construction
Opening ceremony	Nil	Not a direct cost of construction
Finance costs	612.5	Capitalise the interest cost incurred in a seven-month period (purchase of land would not trigger off capitalisation since land is not a qualifying asset. Infact, the construction started from 1st May, 20X1)
Investment income on temporary investment of the loan proceeds	(100)	offset against the amount capitalized
Demolition cost recognised as a provision	920	Where an obligation must recognise as part of the initial cost

Total	19,912.50	All of the net finance cost of 512.50 (612.50 – 100) has been allocated to the depreciable amount. Also acceptable to reduce by allocating a portion to the non- depreciable land element principle

Computation of accumulated depreciation and Carrying Amount

Total depreciable amount	9,912.50	
Depreciation must be in two parts: Depreciation of roof component Depreciation of remainder	 49.56 57.82	 9,912.50 x 30% x 1/20 x 4/12 9,912.50 x 70% x 1/40 x 4/12
Total depreciation	107.38	
Computation of carrying amount	19,805.12	19,912.50 – 107.38

8. In the books of Optic Fiber Ltd., plant and machinery stood at Rs. 6,32,000 on 1.4.2013. However on scrutiny it was found that machinery worth Rs. 1,20,000 was included in the purchase on 1.6.2013. On 30.6.2013 the company disposed a machine having book value of Rs. 1,89,000 on 1.4.2013 at Rs. 1,75,000 in part exchange of a new machine costing Rs. 2,56,000. The company charges depreciation @20% WDV on plant and machinery.
You are required to calculate:

(i) Depreciation to be charged to P/L
(ii) Book Value of Plant and Machinery A/c as on 31.3.2014
(iii) Loss on exchange of machinery .

Solution:

(i) Total Depreciation to be charged in the Profit and Loss Account	**Rs.**
Depreciation on old machinery in use [20% of (6,32,000-1,89,000)]	88,600
Add: Depreciation on machine included in purchase @ 20% of Rs.1,20,000 for 10 months	20,000
Add: Depreciation on new machine @ 20% of Rs. 2,56,000 for 9 months	38,400
Add: Depreciation on machine disposed of (20% on Rs. 1,89,000 for 3 months)	9,450
Total depreciation to be charged in Profit and Loss A/c	1,56,450

(ii) Book Value of Machinery in the Balance Sheet as on 31.03.2014	**Rs.**
Opening Balance	6,32,000
Less: Book value of machine sold	(1,89,000)
Add: Purchase of new machine	2,56,000
Add: Machinery included in purchase	1,20,000
Less: Depreciation on machinery in use (88,600+20,000+38,400)	(1,47,000)
	6,72,000

(iii) Loss on Exchange of Machine	**Rs.**
Book value of machine as on 1.4.2013	1,89,000
Less: Depreciation for 3 months @ 20%	(9,450)
Written Down Value as on 30.6.2013	1,79,550
Less: Exchange value	(1,75,000)
Loss on exchange of machine	4,550

CHAPTER 5 AS 26: INTANGIBLE ASSETS

1. Initial measurement of intangible asset: Initially Intangible Asset shall be recorded at cost price. It can be acquired as follows:-

(1) Purchased asset: Such asset shall be recorded at cost of acquisition which includes:

Particulars	Amount
Purchase price including taxes (Reduced by tax credit if any)	XXX
(+)Valuation expanses	XXX
(+) Registration expenses	XXX
(+) Any Expenses incurred to ready Asset for its intended use	XXX
	XXX

(2) Self-generated/Internally generated intangible assets: These are of 2 types:

A. I.A. on which no amount has been incurred/Items that should not be recognised as internally generated intangible assets: This standard prohibits the recognition of internally generated assets on which no expenditure has been incurred.
Examples of these assets are: (i) Goodwill, (ii) Brands, (iii) Trademark, (iv) Copyright, (v) mastheads, (vi) Publishing titles, (vii) Customer lists & items similar in substance.

B. I.A. on which cost has been incurred: Such assets has been recorded at cost incurred to the extent of its Fair Value. E.g. Software, patents, website etc.

Note 1: Expenditure on self - generated I.A. is at 2 phases:

(i) Research phase: Expenditure on research should be recognised as an expense and charged into SPL when it is incurred.

(ii) Development Phase: Any expenses incurred during development phase shall be capitalized to the extent of expected benefit. In case expected benefit is lower than cost of the asset then difference between expected benefit and cost of the asset shall be charged into SPL. In case any amount charged into SPL due to expected benefit is lower than cost price then such expenditure will not be capitalized in future even if expected benefit increased in comparison to Carrying amount.

Development phase has been begun when all conditions are fulfilled (PIRATE)

(i) (P) The intangible asset will generate probable future economic benefits.
(ii) (I) Intention to complete the intangible asset and use or sell it.
(iii) (R) Adequate resources (like technical, financial or others) to complete the development.
(iv) (A) Ability to use or sell the intangible asset.
(v) (T) Technical feasibility of completion of I.A. make it available for use/sale.
(vi) (E) Ability to measure reliably the expenditure attributable to I.A. during its development.

Note 1: Any expenditure incurred on asset after the period when it is ready to use shall be charge into P&L A/c.

Note 2: If an entity cannot distinguish the research phase from the development phase of an internal project to create an IA, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Note 3: Examples of expenditures that are not part of the cost of an IA are:

(a) Costs of introducing a new product or service (including cost of advertising and promotional activities) / selling and distribution expenses
(b) Costs of conducting business in a new location or with a new class of customer (including cost to staff training)
(c) Administrative and other general overhead costs
(d) Abnormal loss

(3) Intangible asset acquired in exchange /in non-monetary consideration: Same concept as already discussed in AS 10.

2. Measurement subsequent to initial recognition: at its cost less any accumulated amortisation and any accumulated impairment losses.

3. Subsequent expenditures on IA: should be recognised 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) The 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.

4. Amortisation of Intangible Asset:
   (i) Intangible asset shall be amortised in the ratio of expected benefits.
   (ii) In case expected benefit is not identified then intangible asset shall be amortised over a maximum period of 10 years by using SLM. However in case of software and website such life is generally taken 3 to 5 years.
   (iii) Residual Value is assumed to be zero unless there is
      (a) Commitment by a third party to purchase at end of useful life i.e. have a guaranteed residual value
      (b) IA has an active market.
   (iv) The amortisation period and method should be reviewed at least at each year end. In case there is any changes in expected benefit or useful life of asset then it is considered as change in accounting estimate and its impact shall be taken on prospective basis.

   Notes:

   (1) Expected benefit either can be taken on the basis of expected revenue or profit or cash flow. (Expected cash flow is more reliable).
   (2) In case entity not amortised intangible asset in early year then amortised amount till the date of first day of the year shall be charged into P&L A/c as prior period items(expenditure) as per AS 5.
   (3) Sometime entity take different life of amortization of I.A. in comparison to AS 26 (i.e. 10 years): In such case calculate amount as per AS-26 and any difference between existing book value / carrying amount and new carrying amount shall be transfer into revenue reserve. Further amortisation will be on the basis of new carrying amount.

5. On disposal or sale of intangible Asset: any difference between sale price and carrying amount shall be transferred into SPL.

6. In case any expenditure do not qualify the definition of Intangible Assets then such expenditure shall not be capitalized rather it shall be charged into P&L A/c immediately irrespective of amount of expenditure. Examples of such expenditures may be:
   (a) expenditure on start-up activities (start-up costs). Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);
   (b) expenditure on training activities;
   (c) expenditure on advertising and promotional activities; and
   (d) expenditure on relocating or re-organising part or all of an enterprise.

7. AS 14 - Amalgamation of companies: As per AS-14 if amount paid for purchase consideration is more than fair value of net Asset of that company which is acquired is known as goodwill.
   Formula:

Consideration paid	XXX
Less: Fair value of net Asset	(XXX)
Goodwill	XXX

PRACTICAL QUESTIONS

1. A company acquired for its internal use a software on 28.01.2012 from the USA for US $ 1,00,000. The exchange rate on that date was Rs. 52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:
   (i) Import Duty : 20%
   (ii) Purchase Tax : 10%
   (iii) Entry Tax : 5 % (Recoverable later from tax department)
   (iv) Installation expenses : Rs. 25,000
   (v) Profession fees for Clearance from Customs: Rs. 20,000
   Compute the cost of Software to be capitalized.
   Solution: Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	$ 1,00,000
Less: Trade discount @ 5%	($ 5,000)
	$ 95,000
Cost in Rs. (US $ 95,000 x Rs. 52)	49,40,000
Add: Import duty on cost @ 20% (Rs.)	9,88,000
	59,28,000
Purchase tax @ 10% (Rs.)	5,92,800
Installation expenses (Rs.)	25,000
Profession fee for clearance from customs (Rs.)	20,000
Cost of the software to be capitalized (Rs.)	65,65,800

   Note: Since entry tax has been mentioned as a recoverable/refundable tax, it is not included as part of the cost of the asset.

2. U.K. International Ltd. is developing a new production process. During the financial year ending 31st March, 2011, the total expenditure incurred was Rs. 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2010. Expenditure incurred till this date was Rs. 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2012 was Rs. 80 lakhs. As at 31st March, 2012, 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, 2011 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, 2012.
   Ignore depreciation.

Solution: As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2011

(1) Carrying value of intangible as on 31.03.2011: At the end of financial year 31st March 2011, 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 2010).

(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 2011. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2012

(1) Expenditure to be charged to Profit and Loss account:	**(Rs. in lakhs)**
Carrying Amount as on 31.03.2011	28
Expenditure during 2011 – 2012	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 31.03.2012.

(2) Carrying value of intangible as on 31.03.2012:	**(Rs. in lakhs)**
Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2012	72

3. Swift Ltd. acquired a patent at a cost of ₹ 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹ 10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000. Find out the amortization cost of the patent for each of the years.

Solution: Swift Limited amortised ₹ 10,00,000 per annum for the first two years i.e. ₹ 20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows (₹)	Amortisation Ratio	Amortisation Amount (₹)
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

4. Nirman Solutions incurred costs to develop and produce a routine, low risk Computer Software Product, as follows, as on 31.03.2016

Completion of Detailed Program Design	Rs. 15,00,000
Costs incurred for Coding and Testing to establish technological feasibility	Rs. 8,00,000
Other Coding and Testing Costs after establishment of technological feasibility	Rs. 6,50,000
Cost of producing Product Masters for Training Materials	Rs. 4,20,000
Duplication of Computer Software and Training Materials from Product Master (5,000 Units)	Rs. 2,50,000
Packaging Product (2,500 Units)	Rs. 1,50,000

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Required:

(i) What amount should be capitalized as Software Cost, subject to amortization of Nirman Solutions as on 31st March 2016?

(ii) What amount should be reported in Inventory of Nirman Solutions as on 31st March 2016?

Solution:

(i) 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 has been established for the product. Technological feasibility has been established upon completion of detailed program design or working model. In this case, Rs. 23,00,000 would be recorded as an expense (Rs. 15,00,000 for completion of detailed program design and Rs. 8,00,000 for coding and testing to establish technological feasibility). Cost incurred from the point of technological feasibility until the time when products costs are incurred are capitalized as software cost. In this situation, Rs. 10,70,000 (i.e. Rs. 6,50,000 + Rs. 4,20,000) will be capitalized as the cost of the software.

(ii) The cost of duplication of computer software and training materials from product masters (5,000 units) amounting Rs. 2,50,000 and packaging product (2,500 units) amounting Rs. 1,50,000 should be reported as inventory cost as on 31st March, 2016 i.e. inventory value is total of Rs. 4,00,000.

5. Base Limited is showing an intangible asset at Rs. 85 lakhs as on 1-4-2011. This asset was acquired for Rs. 112 lakhs on 1-4-2008 and the same was available for use from that date. The company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.

Solution: As per para 63 of AS 26 “Intangible Assets,” the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates 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. Amortization should commence when the asset is available for use.

Base Limited has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, Base Limited would be required to restate the carrying amount of intangible asset as on 1.4.2011 at Rs. 112 lakhs less Rs. 33.6 lakhs (112 lakhs ×3 years/10 years) = Rs. 78.4 lakhs.

The difference of Rs. 6.6 lakhs i.e. (Rs. 85 lakhs – Rs. 78.4 lakhs) will be adjusted against the opening balance of revenue reserve.

The necessary journal entry (for rectification) will be

Revenue Reserves	Dr.	Rs. 6.6 Lakhs	
To Intangible Assets			Rs. 6.6 Lakhs
(Adjustment to reserves due to restatement of the carrying amount of intangible asset)			

The carrying amount of Rs. 78.4 lakhs would be amortized over remaining 7 years by Rs. 11.2 lakhs per year.

6. ABC Ltd. developed know-how by incurring expenditure of Rs. 20 lakhs, The know-how was used by the company from 1.4.2005. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.2012. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.2012.

Solution:- Journal Entry

		Rs.	Rs.
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	
Depreciation A/c	Dr.	2,00,000	
To Know-how A/c			14,00,000

[Being depreciation of 7 years (out of which depreciation of 6 years charged as PPI)]

7. Surya Ltd. had the following transactions during the year ended 31st 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 Staright 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.

Solution:

Surya Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31 st 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

CHAPTER 6 AS 28: IMPAIRMENT OF ASSETS

1. Meaning of impairment Loss: Impairment Loss is the amount by which carrying amount of an asset OR CGU (Cash Generating Unit) reduces to the extent of recoverable amount of asset.

2. At each reporting date or any date as decided by an entity on consistent basis, check Indicator of impairment on each asset or CGU.
   These Indicators are of two types:
   (A) External Indicator:
   (i) Market Value of principal assets of entity has been declined significantly.
   (ii) Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated;
   (iii) Market rate of interest has been increased.
   (iv) Market capitalization of an entity is lower than CA of net asset of entity.

   (B) Internal Indicator:
   (i) Evidence is available of obsolescence or physical damage of an asset;
   (ii) Entity is planning to restructure/changes. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;
   (iii) The economic performance of an asset is, or will be, worse than expected.
   The above list is not exhaustive. An entity may identify other indications.

3. In case Indicator exists of impairment then entity make a formal calculation of impartment irrespective of actual impairment loss or not.

4. Calculation of Impairment loss = Carrying Amount of Asset – Recoverable Amount of Asset

5. Calculation of carrying amount of Asset

Cost of asset	XXX
(±)Revaluation Profit/(loss)	XXX
(-)Acc. Depreciation	(XXX)
	(XXX)

6. Calculation of Recoverable amount: Higher of two
   (a) Net selling price; or
   (b) Value in use

   (a) Net selling price = Expected Selling Price – Expected selling expenses

   (b) Calculation of value in use = Present value of net cash flow by using discount Rate

   *1 Expected cash flows should cover a maximum period of 5 years unless a longer period can be justified. (However for examination purpose use expected cash how for such number of years as given in question.)

   *2 Discount Rate The discount rate (rates) shall be a pre-tax rate (rates)

7. **Accounting treatment of Impairment Loss**

(A) On recognition of Impairment loss

Impairment loss A/c	Dr.	XXX	
To provision for impairment loss A/c			XXX

(B) On charging of impairment loss

Revaluation Reserve A/c (if any)	Dr.	XXX	
P&LA/c (B/F)	Dr.	XXX	
To impairment loss A/c			XXX

(C) PPE shall be shown in Balance Sheet (Extract) at net off impairment loss.

Assets		
Non–Current Assets		
PPE at cost	XXX	
(±)Revaluation	XXX	
(-)Acc. Depreciation	(XXX)	
(-)Provision for Impairment loss	(XXX)	XXX

8. **Calculation of Revised carrying amount =** Carrying Amount - Provision for Impairment loss.

9. Depreciation shall be charged on revised carrying amount for subsequent years.

10. **Sometime recoverable amount is NIL due to disposal Cost of asset and because of value in use is zero**
    (a) In that case Impairment loss can be maximum to the Carrying amount of the asset.
    (b) In case any expected disposal cost, create Provision for such expected loss in other AS (i.e. AS 29).

11. **Calculation of impairment loss cash generating unit(CGU):**
    (i) CGU is the smallest identifiable Group of asset that generates cash inflows that are large independent of the cash inflow from other asset or group of asset.

    (ii) **How to calculate impairment loss in case of CGU:** For the purpose of calculation of impairment loss of CGU following steps are applied:-
    Step 1: Calculate carrying amount of all assets under CGU.
    Step 2: Calculate recoverable Amount of CGU as a whole.
    Step 3: Compare step 1 & Step 2 and calculate impairment loss of CGU as a Whole.
    Step 4: Allocate Impairment loss calculated under Step 3 in the ratio of carrying amount of assets under CGU.
    Step 5: Calculate revised carrying amount of each asset under CGU by comparing step 1 with Step 4.

    Note 1: In case any another assets which are part of CGU but out of scope of AS 28, then impairment loss shall not be allocable on those assets. Examples of those assets are trade receivable, inventory etc. Further amount of these assets shall be calculated on the basis of respective AS.

    Note 2: Impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired.

PRACTICAL QUESTIONS

1. Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year	Cash Flow (₹ in lakhs)
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000

Residual value at the end of 20X6	=	₹ 1,000 lakhs
Property, Plant and Equipment purchased on 1-1-20XX	=	₹ 40,000 lakhs
Useful life	=	8 years
Net selling price on 31-12-20X1	=	₹ 20,000 lakhs

Calculate on 31-12-20X1:
(a) Carrying amount at the end of 20X1
(b) Value in use on 31-12-20X1
(c) Recoverable amount on 31-12-20X1
(d) Impairment loss to be recognized for the year ended 31-12-20X1
(e) Revised carrying amount
(f) Depreciation charge for 20X2.

Note: The year 20XX is the immediate preceding year before the year 20X0.

Solution: Calculation of value in use

Year	Cash Flow	Discount as per 15%	Discounted cash flow
20X2	4,000	0.870	3,480
20X3	6,000	0.756	4,536
20X4	6,000	0.658	3,948
20X5	8,000	0.572	4,576
20X6	4,000	0.497	1,988
20X6	(residual) 1,000	0.497	497
			19,025

(a) Calculation of carrying amount:

Original cost	=	₹ 40,000 lakhs
Depreciation for 3 years = [(40,000-1000) X 3/8]	=	₹ 14,625 lakhs
Carrying amount on 31-12-20X1 = [40,000-14,625]	=	₹ 25,375 lakhs

(b) Value in use = ₹ 19,025 lakhs

(c) Recoverable amount = higher of value in use and net selling price i.e. ₹ 20,000 lakhs.
Recoverable amount = ₹ 20,000 lakhs

(d) Impairment Loss = ₹ (25,375-20,000) = ₹ 5,375 lakhs

(e) Revised carrying amount = ₹ (25,375-5,375) = ₹ 20,000 lakhs

(f) Depreciation charge for 20X2 = (20,000-1000)/5 = ₹ 3,800 lakhs

2. Great Ltd., acquired a machine on 1st April, 2012 for Rs. 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, 2016, the carrying value of the machine was reassessed at Rs. 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2018, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs. 79 lakhs.

Calculate the loss on impairment of the machine and show how this loss is to be treated in the books of Great Ltd. Great Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Solution: Statement Showing Impairment Loss

		(Rs. in crores)
Carrying amount of the machine as on 1st April, 2012 [7 crores × 4 years]		7.00
Depreciation for 4 years i.e. 2012-2013 to 2015-2016[7 years]		(4.00)
Carrying amount as on 31.03.2016		3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)		2.10
Carrying amount of the machine as on 1st April 2016 (revalued)		5.10
Less: Depreciation for 2 years i.e. 2016-2017 & 2017-2018 [5.10 crores × 2 years] / 3 years		(3.40)
Carrying amount as on 31.03.2018		1.70
Less: Recoverable amount		(0.79)
Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.2018:		
Balance in revaluation reserve as on 31.03.2016	2.10	
Less: Enhanced depreciation met from revaluation reserve 2016-2017 & 2017-2018 = [(1.70 – 1.00) x 2 years]	(1.40)	
Impairment loss set off against revaluation reserve balance.		(0.70)
Impairment Loss to be debited to profit and loss account		0.21

3. An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 70,000. How is the asset to be accounted for?

   Solution: As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where recoverable amount is the higher of an asset's net selling price* and its value in use#. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (negative ₹ 70,000)]. Thus impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

   Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹ 70,000 as per AS 10 & 29.

   * Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

   In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹ 70,000 = (₹ 70,000)

   # Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.

4. Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed. Discuss the applicability of Impairment loss.

   Solution: As per provisions of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

CHAPTER 7 AS 17: SEGMENT REPORTING

1. Segments are of two types:

(1) A business segment is a distinguishable component of an enterprise that is engaged in providing an individual or a group of related products or services and that is subject to risks & returns that are different from those of other business segments.
Factors, whether products or services are related or different include:
(a) The nature of the products or services e.g. NIIT sales hardware, software and also provides computer training.
(b) The nature of the production processes e.g. handmade and machine made product.
(c) The type or class of customers for the products or services e.g. Individual or institute or industry or domestic or foreign etc.
(d) The methods used to distribute the products or provide the services e.g. Retail sale or wholesale.
(e) If applicable, the nature of the regulatory environment, e.g. banking, insurance, or public utilities

(2) A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. The geographical segments to be based on either:
(a) The location of facilities and assets
(b) The location of its customers.

2. Selection of reportable segment: There are 3 methods to select a reportable segment

Method I: On the basis of the limit / Quantitative Thresholds (para 27): If any segment qualify any one criteria out of following three then it becomes a reportable segment:
(a) Its revenue is 10% or more of the total revenue (Revenue includes both external and internal revenue); or
(b) Its segment result, whether profit or loss, is 10% or more of –
 (i) The combined result of all segments in profit, or
 (ii) The combined result of all segments in loss,
 Whichever is higher in absolute amount;
 [For this purpose profit and loss shall be considered separately and not adjust loss with profit or profit with loss] or
(c) Its segment assets are 10% or more of the total assets of all segments.

Method 2: Comparative method: If segment was reportable in previous year due to limit as mentioned above in case I.

Method 3: On the choice of management: A segment may be designated as a reportable segment despite its size at the discretion of the management.

3. All segments to be reported in primary report should disclose at least 75% of external sale. If such limit is not qualified then select further segment until limit of 75% is attained.

4. Classification of reportable segment: These are of two types
(1) Primary segment
(2) Secondary Segment.
Management has to decide whether business segment or geographical segment is primary on the basis of dominant factor.

Presentation Table

Dominated Factor	Primary Segment	Secondary Segment
(i) Product or service	Business Segment	Geographical Segment
(ii) Area	Geographical Segment	Business Segment
(iii) Both	B.S.+G.S.(Matrix presentation)	G.S.+ B.S.(Matrix presentation)
(iv) None	B. S. (Assume)	G. S. (Assume)

5. Disclosure requirement:

(A) Disclosure in Primary Report: Primary report either can be based on business segment or geographical segment and it includes following

(i) Segment revenue-classified into external and Internal;
(ii) Segment result;
(iii) Total carrying amount of segment assets;
(iv) Total amount of segment liabilities;
(v) Segment capital expenditure;
(vi) Segment depreciation and amortisation in respect of segment assets;
(vii) Non-cash expenses, other than depreciation and amortisation.

Note: All above items should be reconcile with Entity's external sale, PAT, total assets and liabilities.

(B) Disclosure in Secondary Report

Case I: If Business segment is secondary

(i) Segment external revenue
(ii) Total carrying amount of segment assets;
(iii) Segment capital expenditure;

Case II: If Geographical segment is secondary

(i) Based on location of customer: Segment external revenue
(ii) Based on location of Assets
 (a) Total carrying amount of segment assets;
 (b) Segment capital expenditure;

Note: Further entity shall disclosed its accounting policy for disclosure of segment.

6. Definitions

(i) Segment Revenue:

Particulars	Amount
External revenue	XXX
Internal revenue	XXX
Total	XXX

Segment revenue does not include:

(a) Extraordinary income as defined in AS 5.
(b) Interest or dividend income except in a case of a financial segment; and
(c) Gains on sales of PPE or investments.

Note: In Case of combined revenue for two or more segment then allocate such revenue in respective segments on a reasonable basis.

(ii) Segment result:

Particulars	Amount
Segment revenue	XXX
Less: Segment expense	(XXX)
	XXX

(iii) Segment expenses: includes all cost incurred at segment including cost incurred in relation to transaction with other segment.
Segment expense does not include:
(a) Extraordinary items as defined in AS 5;
(b) Interest expense except in a case of a financial segment;
(c) Losses on sales/redemption of investments;
(d) Income tax expense; and
(e) General administrative expenses and head-office expenses

Note: In Case of combined expenses incurred for two or more segment then allocate such expenses in respective segments on a reasonable basis.

(iv) Segment assets are those operating assets that are employed by a segment in its operating activities.

Particulars	Amount
Segment fixed Assets	XXX
+ Segment net current Assets	XXX
	XXX

Note 1: Segment Assets does not include:
(a) Income tax asset
(b) Deferred tax asset
(c) Advance Interest
(d) Head office Asset

Note 2: In case any asset is used to generate revenue for two or more segments then such assets shall be allocated among two or more segments

(v) Segment liabilities are those operating liabilities that result from the operating activities of a segment.
Segment Liability does not include
(a) Head office liability
(b) Income tax liability
(c) Outstanding Interest

Note 1: Assets and liabilities that relate jointly to two or more segment should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

Note 2: In case any provision is created against any asset of the segment then such provision shall be reduced from segment asset.

7. If company prepared consolidated financial statement then segment reporting is optional for standalone financial statement.

8. Entity shall be disclosed its accounting policy in regards to segment reporting.
Question: A reportable segment recorded its external revenue at cost (+) 20% but internal revenue is recorded at cost(–)10%. Can this policy is adopted by the entity?
Answer: As per AS - 17 inter transfer (internal revenue) should be measured on the basis that entity actually use to price on these transfers
- such price or any change should be disclosed; and
- such policy is being disclosed into notes to account; and
- Such policy is being followed on consistent basis

PRACTICAL QUESTIONS

1. Heavy Goods Ltd. has 6 segments namely L-Q (below).
The total revenues (internal and external), profits or losses and assets are set out below:

(In ₹)

Segment	Inter Segment Sales	External Sales	Profit / loss	Total assets
L	4,200	12,300	3,000	37,500
M	3,500	7,750	1,500	23,250
N	1,000	3,500	(1,500)	15,750
0	0	5,250	(750)	10,500
P	500	5,500	900	10,500
Q	1,200	1,050	600	5,250
	10,400	35,350	3,750	1,02,750

Heavy Goods Ltd. needs to determine how many reportable segments it has.
You are required to advice Heavy Goods Ltd. as per the criteria defined in AS 17.

Solution:

Quantitative Threshold Test:

Revenue Test:
Combined total sales of all the segment = ₹ 10,400 + ₹ 35,350 = ₹ 45,750.
10% thresholds = 45,750 x 10% = 4,575.

Profitability Test:
In the given situation, combined reported profit = ₹ 6,000 and combined reported loss (₹ 2,250). Hence, for 10% thresholds ₹ 6,000 will be considered.
10% thresholds = ₹ 6,000 x 10% = ₹ 600

Asset Test:
Combined total assets of all the segment = ₹ 1,02,750 10% thresholds = ₹ 1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:

Segments	L	M	N	O	P	Q	Reportable segments
% segment sales to total sales	36.66%	24.59%	9.84%	11.48%	13.11%	4.92%	L, M,O,P
% segment profit to total profits	50%	25%	25%	12.5%	15%	10%	L,M,N,O,P,Q
% segment assets to total assets	36.50%	22.63%	15.33%	10.22%	10.22%	5.11%	L,M,N,O,P

Conclusion:
Segments L, M, O and P clearly satisfy the revenue and assets tests and they are separate reportable segments.
Segment N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.
Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.
Hence all segments i.e. L, M, N, O, P and Q are reportable segments.

2. Calculate the segment results of a manufacturing organization from the following information:

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

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	

Solution: Computation of segment result:

Segments	A (₹)	B (₹)	C (₹)	Total (₹)
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 :4 :2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue (1)	**6,60,000**	**4,15,000**	**2.70,000**	**13,45,000**
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 :4 :2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses (2)	**4,16,000**	**2,36,000**	**2,01,000**	**8,53,000**
Segment result (1-2)	**2,44,000**	**1,79,000**	**69,000**	**4,92,000**

3. M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹ 10.00 crores. Segment X has ₹ 2.00 crores, segment Y has ₹ 3.00 crores and segment Z has ₹ 5.00 crores. Deferred tax assets included in the assets of each segments are X- ₹ 0.50 crores, Y— ₹ 0.40 crores and Z— ₹ 0.30 crores. The accountant contends that all the three segments are reportable segments. Comment.
Solution According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are ₹ 8.8 crores [₹ 10 crores – (₹ 0.5 + ₹ 0.4 + ₹ 0.3)]. Segment X holds total assets of ₹ 1.5 crores (₹ 2 crores – ₹ 0.5 crores).
Segment Y holds ₹ 2.6 crores (₹ 3 crores – ₹ 0.4 crores); and Segment Z holds ₹ 4.7 crores (₹ 5 crores – ₹ 0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

4. A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?
Answer: AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter -segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

CHAPTER 8 INTERNAL RECONSTRUCTION

1. Accounting treatment

(i) On revaluation of Asset:

(a) If increase in the value of Asset

Asset A/c	Dr.	XXX	
To capital reconstruction / reduction A/c			XXX

(b) If decrease in the value of asset

Capital reduction A/c	Dr.	XXX	
To Asset A/c			XXX

(ii) On re-assessment / restated of liability:

(a) If decrease in the value of liability

Liability A/c	Dr.	XXX	
To capital reduction A/c			XXX

(b) On recognition of unrecorded liability (Increase in Liability)

Capital reduction A/c	Dr.	XXX	
To liability A/c			XXX

(iii) On payment to reconstruction expenses:

Capital reduction A/c	Dr.	XXX	
To bank A/c			XXX

(iv) On Settlement of liability: Sometime liability can be settled either through

- cash and Bank; or
- assets; or
- issue of new security (share capital / debenture)

then any difference shall we transferred into capital reduction account

(v) On reduction of share capital:

Case I: If reduction is only in Paid-up value

Share capital A/c	Dr.	XXX	
To capital reduction A/c			XXX

Case II: If reduction is in face value as well as in paid-up value

Share capital A/c (old face value)	Dr.	XXX	
To capital reduction A/c (b/f)			XXX
To share capital A/c (new face value)			XXX

Note 1: In case question is silent weather reduction is in paid-up value or face value take necessary assumption.

*1 In case question specify that share capital is being reduced to ₹ ______ it is a case of reduction in face value (Case 2).

*2 In case question specify that share capital is being reduced by ₹ ______ it is a case of reduction in paid up value only (Case 1).

Note 2: In case any share capital is settled by issue of new security then any difference shall be transferred into capital reduction account.

Note 3: In case new share capital is issued at an amount other than face value then difference between issue price and face value shall be transferred into security premium or discount account as the case may be.

(vi) Any penalty or commitment charges or losses arising during the scheme shall be charged / debited into capital reduction A/c.

Capital reduction A/c	Dr.	XXX	
To bank A/c			XXX

(vii) Debit balance of P&L A/c (losses), deferred revenue expenditure (if any) and intangible asset shall be written off if question is silent about these items

Capital reduction A/c	Dr.	XXX	
To P & L A/c			XXX
To deferred revenue expenditure			XXX
To intangible asset*			XXX

* Give a note in exam that we assume Nil value of intangible asset.

(viii) Treatment of preference dividend

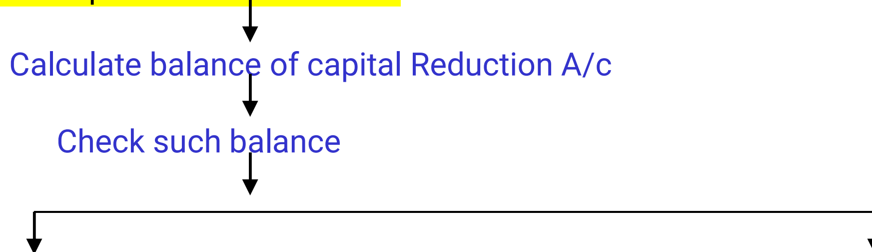
Case 1: If preference dividend is appeared in balance sheet: considered as a liability and any reduction shall be created into capital reduction A/c as a profit.

Case II: if preference dividend is in arrear: Any payment is considered as a loss and debited into capital reduction A/c.

(ix) Treatment of balance of capital reduction A/c

Case 1: If treatment is given / mentioned in question: as specified in question.

Case II: If question remain silent:



Calculate balance of capital Reduction A/c

Check such balance

If debit balance: Adjust with reserve in the following order:

→ Capital reserve

→ Security premium

→ Revenue reserve

If still debit balance

→ Transfer into goodwill (only theoretical)

If credit balance: Adjust with loss arises in the scheme i.e. discount on issue of new security (if any)

If still credit balance

→ transfer into capital reserve A/c

Note: Any profit or loss during the scheme, generally shall be adjusted / transferred into capital reduction account. However if question specify adjustment of any profit or loss against any reserve, then we will treat accordingly.

2. Surrender of shares it means share are surrendered by shareholder to the company for the purpose of issue to its Liability holder. Such shares are benami and held by entity till the date issue to its liability holder or cancelled.

Journal entries

(i) On surrender of shares

Share capital A/c	Dr.	XXX	
To share surrender A/c			XXX

Note: sometime company has equity share surrender but liability holder demands for preference share in that case company convert equity share surrender into preference share surrender.

(ii) On issue of surrender share

A. On reduction of liability:

Liability A/c	Dr.	XXX	
To capital reduction A/c			XXX

B. On issue of surrender shares to liability holders

Share surrender A/c	Dr.	XXX	
To share capital A/c			XXX

Note: Issue of surrender share and reduction of liability both are different, and amount can also be different.

(iii) On cancellation of surrender Shares which are not re-issued:

Share surrender A/c	Dr.	XXX	
To capital reduction A/c			XXX

3. Consolidation of shares and sub - division of shares:

A. Consolidation of shares: means increase in the value of share with corresponding decrease in number of shares without any change in total share capital.

Journal entry

Equity share capital A/c (Old number of share X old value)	Dr.	XXX	
To equity share capital A/c (New number of share X new value)			XXX
(Being share capital consolidated)			

B. Sub-division of shares: means decrease in the value of share with corresponding increase in number of share without any change in total share capital.

Journal entry

Equity share capital A/c (Old number of share X old value)	Dr.	XXX	
To equity share capital A/c (New number of share X new value)			XXX
(Being share capital consolidated)			

PRACTICAL QUESTIONS

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

   (ii) Goodwill which stood at Rs. 2,70,000 is to be completely written off.
   (iii) Plant & Machinery to be reduced by Rs. 1,00,000, Furniture to be reduced by Rs. 88,000 and Building to be appreciated by Rs. 1,50,000.
   (iv) Investment of Rs. 6,00,000 to be brought down to its existing market price of Rs. 1,80,000.
   (v) Write off Profit & Loss Account debit balance of Rs. 2,25,000.
   In case of any shortfall, the balance of General Reserve of Rs. 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.

Solution: **Journal Entries**

		Rs.	Rs.
Equity Share Capital (old) A/c	Dr.	75,00,000	
To Equity Share Capital (Rs. 10) A/c			45,00,000
To 6% Preference Share Capital (Rs. 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.

2. M/s Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the company as on 31st March, 2012 before reconstruction:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital		Goodwill	22,00,000
50,000 shares of Rs. 50 each fully paid up	25,00,000		
1,00,000 shares of Rs.50 each Rs.40 paid up	40,00,000	Land and building	42,70,000
Capital Reserve	5,00,000	Machinery	8,50,000
8% Debentures of Rs.100 each	4,00,000	Computers	5,20,000
12% Debentures of Rs.100 each	6,00,000	Stock	3,20,000
Trade Creditors	12,40,000	Trade Debtors	10,90,000

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Outstanding expenses	10,60,000	Cash at Bank	2,68,000
		Profit and Loss account	7,82,000
Total	1,03,00,000	Total	1,03,00,000

Following is the interest of Mr. Shiv and Mr. Ganesh in M/s Platinum Linited:

	Mr. Shiv	**Mr. Ganesh**
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 Rs. 40 each for Rs. 12,50,000.
(3) Trade creditors are given option of either to accept fully paid equity shares of Rs. 40 each for the amount due to them or to accept 70% of the amount due to them in cash in fully settlement of their claim. Tread Creditors for Rs. 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
(4) Mr. Shiv agrees to cancel debenture amounting to Rs.2.00,000 out of total debenture due to him and agree to 15% Debenture for the balance amount due. He also agree to subscribe further 15% Debenture in cash amounting to Rs.1,00,000.
(5) Mr. Ganesh agree to cancel debenture amounting to Rs. 50,000 out of total debenture due to him and agree to accept 15% Debenture for the balance amount due.
(6) Land and Building to be revalued at Rs. 51,84,000, Machinery at Rs. 7,20,000, Computers at Rs. 4,00,000, Stock at Rs. 3,50,000 and Tread Debtors at 10% less to as they are appearing in Balance Sheet as above.
(7) Outstanding Expenses are fully paid in cash.
(8) Goodwill and Profit and 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.

Solution: **Journal Entries**

			Dr. (₹)	Cr. (₹)
1.	Equity Share final call A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(Being final call made for ₹10 each on 1,00,000 shares)			
2.	Bank A/c	Dr.	10,00,000	
	To Equity Share final call A/c			10,00,000
	(Being money on final call received)			
3.	Equity share capital (₹ 50) A/c	Dr.	75,00,000	
	To Equity Share Capital (₹40) A/c			60,00,000
	To Capital Reduction A/c			15,00,000
	(Being conversion of equity share capital of ₹50 each into ₹40 each as per reconstruction scheme)			
4.	Bank A/c	Dr.	12,50,000	
	To Equity Share Capital A/c			12,50,000
	(Being new shares allotted at ₹40 each)			
5.	Trade Creditors A/c	Dr.	12,40,000	
	To Equity Share Capital A/c			7,50,000
	To Bank A/c			3,43,000
	To Capital Reduction A/c			1,47,000
	(Being payment made to creditors in shares or cash to the extent of 70% as per reconstruction scheme)			
6.	8% Debentures A/c	Dr.	3,00,000	
	12% Debentures A/c	Dr.	4,00,000	
	To 15% Debentures A/c			5,00,000
	To Capital Reduction A/c			2,00,000

	(Being cancellation of 8% and 12% debentures of Shiv, & issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
7.	Bank A/c	Dr.	1,00,000	
	To 15% Debentures A/c			1,00,000
	(Being new debentures subscribed by Shiv)			
8.	8% Debentures A/c	Dr.	1,00,000	
	12% Debentures A/c	Dr.	2,00,000	
	To 15% Debentures A/c			2,50,000
	To Capital Reduction A/c			50,000
	(Being cancellation of 8% and 12% debentures of Ganesh, & issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
9.	Land and Building (51,84,000-42,70,000)	Dr.	9,14,000	
	Stock	Dr.	30,000	
	To Capital Reduction A/c			9,44,000
	(Being value of assets appreciated)			
10.	Outstanding expenses A/c	Dr.	10,60,000	
	To Bank A/c			10,60,000
	(Being outstanding expenses paid in cash)			
11.	Capital Reduction A/c	Dr.	33,41,000	
	To Machinery A/c			1,30,000
	To Computers A/c			1,20,000
	To Trade Debtors A/c			1,09,000
	To Goodwill A/c			22,00,000
	To Profit and Loss A/c			7,82,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance, goodwill and downfall in value of other assets)			
12.	Capital Reserve A/c	Dr.	5,00,000	
	To Capital reduction A/c			5,00,000
	(Being debit balance of capital reduction account adjusted against capital reserve)			

Balance Sheet (as reduced) as on 31.3.2012

Particulars	Rs.
Equity and Liabilities	
Shareholders' funds	
Share capital	
2,00,000 Equity shares of ₹ 40 each	80,00,000
Non-current liabilities	
Long-term borrowings	
15% Debentures	8,50,000
Total	88,50,000

Assets	
Non-current assets	
Property, plant and equipment	
Land and Building	51,84,000
Machinery	7,20,000
Computers	4,00,000
Current assets	
Inventory	9,81,000
Trade Receivable	3,50,000
Cash and Bank (WN 1)	12,15,000
Total	88,50,000

Working Notes:

1. Cash at Bank Account

	Particulars	₹		Particulars	₹
To	Balance b/d	2,68,000	By	Trade Creditors A/c	3,43,000
To	Equity Share final call A/c	10,00,000	By	Outstanding expenses A/c	10,60,000
To	Equity Share Capital A/c	12,50,000	By	Balance c/d (bal. fig.)	12,15,000
To	15% Debentures A/c	1,00,000			
		26,18,000			26,18,000

2. Capital Reduction Account

	Particulars	₹		Particulars	₹
To	Machinery A/c	1,30,000	By	Equity Share Capital A/c	15,00,000
To	Computers A/c	1,20,000	By	Trade Creditors A/c	1,47,000
To	Trade Debtors A/c	1,09,000	By	8% and 12% Debentures A/c	2,00,000
To	Goodwill A/c	22,00,000	By	8% and 12% Debentures A/c	50,000
To	Profit and Loss A/c	7,82,000	By	Land & Building	9,14,000
			By	Stock	30,000
			By	Capital Reserve A/c	5,00,000
		33,41,000			33,41,000

3. The Balance sheet of Vaibhav Ltd. as on 31st March 2014 is as follows:

Liabilities	Rs.	Assets	Rs.
Equity Shares of Rs. 100 each	2,00,00,000	Fixed Assets	2,50,00,000
6% Cumulative Preference Shares of Rs. 100 Each	1,00,00,000	Investments (Market Value Rs. 19.00,000)	20,00,000
5% Debentures of Rs. 100 each	80,00,000	Current Assets	2,00,00,000
Sundry Creditors	1,00,00,000	P & L A/c	12,00,000
Provision for Taxation	2,00,000		
TOTAL	4,82,00,000	TOTAL	4,82,00,000

The following scheme of Internal Reconstruction is sanctioned:

(i) All the existing equity shares are reduced to Rs. 40 each .

(ii) All preference shares are reduced to Rs. 60 each.

(iii) The rate of Interest on Debentures is increased to 6%. The Debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 70 each for every debenture held by them.
(iv) Fixed assets are to be written down by 20%
(v) Current assets are to be revalued at Rs. 90,00,000
(vi) Investments are to be brought to their market value.
(vii) Ones of the creditors of the company to whom the company owes Rs. 40,00,000 decides to forgo 40% of his claim. The Creditor is allotted with 60000 equity shares of Rs. 40 each in full and final settlement of his claim.
(viii) The taxation liability is to be settled at Rs. 3,00,000.
(ix) It is decided to write off the debit balance of Profit & Loss A/c.

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

Solution: **Journal Entries in the books of Vaibhav Ltd.**

		Rs.	Rs.
(i)	Equity share capital (Rs. 100) A/c Dr.	2,00,00,000	
	To Equity Share Capital (Rs. 40) A/c		80,00,000
	To Capital Reduction A/c		1,20,00,000
	(Being conversion of equity share capital of Rs. 100 each into Rs.40 each as per reconstruction scheme)		
(ii)	6% Cumulative Preference Share capital (Rs. 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference Share Capital (Rs. 60)A/c		60,00,000
	To Capital Reduction A/c		40,00,000
	(Being conversion of 6% cumulative preference share capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)		
(iii)	5% Debentures (Rs. 100) A/c Dr.	80,00,000	
	To 6% Debentures (Rs. 70) A/c		56,00,000
	To Capital Reduction A/c		24,00,000
	(Being 6% debentures of Rs. 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Sundry Creditors A/c Dr.	40,00,000	
	To Equity Share Capital (Rs. 40) A/c		24,00,000
	To Capital Reduction A/c		16,00,000
	(Being a creditor of Rs. 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of Rs. 40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	2,00,000	
	Capital Reduction A/c Dr.	1,00,000	
	To Liability for Taxation A/c		3,00,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)		
(vi)	Capital Reduction A/c Dr.	199,00,000	
	To P & L A/c		12,00,000
	To Property, Plant and Equipment A/c		50,00,000
	To Current Assets A/c		110,00,000
	To Investments A/c		1,00,000
	To Capital Reserve A/c (Bal. fig.)		26,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)		
(vii)	Liability for Taxation A/c Dr.	3,00,000	
	To Current Assets (Bank A/c)		3,00,000
	(Being the payment of tax liability)		

Balance Sheet of Vaibhav Ltd. (and reduced) as at 31st March, 20X1

Particulars	Notes	Rs.
Equity and Liabilities		
Shareholders' funds		
Share capital	1	164,00,000
Reserves and Surplus	2	26,00,000
Non-current liabilities		
Long-term borrowings	3	56,00,000
Current liabilities		
Trade Payables (1,00,00,000 less 40,00,000)		60,00,000
Total		3,06,00,000
Assets		
Non-current assets		
Property, plant and equipment	4	2,00,00,000
Investments	5	19,00,000
Current assets	6	87,00,000
Total		3,06,00,000

Notes to accounts

		Rs.
1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
2,60,000 equity shares of Rs. 40 each (of the above 60,000 shares have been issued for consideration other than cash)		1,04,00,000
Preference share capital		
Issued, subscribed and paid up		
1,00,000 6% Cumulative Preference shares of Rs. 60 each		60,00,000
Total		1,64,00,000
2. Reserves and Surplus		
Capital Reserve		26,00,000
3. Long-term borrowings		
Secured		
6% Debentures		56,00,000
4. Property, Plant and Equipment		
Carrying value	2,50,00,000	
Adjustment under scheme of reconstruction	(50,00,000)	2,00,00,000
5. Investments	20,00,000	
Adjustment under scheme of reconstruction	(1,00,000)	19,00,000
6. Current assets	2,00,00,000	
Adjustment under scheme of reconstruction	(1,10,00,000)	
	90,00,000	
Taxation liability paid	(3,00,000)	87,00,000

Working Note: **Capital Reduction Account**

To	Liability for taxation A/c	1,00,000	By	Equity share capital	1,20,00,000
To	P & L A/c	12,00,000	By	6% Cumulative preferences	
To	Property, plant and equipment	50,00,000		Share capital	40,00,000
To	Current assets	1,10,00,000	By	5% Debentures	24,00,000
To	Investment	1,00,000	By	Sundry creditors	16,00,000
To	Capital Reserve (Bal. fig.)	26,00,000			
		2,00,00,000			2,00,00,000

4. The Balance Sheet of M/s Clean Ltd. as on 31st March. 2015 was summarized as follow :

Liabilities	Amount(Rs.)	Assets	Amount(Rs.)
Share Capital : Equity Shares of Rs.50 Each fully paid up	60,00,000	Land & Building	75,00,000
9% Preference Shares of Rs.10 each fully paid up	40,00,000	Plant & Machinery	22,00,000
7% Debentures (secured by plant & machinery)	23,00,000	Trade Investment	16,50,000
8% Debentures	17,00,000	Inventories	9,50,000
Trade Payables	6,00,000	Trade Receivables	18,00,000
Provision for Tax	75,000	Cash and Bank Balances	3,60,000
		Profit & Loss Account	2,15,000
	1,46,75,000		1,46,75,000

The Board of Directors of the company decided upon the following scheme of reconstruction duly approved by all concerned parties:

(1) The equity shareholders agreed to receive in lieu of their present holding of 1,20,000 shares of Rs.50 each as under:

(a) New fully paid equity shares of Rs.10 each equal to 2/3rd of their holding.

(b) 9% preference shares of Rs.8 each to the extent of 25% of the above new equity share capital.

(c) Rs.2, 80,000, 10% debentures of Rs.80 each.

(2) The preference shareholders agreed that their Rs.10 shares should be reduced to Rs. 8 by cancellation of Rs.2 per share. They also agreed to subscribe for two new equity shares of Rs.10 each every five preference shares held.

(3) The taxation liability of the company is settled at Rs. 66,000 and the same is paid immediately.

(4) One of the trade creditors of the company to whom the company owes Rs.1,00,000 decides to forgo 30% of his claim. He is allotted equity shares of Rs. 10 each in full satisfaction of his balance claim.

(5) Other trade creditors of Rs.5,00,000 are given option of either to accept fully paid 9% preference shares of Rs 8 each for the amount due to them or to accept 80% of the amount due to them in cash in full settlement of their claim. Trade creditors for Rs.3,50,000 accepted preference shares option and rest of them opted for cash towards full settlement of their claim.

(6) Company's contractual commitments amounting to Rs.6,50,000 have been settled by paying 4% penalty of contract value.

(7) Debenture holders having charge on plant and machinery accepted plant and machinery in full settlement of their dues.

(8) The rate of interest on 8% debentures is increased to 10%. The debenture holders surrender their existing debenture of Rs50 each & agreed to accept 10%debenture of Rs80 each for every 2 debentures held by them.

(9) The land and building to be depreciated by 5%.

(10) The debit balance of profit and loss account is to be eliminated.

(11) 1/4th of trade receivables and 1/5th of inventory to be written off.

Pass journal Entries and prepare Balance Sheet after completion of the reconstruction scheme in the books of M/s Clean Ltd. as per Schedule III to the Companies Act, 2013.

Solution: 1. **Journal Entries in the books of clean Ltd.**

S.N.	Particulars	Dr.(Rs)	Cr.(Rs)
1.	Equity share Capital Capital (Rs50) A/c Dr. To Equity share Capital(Rs 10) A/c (1,20,000 X 2/3) X Rs. 10 To 9%Prefernce Share Capital (Rs8) A/C (for 25%of Rs. 8,00,000) To 10%Debentures (Rs 80)A/c To Capital Reconstruction A/c (Balancing Figure) (Being Equity share capital restated)	60,00,000	 8,00,000 2,00,000 2,80,000 47,20,000
2.	9%Preference Share Chare Capital (Rs. 10 X 4,00,000) A/c Dr. To 9%Preference Share Capital (Rs. 8 X 4,00,000)A/c To Capital Reconstruction A/c (B/F) (Being 9%Prefernce share capital restated)	40,00,000	 32,00,000 8,00,000
3.	Bank A/c Dr. To Equity Share Capital A/c(4,00,000 X 2/5) X Rs. 10 (Being Equity share capital issued)	16,00,000	 16,00,000
4.	Provision for Tax A/c Dr. To Cash & Bank A/c To Capital Reconstruction A/c (B/F) (Being Taxation Liability of the Company settled at Rs 66,000.)	75,000	 66,000 9,000
5.	Trade Creditors / payables A/c Dr. To Equity Share Capital (Rs10) A/c To Capital Reconstruction A/c (Being trade creditor of Rs. 1,00,000 settled)	1,00,000	 70,000 30,000
6.	Trade Creditors /Payables A/c Dr. To 9%Preference Share Capital (Rs8) A/c To Cash & Bank A/c (1,50,000 X 80%) To Capital Reconstruction A/c (1,50,000 X 20%) (Being 9% Preference Shares of Rs.8 each issued to Trade Creditors of Rs.3,50,000 and balance 80% of Claims settled in cash)	5,00,000	 3,50,000 1,20,000 30,000
7.	Capital Reconstruction A/c Dr. To Cash & Bank A/c (Being payment of Penalty for setting Contractual Obligation)	26,000	 26,000
8.	7% Debentures A/c Dr. To Plant and Machinery A/c To Capital Reconstruction A/c (Being takeover of Plant and Machinery by 7% Debenture holders)	23,00,000	 22,00,000 1,00,000
9.	8% Debentures (Rs.50 each) A/c Dr. To 10% Debentures A/c (Rs.80 each) [{(17,00,000)/50}/2] X 80 To Capital Reconstruction A/c (B/F) (Being 8% Debenture settled)	17,00,000	 13,60,000 3,40,000
10.	Capital Reconstruction A/c Dr. To Land and Building A/c (75,00,000 X 5%) To Profit and loss A/c To Trade Receivables A/c ($1/4^{th}$ x Rs.18,00,000) To inventories A/c ($1/5^{th}$ x Rs.9,50,000) (Being sundry assets reduced and losses written off)	12,30,000	 3,75,000 2,15,000 4,50,000 1,90,000
11.	Capital Reconstruction A/c Dr. To Capital Reserve A/c (Being balance in Reconstruction A/c transferred to Capital Reserve WN 1)	47,73,000	 47,73,000

II. Balance Sheet of Clean Ltd. and Reduced as at 1st April 2015

	Particulars as at 31st March	Note	Current Year
I (1)	Equity AND LIABILITIES: Shareholders' Funds: (a) Share Capital (b) Reserve and Surplus Capital Reserve (on Reconstruction) (WN 2)	 1	 62,20,000 47,73,000

(2)	None-Current Liabilities: Long Team Borrowings: 10% Debentures (2,80,000 + 13,60,000)		16,40,000
	Total		1,26,33,000
II (1)	ASSETS None-Current Assets (a) Property, Plant and Equipment: Land and Building (75,00,000 – 5%) (b) None-Current Investments		71,25,000 16,50,000
(2)	Current Assets: (a) Inventories (9,50,000 – 1,90,000) (b) Trade Receivables (18,00,000 – 4,50,000) (c) Cash and Cash Equivalents - (WN 3)		7,60,000 13,50,000 17,48,000
	Total		1,26,33,000

Note 1: Share Capital

Particulars	Amount
Authorised:……Equality Shares of Rs.10 each & …….9% Preference Share of Rs.8 each	
Issued, Subscribed & Paid up: 2,47,000 Equity Shares of Rs10each 4,68,750 9% Preference Shares of Rs.8 each (all the above Shares are issued as per approved scheme of reconstruction)	24,70,000 37,50,000
Total	62,20,000

Working Notes:

1 Capital Reconstruction A/c

Particulars	Rs.	Particulars	Rs.
To Cash / Bank A/c (Penalty on Contract)	26,000	By Equity Share Capital A/c	47,20,000
To Land and Building A/c	3,75,000	By 9% Preference Share Capital A/c	8,00,000
To Profit and Loss A/c (Debit balance)	2,15,000	By Provision for Tax A/c	9,000
To Trade Receivables	4,50,000	By Trade Creditors A/c (30,000 + 30,000)	60,000
To Inventories	1,90,000	By 7% Debentures A/c	1,00,000
To Capital Reserve (balancing figure)	47,73,000	By 8% Debentures A/c	3,40,000
Total	**60,29,000**	**Total**	**60,29,000**

2. Cash and Bank A/c

Particulars	Rs.	Particulars	Rs.
To balance b/d	3,60,000	By Provision for Tax	66,000
To Equity share capital A/c	16,00,000	By Trade Creditors A/c	1,20,000
		By Capital Reconstruction A/c	26,000
		By balance c/d (balancing figure)	17,48,000
Total	**19,60,000**	**Total**	**19,60,000**

Note:- Trade Investments are assumed as Long Term. Alternatively, it can be assumed as Investments held for trading purposes, and classified under Current Investments Category.

5. 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.

Solution:

Journal Entries In the books of Purple Ltd.

	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 : (6/100) x ₹ 6,00,000 = ₹ 36,000
Rate of return : 8% on Preference Shares
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 = (80/100) x 4,80,000 = ₹ 4,59,000
Plant & Machinery Reduced by: = (85/100) x 5,40,000 = ₹ 3,84,000
Land & Building = (5,40,000 - 4,59,000) = ₹ 81,000
Plant & Machinery = (4,80,000 - 3,84,000) = ₹ 96,000

6. The Balance Sheet of Revise Limited as at 31st March, 1999 was as follows:

Liabilities	**Rs.**	**Assets**	**Rs.**
Authorized and subscribed Capital:		Fixed Assets: Machineries	1,00,000
10,000 Equity shares of		Current assets:	
Rs. 100 each fully paid	10,00,000	Stock	3,20,000
Unsecured Loans:		Debtors	2,70,000
12% Debentures	2,00,000	Bank	30,000
Accrued interest	24,000	Profit and Loss A/c	6,00,000
Current liabilities-creditors	72,000		
Provision for income tax	24,000		
	13,20,000		13,20,000

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

(i) Each share be sub-divided into ten fully paid up equity shares of Rs. 10 each.
(ii) After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and creditors as necessary.
(iii) Out of shares surrendered, 10,000 shares of Rs. 10 each shall be converted into 12% preference shares of Rs. 10 each fully paid up.
(iv) The claims of the debenture-holders shall be reduced by 75%. In consideration of the reduction, the debenture holders shall receive preference shares of Rs. 1,00,000 which are converted out of shares surrendered.
(v) Creditors claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of Rs. 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.

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

Solution: **Journal Entries**

		Dr.	Cr.
Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000
To Equity Share Capital (₹ 10) A/c			5,00,000
(Subdivision of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			
12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000
(Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c			3,64,000
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)			
Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c			4,000
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			

Balance Sheet of Revise Limited (and reduced) as at...

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities		
(a) Other current liabilities	4	6,000
(b) Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,00,000
(2) Current assets		
(a) Inventories		3,20,000
(b) Trade receivables		2,70,000
(c) Cash and cash equivalents		30,000
Total		7,20,000

Notes to Accounts

		₹
1.	**Share Capital**	
	Equity Share Capital	
	Issued Capital: 53,600 Equity Shares of ₹ 10 each	5,36,000
	Preference Share Capital	
	Preference Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
2.	**Reserve and Surplus**	
	Capital Reserve	4,000
3.	**Long-term borrowings**	
	Unsecured Loans	
	12% Debentures	50,000
4.	**Other current liabilities**	
	Interest payable on debentures	6,000
5.	**Short-term provisions**	
	Provision for Income-tax	24,000
6.	**Property, plant and Equipment**	
	Machinery	1,00,000

CHAPTER 9 AS 7 - CONSTRUCTION CONTRACTS

1. Calculation of contract revenue and profit or loss on contract: Following steps are applied

   Step 1: Calculate % of completion / stage of completion: There are three methods

   Method 1: Cost method: (Cost incurred up to date / total estimated cost) X 100

   Method 2: Labour hour method: (Labour hours invested / total estimated labour hours)X 100

   Method 3: Surveyor method: % of completion as per surveyor report.

   Step 2: Calculate contract revenue: Contract price X % of completion

   Step 3: Calculate profit / (loss) on contract

Particulars	Amount
Contract revenue upto date	XXX
(-) Cost incurred upto date	(XXX)
Profit / loss upto date	XXX
(-) Total profit / loss already recognised	(XXX)
Profit / loss for the year	XXX

2. Calculation of total contract price / total contract revenue

Particulars	Amount
Initial contract price (fixed / Cost-plus price)	XXX
(+) Claims(reimbursement for costs not included in the contract price)*	XXX
(+) Adjusted for Variations*	XXX
(+) Incentive (usually for early completion)*	XXX
(+) Agreed Cost Escalation*	XXX
(-) Penalties (usually for late completion)	(XXX)
	XXX

*Revenue on these items shall be recognised only when:
- it is probable that these will be results in revenue (It means there should be certainty of collection and consideration); and
- they are capable of being reliably measured

3. Calculation of contract cost it includes

Particulars	Amount
Direct cost (Direct material cost, direct labour cost and direct overhead cost)	XXX
(+) Allocable / attributable cost	XXX
(+) Other cost that are chargeable to the customer under the terms of contract	XXX
Total contract cost	XXX

Note: Contract cost does not include

(a) General & administration costs for which reimbursement is not specified in the contract
(b) selling costs
(c) research & development costs for which reimbursement is not specified in the contract
(d) depreciation of idle plant and equipment that is not used on a particular contract

4. Sometime question does not give the information of estimated cost rather give the information of estimated profit in that case amount of estimated cost shall be calculated as follows:
Estimated cost = Total contract price / revenue (-) Estimate amount of profit

5. Provision for expected loss: in case there is any expected loss on contract (i.e. expected contract cost is more than contract price), then the contractor shall recognised provision for expected loss irrespective of work started or not on contract.

6. Total cost incurred shall also be calculated as follows = Work certified (+) work not certified

7. Disclosures requirement as per AS 7

		(₹ in lakhs)
(i)	Contract revenue	XXX
(ii)	Contract expenses / cost incurred on contract	XXX
(iii)	Recognised profits / (losses)	XXX
(iv)	Progress billings ₹ (Payment received + Payment to be received)	XXX
(v)	Retentions (billed but not received from contractee)	XXX
(vi)	Gross amount due from/to customers	XXX
(vii)	Security deposit	XXX
(viii)	Method of revenue recognition	XXX
(ix)	Method of determining stage of completion	XXX

8. Calculation of Gross Amount due from/to customers
= (Contract costs (+) Recognized profits / (Losses) – Progressive billing

9. Calculation of amount of contract work-in-progress
= Cost incurred to date or (Work certified + Work not certified)

10. Generally contractor calculate profit or loss on each contract separately: However for accounting purpose contractor can be combined two or more contracts into a single contract or segment a contract into two or more contracts.

A. Combination of two or more contracts a single construction contract: when all following conditions are fulfilled:
 (i) the group of contracts is negotiated as a single package;
 (ii) the contracts are so closely interrelated; and
 (iii) the contracts are performed concurrently or in a continuous sequence.

B. Segment of one contract into 2 or more contracts: If all following conditions are fulfilled:
 (i) separate proposals have been submitted for each asset;
 (ii) each asset has been subject to separate negotiation and the contractor & customer have been able to accept or reject that part of the contract relating to each asset; &
 (iii) the costs and revenues of each asset can be identified.

PRACTICAL QUESTIONS

1. Constructions Limited is engaged in the business of constructing Flyovers and Railway over bridges. It obtained a contract from Railway Authorities to construct a railway over bridge for ₹ 400 crores. The construction of the railway over bridge is expected to be completed in 4 years.
At the outset of the contract, it was estimated that the total costs to be incurred will be ₹ 370 crores but by the end of year 1, this estimate stands revised to ₹ 375 crores.
During year 3, the Construction Limited has requested for a variation in the contract which is approved by Railway Authorities and accordingly the total contract value will increase by ₹ 10 crores and costs will increase by ₹ 7 crores.
The Constructions Limited decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is
Year 1 : ₹ 98.8 crores
Year 2 : ₹ 202.4 crores
Year 3 : ₹ 310 crores (including unused material of 3 crores)
Year 4 : ₹ 382 crores

You are required to:
(i) Calculate stage of completion of contract for each year.
(ii) Profit to be recognized for each year.

Solution: Calculation of stage of completion and profit for the year

Particulars	Year 1	Year 2	Year 3	Year 4
(i) Calculation of % of completion / stage of completion (Cost incurred up to date / total estimated cost) X 100	(98.8 / 375) X 100 = 26.35%	(202.4 / 375) X 100 = 53.97%	[(310-3) / 382] X 100 = 80.37%	382/382 = 100%
Contract revenue = Contract price X % of completion	400 X 26.35% = 105.40	400 X 53.97% = 215.88	410 X 80.37% = 329.52	410 X 100% = 410
(ii) Calculation profit / (loss) on contract				
Contract revenue upto date	105.40	215.88	329.52	410.00
(-) Cost incurred upto date	(98.80)	(202.40)	(307.00)	(382.00)
Profit / loss upto date	6.60	13.48	22.52	28.00
(-) Total profit / loss already recognised	(0.00)	(6.60)	(13.48)	(22.52)
Profit / loss for the year	6.60	6.88	9.04	5.48

2. A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

(Amount ₹ in lacs)

	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	-	200	200
Contracts costs incurred up to the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.
**Excludes ₹ 100 lacs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer.
Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

Solution: The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below: **(Amount in ₹ lakhs)**

	Up to the reporting date	Recognized in previous years	Recognized in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	Year 2	Year 3
Revenue after considering variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

3. Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next year. The contract is for a fixed price of Rs. 12 crores with an escalation clause. The costs to complete the whole contract are estimated at Rs.9.50 crores of rupees. You are given the following information for the year ended 31.03.2016.
Cost incurred upto 31.03.2016 Rs. 4 crores
Cost estimated to the contract Rs. 6 crores
Escalation in cost by 5% and accordingly the contract price is increased by 5%.
You are required to ascertain the state of completion and state the revenue and profit to be recognised for the year as per AS-7.
Solution: ***As per AS 7 'Construction Contracts'*** the amount of revenue agreed in a fixed price contract may increase as a result of cost. So in the given question:
Contact price will be Rs. 12 crores plus 5%= Rs. 12.60 Crores
Percentage of completion method = (Actual cost / Total estimated cost) X 100
= (4 crores / 10 crores) X 100
= 40%

Revenue to be recognised= (12crores+5%) =12.60crores X 40% = 5.04 Crores
Less: Actual cost has been incurred (4.00) Crores
Profit recognised. = 1.04 crores

4. Akar Ltd. Signed on 01/04/16, a construction contract for Rs 1,50,00,000.
Following particulars are extracted in respect of contract, for the period ending 31/03/17.
- 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 31.3.17.
- It is estimated that by spending further Rs. 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss to be taken to profit & Loss Account and additional provision for foreseeable loss as per AS-7.

Solution: As per AS-7, "Construction Contracts" profit/loss to be taken to profit & Loss Account and additional provision for foreseeable loss is calculated as follows:-

(i) **Calculation of % of Completion:**

$$\frac{\text{Cost incurred upto date}}{\text{Total Estimated cost}} x100$$

$$\frac{13,40,0000}{1,67,50,000} x100 = 80\%$$

(1) Calculation the Total Cost Incurred upto date:

Material : Issued		75,00,000	
Less:- Closing		(4,00,000)	71,00,000
Labour :	Paid	36,00,000	
	+O/S	2,00,000	38,00,000
Hire Charges			10,00,000
Other cost incurred			15,00,000
			1,34,00,000

(2) Total Estimated Cost:

Cost incurred upto date:	1,34,00,000
+Further estimated cost to be incurred	33,50,000
	1,67,50,000

(ii)Calculation of revenue to be recognized

Contract Price X % of Stage of completion = 80% x 1,50,00,000 = 1,20,00,000

(iii) Calculation of loss recognised on contract

Contract Revenue recognised	1,20,00,000
Less:- Total cost incurred	(1,34,00,000)
	14,00,000

(iv) Calculation of total expected loss on contract

Contract Price	1,50,00,000
Less: Total estimated cost to be incurred	(1,67,50,000)
Total Expected loss on contract	17,50,000

(v) Calculation of provision for expected loss:-

Total Expected loss on contract	17,50,000
Less: Total loss recognised on contract	14,00,000
Provision for expected loss	3,50,000

(vi) Loss of 17,50,000 (14,00,000 + 3,50,000) is be to recognized immediately by debiting into profit & loss A/c.

5. Sarita Construction Co. obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2018:

	₹ In Lakhs
Total Contract Price	12,000
Work Certified	6,250
Work not certified	1,250
Estimated further cost to completion	8,750
Progress payment received	5,500
Progress payment to be received	1,500

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2018.
(ii) Contract work in progress as at end of financial year 2017-18.
(iii) Revenue to be recognized out of the total contract value.
(iv) Amount due from/to customers as at the year end.

Solution:

(i) Loss for the year ended, 31st March, 2018 **(₹ in lakhs)**

Amount of foreseeable loss	
Total cost of construction (6,250 + 1,250 + 8,750)	16,250
Less: Total contract price	(12,000)
Total foreseeable loss to be recognised as expense	4,250

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Loss for the year ended, 31st March, 2018 amounting ₹ 4,250 will be recognized.

(ii) Contract work-in-progress as on 31.3.18(₹ in lakhs): Contract work-in-progress i.e. cost incurred to date are ₹ 7,500 lakhs:

Work certified	6,250
Work not certified	1,250
	7,500

(iii) Proportion of total contract value recognised as revenue

Cost incurred till 31.3.18 is 46.15% (7,500/16,250 X 100) of total costs of construction.

Proportion of total contract value recognised as revenue: 46.15% of ₹ 12,000 lakhs = ₹ 5,538 lakhs

(iv) Amount due from/to customers at year end

(Contract costs + Recognised profits – Recognised Losses) – (Progress payments received + Progress payments to be received)

= (7,500 + Nil – 4,250) – (5,500 + 1,500) ₹ in lakhs

= [3,250 – 7,000] ₹ in lakhs Amount due to customers

= ₹ 3,750 lakhs

6. AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. 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 AP Ltd., should treat it as a single contract or three separate contracts.

Solution:

Provision of Accounting Standard(AS) – 7 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.

In the given case, each unit is submitted as a separate proposal, which can be separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a “single contract” even if there is one single agreement for contracts.

Therefore, three separate contract accounts must be recorded and maintained in the books of AP Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.

CHAPTER 10 AS 9 - REVENUE RECOGNITION

1. Revenue recognition:

(A) From sale of goods: A transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer.

(B) From rendering of services: Revenue from service transactions is usually recognised as the service is performed, either by:

(a) Proportionate completion method is a method of accounting which recognises revenue in the SPL proportionately with the degree of completion of services under a contract.

(b) Completed service contract method is a method of accounting which recognises revenue in the SPL only when the rendering of services under a contract is completed or substantially completed.

(C) From resources:

(a) Interest: Revenue is recognized on a time proportion basis taking into account the amount outstanding and the rate applicable.

(b) Royalty: Revenue is recognized on an accrual basis in accordance with the terms of the relevant agreement. E.g. if agreement is signed for royalty payable on the basis of the number of copies of the book published, it will be recognised on that basis only.

(c) Dividend: Upon declaring basis.

Note: There should be reasonable certainty of collection & consideration before booking any of the all types of above recognised income.

2. In case there is no uncertainty of collection and consideration on the date of sale then entity shall records revenue with total / gross amount.
However if there is any uncertainty arise in future either on the basis of performance of asset or any other reason (like financially issue with customer) then entity shall create a provision against such uncertainty which shall be charged into P & L A/c (not reduced from revenue) separately or recognized as a bad debt and charged into P&L A/c as the case may be.

3. In case revenue is recognised on fulfillment of all conditions
   - then any pending payment shall be shown as trade receivable / debtor.

4. In case payment is received but delivery of goods or rendering of service is pending then no revenue shall be recognized, rather advance payment received shall be shown as liability.

5. If sale agreed before Balance Sheet date and only formality of registry taken place in next year before approval date, then sale shall be recognised in current year. Because it becomes adjustable item as per AS 4.

6. Some special cases covered in AS – 9:

(1) **Re-purchase agreement or sale and purchase agreement:** In case one entity sold goods to another entity with an agreement to re-purchase of same goods then AS - 9 does not allow to recognize revenue for sale of such goods.
Further another party recognised finance income as the difference between original sale prices and repurchase price
The original seller record such amount as a loan and difference between original sale price and re-purchase price is the finance charge / cost.
Both the parties recognised finance charge and finance income respectively on accrual basis.

(2) **Delivery delayed at buyer's request and Buyer takes the title of goods and accept billing**
In such case revenue shall be recognised for such goods provided such goods must be:
- in hand
- separately identified and
- ready for delivery

irrespective of no physical delivery is made

(3) **In case of consignment sale:** Revenue shall be recognised on sale of goods to third party.

(4) **Goods are delivered subject to conditions:** Revenue shall be recognised based on substance of the agreement

A. **Cash on delivery:** When cash is received and delivery is made.

B. **Goods are sold on approval basis:** when approval is received or time period of approval has been expired.
Note: In case all / maximum goods are sold on approval basis then entity shall not recognised revenue to the extent of goods are expected to be return.

C. **Warranty or Guarantee on Sale:** Revenue is generally recognised on gross basis as usual further a provision is created against warranty or guarantee as per AS 29 and charge into P & L A/c as a separate item and not reduce from sale.

(5) **Treatment of trade discount and volume discount:** shall be adjusted with revenue (It means revenue shall be recorded on net basis).
- All other discount shall be charged into P&L A/c (means not adjusted along with revenue.)

(6) **Revenue recognised by advertisement agency:** when advertisement service is completed
- Advertisement service is considered completed when it appeared before public

(7) **Revenue recognised for subscription and publication:** Revenue shall be recognised on SLM basis. However, if items delivered is vary in value then revenue shall be recognised in the ratio value of items delivered.

(8) **Insurance agency commission:** Revenue shall be recognised on the date of effective commencement or renewal date of the related policy.

(9) **Recognition of insurance claim:** Revenue shall be recognised only when there is certainty of receiving claim amount.

7. Weather revenue shall be recognised on Gross basis or Net basis
   - In case entity works as a principal: Revenue shall be recognised on gross basis.
   - In case entity works as an agent: Revenue shall be recognised on net basis.

8. Sometime entity collect amount on behalf of 3rd party in that case collection on behalf of 3rd party shall not be recognised as revenue. E.g. GST collect on behalf of Govt.

PRACTICAL QUESTIONS

1. Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received Rs. 2,40,000 on 10.3.2014 and Rs. 60,000 on 10.4.2014 for the March 2014 issue. Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.03.2014. What will be the treatment if the publication is delayed till 02.04.2014.

   Solution:-As per AS – 9 ,"Revenue Recognition" Revenue from a transaction involving the sale of goods is recorded when the transfer of significant risks and rewards of ownership with ownership is transferred to the buyer . Further there should be certainty of collection and consideration.

   In the given case Sarita Publications recorded the sale of Rs. 3,00,000 in the year ended 31/03/2014. And advance received Rs. 2,40,000 is adjusted with sale value and balance due Rs. 60,000 is shown as trade receivable.

   If the publication is continued or delayed till 02/04/2014 then revenue should not be recognised and advance of Rs. 2,40,000 should be shown as advance from customer as current liability.

2. Moon Ltd. entered into agreement with Sun Ltd. for sale of goods of Rs. 8 lakhs at a profit of 20% on cost. The sale transaction took place on 1st February, 2011. On the same day Sun Ltd. entered into another agreement with Moon Ltd. to resell the same goods at Rs. 10.80 lakhs on 1st August, 2011. State the treatment of this transaction in the financial statements of Moon Ltd. as on 31.03.11. The pre-determined re-selling price covers the holding cost of Sun Ltd. Give the Journal Entries as on 31.03.11 in the books of Moon Ltd.

   Solution: In the given case, Moon Ltd. concurrently agreed to repurchase the same goods from Sun Ltd. on 1st Feb., 2011. Also the re-selling price is pre-determined and covers purchasing and holding costs of Sun Ltd. Hence, the transaction between Moon Ltd. and Sun Ltd. on 1st Feb., 2011 should be accounted for as financing rather than sale. The resulting cash flow of Rs. 9.60 lakhs received by Moon Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of Moon Ltd. (Rs. in lakhs)

Date	Particulars		Dr.	Cr.
1.02.11	Bank Account	Dr.	9.60	
	To Advance from Sun Ltd*.			9.60
	(Being advance received from Sun Ltd amounting [Rs. 8 lakhs + 20% of Rs. 8 lakhs= 9.60 lakhs] under sale and re-purchase agreement)			
31.03.11	Financing Charges Account	Dr.	0.40	
	To Sun Ltd.			0.40
	(Financing charges for 2 months at Rs. 1.20 lakhs [10.80 – 9.60] i.e. 1.2 lakhs x 2/6)			
31.03.11	Profit and Loss Account	Dr.	0.40	
	To Financing Charges Account			0.40
	(Being amount of finance charges transferred to P& L Account)			

* The balance of Sun Ltd. account will be disclosed as an advance under the heading liabilities in the balance sheet of Moon Ltd. as on 31st March, 2011.

3. Given the following information of M/s. paper Products Ltd.
   (i) Goods of Rs 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on10-4-2015.
   (ii) On 15-1-2015 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 31-3-2015.
   (iii) Rs 1,20,00 worth of goods were sold on approval basis on 1-12-2014 The period of approval was 3 months after which they were considered sold Buyer sent approval for 75%goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015.

(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 M/s. Paper products Ltd. with valid reasons the amount to be recognized as revenue in above cases in the context of As 9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

Solution:- Calculation of total revenue Recognised as Per AS-9

Particulars	Amount(Rs.)
Case I:- Sale is recorded because Risk and Rewards has been transferred.	60,000
Case II:- Sale should be recorded upto 80% (1,50,000*80%)	1,20,000
Case III:- Since period of approval has expired so whole sale should be recorded.	1,20,000
Case IV:- Trade Discount shall be adjusted in cash sale (Rs. 7,80,000-5%)	7,41,000
Total Revenue to be recognized	Rs.10,41,000

4. Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item	-	₹ 200 lakhs
Delivery charges	-	₹ 60 lakhs
GST	-	₹ 40 lakhs
Total	-	₹ 300 lakhs

Zigato has received ₹ 300 lakhs for the above orders from customers and the orders were delivered to the customer in stipulated time.

How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?

Solution: The risks and rewards associated with the food item are not with Zigato. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare the food and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, Zigato is acting as an agent. Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹ 200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

5. 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., Henna Ltd. requested to Raj Ltd. not to dispatch goods untill further notice. Due to this, Raj Ltd. is holding the remaining 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.

Solution: 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 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.

Further as per Point 1 of Appendix of AS-9 Revenue should be recognised 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 recognised rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risk and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. A Ltd. should be recognized the entire sale of Rs. 30,00,000 (Rs.5,00,000 x6) and no part of the same is to be treated as Advance Receipt against Sales.

CHAPTER 11 AS 25: INTERIM FINANCIAL REPORTING

1. Interim period is a financial reporting period shorter than a full financial year.

2. Interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period.

3. Contents of an interim financial report include, at minimum, the following:
   (i) A condensed balance sheet
   (ii) A condensed statement of profit and loss
   (iii) A condensed statement of cash flows
   (iv) Notes, comprising significant accounting policies & other explanatory information.

4. Periods for which interim financial statements are required to be presented

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

5. 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.
   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.

6. In case there is any change in accounting estimate in any interim period then its effect shall be taken in the respective interim period on prospective basis.
   Further any provision first shall be calculated till the end of current interim period and compare with the opening balance. Any difference shall be taken into current interim period.

7. In case there is any change in any accounting policy in the interim reporting period then its impact shall be taken retrospectively. E.g. If during interim reporting period entity change method of inventory valuation then its impact shall be taken retrospectively.

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

PRACTICAL QUESTIONS

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

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

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

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

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

Solution:

Particulars		**(₹ In crores)**
Result of first quarter ended 30th June, 20X1		
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

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

2. Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:
   (i) Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.
   (ii) 80% of sales promotion expenses ₹ 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.
   (iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹ 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.
   (iv) ₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.
   (v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.
   (vi) Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs. The company had apportioned this equally to the four quarters.

   Prepare the adjusted profit before tax for the third quarter.

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

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

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

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹(4-1) lakhs	3
Excess depreciation charged in the 3rd quarter,due to change in the method	-
Extra ordinary gain ₹(2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹(3-2) lakhs	1
	9
Less: Sales promotion expenses (80% of ₹15 lakhs)	(12)
Gain on sale of investment (occasional gain shouldnot be deferred)	(5)
Adjusted Profit before tax for the third quarter	(8)

3. 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.

   Solution: 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 = A/B = 3,50,000 / 10,00,000 = 35%

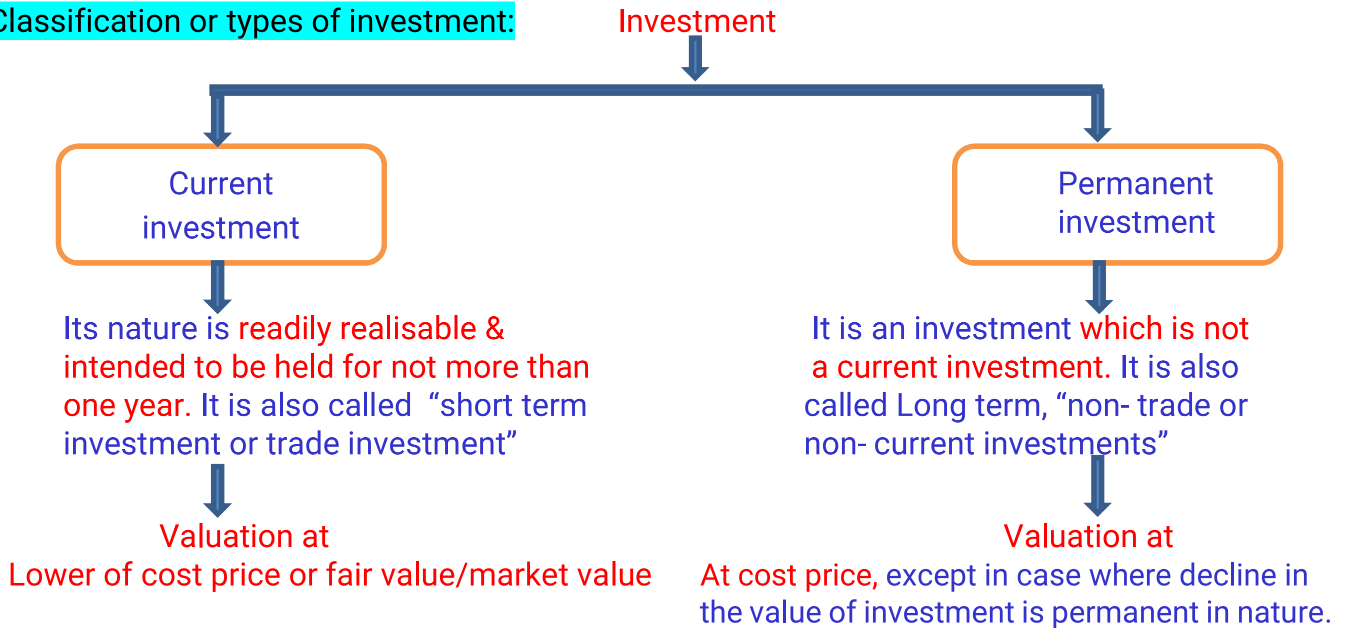
Tax expense to be recognized in each of the quarterly reports		₹
Quarter I -	₹ 75,000 x 35%	26,250
Quarter II -	₹ 2,50,000 x 35%	87,500
Quarter III -	₹ 3,75,000 x 35%	1,31,250
Quarter IV -	₹ 3,00,000 x 35%	1,05,000
	₹ 10,00,000	3,50,000

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

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

CHAPTER 12 AS 13 - ACCOUNTING FOR INVESTMENTS

1. Classification or types of investment:



2. Calculation of cost price or cost of Investment:

Particular	Amount
Purchase price (including taxes if any)	XXX
(+) Expenses incurred in relation to purchase e.g. brokerage, commission etc.	XXX
(+)Expenses incurred to obtained title i.e. registration fees	XXX
(-)Pre-acquisition dividend in case of equity share	(XXX)
Cost price	XXX

3. Method of calculating cost price: There are two methods of calculating cost price
   (A) First in first out method (FIFO)
   (B) weightage average cost method (WACM)
   Note: In case question is silent regarding method used WACM.

4. On disposal of Investments: the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement.

5. Investment in share or equity securities:
   Format: In the Books of Investors
   Investment in Equity Shares of X Ltd.

Date	Particulars	Number of shares	Dividend	Amount	Date	Particulars	Numbers of shares	Dividend	Amount
1/4/X1	To balance b/d	XXX		XXX	30/9/X1	By bank A/c (dividend)-Note 3		XXX (POST)	XXX (PRE)
1/7/X1	To Bank A/c – purchase	XXX		XXX	1/2/X1	By bank A/c – sale	XXX		XXX
1/8/X1	To bonus share-Note 1	XXX		-	31/3/X2	By balance c/d	XXX		XXX
1/11/X1	To bank A/c (subscribed for Rights Issue) - Note 2	XXX		XXX					

31/3/X2	To P&L A/c (B/F)		XXX	XXX					
		XXX	XXX	XXX			XXX	XXX	XXX

Treatment of Brokerage, Commission and Registration Expenses etc.

(A) If paid by purchaser: Add in the cost of investment

(B) If paid by sellor: Reduce from sale proceeds

Note 1: Treatment of Bonus share: Due to bonus shares, the number of shares increases without any payment, reducing the cost per share. No journal entry is made by the investor for bonus shares.

Note 2: Treatment of right share: Right share are those shares which are offered by a company to its existing shareholders to subscribe at a price lower than market price. Accounting Treatment:

Case 1: For subscribed shares: Considered a simple case of purchase.

Case2: For sale of right: Such amount can be transferred into P & L account as income.

Note 3: Treatment of Dividend Received: Divided received are of 2 types

(A) Pre-acquisition dividend - Considered as recovery of cost of investment
- So credited into investment account (amount column of investment)

Journal Entry

Bank A/c	Dr.	xxx	
To investment A/C		xxx	

(B) Post-acquisition dividend - Considered as income
- So credited into P&L A/C

Journal Entry

Bank A/C	Dr.	xxx	
To P&L A/C			xxx

Dividend shall be paid on face value (subject to paid-up values)

Calculation of cost price of shares, investments in share under WACM

$$\frac{\text{Opening cost + Purchase cost(including cost of right share subscribe) – Pre-acquisition dividend}}{\text{Opening number + purchase (including right shares)+ bonus share of shares}}$$

6. Final Dividend and Interim Dividend

(1) Final dividend: is a divided which is paid in C.Y but belongs to immediately P.Y and payable on closing capital of immediately P.Y.

(2) Interim dividend: is a divided which belongs to a period started from first day of the year up to the date of payment. Interim dividend is payable on outstanding capital on the date of payment

7. In case investment is purchased on cum-right basis and when it becomes ex-right: The market value of investment is declined below its cost price, then sale of Right shall be credited into investment account (means cost of investment shall be reduced by sale of right) to the extent of lower of two:

A. Difference between cost price and market value of share after becoming ex-right [Cost Price (-) Ex-right market value]

B. Sale of right

Note: Any access amount of sale of right shall be credited into p &L A/c.

8. Valuation of permanent investment: At cost price except in a case where decline in the value of investment is permanent in nature (means decline in the value is other than temporary).
   In case permanent decline in the value of long term or permanent investment then entity reduced the value of investment by creating a provision 'Provision for permanent fall in the value of investment" and charged such provision into P&L A/C
   For Examination purpose following are the example of permanent decline
   (i) Company lost patent or copyright.
   (ii) Company incurred huge cash losses.
   (iii) Company lost license of production of any product.

9. Investment in debentures

   Format: In the books of A

   Investment in 12% debenture of X Ltd.

DATE	PARTICULARS	FACE VALUE	INTEREST	AMOUNT	DATE	PARTICULARS	FACE VALUE	INTEREST	AMOUNT
1/4/X1	TO BALANCE B/D	XXX	XXX	XXX	30/6/X1	BY BANK A/c (INTEREST)		XXX	
1/5/X1	TO BANK A/c (PURCHASE)	XXX	XXX	XXX	31/10/X1	BY BANK A/c – SALE	XXX	XXX	XXX
31/8/X1	TO BANK A/c (PURCHASE)	XXX	XXX	XXX	31/12/X1	BY BANK A/c (INTEREST)		XXX	
31/3/X2	TO P&L A/c (B/F)		XXX	XXX	31/1/X2	BY BANK A/c (SALE)	XXX	XXX	XXX
					31/3/X2	BY BALANCE C/D	XXX	XXX	XXX
		XXX	XXX	XXX			XXX	XXX	XXX

[Due date 30/6 & 31/12]

Note: In case question is silent weather transaction is cum-interest or ex-interest always assume transaction is ex-interest except otherwise specified.

Interest amount shall be calculated on face value.

10. Received equity share in lieu of conversion of investment in debenture.

    Journal Entry

    Investment in equity Share A/c Dr. XXX
    To investment in debenture account XXX

    Notes:
    (i) Cost of investment in equity share will be equal to cost of investment in debenture converted.
    (ii) On the date of conversion, interest on conversion part has been received in cash except otherwise specified.

11. Accounting Treatment for Reclassification of investments:
    A. From long term to short term investment (non-current to current investment): On the date of the Reclassification transfer is made at lower of two
       (a) Cost price
       (b) Carrying amount(book value)
    B. From current to non-current: On the date of reclassification transfer is made at lower of two
       (a) Cost price
       (b) Fair value

    Note: In case there is any change in existing book value then difference between existing book value and new book value shall be transferred into P&L A/c

12. Investment Properties: An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.

PRACTICAL QUESTIONS

1. On 1st April, 2009 XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of Rs. 15 per share (face value Rs. 10 per share). On 1st June, 2009, XY Ltd. acquired 5,000 equity shares of ABC Ltd. Rs. 1,00,000 on cum right basis. ABC Ltd. announced a bonus and right issue.

(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 2009.

(2) Right shares are to be issued to the existing shareholders on 01st September 2009. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.

(3) Dividend for the year ended 31.03.09 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 2009.

XY Ltd.

(i) Took up half the right issue.

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

(iii) Sold half of its share holdings on 01st January 2010 at Rs. 16.50 per share. Brokerage being 1%.

You are required to prepare Investment Account of XY Ltd. for the year ended 31st March 2010 assuming the shares are being valued at average cost.

Solution: **In the books of XY Ltd.**

Investment in Equity Shares of ABC Ltd. for the year ended 31st March 2010

Date	Particulars	No.	Income Rs.	Amount Rs.	Date	Particulars	No.	Income Rs.	Amt Rs.
2009 April 1	To Balance b/d	15,000	-	2,25,000	2009 Oct. 31	By Bank A/c (W.N. 5)	-	30,000	10, 000
June 1	To Bank A/c	5,000	--	1,00,000	2010 Jan. 1	By Bank A/c (W.N.4)	13,000	-	2,12,355
July 1	To Bonus Issue (W.N. 1)	4,000	-	-	March 31	By Balance c/d (W.N. 6)	13,000	-	1,69,500
Sept.1	To Bank A/c (W.N. 2)	2,000	-	24,000					
2010 Jan 1	To P & L A/c (W.N. 4)	-	-	42,855					
2010 March 31	To P & L A/c	-	30,000	-					
		26,000	30,000	3,91,855			26,000	30,000	3,91,855

Working Notes:

1. **Calculation of no. of bonus shares issued** = (15,000 shares + 5,000 shares) x 1/5 = 4,000 shares

2. **Calculation of right shares subscribed**

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

   = 4,000 shares

   Shares subscribed by XY Ltd. = 4,000/2 = 2,000 shares

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

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

   2,000 shares x Rs. 8 per share = Rs. 16,000

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

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

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

   50% of the holdings were sold i.e. 13,000 shares (26,000 x1/2) were sold.

   Cost of total holdings of 26,000 shares (on average basis)
   = Rs. 2,25,000 + Rs. 1,00,000 + Rs. 24,000– Rs. 10,000 = Rs. 3,39,000

Average cost of 13,000 shares would be
= (3,39,000 / 26,000) X 13,000
= Rs. 1,69,500

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

5. **Dividend received on investment held as on 1st April, 20X1**
= 15,000 shares X Rs. 10 X 20%
= Rs. 30,000 will be transferred to Profit and Loss A/c
Dividend received on shares purchased on 1st June, 20X1
= 5,000 shares X Rs. 10 X 20% = Rs.10,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus share as bonus share are declared on 1st July, X1 and dividend pertains to the year ended 31.03.X1.

6. **Calculation of closing balance of shares (On average basis) as on 31st March X2.**
= (3,39,000/26,000) X 13,000 = Rs. 1,69,500

2. Mr. X acquires 200 shares of a company on cum-right basis for Rs. 70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at Rs. 107 each. He does not subscribe but sells all the rights for Rs. 12,000. The market value of the shares after their becoming ex-rights has also gone down to Rs. 60,000. What should be the accounting treatment in this case?
Solution: 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 Rs.60,000. In this case, out of sale proceeds of Rs. 12,000, Rs. 10,000 may be applied to reduce the carrying amount to bring it to the market value and Rs. 2,000 would be credited to the profit and loss account.

3. On 1st December 2015, M/s. Blue & Black purchased, 20,000 12% fully paid debentures of Rs.100 each at Rs.105 cum Interest price, also paying brokerage @ 1% of cum interest amount of the purchase. On 1st March, 2016, the firm sold all these debentures at Rs.110 cum-interest price, again paying brokerage @ 1% cum interest amount. Prepare Investment Account in the books of M/s. Blue & Black for the period 1st December, 2015 to 1st March 2016. Interest being payable half yearly on 30th September and 31st March of every accounting year.

Solution: **Books of M/s. Blue & Black for the period 1st Dec., 2015 to 1st March 2016**

Investment in 12% Debentures Account

Date	Particulars	Face Value	Interest	Amount	Date	Particulars	Face Value	Interest	Amount
1.12.2015 31.3.2016	To bank To profit & loss (B/F)	20,00,000	40,000 60,000	20,81,000	1.3.2016	By Bank A/c BY P & L A/c (B/F)	20,00,000 -	1,00,000	20,78,000 3,000
		20,00,000	1,00,000	20,81,000			20,00,000	1,00,000	20,81,000

Working Notes:

1. Calculation of cost of investments made on 1.12.2015

Purchase price (20,000 X 105)	21, 00,000
Brokerage @ 1% on cum interest price	21,000
	21, 21,000
Less: Interest for 2 months (20000x100x12%x2/12)	(40,000)
Cost of investments	20,81,000

2. Calculation of sale value of investments as on 1.3.2016

Selling price (20,000x110)	22,00,000
Brokerage @1% on cum interest price	(22,000)
	21,78,000
Less: Interest for 5 months(20,000X100X12%X5/12)	(1,00,000)
Net selling price	20,78,000

4. 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.

Solution: **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 (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec.31	To P&L A/c		52,313						
					Dec.31	By Balance c/d	5,50,000	18,563	5,60,542
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

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

Working Notes:

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 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 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

3. Interest received on 30th Sept. 2021 =On ₹ 5,00,000 + ₹ 2,50,000 = 7,50,000 x 13.5% x ½ = ₹ 50,625

4. Profit / Loss on Sale of Debentures

Sale Price (2,000 X 103)	=	2,06,000
Less: Cost of acquisition		
(₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000	=	2,03,833
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

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

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

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

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

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

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

Working Notes:

1. Purchase of debentures on 1.7.20X1

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

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

2. Purchase of debentures on 1.1.20X2

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

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

3. Profit on sale of debentures as on 1.10.20X1

		₹
Sales price of debentures (200 x ₹ 100)		20,000
Less: Brokerage @ 1%		(200)
		19,800
Less: Cost of Debentures	(1,18,000 / 1,20,000) X 20,000	(19,667)
Profit on sale		133

4. Loss on sale of debentures as on 1.2.20X2

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

5. Valuation of closing balance as on 31.3.20X2:

Market value of 950 Debentures at ₹ 99	=		₹ 94,050
Cost of			
800 Debentures cost = (1,18,000 / 1,20,000) X 80,000	=	78,667	
100 Debentures cost	=	9,898	
50 Debentures cost	=	4,949	
		93,514	

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

6. On 15th June 2018, Y Ltd. wants to re-classify its investment 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 reclassified as current investments. The original cost of these investments was Rs. 14 but had been written down by Rs. 2 lakhs(to recognize 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was Rs. 11laks.

(2) Another portion of long term investments purchased on 15th January, 2017 are to be reclassified as current investments. The original cost of these investments was Rs. 7lakhs but had been written down to Rs. 5 lakhs (to recognize 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was Rs. 4.50laks.

(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. 6lakhs and Fair Value as on 15th June 2018 was Rs. 8.50lakhs.

(4) Another portion of Current investments purchased on 7th December 2017 for Rs. 4 lakhs has 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 2018	Rs. 3.8 lakhs.

Solution:

(i) Provision of Accounting Standard(AS)-13

(a) As per para 23 of 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 date of transfer.

(b) As per Para 24 of AS13 'Accounting for Investments', where investments are reclassified from current to long term, transfers are made at the lower of cost and fair value a date to transfer.

(ii) In the given question treatment will be as follows:-

(1) The book value for the investment is Rs. 12lakhs, which is lower than its cost i.e., Rs.14 lakhs. Here, the transfer should be at carrying amount and hence these reclassified current investments should be carried at Rs. 12lakhs.

(2) The book value for the investment is Rs. 5lakhs, which is lower than its cost i.e., Rs.7 lakhs. Here, the transfer should be at carrying amount and hence these reclassified current investments should be carried at Rs. 5lakhs.

(3) The market value of investment is Rs, 8.50 lakhs, and Cost is Rs. 7 lakhs. Therefore, the transfer to long term investments should be carried in the books at the Cost Price i.e., Rs. 7 lakhs.

(4) The market value of investment is Rs. 3.8lakhs, which is lower than its cost i.e. Rs 4 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e., Rs. 3.8 lakhs.

7. 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?

Solution: 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.

8. A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	Rs.
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

Solution: As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost.

Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs. 2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs. 3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period

then it will continue to be shown at cost in the Balance Sheet of the company. 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.

9. A Ltd. Purchased on 1st April, 2015 8% convertible debenture in C Ltd. of face value of Rs. 2,00,000 @ Rs.108. On 1st July, 2015 A Ltd. purchased another Rs. 1,00,000 debenture @ Rs. 112 cum interest.
On 1st October, 2015 Rs.80,000 debenture was sold @ Rs.105. On 1st December, 2015, C Ltd. give option for conversion of 8% convertible debentures into equity share of Rs. 10 each. A Ltd. Receive 5000 equity share in C Ltd. in conversion of 25% debenture held on that date. The Market price of debenture and equity share in C Ltd. at the end of year 2015 is Rs.110 and Rs.15 respectively.
Interest on debenture is payable each year on 31st March, and 30th September.
The accounting year of A Ltd. is calendar year.
Prepare investment account in the books of A Ltd. on average cost basis.

Solution: **Investment in 8% Convertible Debentures Account**

Date	Particulars	Face Value	Interest	Amount	Date	Particulars	Face Value	Interest	Amount
1.4.2015	To bank	2,00,000	Nil	2,16,000	30.9.2015	By Bank A/c (3,00,000 X 8% X 6/12)		12,000	
1.7.2015	To bank (W.N#1)	1,00,000	2,000	1,10,000	1.10.2015	By Bank A/c	80,000	-	84,000
31.03.2016	To P&L A/c (Interest) (B/F)		14,033			By P& L A/c (loss) (W.N. 3)			2,933
					1.12.2015	By investment in Equity Shares of C Ltd. (WN 3 & 4)	55,000	-	59,767
						By Bank A/c (55,000 X 8% X 2/12)		733	
					31.12.2015	By Balance c/d (W.N.5 & 6)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

INVESTMENT IN SHARES OF C LIMITED ACCOUNT

Date	Particulars	No. of shares	Amount	Date	Particulars	No. of shares	Amount
1.12.2015	To investment in Debentures a/c	5,000	59,767	31.3.2016	By balance c/d (WN 7)	5,000	59,767
		5,000	59,767			5,000	59,767

Working Notes:

(i) Cost of Debenture purchased on 1st July = ₹1,12,000 – ₹2,000 (Interest) = ₹1,10,000
(ii) Cost of Debentures sold on 1st Oct.
= (₹2,16,000 + ₹1,10,000) X 80,000/3,00,000 = ₹ 86,933
(iii) Loss on sale of Debentures = ₹ 86,933– ₹84,000 = ₹2,933
Nominal value of debentures converted into equity shares =₹ 55,000
[(₹ 3,00,000 – 80,000) x.25]
Interest received before the conversion of debentures
Interest on 25% of total debentures = 55,000 x 8% x 2/12 = 733
(iv) Cost of Debentures converted = (₹ 2,16,000 + ₹1,10,000) x 55,000/3,00,000 = ₹ 59,767
(v) Cost of closing balance of Debentures = (₹ 2,16,000 + ₹1,10,000) x 1,65,000 / 3,00,000 = ₹ 1,79,300
(vi) Closing balance of Debentures has been valued at cost being lower than the market value i.e. ₹ 1,81,500 (₹ 1,65,000 @ ₹ 110)
(vii) 5,000 equity Shares in C Ltd. will be valued at cost of ₹ 59,767 being lower than the market value ₹ 75,000 (₹ 15 x5,000)

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

10. 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 8,000 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.
16-09-2020	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 G Ltd. as Long term Investment. On 15th May 2021, the shares were quoted in the stock exchange @ ₹ 180.

You are required to:

(i) Prepare Investment Accounts in the books of Mr. Z for the year 2020-21, assuming that the average cost method is followed.

(ii) Profit and loss Account for the year 2020-21, based on the above information.

(iii)Suggest values at which investment in equity shares should be reclassified in accordance with AS 13.

Solution:

(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.

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	31/3/21	By Balance c/d (WN 11)	16,100		25,00,100
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						
	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)/23,100 X 7,000 = ₹ 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% CorporateBonds Account (Interest on bonds)	2,16,000
		By Sale of Right Shares	67,500
		By Investment in Equity Shares of GLtd (Profit on sale of shares)	7,14,800
		By Investment in Equity Shares of GLtd (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: 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.

CHAPTER 13 AS 19 - LEASE

1. Types of lease: Lease are of two types

   A. A finance lease is a lease that transfers substantially all the risks & rewards incidental to ownership of an asset.

   Indicators of Finance Lease: Situations, which would normally lead to a FL:

   (1) Ownership transfers: The lease transfers ownership of the asset to the lessee by the end of the lease term.

   (2) The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.

   (3) The lease term is for the major part of the economic life of the asset.

   (4) The leased assets are of such a specialised nature that cannot be used by a person other than lessee without major modifications.

   (5) At the inception of the lease the PV of MLP amounts to at least substantially all of the fair value of the leased asset.

   B. An operating lease is a lease other than a finance lease.

2. Accounting Treatment:

   A. Finance lease:

(a) In the books of lessee:

(i) On acquisition of asset under lease

Asset under lease A/c	Dr.	XXX	
To Lessor A/c			XXX

Amount = Lower of two:

(1) PV of minimum lease payment from point of view of lessee(MLP Lessee); OR

(2) Fair value of the asset (Generally given in question)

*Calculation of MLP lessee

PV of lease rentals payable over leased period		XXX
Add: GRV from point view of lessee: Higher of two:		
I. Guarantee given by lessee	XXX; OR	
II. Guarantee given on behalf of lessee	XXX	XXX
		XXX

(ii) On payment of down payment

Lessor A/c	Dr	XXX	
To Bank A/c			XXX

(iii) On payment of instalment

Lessor A/c (B/f)	Dr	XXX	
Finance charges A/c	Dr	XXX	
To Bank A/c			XXX

(iv) At year end:

(1) Due to the principle of substance over form, the lessee charges depreciation

Depreciation A/c	Dr	XXX	
To Asset under lease A/c			XXX

(2) On transfer of expenses into P&L A/c

P&L A/c	Dr	XXX	
To Interest Expenses A/c			XXX
To Depreciation A/c			XXX

Note: Generally, we use market rate of return for the purposes of calculation of present value of MLP lessee. However, if fair value of the asset is lower than MLP lessee then for the purpose of recording interest expenses, IRR shall be calculated by using lease rental, GRV Lessee and fair value of the asset.

(b) In the books of lessor

(i) On recording of sale

Lessee A/c (At Net investment)	Dr.	XXX	
P & L A/c (Bal / Fig)			
To Asset A/c/sale A/c (At BV in case of Asset/At fair value in case of Sale)			XXX

Note-1: Amount of net investment = PV of gross investment.

Gross investment = Annual Lease payment + GRV from point view of lessor*1 + Unguaranteed residual value from point view of lessor*2

*1 Calculation of GRV lessor: Higher of three

(1) Guarantee given by lessee	XXX; or
(2) Guarantee given on behalf of lessee	XXX; or
(3) Guarantee given by third Party	XXX

*2 Calculation of UGRV lessor: Estimated strap value of asset – GRV lessor

Note: Any difference between Gross Investment and Net Investment shall be considered as unearned finance income which will be disclosed into note to account.

Unearned Finance Income = Gross Investment - Net Investment.

(ii) On receipt of down payment

Bank A/c	Dr.	XXX	
To lessee A/c			XXX

(iii) On receipts of installments

Bank A/c	Dr.	XXX	
To lessee A/c (B/f)			XXX
To finance income A/c			XXX

(iv) At year end

(1) Due to the principle of substance over form, the lessor does not charges depreciation

(2) On transfer of interest income into P&L A/c

Finance / Interest Income A/c	Dr		XXX
To P&L A/c			XXX

B. Operating lease

(i) Lease rental shall be recorded by both lessor and lessee by using SLM. However if other method is more appropriate than use another method.

(ii) In case, if any difference between lease rental recorded and lease rental paid /received, then such amount shall be recorded as prepaid lease rental/outstanding lease rental.

(iii) Lease rental recorded shall be transferred into P&L A/c by both lessor and lessee.

3. Sale and lease back Transaction: It means the owner of the asset will first sell the asset and then taken back it on lease: These are of two types

A. Sale and Finance Leaseback: In this case owner of the asset is first sale out the asset and then take back as Finance lease.

Accounting treatment: The profit or loss of sales proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

B. Sale and Operating Leaseback: In this case owner of the asset is first sale out the asset and then take back as operating lease.

Accounting treatment: Following steps are applied

Step-1: Compare fair value of the asset with the carrying amount:

- IF Carrying Amount > fair value = recognized loss immediately in P&L.
- IF Carrying Amount < fair value = Ignored.

Step-2 Compare fair value and sale value:

- If Sale Value > fair value: The excess over fair value shall be recognized as deferred Gain and amortised over the lease period for which the asset is expected to be used.
- If Sale Value < fair value: Recognized loss immediately provided there should be actual loss. [Actual loss means sale value is lower than Book value].
  However, if such loss is being compensated in future then such loss will be deferred and amortized over lease period.

Step - 3 Compare book value and sale value: Any other difference which is not covered above shall be transferred into P&L A/c immediately.

PRACTICAL QUESTIONS

1. AS Ltd. Leased a machine to SB Ltd. on the following terms:

	(Rs. In lakhs)
Fair value of the machine	4.00
Lease term	5 years
Lease Rental Per annum	1.00
Guaranteed Residual value	0.20
Expected Residual value	0.40
Internal Rate of Return	15%

Depreciation is provided on straight line method at 10 per cent per annum. Ascertain Unearned Financial Income. Necessary Journal entries in the books of the Lessee in first year may be shown.

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

Where:

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

Gross investment = Minimum lease payments + Unguaranteed residual value

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

= [(₹ 1,00,000 X 5 years) + ₹ 20,000] + ₹ 20,000 = ₹ 5,40,000 (a)

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

Year	M.L.P. inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	1,00,000	0.8696	86,960
2	1,00,000	0.7561	75,610
3	1,00,000	0.6575	65,750
4	1,00,000	0.5718	57,180
5	1,00,000	0.4972	49,720
	20,000(GRV)	0.4972	9,944
	5,20,000		3,45,164 (i)
	20,000 (URV)	0.4972	9,944 (ii)
	5,40,000	(i) + (ii)	3,55,108 (b)

Unearned Finance Income = (a) – (b) = ₹ 5,40,000 – ₹ 3,55,108 = ₹ 1,84,892

Journal Entries in the books of SB Ltd.

	Particulars	Dr. (₹)	Cr. (₹)
At the inception of lease			
	Machinery account Dr. To AS Ltd.'s account (Being lease of machinery recorded at present value of minimum lease payments)	3,45,164*	3,45,164*
At the end of the first year of lease			
	Finance charges account Dr. (Refer Working Note) To AS Ltd.'s account (Being the finance charges for first year due)	51,775	51,775
	AS Ltd.'s account Dr. To Bank account (Being the lease rent paid to the lessor which includes outstanding liability of ₹ 48,225 and finance charge of ₹ 51,775)	1,00,000	1,00,000
	Depreciation account£ Dr. To Machinery account (Being the depreciation provided @ 10% p.a. on straight line method)	34,516	34,516
	Profit and loss account Dr. To Depreciation account To Finance charges account (Being the depreciation and finance charges transferred to profit and loss account)	86,291	34,516 51,775

*As per para 11 of AS 19, 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 lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 4,00,000 is more than the present value amounting Rs. 3,45,164, the machinery has been recorded at Rs. 3,45,164 in the books of B Ltd. (the lessee) at the inception of the lease.

Working Note: Table showing apportionment of lease payments by SB Ltd. between the finance charges and the reduction of outstanding liability

Year	Outstanding liability (opening balance) (a) ₹	Minimum lease payments (b) ₹	Finance charges (c = a x 15%) ₹	Reduction in principal amount (d= b-c) ₹	Outstanding liability (closing balance (e = a-d) ₹
1	3,45,164	1,00,000	51,775	48,225	2,96,939
2	2,96,939	1,00,000	44,541	55,459	2,41,480
3	2,41,480	1,00,000	36,222	63,778	1,77,702
4	1,77,702	1,00,000	26,655	73,345	1,04,357
5	1,04,357	1,00,000	15,654	84,346	20,011*

* The difference between this figure and guaranteed residual value (Rs. 20,000) is due to approximation in computing the interest rate implicit in the lease.

2. An Equipment having expected useful life of 5 Years, is leased for 3 years. Both the cost and the fair value of the equipment are Rs. 6,00,000. The amount will be paid in 3 equal installments and at the termination of lease, lessor will get back the equipment. The unguaranteed residual value at the end of 3rd year is Rs. 60,000. The IRR of the investment is 10%. The Present Value of annuity factor of Re. 1 due at the end of 3rd year at 10% IRR is 2.4868. The Present Value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513. State with reason whether the lease constitutes finance lease and also compute the unearned finance income.

Solution:

(i) Determination of Nature of Lease: It is assumed that the fair value of the leased equipments is equal to the present value of minimum lease payments.

Present value of residual value at the end of 3rd year = ₹ 60,000 x 0.7513 = ₹ 45,078

Present value of lease payments = ₹ 6,00,000 – ₹ 45,078 = ₹ 5,54,922

The percentage of present value of lease payments to fair value of the equipment is

= (₹ 5,54,922 / ₹ 6,00,000) x 100 = 92.487%.

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

Annual lease payment = ₹ 5,54,922 / 2.4868 =₹ 2,23,147 (approx)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

= (₹ 2,23,147 × 3) + ₹ 60,000 = ₹ 6,69,441 + ₹ 60,000 = ₹ 7,29,441

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

= ₹ 7,29,441 – ₹ 6,00,000 = ₹ 1,29,441

3. 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 Rs. 1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. Compute the following:

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years of lease.

Solution:

(i) Annual lease rent

Total lease rent

= 130% of Rs. 1,50,000 X (Output during lease period / Total output)

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

= 1,95,000 x 1,50,000 units/3,00,000 units = Rs. 97,500

Annual lease rent = Rs. 97,500 / 3 = Rs. 32,500

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

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

Hence income recognised in years 1, 2 and 3 will be as:

Year 1	Rs. 26,000,
Year 2	Rs. 32,500 and
Year 3	Rs. 39,000.

(iii) Depreciation for three years of lease: Since depreciation in proportion of output is considered appropriate, the depreciable amount Rs. 1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

Depreciation for year 1 is Rs. 20,000, year 2 = 25,000 and year 3 = 30,000.

4. X Ltd. sold JCB Machine having WDV of Rs. 50 Lakhs to Y Ltd for Rs. 60 Lakhs and the same JCB was leased back by Y Ltd to X Ltd. The lease is operating lease

Comment according to relevant Accounting Standard if

(i) Sale price of Rs. 60 Lakhs is equal to fair value.

(ii) Fair Value is Rs. 50 Lakhs and sale price is Rs.45 Lakhs.

(iii) Fair value is Rs. 55 Lakhs and sale price isRs. 62 lakhs

(iv) Fair value is Rs. 45 Lakhs and sale price is Rs. 48 Lakhs.

Solution: According to AS 19, following will be the treatment in the given situations:

(i) When sales price of Rs. 60 lakhs is equal to fair value, X Ltd. should immediately recognize the profit of Rs.10 lakhs (i.e. 60 – 50) in its books.

(ii) When fair value of leased JCB machine is Rs. 50 lakhs & sales price is Rs. 45 lakhs, then loss of Rs. 5 lakhs (50 – 45) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payments.

(iii) When fair value is Rs. 55 lakhs & sales price is Rs. 62 lakhs, profit of Rs. 5 lakhs (55 - 50) to be immediately recognized by X Ltd. in its books and balance profit of Rs. 7 lakhs (62-55) is to be amortised/deferred over lease period.

(iv) When fair value is Rs. 45 lakhs & sales price is Rs. 48 lakhs, then the loss of Rs. 5 lakhs (50- 45) to be immediately recognized by X Ltd. in its books and profit of Rs. 3 lakhs (48-45) should be amortised/deferred over lease period.

5. Classify the following into either operating or finance leases:

(i) Ownership of an assets gets vested to the leases at the end of lease term.

(ii) Lease has option to purchase the asset at lower than fair value , at the end of lease term.

(iii) Economic life of the asset is 5 years , lease term is 4-2 years, but asset is not acquired at the end of lease term.

(iv) Present value (PV) of Minimum lease payments (MLP) = “X”, Fair value of the asset is Y.

(v) Economic life is 5 years lease term is 2 years, but the asset is of a special nature, and has been procured only for use of leasee.

Solution:

(i) Finance Lease.

(ii) If it become certain at the inception of lease itself that the option will be exercise by the leases, it is a Finance lease.

(iii) It will still be classified as a finance lease, since a substantial portion of the life of the asset is covered by lease term.

(iv) Where X=Y , or where X substantailly equals Y, it is a finance lease.

(v) Since the asset is procured only for the use of lessee, it is a finance lease.

CHAPTER 14 AS 20: EARNINGS PER SHARE

1. **Earning per share:** are of two types
   (a) Basic Earnings per share.
   (b) Diluted Earnings per share.

2. **Calculation of Basic Earnings per share:**

$$\frac{\text{Earning attributable for ESH}^{*1}}{\text{Weighted average of Equity share}^{*2}}$$

*** 1 Calculation of earnings attributable for Equity shareholder:**

Particulars	Amount
Profit after Tax (PAT)	XXX
(-) Preference dividend	(XXX)
Earning Attributable for ESH	XXX

Notes: Preference dividend shall be deducted as follows

(a) **If preference share capital is cumulative:** Always deduct irrespective of it is declared or not.

(b) **If preference share capital is non-cumulative:** Deduct only if it is declared

In case question is silent whether preference share capital is cumulative or not always assume it is cumulative.

***2 Calculation of weighted average of Equity share:**

Particulars	Numbers
Opening no. of shares taken for whole year	XXX
(+) No. of shares issued during the Year	
➢ On proportionate basis (if Resources are Received)	XXX
➢ Share issued during the year for whole year (if Resources are not received i.e. Bonus Share)	XXX
Weighted Average of Equity Shares	XXX

Some important points for calculating weighted average of Equity Share:

(1) **If Public issue during the year:** Whenever shares are issued as a public issue then such shares are taken on proportionate basis because earning per share represent annualised earning rate per share.

(2) **If shares are partly paid-up:** Convert partly paid up share into fully paid-up share then calculates BEPS.

(3) **If shares are of different Face value:** In such case we first calculate B.E.P. ₹ and then calculate BEPS for earth category of shares.

(4) **If shares are issued at a premium or discount:** Basically earning of entity depends on net asset which represented by share capital. While calculating BEPS only representative capital is used that is face value. BEPS shall be calculated as usual irrespective of shares are issued at par/premium/Discount.

(5) Issue of Bonus share / share issued without considerations / Split of share capital without increase in resources: Bonus share are those share which are being issued by the company to its existing shareholders without any consideration. For the purpose of calculating WAES bonus shares shall be taken for the whole year.
Note: Such bonus shares shall also be taken for the purpose of calculation of weighted average of ES of Previous Year and calculate restated BEPS.

(6) Issue of Right share: Right shares are those share which are issued by a company to its existing shareholder at a price lower than market price. Basically under right share there are 2 elements:
(a) Paid element
(b) Bonus element.
Paid element shall be taken from issue date whereas bonus element shall be taken for the whole year.

Following steps are applied.

Step 1: Calculate Fair value Ex-right.

$$\frac{\text{(No. of ES before issue of Right share X Fair value Cum-right)+Right Proceeds}}{\text{No. of ES after issue of Right share}}$$

Right Proceeds = No. of Right share issued X Issue Price

Step 2: Calculate Adjustment factor / Bonus Fraction

$$\frac{\text{Fair value Cum-right}}{\text{Fair value Ex-right}}$$

OR

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-right value per share (Step 1)}}$$

Note: Adjustment factor shall also be taken for previous year.

(7) Bug Back of Equity Share: Buy back means repayment to Shareholders.
Reduce number of share with number of share buy back from the date of buy back.

(8) Share issued to vendor other than cash consideration: Considered as public issue.

(9) Partly paid up share without dividend Right: Not considered for BEPS

3. Diluted Earnings per share

(a) Meaning: DEPS means calculation of earnings per share after taking effect of potential equity share (PES) on BEPS.

(b) Meanings of potential equity share (PES): These are those Instrument which qualify all following 3 conditions:
(i) Convertible into equity shares.
(ii) Resources has been received (either in cash or kind)
(iii) Such resources have been used in Business.

(c) Examples of Potential Equity Shares:
(i) Convertible debenture
(ii) Convertible preference share

(iii) Employee Stock Option Plan (ESOP)
(iv) Share warrant.
(v) Portly paid up shares without dividend right.

(d) DEPS formula:

$$\frac{\text{Profit/Loss attributable to ESH after taking effect of PES}}{\text{WAES + Weighted average number of PES}}$$

Notes:

(i) Interest expenses shall be taken as net of tax.

(ii) Effect of potential equity shares on earning and WAES shall be taken for outstanding period during the year.

(iii) Calculation of potential Equity share in case of ESOP:

Number of ESOP - {(Number of ESOP X Exercise Price)/Average Fair value of share}

(iv) While calculating DEPS only that PES shall be considered whose nature is diluted. PES should be treated as diluted when and only when, their conversion into equity share would decrease net profit per share from continue ordinary operations (C.O.O).
➢ Those PES whose nature is anti-diluted shall not be considered.

4. Date when equity shares shall be considered for the purpose of calculation of WAES

SN	Nature of transaction	Effective date: when:
1	General Rule	Consideration is Receivable/Received.
2	Exchange for cash	Cash Received
3	Voluntarily Re-investment of dividend	Dividend Received
4	Conversing of Debt instrument	Date of conversion
5	In lieu of Interest/Principal	Date when interest ceases to accrue
6	Exchange / settlement of a liability	Date of Settlement becomes effective
7	Equity Shares issued as consideration for the acquisition of an asset other than in cash.	Date on which the asset is recognised.
8	Rendering of service	Service are rendered
9	General Reference document	All terms of contract are fulfilled.

PRACTICAL QUESTIONS

1. 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:

(i) 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.

(ii) Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?

Solution:

(i) Computation of Basic Earnings per share for the year ended 31st March, 20X2: (including the comparative figure)

Working Note – I:

Earnings for the year ended 31st March, 20X1:
= EPS x Number of shares outstanding during 20X0-20X1
= ₹ 62.30 x 10,00,000 equity shares
= ₹ 6,23,00,000

Adjusted/Restated Earnings per share for the year ended 31st March 20X1: (after taking into consideration bonus issue)

Adjusted/Restated Basic EPS:

= Earnings for the year 20X0-20X1 / (Total outstanding shares +Bonus issue)
= ₹ 6,23,00,000 / (10,00,000+ 5,00,000)
= ₹ 6,23,00,000 / 15,00,000
= ₹ 41.53 per share

Computation of Basic EPS for the year 20X1-20X2:

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 20X2)
= (₹ 90,00,000 – ₹ (1,00,00,000 x 8%)) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))
= ₹ 82,00,000 / 15,50,000 shares
= ₹ 5.29 per share

(ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

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

2. X Ltd. supplied the following information. You are required to compute the basic earnings per share:

(Accounting year 1.1.20X1– 31.12.20X1)

Net Profit : Year 20X1: ₹ 20,00,000
: Year 20X2: ₹ 30,00,000

No. of shares outstanding prior to Right Issue : 10,00,000 shares

Right Issue : One new share for each four outstanding i.e., 2,50,000 shares.

Right Issue price – ₹ 20

Last date of exercise rights– 31.3.20X2.

Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2 : ₹ 25

Solution: Computation of Basic Earnings Per Share
(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 20X1 ₹	Year 20X2 ₹
EPS for the year 20X1 as originally reported Net profit of the year attributable to equity shareholders		
Weighted average number of equity shares outstanding during the year = (₹ 20,00,000 / 10,00,000 shares)	2.00	

EPS for the year 20X1 restated for rights issue = [₹ 20,00,000 / (10,00,000 shares X 1.04)]	1.92 (approx.)	
EPS for the year 20X2 including effects of rights issue $\frac{₹ 30,00,000}{(10,00,000 \text{ shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$ $\frac{₹ 30,00,000}{11,97,500 \text{ shares}}$		2.51 (approx.)

Working Notes:

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

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

$$\frac{(₹ 25 \times 10,00,000 \text{ shares}) + (₹ 20 \times 2,50,000 \text{ shares})}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}}$$

= ₹ 3,00,00,000 / 12,50,000 shares

= ₹ 24

2. Computation of adjustment factor

= Fair value per share prior to exercise of rights / Theoretical ex-rights value per share

= ₹ 25 / ₹ 24 (Refer Working Note 1)

= 1.04 (approx.)

3. Net profit for the current year — Rs. 1,00,00,000
   No. of equity shares outstanding — 50,00,000
   Basic earnings per share — Rs. 2.00
   No. of 12% convertible debentures of Rs. 100 each — 1,00,000
   Each debenture is convertible into 10 equity shares
   Interest expense for the current year — Rs. 12,00,000
   Tax relating to interest expense (30%) — Rs. 3,60,000
   Compute Diluted Earnings Per Share.
   Solution: Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = ₹ 1,08,40,000
   No. of equity shares resulting from conversion of debentures: 10,00,000 Shares
   No. of equity shares used to compute diluted EPS: (50,00,000 + 10,00,000) = 60,00,000 Shares
   Diluted earnings per share: (1,08,40,000/60,00,000) = ₹ 1.81

4. "While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period." Explain this statement in the light of relevant AS.
   Also calculate the diluted EPS from the following information:
   Net Profit for the current year (After Tax) — ₹ 1,00,00,000
   No. of Equity shares outstanding — 10,00,000
   No. of 10% Fully Convertible Debentures of ₹ 100 each — 1,00,000
   (Each Debenture is compulsorily & fully convertible into 10 equity shares)
   Debenture interest expense for the current year — ₹ 5,00,000
   Assume applicable Income Tax rate @ 30%.

Solution: As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Computation of diluted earnings per share =
Adjusted net profit for the current year / Weighted average number of equity shares

Adjusted net profit for the current year	₹
Net profit for the current year (after tax)	1,00,00,000
Add: Interest expense for the current year	5,00,000
Less: Tax relating to interest expense (30% of ₹5,00,000)	(1,50,000)
Adjusted net profit for the current year	1,03,50,000

Weighted average number of equity shares
Number of equity shares resulting from conversion of debentures
= (1,00,000 X 100) / 10 = 10,00,000 Equity shares

Weighted average number of equity shares used to compute diluted earnings per share
= [(10,00,000 x 12) + (10,00,000 x 6)]/12 = 15,00,000 equity shares

Diluted earnings per share
= ₹ 1,03,50,000 / 15,00,000 shares = ₹ 6.90 per share.

Note: Interest on debentures for full year amounts to ₹ 10,00,000 (i.e. 10% of ₹ 1,00,00,000). However, interest expense amounting ₹ 5,00,000 has been given in the question. It may be concluded that debentures have been issued at the mid of the year and interest has been provided for 6 months.

5. | | |
|---|---|
| Net profit for the year 2012 | Rs. 12,00,000 |
| Weighted average number of equity shares outstanding during the year 2012 | 5,00,000 shares |
| Average fair value of one equity share during the year 2012 | Rs. 20.00 |
| Weighted average number of shares under option during the year 2012 | 1,00,000 shares |
| Exercise price for shares under option during the year 2012 | Rs. 15.00 |

Compute Basic and Diluted Earnings Per Share.

Solution: Computation of earnings per share

	Earnings ₹	Shares	Earnings/Share ₹
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares during year 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (100,000 x 15.00)/20.00		(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

6. 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?

Solution: 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).

CHAPTER 15 AS 24: DISCONTINUING OPERATIONS

1. 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.

   Following are not D.C.O:

   (a) Gradual or evolutionary phasing out of a product line or class of service.
   (b) Reducing activity to save in cost.
   (c) Changes in the scope of work
   (d) Change in the Product Mix
   (e) Decline in the production
   (f) Shifting of location of some production or marketing activities
   (g) Improvement in machine
   (h) Closing of a facility to achieve productivity improvements or other cost savings.
   (i) Outsourcing of a process

2. Initial Disclosure Events: It means any event which trigger disclosure of AS-24. Any event from following is called Initial Disclosure Event.
   (a) The enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
   (b) The enterprise's board of directors or similar governing body has both
      (i) approved a detailed, formal plan for the discontinuance and
      (ii) made an announcement of the plan.

      Note: Detail plan includes following features:
      (i) identification of the major assets to be disposed of;
      (ii) the expected method of disposal;
      (iii) the period expected to be required for completion of the disposal;
      (iv) the principal locations affected;
      (v) the location, function, and approximate number or employees who will be compensated for terminating their services; and
      (vi) the estimated proceeds or salvage to be realised by disposal.

PRACTICAL QUESTIONS

1. A healthcare goods producer has changed the product line as follow :

	Washing soap	Bathing soap
January 2007 –september 2007 per month	2,00,000	2,00,000
October 2007 –december 2007 per month	1,00,000	3,00,000
January 2008- March 2008 per month	0	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plant capacity . The board of Directors of the company has passed a resolution in March 2007 to this effect. The companies follow calendar year as its accounting year. Should it be treated as discontinuing operation?

Solution: Business enterprises frequently close facilities, abandon products, or even product line, and reduce the size of their work force in response to market force. These kinds of terminations, generally are not in themselves discontinuing operations unless they satisfy the definition criteria. By gradually reducing the size of operation in product line of washing soap, the company has increased its scale of operation in bathing soap. Such a change is gradual or evolutionary, phasing out of a product line or class of services does not meet definition criteria in paragraph 3(a) of AS 24 –namely , disposing substantially in its entirely a component of enterprise. Hence changeover is not a discontinuing operation.

2. Qu Ltd. in the business of manufacture of Passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment over the coming 5 years However no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles and transfer plus employees in a phased manner.

(i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discounting 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 of the passenger car division to the new factory. Does this trigger the application or 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 phased but time manner?

Solution: Mere gradual phasing is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operation'.

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

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

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

(3) Closing of a facility to achieve productivity improvements or other cost savings.

A Reportable business segment or geographical segment as defined in AS-17, would normally satisfy criteria (b) of the definition.

In view of the above the answers are:

(i) No. The companys' strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has started.

(ii) No. The resolution is salient about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and new segment starting road map is missing. Hence, AS-24 will not be applicable.

(iii) Yes. Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map. Hence, this action will attract AS-24 compliance.

CHAPTER 16 CASH FLOW STATEMENTS (AS – 3)

1. Meaning of cash flow statement: It is a statement which includes:
   - Inflow and
   - Outflow of
   - cash and cash equivalent #

   for a particular period (Generally 1 year).

   # Meaning of Cash and cash equivalents:

   A. Cash include:
      (a) Cash in hand,
      (b) Demand deposits with banks.

   B. Cash equivalents include: Short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
      - Securities with short maturity period of, say, 3 months or less from the date of acquisition.

2. Presentation of cash flow statements: It is a statement, which provides the details about how the cash is generated by an entity during the particular reporting period and how it is applied. The cash flows are classified into following three main categories:

   A. Cash Flow from operating Activities (CFFOA): are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
      E.g. Collection from debtors, payment of business expenses, income tax paid etc.

   B. Cash Flow from Investing Activities (CFFIA): are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
      E.g. Sale of building, purchase of long term investment, rent and interest received etc.

   C. Cash Flow from Financing Activities (CFFFA): These are the activities that result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise. E.g. Issue of equity share capital, redemption of debenture, interest and dividend paid etc.

3. Methods of preparation of cash flow statement: There are two methods
   (A) Direct method
   (B) Indirect method

   Note: Under both the methods cash flow from investing activities and financing activities are prepared in the same manner. Cash flow from operating activity are prepared separately under both the methods.

   (A) Cash flow from operating activity under direct method:
      - All receipts from principal revenue generating activity and those activities which are neither investing activity nor financing activity shall be considered as inflow.
      - All payments of principal revenue generating activity and those activities which are neither investing activity nor financing activity shall be considered as outflow.

   (B) Cash flow from operating activity under indirect method: Always assume net profit is
      - from operating activity and all items are cash activities

      so all non-cash activity and non-operating activity shall be adjusted.

Format of cash flow from operating activity under indirect method

Particulars	Amount (Rs.)
Profit after appropriations	XXX
(+) Appropriation (like transfer into General / Revenue Reserve, dividend paid etc.)	XXX
Profit after taxation	XXX
(+) Provision for taxation	XXX
Profit before taxation	XXX
(+)Adjustments for: ➢ Non-operating income/expenses ➢ Non cash income expensive	XXX XXX
(+)Adjustment for change in working capital (Increase / decrease in current asset / current liabilities)	XXX
Cash generated from operations	XXX
(-) Income tax paid	(XXX)
(+) Extra ordinary expenses / income	XXX
Net cash flow from operating activities	XXX

4. Adjustments:

(1) Property, Plant and Equipment: For the purpose of preparation PPE A/c there are two methods
(A) Gross block method
(B) Net block method

(A) Gross block method: under gross block method fixed assets are shown at cost price / historical cost and amount of depreciation shall be credited into accumulated depreciation or provision for depreciation A/c.

(B) Net block method: under net block method depreciation is directly charged into fixed asset

Some relevant points for fixed assets

(i) In case date of purchase and date of sale of fixed asset is not given then assume fixed assets are purchased and sold on first day of the Year.

(ii) In case fixed asset purchased or sold on first day of the year or date of purchase and sale is not given

and

Rate of depreciation is given under net block method

✓ then depreciation for current year shall be calculated by applying following formula:
= {Closing WDV / 100 - rate of depreciation} X Rate of depreciation

(2) Provision for tax

Particulars	Amount(Rs.)	Particulars	Amount(Rs.)
To Bank A/c (Tax Paid)	XXX	By Balance b/d	XXX
To Balance c/d	XXX	By P & L A/c (Current Year Provision)	XXX
	XXX		XXX

(3) Expenses account:

Case I: If information of prepaid expenses is given:

Expenses Account

Particulars	Amount	Particulars	Amount
To Balance b/d (Prepaid) To Bank A/c (B/F)	XXX XXX	By P & L A/c (Current Year Expenses) By Balance c/d (Prepaid)	XXX XXX
	XXX		XXX

Case II: If information of outstanding expensive is given:

Expenses Account

Particulars	Amount(Rs.)	Particulars	Amount(Rs.)
To Bank A/c To Balance c/d (O/S)	XXX XXX	By Balance b/d (O/S) By P & L A/c (Current Year Expenses)	XXX XXX
	XXX		XXX

Case III: If information of both prepaid expenses and outstanding expenses are given but allocation of current year expenses is not given then prepare combined expenses Account

Expenses Account

Particulars	Amount(Rs.)	Particulars	Amount(Rs.)
To Balance b/d (Prepaid) To Bank A/c To Balance c/d (O/S)	XXX XXX XXX	By Balance b/d (O/S) By P & L A/c (Current Year Expenses) By Balance c/d (Prepaid)	XXX XXX XXX
	XXX		XXX

(4) Sometime we have to calculate
- collection from debtor and
- payment to creditor.

in that case we will prepared debtor Account, Creditor Account and Inventory Account.

(5) Dividend Payable: dividend payable / Dividend are of two types

(i) Final dividend: is a divided which is paid in C.Y but belongs to immediately P.Y and payable on closing capital of immediately P.Y.

(ii) Interim dividend: is a divided which belongs to a period started from first day of the year up to the date of payment. Interim dividend is payable on outstanding capital on the date of payment

- Before paying dividend to Equity Shareholder, Company pay dividend first to Preference Shareholder.
- Journal entry

(a) On declaration of dividend:

P & L Account	Dr.	XXX	
To dividend payable A/c			XXX

(b) On payment of dividend

Dividend payable A/c	Dr.	XXX	
To bank A/c			XXX

Note: In case dividend is not claimed by shareholder then such amount of dividend shall be transferred into unclaimed dividend or unpaid dividend.

Dividend payable A/c	Dr.	XXX	
To unpaid dividend / unclaimed dividend A/c			XXX

(6) In case any security have fixed rate (e.g. Debentures, Preference share etc.), then always taken care of interest or dividend respectively.

(7) In case any activity which is operating and cash activity but its impact was not taken in SPL, then:
- ➢ takes its impact in cash flow from operating activity.

(8) In case question is silent regarding payment of income tax for the year as well as regarding current year provision for tax but gives information about opening and closing balance of provision for tax then always assume
- ➢ Opening balance of provision for tax has been paid; and
- ➢ Closing balance of provision for tax is current year provision for tax.

(9) In case any error or omission in the books of account then first pass rectified journal entry before taking any step of preparing cash flow statement.
- ➢ After adjustment of rectification of error & omission prepared cash flow statement.

(10) Treatment of Dividend Received:

(i) Divided received are of 2 types

(A) Pre-acquisition dividend - Considered as recovery of cost of investment
- So credited into investment account (amount column of investment)

(B) Post-acquisition dividend - Considered as income
- So credited into P&L A/C

(ii) Treatment of dividend received under the chapter of cash flow statement

(A) Pre-acquisition dividend: under both the methods
- once credited into investment account; and
- shown as inflow under investing activity

(B) Post-acquisition dividend:
(a) Under direct method: shown as inflow under investing activity.
(b) under indirect method: reduce from operating activity and shown as inflow under investing activity.

Note: In case question is silent whether dividend received is pre-acquisition or post-acquisition always assume it is post-acquisition dividend.

(11) Creation of Capital Redemption Reserve (CRR): In case company redeemed preference share capital and use free reserve then for the purpose of creation of CRR free reserve Shall be used in the following order:
(a) General reserve / Revenue Reserve
(b) P&L account

(12) Proceeds from calls in arrear: Shall be shown as inflow under financing activity.

(13) Borrowing under financing activity shall include both long term & short term borrowing.

(14) Government grant received for capital projects: inflow under investing activity.

(15) Treatment of amortization of deferred Govt. grant / treatment of deferred income of government grant: Reduce from operating activity under indirect method

(16) Treatment of foreign exchange difference (FED): It is a book entry as per AS-11, so under cash flow statement its effects shall be nullify or reversed.

A. In case of foreign exchange Gain:
- Reduced from operating activity (- O.A.); and
- Corresponding increase in liability or decrease in asset.

B. In case of foreign exchange loss:
- Added in operating activity (+ O.A.); and
- Corresponding decrease in liability or increase in asset.

Note: Disclosure of effect of foreign exchange difference if it is related to C & C E.

Particulars	Opening	Closing
Cash and cash equivalent	XXX	XXX
Effect of exchange rate changes	XXX	XXX
Cash and cash equivalent as restated	XXX	XXX

(17) Treatment of provision for doubtful debts:

Alternative I: Adjust with balance of trade receivable and treated balance of trade receivable after adjustment of provision for doubtful debts

Alternative 2: ($\pm$)in operating activity separately both
- provision for doubtful debts; and
- trade receivable.

Note: In case there is any bad debt adjusted with provision for doubtful debts then there are two alternatives

Alternative I: Take trade receivable as given in balance sheet as net of provision for doubtful debts.
Alternative 2: Added back in provision for doubtful debts and trade receivable and takes the effect of both.

(18) In case any income received on investment after detecting TDS:

Bank A/c (net of TDS)	Dr.	XXX	
TDS A/c (Asset)	Dr.	XXX	
To income A/c (on gross basis) (-OA under indirect method)			XXX

(19) Capital introduced or drawings made by the Partner or Individual: considered as financing activity. For the purpose of calculation of introduction of capital or drawings prepare capital A/c.

Capital Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To drawings	XXX	By Balance b/d	XXX
To Net loss c/d	XXX	By Capital introduced	XXX
To Balance c/d (O/S)	XXX	By net profit c/d	XXX
	XXX		XXX

(20) Sometime question gives information about fixed asset on the basis of net block in balance sheet (means fixed asset shown in balance sheet at net block) and information of opening balance and closing balance of accumulative depreciation is given in additional information: then for the purpose of calculation of current year depreciation or adjustment of other transactions in relation to fixed asset:
- (a) Prepare fixed asset Account at cost price (For this opening and closing balance shall be calculated by adding balance of Acc. Depreciation in net block of fixed asset)
- (b) Prepare accumulated depreciation account as usual by starting and ending with the balance of accumulated depreciation as given in information.

Note: In such kind of question rate of depreciation & current year amount of depreciation is missing.

(21) Treatment of bank overdraft:
- (i) AS - 3 is silent regarding treatment of bank overdraft.
- (ii) Bank overdraft is a facility provided by bank to entity as a short term finance so it is considered as a financing activity under cash flow statement (Interest paid on Bank overdraft is also considered as an outflow in financing activity).

Notes:
- (i) As per opinion of some authors Bank OD is related to working capital requirement so it may be considered as an operating activity.
- (ii) As per IND AS-7 Bank O/D is considered as a part of cash and cash equivalent, but in our syllabus IND AS are not applicable. So this treatment is irrelevant for our exam.
- (iii) For examination purpose we assumed Bank O/D as a financing activity and also write a note in exam.

(22) Treatment of cash credit: same treatment as in case of bank O/D.

(23) Purchase of goodwill: Outflow in investing activity.

(24) Underwriting commission paid: Outflow in financing activity.

(25) In case any advance given to supplier or employee or any advanced taken from customer and interest on these: Operating Activities.

(26) In case any extraordinary item: it shall be disclose separately in cash flow statements.

(27) Issue of bonus shares: If bonus shares were issued from P & L A/c then it is an appropriation of profit so bonus shares shall be added in operating activity under indirect method.

(28) Short term investment which is not a cash and cash equivalent are considered as a part of investing activity.

PRACTICAL QUESTIONS

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

Particulars	Note No	2022 (₹)	2021 (₹)
Equity and Liabilities			
Shareholders' funds			
Equity share capital		1,20,000	1,00,000
Reserves	1	9,000	8,000
Current Liabilities			
(i) Trade Payables		8,000	5,000

	Note		
(ii) Short term provision	2	7,000	4,000
		1,44,000	1,17,000
Non-current assets			
(i) PPE (at W.D.V)	3	78,000	58,000
(ii) Long Term Investments		32,000	28,000
Current Assets			
(i) Inventory		14,000	8,000
(ii) Trade Receivables		8,000	6,000
(iii) Cash & Bank		12,000	17,000
		1,44,000	1,17,000

Notes to accounts

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

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

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

Further Information is available:

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

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

Solution: **Max Ltd.**

Cash Flow Statement for the year ended 31st March, 2022	**(₹)**	**(₹)**
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation ₹ (1,000 + 2,000 +5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(4,000)	
Net cash generated from operating activities (A)		**(2,400)**
Cash flows from investing activities		
Sale of car	3,400	

Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		**(22,600)**
Cash flows from financing activities		
Issue of shares for cash	20,000	
Net cash from financing activities(C)		**20,000**
Net decrease in cash and cash equivalents (A + B +C)		**(5,000)**
Cash and cash equivalents at beginning of period		**17,000**
Cash and cash equivalents at end of period		**12,000**

Working Notes:

1. Calculation of Income taxes paid

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

2. Calculation of Fixed assets acquisitions

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

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

Balance Sheets

	Particulars	**Note**	**31.03.2019 (Rs.)**	**31.03.2018 (Rs.)**
I	EQUITY AND LIABILITES			
	(1) Shareholder's Funds			
	(a) Share Capital	1	3,50,000	3,00,000
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities			
	(a) Trade Payables		65,000	44,000
	(b) Other Current Liabilities	3	37,000	27,000
	(c) Short term Provisions (provision for tax)		32,000	28,000
	Total		5,66,000	4,37,000
II	ASSETS			
	(1) Non-current Assets	4		
	(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 (Rs.)	31.03.2018 (Rs.)
Equity Share Capital	3,50,000	3,00,000

Note 2: Reserves and Surplus

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
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 (Rs.)	31.03.2018 (Rs.)
Dividend declared	37,000	27,000

Note 4: Tangible Assets

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
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 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.

Solution: 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 & Loss Account		(18,000)
		Add: Dividend declared during the year		37,000
		Add: Interim dividend paid during the year		10,000
		Add: Transfer to reserve		10,000
		Add: Provision for Tax		32,000
	B.	Net profit before taxation, and extra-ordinary item		98,000
	C.	*Add:* Items to be added		
		Depreciation	18,000	
		Loss on sale of Plant	3,000	
		Goodwill written off	13,000	34,000
	D.	*Less:* Dividend Income		(1,500)
	E.	Operating profit before working capital changes [B + C - D]		1,30,500

	F.	*Add:* Decrease in Current Assets and Increase in Current Liabilities		
		Decrease in Inventories	7,000	
		Increase in Trade Payables	21,000	28,000
	G.	*Less:* Increase in Trade Receivables		(33,000)
	H	Cash generated from operations (E+F-G)		1,25,500
	I	Less: Income taxes paid		(28,000)
	J	Net Cash from (used in) operating activities		97,500
II.		**Cash Flows from investing activities:**		
		Purchase of Plant		(1,34,000)
		Sale of Land		50,000
		Sale of plant		12,000
		Purchase of investments		(25,600)
		Dividend Received		2,100
		Net cash used in investing activities		(95,500)
III.		**Cash Flows from Financing Activities:**		
		Proceeds from issue of equity share capital		50,000
		Interim Dividend paid		(10,000)
		Final dividend paid		(27,000)
		Net cash from financing activities		13,000
IV.		**Net increase in cash and cash equivalents (I+II+III)**		15,000
V.		**Cash and cash equivalents at beginning of period**		17,000
VI.		**Cash and cash equivalents at end of period (IV+V)**		32,000

1. Land and Building Account

Particulars	₹	*Particulars*	₹
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

2. Plant and Machinery Account

Particulars	₹	*Particulars*	₹
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss on sale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

3. Investments Account

Particulars	₹	*Particulars*	₹
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To bank A/c (Purchase	25,600	By Balance c/d	35,000
	35,600		35,600

3. J Ltd. presents you the following information for the year ended 31st March, 2007:

		(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 in P & L account	24,000
(vi)	Capital grant received – amortised in 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 in P & L A/c	3,000
(ix)	Interest expenditure debited in P & L A/c	12,000
(x)	Interest actually paid (Financing activity)	13,042
(xi)	Increase in working Capital [Excluding cash and Bank Balance]	67,290
(xii)	Purchase of fixed assets	22,092
(xiii)	Expenditure on construction work	41,688
(xiv)	Grant received for Capital projects	18
(xv)	Long-term borrowings from Banks	55,866
(xvi)	Provision for Income-tax debited in P & L A/c	6,000
	Cash and Bank Balance on 1.4.2006	6,000
	Cash and Bank Balance on 31.3.2007	8,000

You are required to prepare a Cash flow statement as per AS-3 (Revised).

Solution: 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
Less: Non cash income		72,048
Amortisation of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Grants for capital projects	18	
Sale of assets (222 – 48)	174	
Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of fixed assets	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,150)

Cash flows from financing activities:		
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,622
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

4. From the following information, prepare a CFS as per AS-3 for Banjara Ltd., using direct method:

Balance Sheet as on 31st March 2010 (Rs. '000)

		2010		2009
Assets:-				
Cash on hand and balances with bank		200		25
Marketable Securities (Having one month maturity)		670		135
Sundry Debtors		1,700		1,200
Interest Receivable		100		-
Inventories		900		1,950
Investments		2,500		2,500
Fixed Assets at Cost	2,180		1,910	
Accumulated Depreciation	(1,450)		(1,060)	
Fixed Assets(Net)		730		850
Total Assets		6,800		6,660
Liabilities:-				
Sundry Creditors		150		1,890
Interest Payable		230		100
Income tax Payable		400		1000
Long Term Debt		1,110		1,040
Total Liability		1,890		4,030
Shareholder's Fund:				
Share Capital		1,500		1,250
Reserves		3,410		1,380
		4,910		2,630
Total Liabilities & Shareholders' Fund		**6,800**		**6,660**

Statement of Profit or Loss for the year ended 31st March 2010

Particulars	**Amount in Rs. '000**
Sales	**30,650**
Cost of Sales	**(26,000)**
Gross Profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest Expenses	(400)
Interest Income	300
Dividend Income	200
Net Profit before taxation and Extraordinary items	3,390
Extraordinary items:	
Insurance Proceeds from earthquake disaster settlement	140
Net Profit after extraordinary items	3,530
Income Tax	(300)
	3,230

Additional Information:-

(i) An amount of Rs. 250 was raised from the issue of share capital and a further Rs. 250 was raised from long-term borrowings.

(ii) Interest expenses was Rs. 400 of which Rs. 170 was paid during the period Rs. 100 relating to interest expenses of the prior period was also paid during the year.

(iii) Dividend paid were Rs. 1,200.

(iv) Tax Deducted at Source on Dividends received (Including in the tax expenses of Rs. 300 for the year) amounted to Rs. 40.

(v) During the period the enterprise acquired fixed assets for Rs. 350. The payment was made in cash.

(vi) Plant with original cost Rs. 80 and Accumulated depreciation of Rs. 60 was sold for Rs. 20.

(vii) Sundry debtors and sundry creditors include amounts relating to credit sales and credit purchase only.

Solution: Cash Flow Statement (direct method)

Cash flows from Operating Activities		
Cash receipts from customers (W.N.2)	30,150	
Cash paid to suppliers, employees and for expenses (W.N.3)	(27,600)	
Cash generated from operations	2,550	
Income tax paid (W.N.4)	(860)	
	1,690	
Cash flow before extraordinary item:		
proceeds from earthquake disaster settlement	140	
Net cash from operating activities		1,830
Cash flows from Investing Activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received (300 – 100)	200	
Dividends received (200 – 40)	160	
Net cash from investing activities		30
Cash flows from Financing Activities		
Proceeds from issuance of share capital	250	
Proceeds from long term borrowings	250	
Repayment of long term borrowings (W.N.5)	(180)	
Interest paid (W.N.6)	(270)	
Dividends paid	(1,200)	
Net cash used in financial activities		(1,150)
Net increase in cash and cash equivalents		710
Cash and cash equivalents at beginning of the period (W.N.1)		160
Cash and cash equivalents at end of the period (W.N.1)		870

Working Notes:

(1) Cash and cash equivalents: Cash and cash equivalents consist of cash in hand and balances with banks and investments in money market instruments for short period. ₹'000

	2010	2009
Cash in hand and balance with bank	200	25
Short-term investments	670	135
Cash and cash equivalents	870	160

(2) Cash receipts from customers ₹'000

Total sales	30,650
Add: Sundry debtors at the beginning of the year	1,200
	31,850

Less: Sundry debtors at the end of the year		(1,700)
Cash sales		30,150

(3) Cash paid to suppliers, employees and for expenses

		₹'000
Cost of sales		26,000
Administrative and selling expenses		910
		26,910
Add: Sundry creditors at the beginning of the year	1,890	
Inventories at the end of year	900	2,790
		29,700
Less: Sundry creditors at the end of year	(150)	
Inventories at the beginning of the year	(1,950)	(2,100)
		27,600

(4) Income tax paid (including TDS from dividends received)

	₹'000
Income tax expense for the year (including tax deducted at source from dividends received)	300
Add: Income tax liability at the beginning of the year	1,000
	1,300
Less: Income tax liability at the end of the year	(400)
	900

Out of ₹ 900 thousands, tax deducted at source on dividends received (amounting to ₹40 thousands) is included in cash flows from investing activities and the balance of ₹860 thousands is included in cash flows from operating activities.

(5) Repayment of long term borrowings during the year

	₹'000
Long term debts at the beginning of the year	1,040
Add: Long term borrowings made during the year	250
	1,290
Less: Long term borrowings at the end of the year	(1,110)
	180

(6) Interest paid during the year

	₹'000
Interest expense for the year	400
Add: Interest payable at the beginning of the year	100
	500
Less: Interest payable at the end of the year	(230)
	270

5. Prepare cash flow statement of M/s MNT Ltd. for the year ended 31/03/15 with the help of the following information:

(1) Company sold goods for cash only.
(2) Gross Profit Ratio was 30% for the year, gross profit amounts to Rs.3,82,500.
(3) Opening inventory was lesser than closing inventory by Rs.35,000.
(4) Wages paid during the year Rs.4,92,500.
(5) Office and selling expenses paid during the year Rs.75, 000.
(6) Dividend paid during the year Rs.30, 000 (including dividend distribution tax.)
(7) Bank loan repaid during the year Rs.2,15,000 (included interest Rs.15,000)
(8) Trade payables on 31st March, 2014 exceed the balance on 31st March, 2015 by Rs.25, 000.
(9) Amount paid to trade payables during the year Rs.4,60,000.
(10) Tax paid during the year amount to Rs.65,000 (Provision for taxation as on 31.03.2015 Rs. 45,000)
(11) Investment of Rs.7,00,000 sold during the year at a profit of Rs.20,000.
(12) Depreciation on fixed assets amount to Rs.85,000.
(13) Plant and machinery purchased on 15th November, 2014 for Rs.2, 50,000.
(14) Cash and Cash Equivalents on 31st March, 2014 Rs.2,00,000.
(15) Cash and Cash Equivalents on 31st March, 2014 Rs.6,07,500.

Solution: Cash Flow Statement for the year ended 31st March 2015 (Direct Method)

Particulars	Rs.	Rs.
A. CASH FLOW FROM OPERATING ACTIVITIES:		
Cash Receipt from Sale of Goods (Rs. 3,82,500/30%)	12,75,000	
Cash Payments to Suppliers of Goods	(4,60,000)	
Cash Payments to & on behalf of Employees (Wages)	(4,92,500)	
Cash Payments for Expense/ services (Administration and selling Expenses)	(75,000)	
Cash Generated from Operations before Taxes & Extra Ordinary Items	2,47,500	
Less: Taxes Paid	(65,000)	
Net Cash Flow from Operating Activities [A]		1,82,500
B. CASH FLOW FROM INVESTING ACTIVITIES:		
Sale Proceeds of Investments (Book Value 7,00,000 + Profit 20,000)	7,20,000	
Purchase of New Plant & Machinery	(2,50,000)	
Net Cash Flow from / (Used in) Investing Activities [B]		4,70,000
C. CASH FLOW FROM FINANCING ACTIVITIES:		
Repayment of Bank Loan Principal (2,15,000 – 15,000)	(2,00,000)	
Interest on Bank Loan	(15,000)	
Dividends paid (inclusive of Dividend Distribution Tax)	(30,000)	
Net Cash Flow from/ (used in) Financing Activities [C]		(2,45,000)
D. Net Increase or Decrease in Cash or Cash Equivalents [A+B+C]		4,07,500
E. Opening Balance of Cash & Cash Equivalents (given)		2,00,000
F. Closing Balance of Cash & Cash Equivalents (given)		6,07,500

Note: Change in Inventory & Trade payables are not relevant for above Direct Method.

6. 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 :

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

Solution:

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

7. Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Ltd. for year ended 31.3.2019.

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 from associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of 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

Solution: Cash Flow Statement from Investing Activities of Subham Creative Ltd. for the year ended 31/03/19

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) (73,800+8,200)	82,000	
Less TDS deducted on interest	(8,200)	
Sale of Plant & Machinery Rs.(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)

Notes:

(1) Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.

(2) Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.

(3) The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

8. ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

Particulars			Notes	31st March 20X0 (₹)	31st March 20X1 (₹)
		Equity and Liabilities			
1		Shareholders' funds			
	A	Share capital		50,00,000	50,00,000
	B	Reserves and Surplus		26,50,000	36,90,000
2		Non-current liabilities			
		Long term borrowings	1	-	9,00,000
3		Current liabilities			
	A	Short-term borrowings (Bank loan)		1,50,000	3,00,000
	B	Trade payables		8,80,000	8,20,000
	C	Other current liabilities	2	4,80,000	2,70,000
		Total		91,60,000	1,09,80,000
		Assets			
1		Non-current assets			
	A	Property, plant and Equipment	3	21,20,000	32,80,000
2		Current assets			
	A	Current Investments		11,80,000	15,00,000
	B	Inventory		20,10,000	19,20,000
	C	Trade receivables	4	22,40,000	26,40,000
	D	Cash and Cash equivalents		15,20,000	15,20,000
	E	Other Current assets (Prepaid expenses)		90,000	1,20,000
		Total		91,60,000	1,09,80,000

Notes to accounts

No.	Particulars		₹20X0	20X1
1	Long term borrowings			
	9% Debentures (issued at the end of year)		-	9,00,000
	Total		-	9,00,000
2.	Other current liabilities			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		4,80,000	2,70,000
3	Property, plant and equipment			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		21,20,000	32,80,000
4	Trade receivables			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000)	(1,90,000)
	Total		22,40,000	26,40,000

Additional Information:

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

(ii) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

Solution: Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities	₹	₹
Net Profit	10,40,000	
Add: Adjustment For Depreciation (₹7,90,000 – ₹6,10,000)	1,80,000	

Add: Adjustment for Provision for Doubtful Debts (₹ 4,20,000 – ₹1,50,000)		2,70,000	
Operating Profit Before Working Capital Changes		14,90,000	
Add: Decrease in Inventories (₹ 20,10,000 – ₹ 19,20,000)		90,000	
		15,80,000	
Less: Increase in Current Assets			
Trade Receivables (₹ 30,60,000 – ₹23,90,000)	6,70,000		
Prepaid Expenses (₹ 1,20,000 – ₹90,000)	30,000		
Decrease in Current Liabilities:			
Trade Payables (₹ 8,80,000 – ₹ 8,20,000)	60,000		
Expenses Outstanding (₹ 3,30,000 – ₹ 2,70,000)	60,000	(8,20,000)	
Net Cash generated from Operating Activities			**7,60,000**
Cash Flows from Investing Activities			
Investment in Current Investments		(3,20,000)	
Purchase of Plant & Machinery (₹ 40,70,000 – ₹ 27,30,000)		(13,40,000)	
Net Cash Used in Investing Activities			**(16,60,000)**
Cash Flows from Financing Activities			
Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000)		1,50,000	
Issue of Debentures		9,00,000	
Payment of Dividend		(1,50,000)	
Net Cash Used in Financing Activities			9,00,000
Net Increase in Cash During the Year			-
Add: Cash and Cash Equivalents as on 1.4.20X0			15,20,000
Cash and Cash Equivalents as on 31.3.20X1			15,20,000

Note:

(1) Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.

(2) Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

9. From the following Balance Sheets of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.2010:

Liabilities	**As on 1.4.2009**	**As on 1.4.2010**
Zen's Capital A/c	10,00,000	12,24,000
Sundry creditors	3,20,000	3,52,000
Mrs. Zen's loan	2,00,000	--
Loan from Bank	3,20,000	4,00,000
	18,40,000	19,76,000
Assets	**As on 1.4.2009**	**As on 1.4.2010**
Land	6,00,000	8,80,000
Plant and Machinery	6,40,000	4,40,000
Stock	2,80,000	2,00,000
Debtors	2,40,000	4,00,000
Cash	80,000	56,000
	18,40,000	19,76,000

Additional information:

A machine costing Rs. 80,000 (accumulated depreciation there on Rs. 24,000) was old for Rs. 40,000. The provision for depreciation on 1.4.2009 was Rs. 2,00,000 and 31.3.2010 was Rs. 3,20,000. The net profit for the year ended on 31.3.2010 was Rs. 3,60,000.

Solution: Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.2010

		Rs.
(i) Cash flow from operating activities		
Net Profit (given)		3,60,000
Adjustments for		
Depreciation on Plant & Machinery	1,44,000	
Loss on Sale of Machinery	16,000	1,60,000
Operating Profit before working capital changes		5,20,000
Decrease in Stock	80,000	
Increase in Debtors	(1,60,000)	
Increase in Creditors	32,000	(48,000)
Net cash generated from operating activities		4,72,000
(ii) Cash flow from investing activities		
Sale of Machinery	40,000	
Purchase of Land	(2,80,000)	
Net cash used in investing activities		(2,40,000)
(iii) Cash flow from financing activities		
Repayment of Mrs. Zen's Loan	2,00,000	
Drawings	(1,36,000)	
Loan from Bank	80,000	
Net cash used in financing activities		(2,56,000)
Net decrease in cash		(24,000)
Opening balance as on 1.4.2009		80,000
Cash balance as on 31.3.2010		56,000

Working Notes:

1. Plant & Machinery A/c

	Rs.		Rs.
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision for Depreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 60,000)	16,000
		By Balance c/d (4,40,000 + 3,20,000)	7,60,000
	8,40,000		8,40,000

2. Provision for depreciation on Plant and Machinery A/c

	Rs.		Rs.
To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c (Bal. fig)	1,44,000
	3,44,000		3,44,000

3. To find out Mr. Zen's drawings:

	Rs.
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,400)
Drawing	1,36,000

10. Explain the meaning of the terms 'cash' and 'cash equivalent' for the purpose of Cash Flow Statement as per AS-3 Ruby Exports had a bank balance of USD 25,000, stated in books at Rs 16,76,250 using the rate of exchange Rs 67.05 per USD prevailing on the date of receipt of dollars. However, on the balance sheet date, the closing rate of exchange was Rs 67.80 and the bank balance had to be restated at Rs 16,95,000. Comment on the effect of change in bank balance due to exchange rate fluctuation and also discuss how it will be disclosed in Cash Flow Statement of Ruby Exports with reference to AS-3.

Solution:

Meaning of Cash: Cash in hand and deposits repayable on demand with any bank or other financial institutions.

Meaning of 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 realisable value. Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of charges in value.

Effect of change in bank balance due to exchange rate fluctuation: Cash flows arising from transactions in foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would arise if the rates at the dates of the cash flows were used. The effect of charges in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

In the given question Foreign Exchange differences shall be treated as follows:

(i) **Under direct Method:** Rs. 67.80 X $ 25,000=Rs. 16,95,000 – Rs. 16,76,250 = Rs. 18,750 is to deducted from closing bank balance of the purpose of reconciliation.

(ii) **Under indirect Method:** Once Rs. 67.80 X $ 25,000=Rs. 16,95,000 – Rs. 16,76,250 = Rs. 18,750 is to deducted from closing bank balance of the purpose of reconciliation and also deducted from operating Activity as foreign exchange gain.

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

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

Solution: Classification of activities with reference to AS 3

	Activity	Classification
a.	Brokerage paid on purchased of investments	Investing Activities
b.	Underwriting Commission paid	Financing Activities
c.	Trading Commission received	Operating Activities
d.	Proceeds from sale of investment	Investing Activities
e.	Purchase of goodwill	Investing Activities
f.	Redemption of Preference shares	Financing Activities
g.	Rent received from property held as investment	Investing Activities
h.	Interest paid on long term borrowings	Financing Activities
i.	Marketable securities	Not a Cash equivalent
j.	Refund of Income tax received	Operating activities

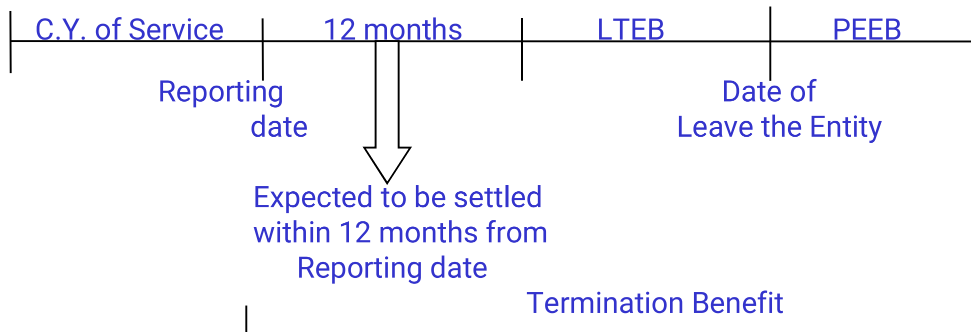
CHAPTER 17 AS 15 – EMPLOYEE BENEFITS

1. Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for termination of employment.

2. Any benefit given by entity to employee against any service rendered in current year, such benefits shall be recorded as expenses (employee benefit) in current year only. [It means employee benefit / expenses shall be recorded on accrual basis].

3. Types of Employee benefits:
   (i) Short term Employee Benefit (STEB)
   (ii) Other Long Term Employee Benefit (LTEB)
   (iii) Post-employment Benefit (PEB)
   (iv) Termination benefit

   For Understanding:



4. Short Term Employee Benefit: those benefit that are expected to be settle wholly before 12 months after the end of annual reporting period in which the employee render to related service. e. g. Bonus, Commission, Leave encashment/paid absence etc.

5. Accounting treatment of STEB:

(i) STEB other than leave encashment:

Employee Benefit A/c	Dr.	XXX	
To employee benefit payable A/C			XXX

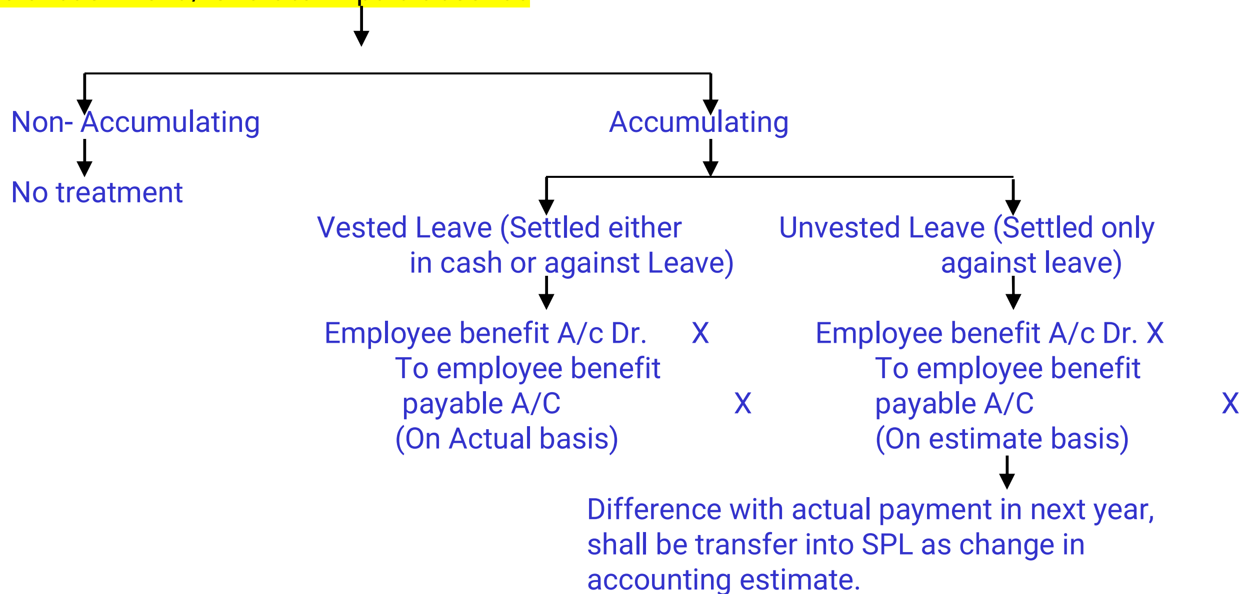
(Amount = such amount either can be fixed or variable)

E.g.: X Ltd. issued a Bonus scheme on the basis of 5% profit of current year, subject to completion of one year of service by employee.
Net profit of Current Year is $ 50 crore & Labour Turnover Ratio is 6%. Pass journal entity to record employee benefit under AS-15.
Solution:

Employee benefit A/c Dr.	2.35	
To employee benefit payable A/c [50cr.*5%*94%]		2.35

*In next year Bonus payable to employee shall be paid on actual basis and any difference shall be charged in to SPL as change in accounting estimate & disclose separately as per IAS - 5.

(ii) Sort term leave encashment / Short term paid absence



6. Post employment employee benefit (PEEB): It is to be settled when employee leave the entity.
These benefits are of two types:
(A) Define contribution plan (B) Define benefit plan/obligation

A. Define Contribution plan: These are those benefits where obligation of employer is limited to the amount that it agrees to contribute into specified fund. All risk & reward of specified fund is lying with employee. Any contribution made by employer shall be considered as an expense for employer and if contribution is pending from the side of employer it shall be considered as short term liability. E.g - PF, ESI, etc.

Journal Entry

Employee benefit A/c (Expenses – in SPL)	Dr.	XXX	
To employee benefit payable A/c			XXX

B. Define benefit plan/obligation: Under this plan employer is required to pay certain amount to employee for which no mandatory contribution is required. All risk & rewards of such obligation is lying with employer. On each reporting date employer records such expense on the basis of actuarial calculation & assumption. E.g. - Gratuity, Pension etc.
Projected Unit Credit Method (PUCM) is used by an entity to determine the PV of its DBO and the related current service cost and, where applicable, past service cost.
Accounting treatment of DBO: For the purpose of recording of present value of DBO, current service cost & interest cost following steps are Applied:-
Step 1: Calculate amount of expected benefit to be paid.
Step 2: Allocate total amount of expected benefit P.A. on the basis of Expected remaining years of service.
Step 3: Calculate current service cost based on PV of allocable amount calculated under step 2.
Step 4: Prepare liability sheet & calculate PV of DBO

Journal Entries

(i) On recognition of expense

Current service cost A/c	xx	
Interest expense A/c	xx	
To PV of DBO A/c		xx

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(ii) On contribution into plan asset

Plan Asset A/C	xx	
To cash and bank A/c		xx

(iii) On benefit paid to employee

(a) On withdrawal of amount from plan asset

Bank A/C	xx	
To plan asset A/c		xx

(b) On amount paid to employee

PV of DBO A/C	xx	
To cash & bank A/c		xx

(iv) On recording of Expected Return:

Plan asset A/C	xx	
To Expected Return		xx

Note 1: If the dates of contribution and benefit payments are missing, assume they occur in the middle of the year.

Note 2: Calculation of amount of expected return

Return on opening balance of plan asset @P.A.	XXX
Add: Return on contribution & benefit paid during the year	XXX
	XXX

(v) On recognition of Actuarial gain or loss at year end:

(a) On PV of DBO

Actuarial Loss A/c	Dr.	xx	
To PV of DBO A/C			xx
OR			
PV of DBO A/C	Dr.	xx	
To Actuarial Gain A/c			xx

(b) On Plan Asset:

Actuarial Loss A/c	Dr.	xx	
To plan asset A/C			xx
OR			
Plan Asset A/C	Dr.	xx	
To Actuarial Gain			xx

Note: Any actuarial gain or loss on PV of DBO and Plan Asset transferred into P&L A/c.

Calculation of Actual Return on Plan Asset:

Particulars		$
Closing fair value of plan asset		XXX
(-) Book value of plan asset		
Opening balance	XXX	
(+) Contribution made	XXX	
(-) Benefit Paid	(XXX)	XXX
Actual Return		XXX

Note: Difference between actual return & expected return shall be record as actuarial gain/loss on plan asset.

7. Some relevant points in regards to D.B.O. and Plan Asset:

(1) **Meaning of plan asset/contributions into plan asset:** Under DBO, company is not liable to make any contribution but for safer side co. can maintains investment for the purpose of benefit paid to employee. Such investment is called Plan asset.
Further, if an entity has a plan asset against DBO, it is called a funded DBO. Plan assets can be maintained by the employer under a multiple employer plan, group employer plan, state plan, or insurance plan.

(2) **Modification in DBO:** Whenever any entity amend the D.B.O. which is in the favour of employee is called modification. For this purpose actuarial calculate amount of past service cost (for vested period) and amount of unamortised past service cost (for unvested period).

Journal Entry

Past service cost A/c (For Vested Period) Dr.	XXX	
Unamortised Past service cost A/c# (For unvested period) Dr.	XXX	
To PV of DBO A/c		XXX

Amount of unamortised pass service cost will be written off over the unvested period.

(3) **Curtailment:** A curtailment occurs when an employer either commit to reduce the number of employee covered by a plan or reduces the benefit under a plan.
Any gain on curtailment shall be transferred into P&L account (means decrease in PV of DBO shall be credited into P&L account)

Journal entry

PV of DBO Account Dr.	XXX	
To SPL account		XXX

Note: Sometime unamortised past service cost is part of DBO then corresponding unamortised past service cost shall be reduced with % of curtailment.

(4) **Settlement** occurs when an entity enters into a transaction that eliminates all obligation of DBO. Any difference in settlement shall be transferred into P&L A/c.

(5) **Some definitions:**

(a) **Benefits paid:** are the amounts paid to retired employees during the period.

(b) **Current service cost:** is the increase in the PV of the obligation arising from employee service in the current period.

(c) **Interest cost:** This is charged to profit or loss and represents the change in the DBO due to the passage in time.

(6) **Presentation in Financial Statement:**

(A) In SPL:

Expenses	
Employee Benefit	
Current service cost	XXX
Interest Cost	XXX
Past service cost	XXX
Amortisation amount of Unamortised PSC	XXX
(-) Expected return on Plan Asset	(XXX)
(±) Actuarial Loss/(Gain) on PV of DBO	XXX
(±) Actuarial Loss/(Gain) on Plan Asset	XXX

(B) In balance sheet: shall be shown in non-current liability under the head long term provision as net off:

PV of DBO	XXX
(-) Plan Asset	(XXX)
(-) Unamortised Past Service Cost (To the extent amount not written off)	(XXX)
	XXX

8. Other Long Term Employee Benefits: These are those benefits which are provided to employee after 12 months from the end of the current year of service. It includes:
   (a) long-term compensated absences such as long-service or sabbatical leave;
   (b) jubilee or other long-service benefits;
   (c) long-term disability benefits;
   (d) profit-sharing and bonuses payable 12 months or more after the end of the period in which the employees render the related services and
   (e) deferred compensation paid 12 months or more after the end of the period in which it is earned.

9. Termination benefit: The termination benefit arises from either:
   (a) An entity decision to terminate the employment or
   (b) An employee decision to accept an entity's offer of benefits in exchange for termination of employment.

   Note: Measurement of termination benefit, if it is expected to be settled
   (a) Within 12 months: shall apply requirement of STEB.
   (b) To be settled after a period of 12 months: shall apply requirement of LTEB.

   # In case benefits is settled after a period of 12 months then benefit shall be recorded by using discount factor.

PRACTICAL QUESTIONS

1. An employee Roshan has joined a company XYZ Ltd. in the year 20X1. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.
   The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring. Thus he will get 5 yearly increment.
   What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%. (P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

   Solution: Calculation of Defined Benefit Obligation (DBO)

   Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%
   = ₹ 24,00,000

   Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

   Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
A	B	C	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	*Opening balance*	*Interestcost*	*Currentservice cost*	*Closing balance*
a	**b**	**c = b x 8%**	**D**	**e = b + c + d**
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

2. The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was ₹ 3,00,000. On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	10.25
Realized gains on plan assets (after tax)	3.00
Fund administrative costs	(3.00)
Expected rate of return	10.25

Calculate the expected and actual returns on plan assets as on 31 st March, 20X2, as per AS 15.

Solution:

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 20X2	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 20X2		3,00,000
Less: Fair value of Plan Assets as on 1st April, 20X1	(2,00,000)	
Add: Contribution received as on 30th September, 20X1	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 20X1		25,000
Actual returns on Plan Assets as on 31st March, 20X2		70,000

3. Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.
Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:
(a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.
(b) The fair value of plan assets on the date is estimated at ₹ 5,100.
(c) The unamortized past service cost is ₹ 180.
(d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

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Solution:

Gain from curtailment is estimated as under:

	₹
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

		₹
Reduced gross obligation (90% of ₹ 6,000)	5,400	
Less: Fair value of plan assets	(5,100)	300
Less: Unamortised past service cost (90% of ₹ 180)		(162)
Liability to be recognised in the balance sheet		138

4. Omega Limited belongs to the engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

   Solution: According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus amount of ₹ 6 lakhs is required to be credited to the profit and loss statement of the current year.

CHAPTER 18 AS 22: ACCOUNTING FOR TAXES ON INCOME

1. This AS is the example of matching concept and accrual concept. This AS is basically calculate tax expenses on the basis of accounting income irrespective of actual tax paid by the entity.

2. Definitions:

(i) 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.

(ii) 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.

(iii) Current tax: is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

(iv) Deferred tax is the tax effect of timing differences.

(v) Timing differences: are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

(vi) Permanent differences: are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

(vii) Tax expense (tax saving): is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.
Tax expense (Tax saving) = Current Tax + Deferred Tax

3. Calculation of amount of deferred tax = Timing difference X Tax rate as per enacted law

4. Deferred tax shall be calculated on reporting date as closing balance and any difference between closing balance & opening balance shall be transferred into SPL.

Format of calculation of deferred tax

Particulars	₹
Opening timing difference	XXX
(+) Addition timing difference	XXX
(-) Deletion of timing difference	(XXX)
Closing timing difference	XXX
Tax rate	%
Closing balance of deferred tax	XXX
(-) opening balance of deferred Tax	(XXX)
Deferred Tax charged / credited into SPL	XXX

5. Journal Entry:

Deferred Tax Asset A/c	Dr.	XXX	
To SPL A/c			XXX
OR			
SPL A/c	Dr.	XXX	
To deferred tax liability A/c			XXX

Note: Sometime DTA / DTL are reversed during the year in that case above Journal entry will be reversed.

6. Presentation of Deferred Tax in Financial Statement

A. In P&L Statement (Extract)

Profit before taxation		XXX
Tax expenses:		
C.Y. Provision	XXX	
± Deferred tax	XXX	(XXX)
Profit after taxation		XXX

B. In Balance Sheet (Extract)

Non-Current Liability		
Deferred tax liability		XXX
Current Liability		
Short term provision		
Provision for tax	XXX	
(-) Advance Tax	(XXX)	XXX
Non-Current Asset		
Deferred tax assets (Net)		XXX
Current Asset		
Advance Tax	XXX	
(-) Provision for tax	(XXX)	XXX

7. Recognition of Deferred Tax

Case 1: In case of Deferred Tax Liability: Recognize as & when it is being arised.

Case 2: In case of Deferred Tax Asset: shall be recorded only on fulfilment of certain conditions:

(i) Para 15: In case company does not have any carry forward of losses or unabsorbed depreciation or both then, DTA should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such DTA can be realised.

(ii) Para 17: Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, DTA should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such DTA can be realised.

8. DTA and DTL should be recorded at their absolute value, not at their present value.

9. **Calculation of deferred tax in case entity is under the tax holiday period:** Under section 80 IA / 80 IB / 80 IC / 10A / 10B etc. - ASI 3 and 5
   (i) Tax holiday period means entities are exempt from payment of tax some specified years.
   (ii) As per ASI 3 and ASI 5
      (a) If any timing difference which arises during tax holiday period are expected to reversal during tax holiday then these timing difference are not relevant for deferred tax.
      (b) If any timing difference which arises during tax holiday period and are expected to reverse in post-tax holiday period then such difference are relevant for calculation of deferred tax.
      (c) For the purpose of reversal of timing difference use FIFO method.

10. Company covered under MAT:
    (i) Current Year provision for tax shall be higher of following two:
        (a) Regular Tax = Taxable income X Regular Tax Rate.
            OR
        (b) Tax under MAT = Book Profit X tax Rate under MAT
    (ii) In case company paid tax under MAT then it is eligible to take benefits of such excess tax paid known as MAT credit = Tax paid under MAT – Regular Tax
    (iii) In a later year if entity has MAT credit and in current year regular tax is more than tax under MAT, then regular tax under MAT is being reduced upto tax payable under MAT provided MAT credit is available to that extent.
    (iv) Deferred Tax shall be calculated as usual by using regular Tax Rate.

PRACTICAL QUESTIONS

1. PQR Ltd.'s accounting year ends on 31st March. The company made a loss of Rs. 2,00,000 for the year ending 31.3.2001. For the years ending 31.3.2002 and 31.3.2003, it made profits of Rs. 1,00,000 and Rs. 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2001, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 2002 and 2003 for tax purposes. Prepare a statement of Profit and Loss for the years ending 2001, 2002 and 2003.

Solution: **Statement of Profit and Loss** **(Rs.)**

	31.03.01	31.03.02	31.03.03
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/adjusted during the Year		(40,000)	(40,000)
Profit(loss) after tax effect	(1,20,000)	60,000	72,000

2. The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(Rs. 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 Rs. 70 Lakhs whereas Depreciation for Tax purposes was Rs. 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 Rs. 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 Rs. 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for Rs. 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.

Solution: Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (Rs.)
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% = Rs. 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% = Rs. 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

3. Milton Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is Rs. 200 lakhs and Rs. 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by Rs.10 lakhs. Assuming tax rate @35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account.

   Answer: In the case of tax free companies, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.

   Of Rs. 200 lakhs, Rs.80 lakhs will reverse in the tax holiday period. Therefore, Deferred Tax Liability will be created on Rs.120 lakhs @ 35% (i.e.) Rs.42 lakhs.

   In the second year, the entire Rs.400 lakhs will reverse only after the tax holiday period.

   Therefore, deferred tax charge in the Profit and Loss Account will be Rs.400 x 35% = 140 lakhs and deferred tax liability in the Balance Sheet will be (42+140) = Rs.182 lakhs.

4. From the following details of A Ltd. for the year ended 31-03-2010, calculate the deferred tax asset/liability as per AS-22

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

Solution:

Tax as per accounting profit 6,00,000 X 20%= Rs. 1,20,000

Tax as per Income-tax Profit 60,000 X 20% =Rs. 12,000

Tax as per MAT 3,50,000 X 7.50%= Rs. 26,250

Tax expense= Current Tax +Deferred Tax

Rs. 1,20,000 = Rs. 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-201

= Rs. 1,20,000 – Rs. 12,000 = Rs. 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2017
Current Tax + Deferred Tax liability + Excess of MAT over current tax
= Rs. 12,000 + Rs. 1,08,000 + Rs. 14,250 (26,250 – 12,000)
= Rs. 1,34,250

CHAPTER 19 AMALGAMATION OF COMPANIES

1. **Amalgamation:** means where two existing companies first opened a new company and transfer their business to the newly opened company.
2. **Absorption:** means where one existing company acquired the business of another existing company.
3. **External reconstruction:** Under external reconstruction the management of existing company first opened a new company and transfer its existing company business to newly opened company.

   Note: For accounting purpose the company who transfer their business are known as transferor Co. (Old Co.) & the company to whom business is transferred is called transferee Co. (New Co.).

4. **This chapter shall be divided into three parts:**
   A. Calculation of Purchase Consideration
   B. Books of Old Company
   C. Books of New Company

A. **Calculation of purchase consideration:**

(1) **Meaning of purchase consideration:** It is the amount
- ➢ which is paid / payable by new company
- ✓ to the shareholders / owners of old company

for acquisition of assets or liabilities of old company (Business of old company).

(2) **Methods of calculating Purchase Consideration(PC):** there are two methods

(a) **Net Asset method:** Formula

Sundry assets taken over at agreed value	XXX
(-) Sundry liabilities taken over at agreed value	XXX
Purchase consideration	XXX

(b) **Net payment method:** PC shall be calculated as follows:

Payment to	Payment in	Working	Amount
Equity shareholder	ES/PS/Debenture/Cash	XXX	XXX
Preference Shareholder	PS/ES/Debenture/Cash	XXX	XXX
↓ Only to shareholder (both equity & preference share)	↓ It can be in any form		

Case I: If swap ratio / exchange ratio is given: Following steps are applied

Step 1: Calculate number of shares issued by new Co. to the shareholder of old Co.
= (Swap Ratio X Number of shares of old company)
⬇
Number of shares issued by new company to the shareholder of old company

Always check fraction here and if any fraction it will settle in cash.

Step 2: Issue price shall be taken in the following order on priority basis.

(a) Issue price; or
(b) market price of new company share; or
(c) intrinsic value of new company share.

In case question gives information about Swap Ratio but no information is given about issue price, MP of new company shares or Intrinsic value of new company share then use face value of New Company share.

Step 3: Calculate PC = (Step 1 X Step 2) + cash fraction (if any)

Case II: If Swap Ratio is missing but value of both the company's shares are given
In that case for the purpose of calculation of number of shares issued by new company to the shareholders of old company we use deemed swap ratio.

Deemed swap ratio = Value of old company share / Value of new company share

Note: The above value can be market price or intrinsic value of both the companies share, and market price of one Co. share and intrinsic value of another Co. share.

While calculating number of share issued by new company to the shareholders of old company by using deemed swap ratio, always check fraction. If any fraction then such fraction shall be settled in cash.

Case III: If both swap ratio as well as value of both Companies shares are not given:
In that case following steps are applied
Step 1: Calculate intrinsic value of that company share whose value is missing.
Step 2: Calculate deemed swap ratio by using value of shares of both the companies.
Step 3: Calculate PC.

Intrinsic Value: it is the value of the share of the company with the assumption that if company got hypothetical liquidation then how much amount is payable per equity share.
Formula:

Sundry assets at market value	XXX
(-) Sundry liabilities at payable value	(XXX)
Net assets	XXX
(-) Amount payable to preference holder	(XXX)
Amount available for equity share holder	XXX
÷ Number of equity share	XXX
Intrinsic value per equity share	XXX

Note 1: If market value or payable value of any assets or liabilities is not given then:

- use agreed value
- if agreed values are not given then use book value.

Note 2: Intrinsic value of a newly opened company
= Paid up value (+) Security premium (if any) (-) Discount (if any).

Case IV: Cash Adjustment: sometime new company agree to pay some cash along with equity share capital to the shareholder of old company as a part of purchase consideration. In such case cash adjustment shall be calculated as follows:

(Value of old Co. share X Number of share of old company) - (Value of new Co. share X Number of share issued by new company)

Value of old Co. share X Number of share of old company	-	Value of new Co. share X Number of share issued by new company
OR		OR
P.C. to be paid		P.C. actually paid except where Shares were issued as par

Note: Cash adjustment is required: in the following two cases

(1) If question gives information for both swap ratio and value of both the Companies shares (values can be market value or intrinsic value).

(2) Question gives information regarding swap ratio and specify new company will pay cash as much as necessary to adjust the right of shareholders of both the companies.
In this case we first calculate Company's intrinsic value of share and then calculate cash adjustment.

Cash adjustment shall be ignored if it has negative balance.

Some important points in relation to P.C.

(i) In case question specify new company will issue its share at face value or par value or new Co. pass JE at par value or face value then issue price will be face value / par value in all above cases.
(ii) In case any mutual indebtness / Contra balance between two companies then it will not affect intrinsic value or amount of PC.

B. Books of old company: Old company get liquidate and its operations are wound-up. Here books of old company means closing of books of Old Co. For this purpose following steps are applied:
Step 1: Transfer all items of balance sheet at book value into Realisation Account, ESH Account, PSH Account and Cash & Bank Account.
1 Equity Share Capital, Reserve and Surplus balance, Debit balance of P & L account and deferred revenue expenditure shall be transferred into equity share holder Account.
2 Preference share capital (if any) shall be transferred into Preference shareholder account.
3 Cash & Bank Account (only positive) and if not taken over by new company transferred into case and bank account.
4 Remaining items of balance sheet shall be transferred into realisation account

Step 2: Raise purchase consideration

New company A/c (at PC)	Dr.	XXX	
To Realisation A/c			XXX

Step 3: On disposal / sale of those assets and payment of that liability which are not taken over by new company:
Case I: On disposal of Asset:

Bank A/c	Dr.	XXX	
To realisation A/c (at realisable value)			XXX

Note: In case question is silent regarding disposal of that asset which was not taken over new company assume Asset has Nil value. (Also give a note in exam)

Case II: On payment of liability:

Realisation A/c (at paid amount)	Dr.	XXX	
To bank A/c			XXX

Note: In case question is silent regarding payment of that liability which was not taken over / assumed by new company assume we settled at the book value.

Step 4: On payment of Amalgamation expenses:
Case I: If amalgamation expenses paid by old company:

Realisation Account	Dr.	XXX	
To bank A/c			XXX

Case II: If amalgamation expenses paid by New company: No entry

Case III: If amalgamation expenses paid by Old Co. and reimbursement by New Co.:

(A) On payment of amalgamation expenses:

Realisation Account	Dr.	XXX	
To bank A/c			XXX

(B) On reimbursement by new company:

Bank A/c	Dr.	XXX	
To Realisation A/c			XXX

OR

New company A/c (to the extent reimbursement by number company)	Dr.	XXX	
Realisation A/c (B/F)	Dr.	XXX	
To cash and bank A/c			XXX
and			
Cash & bank A/c	Dr.	XXX	
To new company A/c			XXX

Step 5: Realised and distribute PC among shareholder as per PC schedule.

Step 6: Packing-up
(i) Close PSH A/c first and any difference shall be transferred into Realisation A/c.
(ii) Close realisation account and any difference shall be transferred into ESH A/c as profit or loss on realisation account.
(iii) Cash and bank balance shall be transferred into ESH A/c and ESH A/c shall be tallied automatically.

Note 1: In case any mutual indebtness / contra balance between two companies then it will not affect books of old company.

Note 2: The procedure of books of old company closed shall remained same irrespective of amalgamation is in the nature of purchase or merger.

C. Books of New Company:
(1) From the point of view of New Company Amalgamation are of two types:
(i) Amalgamation in the nature of Purchase
(ii) Amalgamation in the nature of merger. (also called pooling of interest method).

(2) Amalgamation is in the nature of merger, if it satisfies all the following conditions:
(i) All the assets and liabilities of the transferor company has been transferred.
(ii) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company.
(iii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company become equity shareholders of the transferee Co. by virtue of the amalgamation.
(iv) 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.
(v) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(3) Journal Entries in the books of New Company

S N	Nature of transaction	If Amalgamation is in the nature of Purchase	If Amalgamation is in the nature of merger
1	On the date of agreement	Business Purchased A/c Dr. xxx To Liquidator of Old Co (At PC) xxx	Business Merged A/c xxx To Liquidator of old Co (At P.C) xxx
2	On Acquisition of Assets and Liabilities	Sundry Asset A/c Dr. xxx (At agreed value) Goodwill / Capital Reserve A/c(B/F) To Sundry liabilities A/c xxx (At agreed value) To Business Purchased A/c(At P.C) xxx	Sundry Asset A/c Dr. xxx (At Book value) General Reserve A/c (B/F) To Sundry liabilities A/c xxx (At book value) To All kin of reserve A/c xxx (At book value) To Business Merged A/c (At P.C.) xxx
3	On Payment of Purchase Consideration	Liquidator of old Co. A/c Dr. xxx (At PC) To ESC A/c (at face value) xxx To PSC A/c (at face value) xxx To Other Security A/c (if any) xxx To Security Premium A/c xxx To Cash and Bank A/c etc. xxx	Same entry
4	On Settlement of liability	Liability A/C Dr xxx To Liability A/c (At Face Value) xxx To Security Premium A/c (if any) xxx	Same entry
5	On Cancellation of Mutual indebtness / Contra Balance	Liability A/c Dr. xxx To Asset A/c xxx	Same entry
6	On Payment of Amalgamation Expenses	Goodwill / Capital Reserve A/c Dr xxx To Cash and Bank A/c xxx	General Reserve A/c / P & L A/c Dr. xxx To Cash & Bank A/c xxx
7	On Creation of Statutory Reserve (Note 1 & Note 2)	Amalgamation Adjustment Reserve A/c Dr. xxx To Statutory Reserve A/C xxx	No entry
8	On Issue of share Capital by New Company	Bank A/c To share capital A/c To security premium account if any	Same entry
9	For any other Transaction	As mentioned in question	As mentioned in Question

Note 1: Following are considered as Statutory Reserve and has to be maintained by new company if amalgamation is in the nature of purchase.

(1) Investment allowance Reserve
(2) Export profit Reserve
(3) Shipping Reserve
(4) House project Reserve
(5) Foreign Project Reserve
(6) Site restoration Fund.
(7) Tea Development;/coffee development and Rubber development Account

The above reserve shall be transferred into ESH A/c in the books of old company.

Note 2: Discloser of amalgamation adjustment Reserve:

- Either can be shown in the Reserve and Surplus as a negative item adjusted with statutory Reserve created; OR
- As a separate item under the head non-current Assets, as per guidance note on schedule III-Division I

5. Some Important Points:

(1) Treatment of revaluation of its asset and liability by New Company:
- Its impact shall be taken only on calculation of intrinsic value of new Co.'s share.
- However in case question specify that new company takes effect of revaluation of its assets and liabilities in its books in that case:
  - (a) Effect of Revaluation of PPE in case of Revaluation Surplus: shall be taken through revaluation Surplus / Reserve.
  - (b) Effect of other revaluation: Through Profit and Loss account

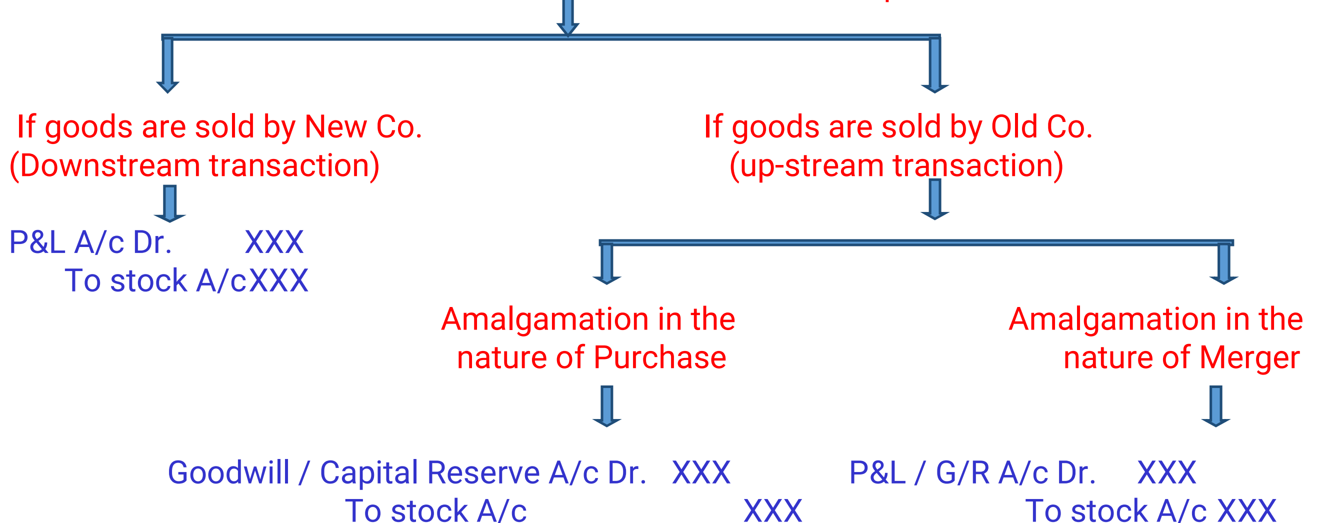
(2) Recognition of unrecorded liability: In case any unrecorded liability for any company (New Company or Old Company) then companies first records such liability through P&L A/C.

P&L A/C	Dr	xxx	
To Liability account			xxx

After recognition of such liability, steps of Amalgamation shall be taken place as usual (after considering such liability).

(3) Treatment of stock reserve / unrealised profit on unsold stock
- (a) Meaning of stock reserve: unrealized profit on unsold stock.
- (b) When stock reserve is to be calculated?
  - A. In case one co. sold goods to another co. within the group at Invoice Price (i.e. cost + profit) and
  - B. Such stock remains unsold with the buyer co. on the date of Amalgamation.
- (c) How to calculate stock reserve?
  = stock held by buyer company X Profit ratio of seller company#

  # Profit ratio of seller Company = [(Profit/Sale) X 100]
- (d) Treatment of stock reserve/Elimination of unrealized profit on stock



Note: Sometime one old company sold goods to another old company in that case pass general entry in a way as in case of old company sold goods to new company.

(4) In case question required Balance Sheet of new company only in that case we can prepared balance sheet of new company, without pass journal entry of acquisition of Assets and liability of old company (without pass JE in the books of New Company).

But for the purpose of calculation of goodwill / capital reserve we apply following formula:

Particulars	Amount (Rs.)
Consideration paid / PC paid	XXX
(+) Amalgamation expensive paid by new company	XXX
(+) Stock reserve in case goods are sold by Old Co. to New Co.	XXX
	XXX
Less: Net assets of old company (At agreed Value)	(XXX)
Goodwill / (Capital Reserve)	XXX

Note: In case amalgamation is in the nature of merger, then

- Net Asset of old company shall include reserve also (excluding general reserve) - [Assets, Liabilities and reserves are taken over at book value]; and
- Any difference shall be transferred into General Reserve.

PRACTICAL QUESTIONS

1. On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(a) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.

(b) Cash payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.

(c) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.

(d) Debentures of Rina Ltd. (₹ 1,20,000) will be converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

Solution: I Calculation of amount of purchase consideration

Particulars	₹
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'.

II. Journal entry relating to discharge of consideration in the books of Tina Ltd.

Liquidation of Rina Ltd.A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Discharge of purchase consideration)		

2. P and Q have been carrying on same business independently. Due to competition in the market, they decided to amalgamate and form a new company called PQ Ltd.

Following is the Balance Sheet of P and Q as at 31.3.2007:

Liabilities	P	Q	Asstes	P	Q
	Rs.	Rs.		Rs.	Rs.
Capital	7,75,000	8,55,000	Plant & Machinery	4,85,000	6,14,000
Current liabilities	6,23,500	5,57,600	Building	7,50,000	6,40,000
			Current assets	1,63,500	1,58,600
	13,98,500	**14,12,600**		**13,98,500**	**14,12,600**

Following are the additional information:

(i) The authorised capital of the new company will be ₹ 25,00,000 divided into 1,00,000 equity shares of ₹ 25 each.

(ii) The assets of P and Q are to be revalued as under:

	P	Q
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

(iii) The purchase consideration is to be discharged as under:

(a) Issue 24,000 equity shares of Rs. 25 each fully paid up in the proportion of their profitability in the preceding 2 year.

(b) Profit for the preceding 2 year are given below:

	P Rs.	Q Rs.
1st year	2,62,800	2,75,125
2nd year	2,12,200	2,49,875
Total	**4,75,000**	**5,25,000**

(c) Issue12% preference shares of Rs. 10 each fully paid up at par to provide income equivalent to 8% return on capita employed in the business as on 31.3.2007 after revaluation of assets of P and Q respectively.

You are required to:

(i) Compute the number of equity and preference shares issued to P and Q.

(ii) Purchase consideration.

Solution: (i) Calculation of equity shares to be issued to P Ltd. and Q Ltd.

Profits of	P	Q
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

The total profits- ₹ 4,75,000+ ₹ 5,25,000= ₹ 10,00,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profits.

	P	Q
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to P Ltd. and Q Ltd.

	P	Q
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued $\left[67{,}200 \times \frac{100}{12}\right] = 5{,}60{,}000$ @ ₹ 10 each	56,000 shares	
$\left[73{,}920 \times \frac{100}{12}\right] = 6{,}16{,}000$ @ ₹ 10 each		61,600 shares

(ii) Total Purchase Consideration

	P	Q
Equity shares @ of ₹25 each	2,85,000	3,15,000
12% Preference shares @ of ₹10 each	5,60,000	6,16,000
Total	8,45,000	9,31,000

Working Note: Calculation of Net assets as on 31.3.20X1

	P	Q
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	(6,23,500)	(5,57,600)
	8,40,000	9,24,000

Note- Since the income from the preference shares shall be equal to the 8% return on assets, the shares are computed in such way that 12% dividend on them shall be equal to 8% of the return on Net assets.

3. 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 (Rs 100 each)	8,20,000	3,20,000	Land & Building	4,50,000	3,40,000
			Furniture & Fittings	1,00,000	50,000
9% Pref. Shares (Rs 100 each)	3,80,000	2,80,000	Plant & Machinery	6,20,000	4,50,000
			Trade receivables	3,25,000	1,50,000
8% Debentures	2,00,000	1,00,000	Inventory	2,33,000	1,05,000
General Reserve	1,50,000	50,000	Cash at bank	2,08,000	1,75,000
Profit & Loss A/c	3,52,000	2,05,000	Cash in hand	54,000	20,000
Unsecured Loan	-	1,75,000			
Trade payables	88,000	1,60,000			
	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 @ Rs18 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.

Solution:

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 (excess payment)	38,000			
		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	
			For Pref.	4,18,000	15,00,400
			By Cash		1,01,700
		16,02,100			16,02,100

8% Debentures holders Account

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	
To	Inventory	1,05,000		consideration)	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**

PQ 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.	Q Ltd.
Payable to preference shareholders:	4,18,000	3,08,000
Preference shares at Rs 22 per share	10,82,400	4,22,400
Equity Shares at Rs 22 per share	1,01,700	61,850
Cash [See W.N. (ii)]	16,02,100	7,92,250

(ii)Value of Net Assets

		P Ltd.		Q Ltd.
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.

4. The financial position of two companies Hari Ltd. and Vayu Ltd. as on 31st March, 2002 was as under:

	Hari Ltd. (Rs.)	Vayu Ltd. (Rs.)
Assets:		
Goodwill	50,000	25,000
Building	3,00,000	1,00,000
Machinery	5,00,000	1,50,000
Stock	2,50,000	1,75,000
Debtors	2,00,000	1,00,000
Cash at Bank	50,000	20,000
	13,50,000	**5,70,000**
Liabilities:		
Share Capital:		
Equity Shares of Rs. 10 each	10,00,000	3,00,000
9% Preference Shares of Rs. 100 each	1,00,000	---
10% Preference Shares of Rs. 100 each	---	1,00,000
General Reserve	70,000	70,000
Retirement Gratuity fund	50,000	20,000
Sundry Creditors	1,30,000	80,000
	13,50,000	**5,70,000**

Hari Ltd. absorbs Vayu Ltd. on the following terms:

1. 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.
2. Goodwill of Vayu Ltd. is valued Rs. 50,000, Building are valued at Rs. 1,50,000 and the Machinery at Rs. 1,60,000.
3. Stock to be taken over at 10% less value and reserve on bad and doubtful debts to the created @ 7.5%.
4. Equity Shareholders of Vayu Ltd. will be issued necessary Equity Shares @ 5% premium.

Prepare necessary Ledger Account to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 2002.

Solution:

In the Books of Vayu Ltd.

Realization Account

		₹			₹
To	Sundry Assets	5,70,000	By	Retirement Gratuity Fund	20,000
To	Preference Shareholders (Premium on Redemption)	10,000	By	Trade payables	80,000
To	Equity Shareholders (Profit on Realization)	50,000	By	Hari Ltd. (Purchase Consideration)	5,30,000
		6,30,000			6,30,000

Equity Shareholders Account

	₹		₹
To Equity Shares of Hari Ltd.	4,20,000	By Share Capital	3,00,000
		By General Reserve	70,000
		By Realization Account (Profit on realization)	50,000
	4,20,000		4,20,000

Preference Shareholders Account

		₹			₹
To	9% Preference Shares of Hari Ltd.	1,10,000	By	Preference Share Capital	1,00,000
			By	Realization Account (Premium on Redemption of Preference Shares)	10,000
		1,10,000			1,10,000

Hari Ltd. Account

		₹			₹
To	Realization Account	5,30,000	By	9% Preference Shares	1,10,000
			By	Equity Shares	4,20,000
		5,30,000			5,30,000

In the Books of Hari Ltd.

Journal Entries

		Dr.	Cr.
Business Purchase A/c	Dr.	5,30,000	
To Liquidators of Vayu Ltd. Account			5,30,000
(Being business of Vayu Ltd. taken over)			
Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Inventory Account	Dr.	1,57,500	
Trade receivables Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Retirement Gratuity Fund Account			20,000
To Trade payables Account			80,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			5,30,000
(Being Assets and Liabilities taken over as per agreed valuation).			

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Particulars		Dr. (₹)	Cr. (₹)
Liquidators of Vayu Ltd. A/c	Dr.	5,30,000	
To 9% Preference Share Capital A/c			1,10,000
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			20,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Hari Ltd. (after absorption) as at 31st March, 2002

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	16,10,000
	B	Reserves and Surplus	2	90,000
2		**Non-current liabilities**		
	A	Long-term provisions	3	70,000
3		**Current liabilities**		
	A	Trade Payables		2,10,000
		Total		19,80,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	11,10,000
	B	Intangible assets	5	1,00,000
2		**Current assets**		
	A	Inventories		4,07,500
	B	Trade receivables	6	2,92,500
	C	Cash and cash equivalents		70,000
		Total		19,80,000

Notes to accounts

	Particulars		₹
1	**Share Capital**		
	Equity share capital		
	1,40,000 Equity Shares of ₹ 10 each fully paid (Out of above 40,000 Equity Shares were issued in consideration other than for cash)		14,00,000
	Preference share capital		
	2,100 9% Preference Shares of ₹ 100 each (Out of above 1,100 Preference Shares were issued in consideration other than for cash)		2,10,000
	Total		16,10,000
2	**Reserves and Surplus**		
	Securities Premium		20,000
	General Reserve		70,000
	Total		90,000
3	**Long-term provisions**		
	Retirement Gratuity fund		70,000
	Total		70,000
4	**Property, Plant and Equipment**		
	Buildings		4,50,000
	Machinery		6,60,000
	Total		11,10,000
5	**Intangible assets**		
	Goodwill		1,00,000
6	**Trade receivables**		3,00,000
	Less: Provision for Doubtful Debts		7,500
			2,92,500

Working Notes:
Purchase Consideration:

	₹
Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Inventory	1,57,500
Trade receivables	92,500
Cash at Bank	20,000
	6,30,000
Less: Liabilities:	
Retirement Gratuity Fund	(20,000)
Trade payables	(80,000)
Net Assets / Purchase Consideration	5,30,000
To be satisfied as under:	
10% Preference Shareholders of Vayu Ltd.	1,00,000
Add: 10% Premium	10,000
1,100 9% Preference Shares of Hari Ltd.	1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium	4,20,000
Total Purchase Consideration	5,30,000

5. 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	
Inventories	10,40,000	7,00,000
Trade Receivables	8,20,000	5,20,000
Cash and Bank	3,00,000	3,00,000
	71,80,000	43,80,000

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.

Solution: **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 borrowings	5	12,00,000
(b) Trade payables	6	4,40,000
(c) 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**

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 considerationother 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
				76,60,000
8.	Inventories			
	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

6. A Limited and B Limited are carrying on business of same nature. On 31st March, 2021 their summarized Balance Sheet was 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
	34,73,000	27,81,000
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
	34,73,000	27,81,000

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 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.

Solution: **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	

Particulars		Dr.	Cr.
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

			Note	₹
		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 considerationother 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

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

		Particulars	Notes	₹ P Ltd	₹ Q Ltd
		Equity and Liabilities			
1		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 of Q Ltd.

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

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

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

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

Prepare:

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

(b) Statement of consideration payable by P Ltd.

Solution:

(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 over from Q Ltd.)			
Property, Plant and Equipment (115% of ₹ 2,50,000)	Dr.	2,87,500	
Inventory (95% of ₹ 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(₹ 40,000 –₹ 30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders of Q Ltd. at a discount of 10%)			

Sundry Creditors of Q Ltd. To Sundry Debtors of P Ltd. (Cancellation of mutual owing)	Dr.	10,000	10,000
Goodwill To Bank (Being liquidation expenses reimbursed to Q Ltd.)	Dr.	30,000	30,000
Capital Reserve To Goodwill (Being goodwill set off)	Dr.	30,000	30,000

(b) Statement of Consideration payable by P Ltd. for 30,000 shares (payment method)

Shares to be allotted (30,000 / 6) X 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		
₹ 1,00,000 × (90 / 100)	₹ 90,000	(ii)
Consideration amount [(i) + (ii)]	**₹ 4,90,000**	

8. 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			
	(a) Share Capital	1	1,650	1,425
	(b) 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	1, 200	1,125
	14% Preference Shares of ₹ 100 each	450	300
		1,650	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 same amount of 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.

Solution:

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 ₹ 10each	1500	
	(Out of which 1,05,00,000 Shares were Issuedfor consideration other than cash)		
	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:				
	$\frac{4,50,00,000}{100}$ i.e. 4,50,000 shares × ₹160 each		720		
	$\frac{3,00,00,000}{100}$ i.e. 3,00,000 shares × ₹160 each				480
	(b) Equity shareholders:				
	$\frac{12,00,00,000 \times 5}{100}$ i.e. 60,00,000 shares x ₹ 35 each		2,100		
	$\frac{11,25,00,000 \times 4}{100}$ i.e. 45,00,000 shares × ₹ 35 each		____		1,575
			2,820		2,055
(2)	Amount of Purchase Consideration				
	Net Assets Taken Over				
	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

Issue of Debentures

Debentures	₹ 90,00,000	₹ 45,00,000
Interest 10%	₹ 9,00,000 $\frac{9,00,000 \times 100}{16}$ = 56,25,000	₹ 4,50,000 $\frac{4,50,000 \times 100}{16}$ = 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.

CHAPTER 20 BUY - BACK OF SECURITIES

This chapter shall be divided into three parts:

(A) Redemption of preference share
(B) Buy-back of equity shares
(C) Bonus shares

A. Redemption of preference shares: As per section 55 of Company Act. 2013 a company can redeemed its preference share capital out of following:
(a) Out of free reserve; or
(b) by making fresh issue; or
(c) A combination of above two.

Journal entries

(i) on completion of conditions of section 55

(a) on making fresh issue

Bank A/c	XXX	
To share capital A/c (Equity and Preference)		XXX

Note: The above capital either can be issued at Par or Premium.

(b) By utilisation of free reserve

Free reserve A/c (Revenue Reserve / General reserve / SPL) Dr.	XXX	
To Capital redemption reserve A/c		XXX

Note: Amount of CRR

Face Value of preference share capital redeemed	XXX
(-) Face Value of new share capital issued	(XXX)
	XXX

(ii) On Redemption of PSC

Redeemable preference share capital A/c	Dr.	XXX	
Premium on redemption of preference shares A/c (if any)	Dr.	XXX	
To Preference shareholders A/c			XXX

(iii) On arrangement of finance: For this purpose company either sold its investment or raised a bank loan or issue of debentures etc.
- Will pass the entry only for those transactions which is specified in the question.
- In case question is silent regarding arrangement of finance assume company have sufficient bank balance

(iv) On payment to preference shareholder

Preference shareholders A/c	Dr.	XXX	
To Bank A/c			XXX

(v) On Written off premium on redemption of preference share capital:

Security Premium A/c	Dr.	XXX	
SPL A/c / Free Reserve A/c Dr. (B/F)		XXX	
To Premium on redemption of preference shares A/c			XXX

B. Buy-back of Equity Shares: As per Sec. 68 a company can buy back of its equity share out of following:
(a) Security premium; or
(b) Out of free reserve; or
(c) by making fresh issue; or
(d) A combination of all above.

Journal entries

(i) On completion of conditions of section 68
(a) On making fresh issue

	Dr.	Cr.
Bank A/c	XXX	
To share capital A/c (Equity and Preference)		XXX

Note: The above capital either can be issued at Par or Premium.

(b) By utilization of reserves

	Dr.	Cr.
Security Premium A/c Dr.	XXX	
Free reserve A/c (Revenue Reserve / General reserve / SPL) Dr.	XXX	
To Capital redemption reserve A/c		XXX

Note: Amount of CRR

Face Value of Equity share capital buy-back	XXX
(-) Face Value of new share capital issued	(XXX)
	XXX

(ii) On Buy-back of ESC

		Dr.	Cr.
Equity share capital A/c (At face value)	Dr.	XXX	
Premium on Buy-back A/c	Dr. (B/F)	XXX	
To Equity shareholders A/c / Equity Share Buy-back A/c (At Buy-Back Price)			XXX

(iii) On arrangement of finance: For this purpose company either sold its investment or raised a bank loan or issue of debentures etc.
- Will pass the entry only for those transactions which is specified in the question.
- In case question is silent regarding arrangement of finance assume company have sufficient bank balance

(iv) On payment to Equity shareholder

	Dr.	Cr.
Equity shareholders A/c / Equity Share Buy-back A/c	XXX	
To Bank A/c		XXX

(v) On Written off premium on Buy back

	Dr.	Cr.
Security Premium A/c Dr.	XXX	
SPL A/c / Free Reserve A/c Dr.	XXX	
To Premium on Buy-back A/c		XXX

Notes:
(i) Free Reserve: are those reserve which are otherwise available for distribution of dividend. E.g. General reserve / Revenue reserve, SPL account, Dividend equalisation reserve etc.
(ii) Capital Redemption Reserve can be utilised only for issue bonus share.
(iii) Security premium is not a free reserve.
(iv) As per Schedule III, buyback of equity share shall be disclosed for 5 years.
(v) Treatment of buyback expenses: shall be charged into P & L account
(vi) Only fully paid – up share can be bought- back

(vii) Limit of buyback: Maximum limit of buyback is lower of three

(a) 25% of paid - up capital (in numbers); or

(b) $\frac{\text{25\% of equity share holder fund}}{\text{Buy-back price}}$

Note: Calculation of equity share holder fund:

Equity share capital	XXX
(+) Free reserve	XXX
(+) Security premium	XXX
	XXX

Equity share holder fund do not include preferences capital and specific reserve.

or

(c) Post buy-back Debt-Equity ratio should be at least 2:1

Here debt includes long term liability as well as short term liability.

C. Issue of bonus share: Bonus shares are issued for capitalisation of profit.

(i) On issue of bonus share capital:

Capital redemption reserve	A/c Dr.	XXX	
Security premium (if realised in cash)	A/c Dr.	XXX	
Capital reserve (if realised in cash)	A/c Dr.	XXX	
Revenue reserve / general reserve	A/c Dr.	XXX	
P & L	A/c Dr.	XXX	
To Bonus to Share Holder A/c			XXX

(ii) On converting bonus share to equity share capital:

Bonus to shareholder	A/c Dr.	XXX	
To equity share capital A/c			XXX

Note: As per Schedule III, Issue of Bonus shares shall be disclosed for 5 years.

PRACTICAL QUESTIONS

1. Kuber Ltd. furnishes you with the following Balance Sheet as at 31st March, 2000:

		(Rs. in crores)
Sources of funds:		
Share Capital:		
Authorized		100
Issued:		
12% redeemable preference share of Rs. 100 each fully paid	75	
Equity shares of Rs. 10 each fully paid	25	100
Reserves and surplus:		
Capital reserve	15	
Share Premium	25	
Revenue Reserves	260	300
		400
Funds employed in:		
Fixed Assets: Cost	100	
Less: Provisions for depreciation	100	NIL
Investments at cost (market value Rs. 400 Cr.)		100
Current assets	340	
Less: Current Liabilities	40	300
		400

The Company redeemed preference shares on 1st April, 2000. It also bought back 50 lakh equity shares of Rs. 10 each at Rs. 50 per share.

The Payments for the above were made out of the huge bank Balance which appeared as part of current assets.
You are asked to:
(i) Pass journal entries to record the above
(ii) Prepare balance sheet

Solution:

(i) Journal entries in the books of Anu Ltd.

₹ in crores

	Particulars		Dr.	Cr.
1st April, 20X1	12% Preference share capital A/c	Dr.	75	
	To Preference shareholders A/c			75
	(Being preference share capital account transferred to shareholders account)			
	Preference shareholders A/c	Dr.	75	
	To Bank A/c			75
	(Being payment made to shareholders)			
	Shares buy-back A/c	Dr.	25	
	To Bank A/c			25
	(Being 50 lakhs equity shares bought back @ ₹50per share)			
	Equity share capital A/c (50 lakhs x ₹10)	Dr.	5	
	Securities premium A/c (50 lakhs x ₹40)	Dr.	20	
	To Shares buy-back A/c			25
	(Being cancellation of shares bought back)			
	Revenue Reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5)			80
	(Being creation of capital redemption reserve to the extent of the face value of preferenceshares redeemed and equity shares bought back)			

(ii) Balance Sheet of Anu Ltd as at 1.4.20X1 **(in crores ₹)**

Particulars			Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	20
	B	Reserves and Surplus	2	280
2		**Current liabilities**		40
		Total		340
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
2		**Current assets (340-25-75)**		240
		Total		340

Notes to accounts

No.	*Particulars*		₹
1	**Share Capital**		
	Authorized, issued and subscribed share capital		
	200 lakhs Equity shares of ₹10 each fully paid		20
	Total		20
2	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4	**Non-Current Investments**		
	Non-current investments at cost (Market value ₹400 Crores)		100

2. X Ltd. furnishes, the following summarized Balance Sheet as at 31-03-2018.

Liabilities	**(in Rs)**	**(in Rs)**
Share Capital		
Equity Share Capital of Rs 20 each fully paid up	50,00,000	
10,000, 10% Preference Share of Rs100 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	3,00,000	
Investment	2,00,000	
Inventory	15,75,000	
Cash and Bank		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 it 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 buyback of share company;
  (a) Issue 3000, 14% debenture of Rs 100 each at a premium of 20%.
  (b) Issue 2500, 10% preference share of Rs100 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 for every 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.

Solution: **In the books of X Limited**

Journal Entries

	Particulars	Dr.(Rs.)	Cr. (Rs.)
1.	Bank A/c Dr.	3,60,000	
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
	(Being 14 % debentures issued to finance buy back)		
2.	Bank A/c Dr.	2,50,000	
	To 10% preference share capital A/c		2,50,000
	(Being 10% preference share issued to finance buy back)		
3.	Bank A/c Dr.	1,50,000	
	To Investment A/c		1,00,000
	To Profit on sale of investment		50,000
	(Being investment sold on profit)		
4.	Equity share capital A/c (62,500 x Rs.20) Dr.	12,50,000	
	Securities premium A/c (62,500 x Rs.16) Dr.	10,00,000	
	To Equity shares buy back A/c (62,500 x Rs.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)		7,50,000
	(Being the utilization of capital redemption reserve to issue 37,500 bonus shares)		
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 Rs.
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

				Rs.
1.	Share Capital			
	Equity share capital (Fully paid up shares of Rs. 20 each)			
	(2,50,000-62,500+37,500 shares)		45,00,000	
	10% preference shares @ Rs. 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	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	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

3. Perrotte Ltd. has the following capital structure as on 31-03-09

		(Rs. In crores)
ESC(Shares of Rs. 10 each fully paid)		330
Reserve & Surplus		
General Reserve	240	
Security premium account	90	
P&L a/c	90	
Infrastructure Development Reserve	180	600
Loan funds		1,800

The shareholders of Perrotte Ltd. have on the recommendation of their Board of Directors approved on 12-9-09 a proposal to buy back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs. 25 per share and in order to induce the existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Reserve is created to satisfy Income-Tax requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either Rs. 1,200 crores or Rs. 1,500 crores.

Assuming that the entire buy back is completed by 09.12.2009, show the accounting entries in the company's books in each situation.

Solution: Statement determining the maximum number of shares to be bought back

Particulars	Number of shares When loan fund is (crores)		
	Rs. 1,800	Rs. 1,200	Rs. 1,500
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy Back (applicable only when loan fund is Rs. 1,200 crores)

			Rs. in crores	
			Debit	Credit
(a)	Equity share buy back account	Dr.	112.5	
	To Bank account			112.5
	(Being buy back of 3.75 crores equity shares of Rs. 10 each @ Rs. 30 per share)			
(b)	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
	To Equity share buy back account			112.5
	(Being cancellation of shares bought back)			
(c)	General reserve account	Dr.	37.5	
	To Capital redemption reserve account			37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1 **Shares Outstanding Test**

Particulars	(Shares in crores)
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. Resources Test

Particulars	
Paid up capital (Rs. in crores)	330
Free reserves (Rs. in crores)	420
Shareholders' funds (Rs. in crores)	750
25% of Shareholders fund (Rs. in crores)	Rs. 187.5 crores
Buy back price per share	Rs. 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3. Debt Equity Ratio Test

	Particulars	When loan fund is(crores)		
		Rs. 1,800	Rs. 1,200	Rs. 1,500
(a)	Loan funds (Rs. in crores)	1,800	1,200	1,500
(b)	Minimum equity to be maintained **after** buy back in the ratio of 2:1 (Rs. in crores)	900	600	750
(c)	Present equity shareholders fund (Rs. in crores)	750	750	750
(d)	Future equity shareholder fund (Rs. in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A
(e)	Maximum permitted buy back of Equity (Rs. in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share (shares in crores) **(See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note: As per Company 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. Also as per the section, on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capita Redemption Reserve (CRR). As per section 80, utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buyback has to be excluded from present equity.

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method. Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$$(750 - x) - 600 = y \qquad (1)$$

$$(y/30*10) = x$$

Or $3x = y$

by solving the above equation we get

x = Rs. 37.5 crores

y = Rs. 112.5 crores

CHAPTER 21 CONSOLIDATED FINANCIAL STATEMENTS

1. Calculation of Cost of Control on the date of acquisition(DOA):

(a) Meaning: It represents difference between the cost of investment and net assets of S Ltd. on the date of acquisition of Investment in S Ltd.

If cost of investment is > the net assets of S Ltd. = Goodwill

OR

If cost of investment is < the net assets of S Ltd. = Capital Reserve

(b) Formula:

Cost of purchase of shares of S Ltd. /PC paid for Investment		XXX
(-) Pre-acquisition dividend		(XXX)
Net cost of investment		XXX
Less: Share of H Ltd. in the Net Assets of S Ltd. on the date of acquisition		
Paid up value of equity shares including Bonus Shares @% held by H Ltd.	(XXX)	
Paid up value of preference shares @ % held by H Ltd.	(XXX)	
Capital profits of S Ltd. / (Pre-acquisition Profits) @ % held by H Ltd.	(XXX)	(XXX)
Goodwill (if +) capital reserve (if -)		XXX

(c) For the purpose of allocation of profit of S Ltd. into capital profit and revenue profit S Ltd. prepared a statement of allocation of profits of S Ltd.

(i) Capital profit of S Ltd. / Pre-acquisition profit: these are those profits of S Ltd. which belongs up to the date of acquisition of shares of S Ltd. by H Ltd.
In simple words these are those profits of S Ltd. for which S Ltd. makes the payment.
These profits are also called pre-acquisition profits.

(ii) Revenue profit of S Ltd. / Post-acquisition profit: these are those profits of S Ltd. which belongs from the date of acquisition up to the date of consolidation.
In simple words these are those profits which are earned by H Ltd. from S Ltd.
These profits are also called post-acquisition profits

2. Minority Interest: Minority interest is that part of the Net Assets of S Ltd., which is attributable to share owned by outside shareholders but control by H Ltd. on the date of consolidation.

Particulars	Amount
Paid up values of equity shares (including bonus shares) & PS	XXX
Share of minority in profits of S Ltd.	XXX
Share of minority in revenue profits of S Ltd.	XXX
Total	XXX

ADJUSTMENTS

1. Treatment of Abnormal Loss/Gain:
   a. Reverse the effect of Abnormal Gain or loss from where it was adjusted.
   b. Apply time adjustment.
   c. Add abnormal gain and reduce abnormal loss from the profit where it belongs.

2. **Revaluation of PPE of S Ltd. on the date of acquisition:** In case S Ltd. followed cost model on the DOA of shares by P Ltd. then impact of such revaluation is taken in the PPE of S Ltd. with corresponding impact in the capital profit (DOA profit) of S Ltd. The reason for taking fair value of PPE is that P Ltd. purchased share of S Ltd. on the basis of fair value whereas net asset of S Ltd. reflect on the basis of carrying amount (i.e. cost price).

Journal Entry

(a) On revaluation of PPE on the DOA

PPE A/c……………………………Dr.	XXX	
To Capital profit of S Ltd. A/c		XXX
OR		
Capital profit of S Ltd. A/c………Dr	XXX	
To PPE A/c		XXX

(b) On charging of depreciation on revaluation of PPE

(i) In case of Additional depreciation - (Revaluation Profit)

Revenue profit of S Ltd. A/c……………………Dr.	XXX	
To PPE A/c		XXX

(ii) In case of Saving in depreciation- (Revaluation Loss)

PPE A/c…………………………Dr	XXX	
To revenue profit of S Ltd. A/c		XXX

Calculation of additional depreciation/saving in depreciation:-

(i) Under SLM: Revaluation profit/loss X rate of depreciation X Post Acquisition period.

(ii) Under WDV Method:

Depreciation to be charged from date of acquisition upto the date of consolidation on revalued amount	XXX
Less: Depreciation already charged	(XXX)
Additional depreciation/saving in depreciation	XXX

Note: In case question is silent regarding method of depreciation then always calculate additional depreciation / saving in depreciation by using WDV method as followed by ICAI.

3. **Treatment of dividend received in consolidated Financial Statement**

(1) **Treatment of dividend of S Ltd. in AOP:** Following Steps are applied

Step I: Add back dividend deducted from where it was deducted.

Step 2: Apply Time Adjustment.

Step 3: Deduct dividend paid from where it belonged.

(2) In case any pre-acquisition dividend received by H Ltd. credited into P&L A/c (means wrong entry pass by H Ltd. for pre-acquisition dividend) then S Ltd. first pass rectified journal entry in CFS.

Profit & Loss of H Ltd. A/c	Dr.	XXX	
To investments in shares of S Ltd.			XXX

Note 1: If question remain silent, always assume H Ltd. passed wrong entry with regards to pre-acquisition dividend.

Note 2: Rectification entry of pre-acquisition entry of S Ltd. is journalised if all following conditions are fulfilled:

(a) Dividend paid by S Ltd. from capital profit; and
(b) Such dividend has been received by H Ltd.; and
(c) Wrong entry has been passed by H Ltd. (H Ltd. credit dividend received into SPL).

4. Treatment of issue of Bonus Shares by S Ltd.

(i) First Calculate holding Ratio:
(Share held by H Ltd including Bonus Shares / Total share of S Ltd including Bonus shares)X100

(ii) As per SEBI guidelines bonus shares shall be issued from earliest profit that is why we will direct bonus share from earliest profit. (i.e. capital profit except otherwise information given in question or capital profit is not available)

(iii) Adjustment of bonus share in AOP
Case I: Journal Entry of Bonus share issue has not been passed by S Ltd.

(a) Apply time adjustment (If any)
(b) Deduct bonus share from where it belongs.

Case II: Journal Entry of Bonus share issue has been passed by S Ltd.
(a) Add Back bonus share amount from where it has been deducted.
(b) Apply time adjustment (If any)
(c) Deduct bonus share from where it belongs.

Note: ESC of S Ltd. shall be shown in Cost of control and Minority Interest including bonus shares.

5. Cancellation of mutual indebtedness/ mutual balance/Contra balance Mutual Owing:
a. In case of debtor and creditor balance:
- Cancelled as contra Item; and
- Any Difference will be transferred into cash/Goods in transit.

b. In case of common bills:
(a) If such bills are held on reporting date: Cancelled B/R and B/P amount
(b) If such bills are discounted/endorsed till reporting date: Reduce the balance of contingent liability on account of bills discounted / endorsed.

c. In case of investment in debentures:
- Cancelled as contra Item; and
- Any difference between carrying amount of debenture issued and investment in debenture should be profit or loss on cancellation which will be profit or loss for Investor Co.

Journal Entry

Debenture A/c (Face Value - Issuer company)	Dr.	XXX	
P & L A/c (Purchaser Co.) (B/F)			
To Investment in Debenture A/c (Cost price – Purchaser co.)			XXX

6. In case question is silent regarding time period of balance of profit & loss a/c and other reserves, always assume:
(a) Balance of profit & loss A/c is of current year.
(b) Balance of other reserve is opening.

7. Treatment of stock reserve / unrealised profit on unsold stock

(a) Meaning of stock reserve: unrealized profit on unsold stock.

(b) When stock reserve is to be calculated?
A. In case one co. sold goods to another co. within the group at Invoice Price (i.e. cost + profit) and
B. Such stock remains unsold with the buyer co. on the date of Consolidation.

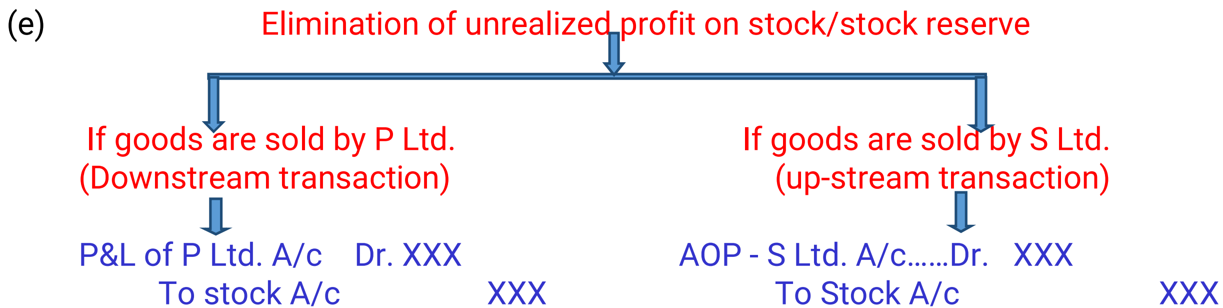
(c) How to calculate stock reserve?
= stock held by buyer company X Profit ratio of seller company#

Profit ratio of seller Company = [(Profit/Sale) X 100]

(d) J.E. for cancellation of Stock Reserve in CFS:

SPL of Sellor Company A/c	Dr.	XXX	
To Stock of Buyer Company A/c			XXX

(e)



Note: Profit of S Ltd. either can be capital profit or revenue profit shall be depends on the date when S Ltd. sold goods to P Ltd.
In case question is silent regarding date of sale of goods by S Ltd. to P Ltd. assume transaction is during post acquisition period.

8. **Treatment of unrealized profit on sale of PPE within a group at a profit/loss:** Same treatment as already discussed in case of stock except unrealized profit on PPE shall be eliminated at net of depreciation.

9. Sometime question does not give information about the reserve and surplus of S Ltd. but give information about the assets and liabilities of S Ltd. on the date of acquisition of control / shares.
In such case calculate value of net assets and minority interest on the basis of market value of assets and payable value of liabilities.

10. **Treatment of loss of subsidiary company:** same treatment as in case of profit. In case of loss net assets of subsidiary company shall be reduced.

11. **Treatment of deferred revenue expenditure of Subsidiary Co.:** same treatment as in case of loss.

12. **Negative balance of Minority Interest:** Some time the losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary.
In such cases, AS 21 prescribes that the excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

13. **Investment in preference share of subsidiary company by holding company:**
(a) Amount of investment in preference share shall be added in the cost of investment in S Ltd.
(b) Further PSC shall be allocated as a part of Net Asset of S Ltd. into cost of control and minority interest in the ratio of % of holding in preference shares.

14. Generally Goodwill / capital reserve is calculated on the date of acquisition is remain same. However in case S Ltd. issued bonus share from its post-acquisition profit then due to capitalisation of profit by S Ltd. Goodwill / Capital reserve shall be changed.

15. Goodwill written off / impaired by Parent company: Written off / impaired goodwill amount shall be charged into Consolidated P & L A/c.

16. Consolidated Statement of P & L: CPL is being prepared in a simple way i.e. aggregating of all income and expenses considered as a single entity business. Any inter-company transactions are to be eliminated in full.
    - If there remains any unrealized profit in the inventory of good, of any of the group co, such unrealized profit is to be eliminated by increasing the cost of sale.
    - If fair value of net assets acquired at the acquisition date were different from the carrying amount specified in subsidiary's books. In such a case, the income and expense should be with reference to those fair values of subsidiary company's Assets and Liabilities.

    Note: In case question required calculation of consolidated P & L transfer into balance sheet in that case such profit shall be calculated as follows:

Particulars	Rs.
Profit calculated as per Consolidated PL	XXX
(-) Share of Minority interest in P & L of S Ltd.	(XXX)
Profit transferred into consolidation Balance Sheet	XXX

17. Accounting policy of preparation of CFS
    (a) CFS shall be prepared on the basis of accounting policy of holding company.
    (b) In case Subsidiary Co. follow different accounting policy then we first update financial statement of Subsidiary Co. on the basis of accounting policy of Holding Co. and then prepared CFS

18. Consolidated Cash Flow Statement: shall be prepared on line by line basis with elimination of intra-group transactions.

19. Investment in Joint Venture:

    (a) Meaning: A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.
    (b) Proportionate Consolidation Method shall be applied: It means all assets and liabilities shall be consolidated to the extent of % of holding by H Ltd. in J Ltd.
    (c) There is no Minority Interest.
    (d) Analyse profits of the Jointly Controlled Entities as pre-acquisition and post-acquisition with reference to date of acquisition as in case of S Ltd.
    (e) Goodwill/Capital Reserve shall be calculated in the same way as in case of S Ltd.
    (f) Mutual Owing and Stock reserve shall be cancelled on proportionate basis. (To the extent of % held by H Ltd. in J Ltd.)

    Note: For exam purpose JV shall be considered as JV only when it is mentioned in question that entity is a JV or entity is jointly controlled, otherwise it shall be considered as an Associate.

20. Investment in Associates: An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary company nor a joint venture of the investor.

(1) Associate should be associate in CFS by applying Equity method as follows:

    (i) Initially recorded at cost.
    (ii) Subsequently, the carrying amount is increased/decreased on the basis of share of profit/loss in the associate.

Journal Entry

(i) On purchase of investment in JV & associates

	Dr	Cr
Investment in Associates A/c.....................Dr	xxx	
To Bank A/c		xxx

(ii) On earned profit/loss by JV and associates.

	Dr	Cr
Investment in Associates A/c......................Dr	xxx	
To P&L A/c		xxx

(iii) On receipt of dividend

	Dr	Cr
Bank A/c...Dr	xxx	
To investment in Associates A/c		xxx

Calculation of Carrying Amount of Investment in A Ltd. on the date of consolidation

Particulars		Rs.
Purchase cost/price or Cost of investment		XXX
It includes:		
Shares in Net Assets of A Ltd.	XXX	
(±) Goodwill / (Capital reserve)	XXX	
(±) Shares in Profit or loss of investment in Associates		XXX
(–) Dividend received from A Ltd.		(XXX)
		XXX

Disclosure of Investment in A Ltd. in CBS as follows:

Particulars	(Rs.)
Non-Current Assets:	
Non-current Investment:	
Investment in Equity shares of A Ltd. (Balance as per Equity Method)	XXX
(Including Goodwill/Capital Reserve# Rs. XXX)	
(This is for presentation purpose only)	

For the purpose of presentation only goodwill/capital reserve shall be calculated as usual.

(2) JE for cancellation of unrealized profit (on proportionate basis)

Case I: If goods are sold by H Ltd. (Down-stream transaction)

	Dr	Cr
CPL A/c Dr.	XXX	
To Investment in Associate Ltd. A/c		XXX

Case II: If goods are sold by A Ltd.(Upward transaction)

	Dr	Cr
Investment in Associate Ltd. A/c Dr.	XXX	
To Stock A/c		XXX

(3) Loss of an Associates: If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value.

Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed.

If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.

PRACTICAL QUESTIONS

1. From the following data, determine in each case:
   (1) Minority interest at the date of acquisition and the date of consolidation.
   (2) Goodwill or Capital Reserve.
   (3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be Rs. 2,00,000 in each case.

Company & % shares owned		Cost	Subsidiary Company – Date of acquisition 1.1.2010: Share Capital	Profit & Loss Account	Consolidation Date 31.12.2010: Share Capital	Profit & Loss Account
		Rs.	Rs.	Rs.	Rs.	Rs.
Case 1	A 90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B 85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C 80%	56,000	50,000	20,000	50,000	20,000
Case 4	D 100%	1,00,000	50,000	40,000	50,000	55,000

Solution:

(1) **Minority Interest = Equity attributable to minorities**

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] ₹	Minority interest as at the date of consolidation [E] X [C + D] ₹
Case 1 [100-90]	10 %	15,000	17,000
Case 2 [100-85]	15 %	19,500	18,000
Case 3 [100-80]	20 %	14,000	14,000
Case 4 [100-100]	NIL	Nil	Nil

A = Share capital on 1.1.2010
B = Profit & loss account balance on 1.1.2010
C = Share capital on 31.12.2010
D = Profit & loss account balance on 31.12.2010

(2) **Calculation of Goodwill or Capital Reserve**

	Shareholding % [F]	Cost [G]	Total Equity [A] + [B]=[C]	Parent's Portion of equity [F] x [C] =H	Goodwill ₹ [G] – [H]	Capital Reserve ₹ [H] – [G]
Case 1	90 %	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85 %	1,04,000	1,30,000	1,10,500	—	6,500
Case 3	80 %	56,000	70,000	56,000	Nil	Nil
Case 4	100 %	1,00,000	90,000	90,000	10,000	—

(3) The balance in the Profit & Loss Account on the date of acquisition (1.1.2010) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2010 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 1.1.2010 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added / (deducted) from holding's P & L [O] = [K] x [N]
1	90 %	50,000	70,000	20,000	18,000
2	85 %	30,000	20,000	(10,000)	(8,500)
3	80 %	20,000	20,000	NIL	NIL
4	100 %	40,000	55,000	15,000	15,000

2. 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.

Solution:	**(Rs. in lakhs)**
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).

3. King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 20X1 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	240
Investments	110
Current Assets	140
Loans & Advances	30
15% Debentures	180
Current Liabilities	100

The following revaluations have been agreed upon (not included in the above figures):
Property, plant and equipment- up by 20% and Investments- down by 10%.
King Ltd. purchased the shares of Queen Ltd. @ ₹20 per share (Face value - ₹10).
Calculate the amount of goodwill/capital reserve on acquisition of shares of Queen Ltd.
Solution: Revalued net assets of Queen Ltd. as on 31st March, 20X1

	₹ in lakhs	₹ in lakhs
PPE [240 X 120%]		288
Investments [110 X 90%]		99
Current Assets		140
Loans and Advances		30
Total Assets after revaluation		557
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		277
King Ltd.'s share of net assets (70% of 277)		193.9
King Ltd.'s cost of acquisition of shares of Queen Ltd. (₹140 lakhs)		(140)
Capital reserve		53.9

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

Particulars	H Ltd. (Rs.)	S Ltd. (Rs.)
Equities and Liabilities:		
Equity Share Capital: Shares of Rs. 10 each	20,00,000	8,00,000
General Reserve (1st April, 2019)	9,60,000	4,20,000
Profit & Loss Account	2,28,800	3,28,000
Preliminary Expenses (1st April, 2019)	-	(20,000)
Bank Overdraft	3,00,000	-

Bills Payable	-	52,000
Trade Payables	1,66,400	80,000
Total	36,55,200	16,60,000
Assets:		
Land and Building	7,20,000	7,60,000
Plant & Machinery	9,60,000	5,40,000
Investment in Equity Shares of S Ltd.	12,27,200	-
Inventories	4,56,000	1,68,000
Trade Receivables	1,76,000	1,60,000
Bills Receivable	59,200	-
Cash in Hand	56,800	32,000
Total	36,55,200	16,60,000

Additional Information:

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

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

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

Solution: Consolidated Balance Sheet of H Ltd. and its subsidiary, S Ltd. as at 31st March, 2020

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	13,07,200
(2) Minority Interest (W.N 4)		2,96,400
(3) Current Liabilities		
(a) Trade Payables	3	2,98,400
(b) Short term borrowings		3,00,000
Total		42,02,000
II. Assets		
(1) Non-current assets		
(i) Property, Plant and Equipment	4	29,34,000
(ii) Intangible assets (W.N.5)		1,60,000
(2) Current assets		
(a) Inventories	5	6,24,000
(b) Trade receivables	6	3,95,200
(c) Cash & Cash equivalents (Cash)	7	88,800
Total		42,02,000

Notes to Accounts

			Rs.	Rs.
1.	Share Capital 2,00,000 equity shares of Rs. 10 each			20,00,000
2.	Reserves and Surplus			
	Reserves		9,60,000	
	Profit & loss			
	H Ltd.	2,28,800		
	S Ltd. (As per W.N. 3)	1,18,400	3,47,200	13,07,200

3.	Trade Payables			
	H Ltd.		1,66,400	
	S Ltd. (80,000+52,000)		1,32,000	2,98,400
4.	Property, Plant and Equipment			
	Land and building			
	H Ltd.	7,20,000		
	S Ltd.	7,60,000	14,80,000	
	Plant & Machinery			
	H Ltd.	9,60,000		
	S Ltd. (As per W.N. 7)	4,94,000	14,54,000	29,34,000
5.	Inventories			
	H Ltd.		4,56,000	
	S Ltd.		1,68,000	6,24,000
6.	Trade Receivables			
	H Ltd.	1,76,000		
	S Ltd.	1,60,000	3,36,000	
	Bills receivable: H Ltd.		59,200	3,95,200
7.	Cash & Cash equivalents			
	Cash			
	H Ltd.		56,800	
	S Ltd.		32,000	88,800

Working Notes:

(1) Share holding pattern

Total Shares of S Ltd 80,000 shares

Shares held by H Ltd 64,000 shares i.e. 80 %;

Minority Shareholding 16,000 shares i.e. 20 %

(2) Capital profits of S Ltd.

	Rs.	Rs.
Reserve on 1st October, 2019 (Assumed there is no movement in reserves during the year and hence balance as on 1st October, 2019 is same as of 31st March 2020)		4,20,000
Profit & Loss Account Balance on 1st April, 2019	1,20,000	
Less: Dividend paid	(80,000)	40,000
Profit for year:		
Total Rs. 3,28,000		
Less: Rs. 40,000 (opening balance)		
Rs. 2,88,000		
Proportionate up to 1st October, 2019 on time basis (Rs. 2,88,000/2)		1,44,000
Reduction in value of Plant & Machinery (WN 6)		(50,000)
		5,54,000
Less: Preliminary expenses written off		(20,000)
Total Capital Profit		5,34,000
Holding company's share (5,34,000 X 80%)		4,27,200
Minority Interest (5,34,000 X 20%)		1,06,800

Note: Preliminary expenses as on 1st April, 2019 amounting Rs. 20,000 have been written off.

(3) **Revenue profits of S Ltd.**

Profit after 1st October, 2019 (3,28,000 - 40,000)/2		1,44,000
Less 10% depreciation on Rs.5,20,000 for 6 months	(26,000)	
Add: Depreciation already charged for 2nd half year on 6,00,000	30,000	4,000

		1,48,000
Holding company's share (1,48,000 X 80%)		1,18,400
Minority Interest (1,48,000 X 20%)		29,600

(4) Minority interest

Par value of 16,000 shares (8,00,000 X 20%)	1,60,000
Add: 1/5 Capital Profits [WN 2]	1,06,800
1/5 Revenue Profits [WN 3]	29,600
	2,96,400

(5) Cost of Control

Amount paid for 64,000 shares		12,27,200
Less:		
Par value of shares (8,00,000 X 80%)	6,40,000	
Capital Profits – share of H Ltd. [WN 2]	4,27,200	(10,67,200)
Cost of Control or Goodwill		1,60,000

(6) Calculation of revaluation loss on Plant and Machinery of S Ltd. on 1st October, 2019

	Rs.
Value of plant and machinery as on 1st April,2019	6,00,000
Less: Depreciation for the six months	(30,000)
Value of plant and machinery as on 1st October, 2019	5,70,000
Less: Plant and machinery valued by H Ltd. on 1st October,2019	(5,20,000)
Revaluation Loss	50,000

(7) Value of plant & Machinery of S Ltd. On 31st March,2020

Value of machinery on 1st October, 2019	5,20,000
Less: depreciation for next six month	(26,000)
	4,94,000

5. On 31st March, 2004 the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Liabilities	H Ltd. Rs. in lakhs	S Ltd. Rs. in lakhs
Share Capital:		
Authorised	15,000	6,000
Issued and Subscribed:		
Equity Shares of Rs. 10 each, fully paid up	12,000	4,800
General Reserve	2,784	1,380
Profit and Loss Account	2,715	1,620
Bills Payable	372	160
Sundry Creditors	1,461	854
Provision for Taxation	855	394
Dividend Payable	1,200	-------
	21,387	**9,208**

Assets	H Ltd. Rs. in lakhs	S Ltd. Rs. in lakhs
Land and Buildings	2,718	-----
Plant and Machinery	4,905	4,900
Furniture and Fittings	1,845	586
Investments in shares in S Ltd.	3,000	-----
Stock	3,949	1,956

Debtors	2,600	1,363
Cash and Bank Balances	1,490	204
Bills Receivable	360	199
Sundry Advances	520	-------
	21,387	**9,208**

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 1st April, 2003 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at Rs. 3,000 lakh and 1,200 lakh respectively.

(b) On 4th July, 2003 S Ltd. declared a dividend @ 20% for the year ended 31st March, 2003. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 2004 S Ltd. issued 3 fully paid-up shares for every 5 shares held as bonus shares out of balances to its general reserve as on 31st March, 2003.

(d) On 31st March, 2004 all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only Rs. 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its creditors.

(e) On 31st March, 2004 S Ltd.'s stock included goods which it had purchased for Rs. 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2004 bearing in mind the requirements of AS 21.

Solution: Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	*Note No.*	*(₹ in Lacs)*
I. Equity and Liabilities		
(1) **Shareholder's Funds**		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) **Minority Interest [W.N.6]**		3,120
(3) **Current Liabilities**		
(a) Trade payables	3	2,802
(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		27,530
II. Assets		
(1) **Non-current assets**		
Property, Plant and Equipment	6	14,954
(2) **Current assets**		
(a) Inventories	7	5,885
(b) Trade receivables	8	4,477
(c) Short term loans and advances	9	520
(d) Cash and cash equivalents	10	1,694
Total		27,530

Notes to Accounts

		(₹ in lacs)	*(₹ in lacs)*
1.	**Share Capital**		
	Authorized share capital		
	Equity shares of ₹10 each, fully paid up		15,000
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up		12,000
	Total		12,000

2.	**Reserves and surplus**			
	Capital Reserve (Note 5)		1,320	
	General Reserve (2,784 + 108)		2,892	
	Profit and Loss Account:			
	H Ltd.	2,715		
	Less: Dividend wrongly credited 360			
	Unrealized Profit 20	(380)		
		2,335		
	Add: Share in S Ltd.'s Revenue profits	612	2,947	
	Total			7,159
3.	**Trade payables**			
	Creditors			
	H Ltd.	1,461		
	S Ltd.	854	2,315	
	Bills Payable			
	H Ltd.	₹ 372		
	S Ltd.	₹ 160		
		₹ 532		
	Less: Mutual owing	₹ (45)	487	2,802
4.	**Short term provisions**			
	Provision for Taxation			
	H Ltd.		855	
	S Ltd.		394	
	Total			1,249
5.	**Other current liabilities**			
	Dividend payable			
	H Ltd.			1,200
6.	**Property, plant and equipment**			
	Land and Buildings			
	H Ltd.		2,718	
	Plant and Machinery			
	H Ltd.	₹ 4,905		
	S Ltd.	₹ 4,900	9,805	
	Furniture and Fittings			
	H Ltd.	₹ 1,845		
	S Ltd.	₹ 586	2,431	
	Total			14,954

7.	**Inventories**			
	Stock			
	H Ltd.		3,949	
	S Ltd.		1,956	
			5,905	
	Less: Unrealized profit		(20)	5,885
8.	**Trade receivables**			
	Debtors			
	H Ltd.	₹ 2,600		
	S Ltd.	₹ 1,363	3,963	
	Bills Receivable			
	H Ltd.	₹ 360		
	S Ltd.	₹ 199		
		₹ 559		
	Less: Mutual Owing	₹ (45)	514	4,477
9.	**Short term loans and advances**			
	Sundry Advances			520
10.	**Cash and cash equivalents**			
	Cash and Bank Balances			1,694

Share holding pattern of S Ltd.

Shares as on 31st March, 20X1 (Includes bonus shares issued on 1st January, 20X1)	480 lakh shares (4,800 lakhs/ ₹ 10)
H Ltd.'s holding as on 1st April, 20X0	180 lakhs
Add: Bonus received on 1st January, 20X1	108 lakhs (180 / 5 × 3)
Total H Ltd.'s holding as on 31st March, 20X1	288 lakhs i.e. 60 % [288/480×100]
Minority Shareholding	40%

Working Notes:

1. S Ltd.'s General Reserve Account

		₹ in lakhs			₹ in lakhs
To	Bonus to equity shareholders (WN-8)	1,800	By	Balance b/d	3,000
To	Balance c/d	1,380	By	Profit and Loss A/c (Balancing figure)	180
		3,180			3,180

2. S Ltd.'s Profit and Loss Account

		₹ in lakhs			₹ in lakhs
To	General Reserve [WN 1]	180	By	Balance b/d	1,200
To	Dividend paid (20% on ₹3,000 lakhs)	600	By	Net Profit for the year* (Balancing figure)	1,200
To	Balance c/d	1,620			
		2,400			2,400

***Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.**

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60%	
(General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	(720)
Share of Minority Shareholders (40%)	480

Note: The question can also be solved by taking ₹ 1,020 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 – ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less dividend paid (₹ 1,200 – ₹ 600)	600
	1,800

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

Minority interest = ₹ 1,800 – ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

	₹ in lakhs
Paid up value of shares held (60% of ₹4,800)	2,880
Add: Share in capital profits [WN 4]	1,080
	3,960
Less: Cost of shares less dividend received (₹ 3,000 – ₹ 360)	(2,640)
Capital reserve	1,320

6. Calculation of Minority Interest

	₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	720
	3,120

7. Unrealized profit in respect of inventory

= ₹ 100 lakhs X 25 / 125

= ₹ 20 lakhs

8. Computation of bonus to equity shareholders

	₹ In lakhs
Shares as on 31 March 20X1 including bonus share issued on 1 January 20X1	4,800
Or we can say these are 1 + 3/5 or 8/5	
i.e. Shares before bonus issue should have been 4,800 ÷ 8/5	
Accordingly, bonus issue would be (4,800-3,000)	1,800

6. On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of ₹ 10 each fully paid	15,00,000
Pre-incorporation profits	30,000
Profit and Loss Account	60,000
Trade payables	1,05,000

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

	P Ltd. (₹)	Q Ltd. (₹)
Equity shares of ₹ 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	–
Pre-incorporation profits	–	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (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.

Solution: Shareholding pattern

Particulars	Number of Shares	% of holding
a. P Ltd.		
(i) Purchased on 31.03.20X1	1,05,000	
(ii) Bonus Issue (1,05,000/2)	52,500	
Total	1,57,500	70%
b. Minority Interest	67,500	30%

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 20X3:

(a) Before issue of bonus shares

		₹	₹
(i)	**Cost of control/capital reserve**	**₹**	**₹**
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (Share Capital)	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control (i.e., Goodwill)		87,000
(ii)	**Minority Interest**		**₹**
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account – P Ltd.**		**₹**
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

		₹	₹
(i)	**Cost of control/capital reserve**	**₹**	**₹**
	Face value of investments (₹ 10,50,000+₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		**₹**
	Share Capital (₹ 4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		**₹**
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note: Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition) (Before and after issue of bonus shares) ₹	Revenue Profits (Post-acquisition)	
		Before Bonus Issue ₹	After Bonus Issue ₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.20X1	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, 20X1 to 31st March, 20X3 (₹ 4,20,000 – ₹ 60,000)		3,60,000	3,60,000
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

7. H Ltd. acquire 70% of equity share of S Ltd. as on 1st January, 2011 at a cost of Rs. 5,00,000 when S Ltd. had an equity share capital of Rs. 5,00,000 and reserve and surplus of Rs. 40,000.
Both the companies follow calendar year as the accounting year.
In the four consecutive years, S Ltd. fared badly and suffered losses of Rs. 1,25,000, Rs. 2,00,000, Rs. 2,50,000 and Rs. 60,000 respectively. Thereafter in 2015, S Ltd. experienced turnaround and registered an annual profit of Rs. 25,000. In the next two years i.e. 2016 and 2017, S Ltd. recorded annual profits of Rs. 50,000 and Rs. 75,000 respectively. Show the Minority Interests and Cost of Control at the end of each year for the purpose of consolidation.
Solution: AS per AS21 consolidated Financial Statements; 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 that the minority has a binding obligation to, and is able to, make good the the losses. If the subsidiary subsequently repots profits, all such profits are allocated to the majority until the minority,s share of losses previously absorbed by the majority has been recovered. **Accordingly,**

Year	Details	Minority Interest (MI) (20%)	Minority's Share of losses borne by H Ltd.	Cost of Control (W.N. 2)
Minority Interest at the time of acquisition i.e. on 01.01.2011		1,62,000 (W.N 1)		1,22,000
For 2011	(1,25,000 x 30%)	(37,500)		
On 31.12.2011		1,24,500		1,22,000
For 2012	(2,00,000 x 30%)	(60,000)		
On 31.12.2012		64,500		1,22,000
For 2013	(2,50,000 x 30%)	(75,000)		
		(10,500)		
	Loss amounting Rs. 10,500 of minority borne by majority shareholders on application of AS 21	10,500	10,500	
On 31.12.2013		Nil	10,500	1,22,000
For 2014	(60,000 x 30%)	(18,000)		
	Loss amounting Rs. 18,000 of minority	18,000	18,000	

	borne by majority shareholders on application of AS 21			
On 31.12.2014 For 2015	(25,000 X 30%) On application of AS 21, profit transferred to majority shareholders	Nil 7,500 (7,500)	28,500 (7,500)	1,22,000
On 31.12.2015 For 2016	(50,000 X 30%) On application of AS 21, profit transferred to majority shareholders	Nil 15,000 (15,000)	21,000 (15,000)	1,22,000
On 31.12.2016 For 2017	(75,000 X 30%) On application of AS 21, profit transferred to majority shareholders to the extent earlier loss was borne by majority share holders	Nil 22,500 (6,000)	6,000 (6,000)	1,22,000
On 31.12.2017		16,500	Nil	1,22,000

Working Notes:

(1) Calculation of Minority Interest as on 01.01.2011

	Total Amount (100%) (Rs)	Minority Interest (20%) (Rs)
Share Capital (30%)	5,00,000	1,50,000
Add: Share in Reserves (30%)	40,000	12,000
		1,62,000

(2) Calculation of Cost of Control

		Rs.
Cost of Investment		5,00.000
Less: Net Asset of S Ltd.		
Share Capital (5,00,000 X 70%)	3,50,000	
Share in Reserves (40,000 X 70%)	28,000	(3,78,000)
Goodwill		1,22,000

8. Consider the following balance sheets of subsidiary B Ltd.:

	2008 (₹)	2009(₹)		2008 (₹)	2009(₹)
Share-Capital			Fixed Assets		
Issued & subscribed			Cost	3,20,000	3,20,000
5,000 equity shares			Less: Accumulated		
of Rs. 100 each	5,00,000	5,00,000	depreciation	48,000	96,000
Reserves & Surplus				2,72,000	2,24,000
Revenue reserves	2,86,000	7,14,000	Investments		
Current Liabilities &			at cost	—	4,00,000
Provisions:			Current Assets:		
Sundry Creditors	4,90,000	4,94,000	Stock	5,97,000	7,42,000
Bank overdraft	—	1,70,000	Sundry Debtors	5,94,000	8,91,000
Provision for taxation	3,10,000	4,30,000	Prepaid Expenses	72,000	48,000
			Cash at Bank	51,000	3,000
	15,86,000	**23,08,000**		**15,86,000**	**23,08,000**

Consider also the following information:

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

(b) A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by ₹12,000 at the end of 2008 and ₹ 34,000 at the end of 2009

(c) B Ltd. deducts 1% from sundry debtors as a general provision against doubtful debts.

(d) Prepaid expenses in B Ltd. include advertising expenditure carried forward of Rs. 60,000 in 2008 and Rs. 30,000 in 2009, being part of initial advertising expenditure of Rs. 90,000 in 2008 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 2008.

Restate the balance sheet of B Ltd. as on 31st December, 2009 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

Solution: As per para 20 and 21 of AS 21, Consolidated financial statements: Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

Adjusted reserves of B Ltd.:

	₹	₹
Reserves as given		7,14,000
Add: Provision for doubtful debts		
{[8,91,000 / 99 X 100]-8,91,000}		9,000
		7,23,000
Less: Reduction in value of Inventory	34,000	
Advertising expenditure to be written off	30,000	(64,000)
Adjusted reserves		6,59,000

Note: No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

Restated Balance Sheet of B Ltd. as at 31st December, 2009

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	6,59,000
(2) Current Liabilities		
(a) Short term borrowings	3	1,70,000
(b) Trade Payables		4,94,000
(c) Short-term provision	4	4,30,000
Total		22,53,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	2,24,000
(b) Non-current Investment		4,00,000
(2) Current assets		
(a) Inventories	6	7,08,000
(b) Trade Receivables	7	9,00,000
(c) Cash & Cash Equivalents		3,000
(d) Other current assets	8	18,000
Total		22,53,000

Notes to Accounts

			20X1 (₹)
1.	**Share capital**		
	5,000 equity shares of Rs 10 each, fully paid up		5,00,000
2.	**Reserves and Surplus**		
	General Reserves (refer to WN)		6,59,000
3.	**Short term borrowings**		
	Bank overdraft		1,70,000
4.	**Short term provisions**		
	Provision for taxation		4,30,000
5.	**Property, plant and equipment**		
	Cost		3,20,000
	Less: Depreciation		(96,000)
	Total		2,24,000
6.	**Inventory**		
	Actual inventory		7,42,000
	Less: Change in method of valuation		(34,000)
	Total		7,08,000
7.	**Trade receivables**		
	Actual trade receivables		8,91,000
	Add: Adjustment for provision		9,000
	Total		9,00,000
8.	**Other current Assets**		
	Prepaid expenses		48,000

9. The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 are given below : (Rs ,000)

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

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

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

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

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

Solution: **Consolidated Statement of Profit & Loss of A Ltd. and its subsidiary B Ltd.**
for the year ended on 31st March, 2022

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	8,797
II. Total revenue		8,797
III. Expenses		
Cost of Material purchased/consumed	3	1,770
Changes of Inventories of finished goods	2	(1,794)
Employee benefit expense	4	1,425
Finance cost	6	225
Depreciation and amortization expense	7	225
Other expenses	5	802
Total expenses		2,653
IV. Profit before Tax(II-III)		6,144
V. Provision for Taxation (1,800 + 300)		(2,100)
VI. Profit after Tax		4,044

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	Revenue from Operations		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealized profits ₹ 180×1/6 x 25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320

	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortization		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225

10. P Ltd. owns 80% of S and 40% of J and 40% of A. J is jointly controlled entity and A is an associate. Balance Sheet of four companies as on 31.03.09 are:

	P Ltd.	S	J	A
Investment in S	800	-	-	-
Investment in J	600	-	-	-
Investment in A	600	-	-	-
Fixed assets	1,000	800	1,400	1,000
Current assets	2,200	3,300	3,250	3,650
Total	5,200	4,100	4,650	4,650
Liabilities:				
Share capital Rs. 1				
Equity share	1,000	400	800	800
Retained earnings	4,000	3,400	3,600	3,600
Creditors	200	300	250	250
Total	5,200	4,100	4,650	4,650

P Ltd. acquired shares in 'S' many years ago when 'S' retained earnings were Rs. 520 lakhs. P Ltd. acquired its shares in 'J' at the beginning of the year when 'J' retained earnings were Rs. 400 lakhs. P Ltd. acquired its shares in 'A' on 01.04.08 when 'A' retained earnings were Rs. 400 lakhs.

The balance of goodwill relating to S had been written off three years ago. The value of goodwill in 'J' remains unchanged.

Prepare the Consolidated Balance Sheet of P Ltd. as on 31.03.09 as per AS 21, 23, and 27.

Solution: Consolidated Balance Sheet of P Ltd. as at 31st March, 2009

Particulars	Note No.	(₹ in Lacs)
I. Equity and Liabilities		
(1) **Shareholder's Funds**		
(a) Share Capital	1	1,000
(b) Reserves and Surplus	2	8,800
(2) **Minority Interest [W.N.3]**		760
(3) **Current Liabilities**		
Creditors	3	600
Total		11,160
II. Assets		
(1) **Non-current assets**		
Property, Plant and Equipment	4	2,360
Goodwill (W.N. 1) (0 + 120)		120
Investment in Associates (W.N. 4)		1,880
(Including Goodwill Rs. 120 lakhs)		
(2) **Current assets**	5	6,800
Total		11,160

Notes to Accounts

		(₹ (₹ in lacs)
1. Share Capital		
Authorized Issued and Subscribed share capital		
Equity shares of ₹1 each, fully paid up		1,000
2. Reserves and surplus		
Retained Earnings (W.N. 2)		8,800
3. Trade payables		
P Ltd.	200	
S Ltd.	300	
J Ltd. (250 X 40%)	100	600
4. Property, plant and equipment		
P Ltd.	1,000	
S Ltd.	800	
J Ltd. (250 X 40%)	560	2,360
5. Current Assets		
P Ltd.	2,200	
S Ltd.	3,300	
J Ltd. (3,250 X 40%)	1,300	6,800

Working Notes:

1. **Computation of Goodwill**

S (subsidiary)

		Rs. in lakhs
Cost of investment		800
Less: Paid up value of shares acquired	320	
Share in pre- acquisition profits of S Ltd. (520 × 80%)	416	736
Goodwill		64
Less: Goodwill written off		64
Balance		Nil

J (Jointly Controlled Entity)

		Rs. in lakhs
Cost of Investment		600
Less: Paid up value of shares acquired (40% of 800)	320	
Share in pre-acquisition profits (40% of 400)	160	480
Goodwill		120

Note: Jointly controlled entity 'J' to be consolidated on proportionate basis i.e. 40% as per AS 27

Associate A (AS 23)		**Rs. in lakhs**
Cost of investment		600
Less: Paid up value of shares acquired (800 x 40%)	320	
Share in pre-acquisition profits (400 x 40%)	160	480
Goodwill		120

2. Consolidated Retained Earnings	**Rs. in lakhs**
P Ltd.	4,000
Share in post acquisition profits of S - 80% X (3,400 – 520)	2,304
Share in post acquisition profits of J - 40% X (3,600 – 400)	1,280
Share in post acquisition profits of A - 40% X (3,600 – 400)	1,280
Less: Goodwill written off of 'S'	(64)
	8,800

3. Minority Interest 'S'	**Rs. in lakhs**
Share Capital (20% of 400)	80
Share in Retained Earnings (20% of 3,400)	680
	760

4. Investment in Associates	**Rs. in lakhs**
Cost of Investments (including goodwill Rs. 120 lakhs)	600
Share of post acquisition profits	1,280
Carrying amount of Investment (including goodwill Rs. 120 lakhs)	1,880

11. A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Solution: Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	**₹**
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1:

ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April 1	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 x 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2:

ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3:

ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹ 4,00,000 + ₹ 5,00,000)	(9,00,000)	
	(4,20,000)	
Add: Goodwill	5,20,000	1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23	**₹**
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) - refer note below	(1,00,000)
Carrying Amount of Investment	-

Consolidated Balance Sheet (Extract) as on March 31, 20X4:

ASSETS

Investment in Associate as per AS 23	**₹**	**₹**
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹ 4,00,000 + ₹ 5,00,000 + ₹ 1,00,000)	(10,00,000)	
	(5,20,000)	
Add: Goodwill	5,20,000	Nil

CHAPTER 22 AS 18: RELATED PARTY DISCLOSURES

1. **Related Party Relationships:** AS 18 deals only with related party relationships described in Para 3 (A) to (E) below:
   (A) Enterprises that directly, or indirectly through one or more intermediaries#, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries & fellow subsidiaries).
   # Meaning of intermediary: Intermediary means subsidiary as mentioned in ASI - 19.

   (B) Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture.

   (C) 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.

Individual's relative includes: spouse, son, daughter, brother, sister, father & mother.

   (D) Key management personnel (KMP) and relatives of such personnel.

KMP: are those persons who have the authority and responsibility ➢ for planning, directing & controlling the activities of the reporting enterprise.

   (E) Enterprises over which any person described in (c) or (d) is able to exercise significant influence.

2. **Not to be related parties:**
   (a) Two companies simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings).
   (b) 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 and
   (c) The parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process).
      (i) Providers of finance
      (ii) Trade unions
      (iii) Public utilities
      (iv) Govt. departments and Govt. agencies including government sponsored bodies.

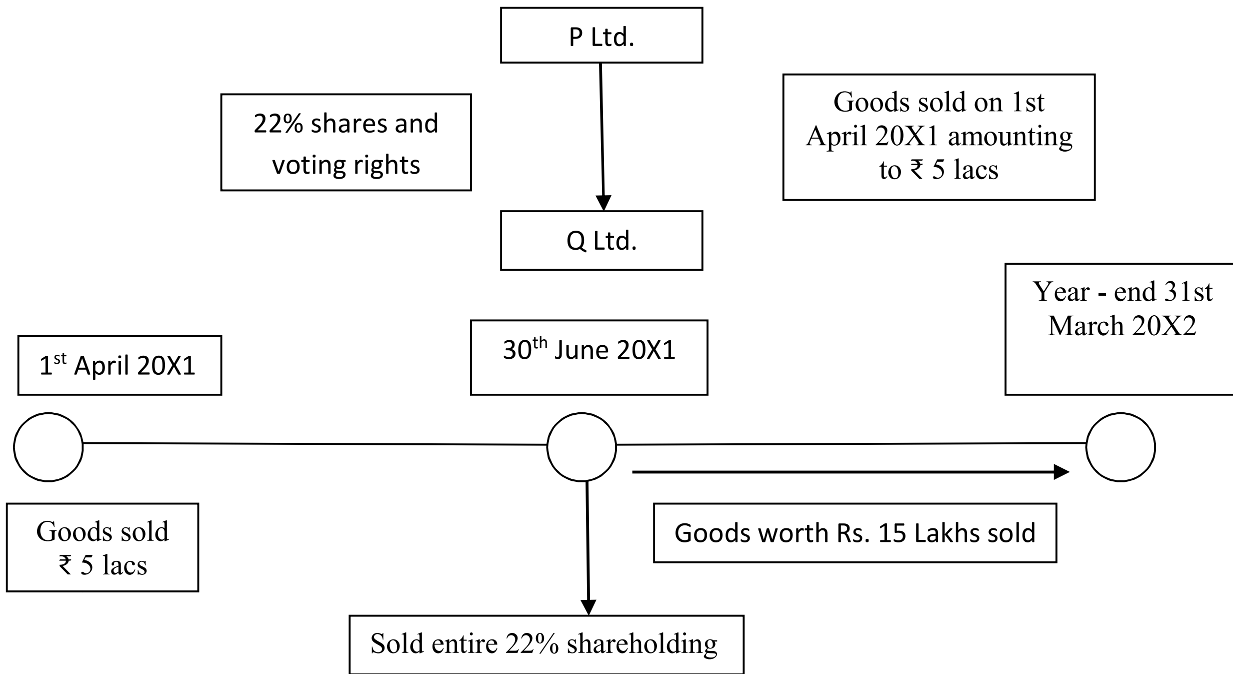
3. Related parties all to be considered as a related party if at any time during the year qualify any one condition of para 3(A) to (E).

4. Transaction between related parties shall be disclosed only for the period in which related party was / is in relationship.

5. Disclosure of AS - 18 is required even if transactions between related parties are at arm-length price or at a normal price.

PRACTICAL QUESTIONS

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



Determine whether the transaction for the entire year (ending on 31st March 20X2) is required to be disclosed under AS-18 as related party transaction.
Solution: No – This is because as per AS-18, the disclosure requirements under the Standard relate only to the period during related party relationship existed.
Accordingly, only transactions between P Ltd and Q Ltd till 30th June 20X1 (being sale of goods worth Rs. 5 lacs) are required to be reported / disclosed under AS- 18.
Transactions entered into after 30th June 20X1 are NOT required to be disclosed under AS-18.

2. 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., She etal Ltd., Care Ltd. and Fair Ltd.)

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

Solution:
(i) As Per AS-18, "Related Party Disclosure"

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

Reporting entity- Sheetal Ltd.

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

Reporting entity- Fair Ltd.

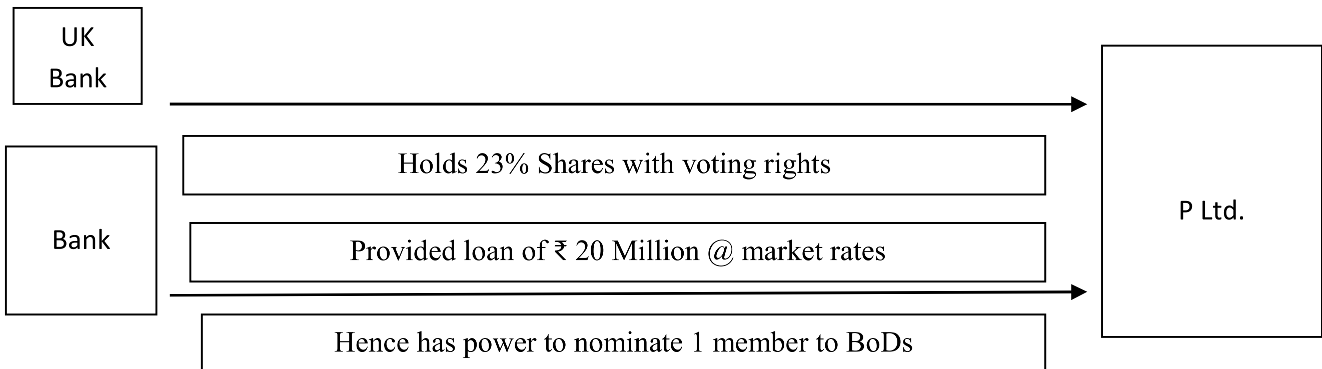
- Maya Ltd. (holding company) is a related party
- Sheetal Ltd. (holding company) is a related party
- Care Ltd. (investor/ investing party) is a related party

Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

(ii) As per Para 3e of AS- 18, ""Related Party Disclosure" Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.
In the given all parties are related to each other.

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



Determine: Whether under AS-18 - UK Bank is a related party to P Ltd. (the reporting enterprise)?
Solution: In the instant case, the UK Bank holds 23% shares with voting rights in P Ltd. and hence is deemed to exercise significant influence over P Ltd.
The bank is also a provider of finance to P Ltd. (the reporting enterprise) and as per AS-18, parties like providers of finance are deemed not to be considered as a related party in the course of normal dealings with an enterprise by virtue only of those dealings. However, this exemption will not be available to UK Bank in this case – since it exercises significant influence over P Ltd. (by virtue of holding 23% shares with voting rights in P Ltd.)
Accordingly, for P Ltd. (the reporting enterprise), the UK Bank is a related party and it will be required to disclose the transactions with UK Bank in its financial statements.

CHAPTER 23 FINANCIAL STATEMENTS OF COMPANIES

1. As per Company Act. 2013, Company prepare its financial statement as per the provision of Schedule III:
   Division 1: is applicable for those companies who follow AS.
   Division II: is applicable for those companies who follow IND AS.
   Division III: is applicable for NBFC.

2. Adjustments:

(1) Dividend Paid: Always paid on paid-up capital. Dividend payable / Dividend are of two types

(A) Final dividend (B) Interim dividend

(i) Final dividend: is a divided which is paid in C.Y but belongs to immediately P.Y and payable on closing capital of immediately P.Y.

(ii) Interim dividend: is a divided which belongs to a period started from first day of the year up to the date of payment. Interim dividend is payable on outstanding capital on the date of payment

(iii) Before paying dividend to ESH, Company pay dividend first to PSH.

(iv) As for AS-4 dividend is not an adjustable event, it shall be disclosed into notes to accounts.

(v) In this chapter for examination purpose:
Case I: If question specify dividend is proposed at year end or declared or proposed in the next year before finalisation of financial statement. Then such dividend is disclosed into notes to accounts (means AS -4 is being followed by company).

Case 2: If question specify dividend is declared at year end and it shall be recorded into books of accounts.
- Reduced from P & L under the head reserve and surplus.
- Shown as liability under the head current liability.

(vi) Journal entry

(a) On declaration of dividend:

P & L Account	Dr.	XXX	
To dividend payable A/c			XXX

(b) On payment of dividend

Dividend payable A/c	Dr.	XXX	
To bank A/c			XXX

(2) Can a company pay dividend out of earlier year profits?
Generally company paid dividend out of current year profit, however a company can pay dividend out of earlier year profits, subject to the fulfilment of the following conditions as per Companies (Declaration and Payment of Dividend) Rules:
(i) The rate of dividend declared should not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year; and
(ii) The total amount to be drawn from such accumulated profits should not exceed 10% of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement; and

(iii) The balance of reserves after such withdrawal should not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

(3) Share forfeited: In case any share is forfeited then amount received shall be credited into Share forfeiture A/c. In case forfeited shares are reissued then amount of forfeited shall be transfer into capital reserve A/c after adjustment of discount on reissue of shares.

(4) Transfer into General reserve / other reserve: In case question specify transfer of profit into general reserve or other reserve, then it will be calculated on profit for the year (i.e. Net Profit). Net Profit means PAT but before any kind of appropriation except otherwise specified.

FORMAT: PART I- BALANCE SHEET

Balance Sheet as at 31st March, 20XX

Particulars	Note No	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I. EQUITY AND LIABILITIES			
(1) Shareholder's Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against share warrants			
(2) Share application money pending allotment			
(3) Non-Current Liabilities			
(a) Long-term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			
(4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
Total			
II.Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment and Intangible Assets			
(i) Property, Plant and Equipment			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other non-current assets			

(2) Current assets (a) Current investments (b) Inventories (c) Trade receivables (d) Cash and cash equivalents (e) Short-term loans and advances (f) Other current assets			
Total			

FORMAT: Part II- STATEMENT OF PROFIT AND LOSS

Profit and Loss statement for the year ended 31st March, 20XX.

Particulars	Note No	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I. Revenue from operations II. Other Income			
III. Total Income (I +II)			
IV. Expenses: Cost of materials consumed Purchase of Stock-in-Trade Changes in inventories of finished goods, work-in-progress and Stock-in-Trade Employee benefit expense Financial costs Depreciation and amortization expense Other expenses			
Total Expenses			
V. Profit before exceptional and extraordinary items and tax (III - IV) VI. Exceptional Items VII Profit before extraordinary items and tax(V-VI) VIII. Extraordinary Items			
IX. Profit before tax (VII - VIII)			
X. Tax expense: (1) Current tax (2) Deferred tax XI. Profit(Loss)from continuing operations(VII-VIII) XII. Profit/(Loss) from discontinuing operations XIII. Tax expense of discounting operations XIV. Profit/(Loss) from Discontinuing operations (XII - XIII)			
XV. Profit/(Loss) for the period (XI + XIV)			
XVI. Earning per equity share: (1) Basic (2) Diluted			

A) General instruction:-

1. Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross referenced to any related information in the notes to accounts.

2. The corresponding amounts for the immediately preceding year to be shown for all items in financial statements including notes except for first financial statements.

3. **Round off:** Depending upon the Total Income of the company, the figures appearing in the Financial Statements shall be rounded off as given below:
   a) Total income < Rs. 100 Crores – Round off to the nearest hundreds, thousands, **lakhs or millions** or decimal thereof.
   b) Total income > Rs. 100 Crores - Round off to **the** nearest lakhs, millions or **crores**, or decimal thereof.
   Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

4. A liability shall be classified as current when it satisfies any of the following criteria:
   (a) it is expected to be settled in the company's normal operating cycle;
   (b) it is held primarily for the purpose of being traded;
   (c) it is due to be settled within twelve months after the reporting date; or
   (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.
   All other liabilities shall be classified as non- current.

5. An asset shall be classified as current when it satisfies any of the following criteria:
   (a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;
   (b) it is held primarily for the purpose of being traded;
   (c) it is expected to be realized within twelve months after the reporting date; or
   (d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.
   All other assets shall be classified as non-current.

6. An operating cycle is the time between the acquisition of assets for processing and their realization in Cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

B) Explanation of Notes:

Part I: Balance Sheet.

SHARE CAPITAL: for each class of share capital (different classes of preference shares to be treated separately)
(a) the number and amount of shares authorized;
(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
(c) par value per share;
(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
(e) shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held;
(f) For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
- Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
- Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
- Aggregate number and class of shares bought back.

(g) Calls unpaid (showing aggregate value of calls unpaid by directors and officers)
(h) Forfeited shares (amount originally paid up)
(i) A company shall disclose Shareholding of Promoters.

RESERVES AND SURPLUS

1. Classification of Reserves and Surplus into
   - Capital reserves
   - Capital Redemption Reserves
   - Securities premium reserves
   - Debenture Redemption Reserve
   - Revaluation Reserve
   - Share Option Outstanding Account
   - Other reserves – (specifying nature, purpose and amount of each reserve)
   - Surplus, showing allocations and appropriations such as dividend, bonus shares and transfer to / from reserves

2. Additions and Deductions since last Balance Sheet date to be shown under each of the specified heads

3. Negative balance of Profit & Loss account, if any, to be shown under the "Surplus" head as a negative figure.

NON-CURRENT LIABILITIES

(a) Long-term Borrowings

(i) Classification of Long term Borrowings into-

a) Bonds / Debentures
b) Term Loans:
   - ✓ From Banks
   - ✓ From Other Parties
c) Deferred Payment liabilities
d) Deposits shown
e) Loans and advances from related parties
f) Long Term maturities of finance lease obligations
g) Other Loans and advances, specifying nature, shown

(ii) Long term Borrowings to be sub-classified as:
- Secured(nature of the security to be specified)
- Unsecured

(iii) Aggregate of loans guaranteed by the following should be disclosed
- Directors
- Others

(b) Other Long-term Liabilities: Classification as:-
- Trade payables
- Others

(c) Long-Term Provisions: Classification of Provisions as:
- Provision for employee benefits
- Others (Specifying nature)

CURRENT LIABILITIES

(a) Short-Term Borrowings

(i) Classification of borrowings as:

(a) Loans repayable on demand
- From banks
- From other parties

(b) Loans and Advances from related parties
(c) Deposits
(d) Other Loans and Advances, specifying nature

(ii) Further sub-classification of the borrowings into:
- Secured(nature of the security to be specified)
- Unsecured

(iii) Aggregate of loans guaranteed by the following should be disclosed:
- Directors
- Others

(b) Trade Payable: The following ageing schedule shall be given for Trade payables due for payment:

Trade Payables ageing schedule **(Amount in Rs.)**

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

similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately;

(c) Other Current Liabilities: Classification of other current liabilities into:

- Current maturities of finance lease obligations
- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings
- Income received in advance
- Application money received for allotment of securities and due for refund and interest accrued thereon.
- Unpaid matured deposits and interests accrued thereon
- Unpaid matured debentures and interest accrued thereon
- Other payables, specifying nature

(d) Short- term Provisions:- Classification of short term provisions into:

- Provision for employee benefits
- Others, specifying nature

NON-CURRENT ASSETS

(i) **Property, Plant and Equipment:**

1. Classification of Tangible Assets into: Land, Buildings, Plant and Equipment, Furniture and fixtures, Vehicles, Office Equipments and Others (specifying nature)
2. Asset under lease shall be shown separately under each class of asset
3. Reconciliation of gross and net carrying amounts of each class of assets at the beginning and end of the reporting period.
4. Where a capital reduction scheme or a revaluation of assets has taken place, every balance sheet subsequent to the reduction or revaluation shall show the reduced/increased figures, the date of the reduction/increase and the amount of reduction / increase for the first 5 years subsequent to the reduction /revaluation.

(ii) **Intangible Assets**

1. Classification of Intangible Assets
2. Reconciliation of gross and net carrying amounts of each class of assets at the beginning and end of the reporting period.
3. Where a capital reduction scheme or a revaluation of assets has taken place, every balance sheet subsequent to the reduction or revaluation shall show the reduced/increased figures, the date of the reduction/increase and the amount of reduction/increase for the first 5 years subsequent to the reduction / revaluation.

(iii) **Capital Work In Progress**

(iv) **Intangible Assets Under Development**

(b) Non-Current Investments

1. Non-current Investments are classified into Trade investments & Other Investments and further classified into
   a) Investments in Property
   b) Investments in Equity instruments
   c) Investments in Preference shares
   d) Investments in Government or trust securities
   e) Investments in Debentures or Bonds
   f) Investments in Mutual funds

g) Investments in Partnership firms
h) Others (specifying nature)

2. Investments carried at other than costs to be separately shown specifying basis of valuation

(d) Long Term Loans and Advances

1. Loans and advances classified into:
   a) Capital Advances
   b) Loans and advances to related parties (giving details thereof)
   c) Other loans and advances (specifying nature)

2. Sub-classification of above as:
   - Secured, considered good
   - Unsecured, considered good
   - Doubtful

3. Allowance for bad and doubtful loans and advances disclosed under relevant heads.

4. Loans and Advances due from:
   - Directors or other officers of the company
   - Amounts due by firms in which any director is a partner
   - Amounts due by private companies in which any director is a director or member.

(e) Other Non-Current Assets

1. Other non-current assets classified into:
   - Long term trade receivables (including deferred credits)
   - Security deposits
   - Others (specifying nature)

2. Long term trade receivables, shall be sub-classified as:
   a) Secured, considered good
   Unsecured, considered good
   Doubtful
   b) Allowance for bad and doubtful loans and advances disclosed under relevant heads.
   c) Loans and Advances due from:
   - Directors or other officers of the company
   - Amounts due by firms in which any director is a partner
   - Amounts due by private companies in which any director is a director or member.
   d) For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule (Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment#					Total
	Less than 6 months	6 months - 1 year	1-2 Years	2-3 Years	More than 3 years	
(i) Undisputed Trade receivables – considered good (ii) Undisputed Trade Receivables – considered doubtful (iii) Disputed Trade Receivables considered good (iv)Disputed Trade Receivables considered doubtful						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.
Unbilled dues shall be disclosed separately.

CURRENT ASSETS

(a) Current Investments

1. Current Investments are classified as follows
   a) Investments in Property
   b) Investments in Equity instruments
   c) Investments in Preference shares

d) Investments in Government or trust securities
e) Investments in Debentures or Bonds
f) Investments in Mutual funds
g) Investments in Partnership firms
h) Others (specifying nature)

2. Following shall be additionally disclosed:
- The basis of valuation of individual investments
- Aggregate book value of Quoted Investments and market value thereof
- Aggregate amount of unquoted investments
- Aggregate provision for diminution in value of investments

(b) Inventories

1. Classification of Inventories into:
a) Raw materials
b) Work in progress
c) Finished goods
d) Stock in trade (in respect of goods acquired for trading)
e) Stores and spares
f) Loose tools
g) Others (specifying nature)

2. Goods-in-transit to be disclosed under relevant sub-head.

3. Mode of Valuation to be stated

(c) Trade Receivables

1. For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule (Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment#					
	Less than 6 months	6 months - 1 year	1-2 Years	2-3 Years	More than 3 years	Total
(i) Undisputed Trade receivables – considered good (ii) Undisputed Trade Receivables – considered doubtful (iii) Disputed Trade Receivables considered good (iv)Disputed Trade Receivables considered doubtful						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.
Unbilled dues shall be disclosed separately.

2. Sub-classification of Trade Receivables:
- Secured, considered good
- Unsecured, considered good
- Doubtful

3. Allowance for bad and doubtful debts disclosed under relevant heads:

4. Debts due from:
- Directors or other officers of the company
- Amounts due by firms in which any director is a partner
- Amounts due by private companies in which any director is a director or member

(d) Cash and Cash Equivalents

1. Classification of Cash and Cash Equivalents into:
a) Balances with Bank
b) Cheques, Drafts on hand
c) Cash on hand
d) Others (specifying nature)

2. The following shall be shown separately :
   a) Earmarked balances with bank.
   b) Balances with bank held as margin money or security against borrowing, guarantees & other commitments.
   c) Repatriation restrictions, if any, in respect of cash and bank balances.
   d) Bank deposits with more than 12 months maturity.

(e) Short Term Loans And Advances

1. Classification of Loans and Advances :
   a) Loans and Advances to Related parties (giving details thereof)
   b) Others (specifying nature)
2. Sub-classification of Loans and Advances :
   a) Secured, considered good
   b) Unsecured, considered good
   c) Doubtful
3. Allowance for bad and doubtful debts disclosed under relevant heads
4. Debts due from:
   - Directors or other officers of the company
   - Amounts due by firms in which any director is a partner
   - Amounts due by private companies in which any director is a director or member

(f) Other Current Assets:

All inclusive heading which incorporates current assets that do not fit in other asset categories.

Contingent Liabilities and Commitments: The following shall be disclosed to the extent not provided for:

1. Classification of Contingent liabilities:
   a) Claims against the company not acknowledged as debts.
   b) Guarantees.
   c) Other money for which the company is contingently liable.
2. Commitments shall be classified as:
   a) Estimated amount of contracts remaining to be executed on capital account and not provided for;
   b) Uncalled liability on shares and other investments partly paid
   c) Other commitments (specify nature).
3. Bills discounted/endorsed.

PROFIT AND LOSS ACCOUNT:

The following shall be disclosed separately by way of notes to accounts:

I. REVENUE FROM OPERATIONS

1. In respect of Company **other than Finance Company**, revenue shall be disclosed separately in notes from:
   - Sale of products
   - Sale of services
   - Grants or donations received (relevant in case of section 8 companies only)
   - Other Operating revenues
   - Less: Excise Duty
2. In respect of **Finance Company**, revenue shall be disclosed separately in notes from:
   - Interest
   - Other Financial Services
3. Gross Income / Sales to be shown under broad heads.

II. OTHER INCOME: Classification of Other Income into:

- Interest Income (except for a finance company)
- Dividend Income
- Net gain / loss on sale of Investments
- Net gain from foreign currency transactions & translations other than those considered as Finance Costs

III. EXPENSES:

a) Employee Benefits Expense: The following shall be shown separately:
- Salaries and Wages
- Contribution to Provident and Other Funds
- Expenses on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP)
- Staff Welfare Expenses

b) Finance Costs: Classification of Finance Cost into:
- Interest Expense
- Other Borrowing Cost
- Net gain / loss from foreign currency transactions and translations

c) Other Expenses
(1) Any item of expenditure which exceed 1% of revenue from operations or Rs.1 lakh, whichever is higher
(2) Adjustments to the carrying amount of investments
(3) Net loss from foreign currency transactions and translations other than those considered as Finance Costs

d) Payment to the Auditors:
- As Auditors
- For Taxation matters
- For Company Law matters
- For Management services
- For other services
- For Reimbursement of expenses

e) Prior Period Items

PRACTICAL QUESTIONS

1. Shweta Ltd. has the Authorised Capital of Rs 15,00,000 consisting of 6,000 6% Preference shares of Rs 100 each and 90,000 equity Shares of Rs10 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 Rs6,000 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 Rs6,000 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 Rs12,000.
(10) Technical Knowhow Fees is to be written off over a period of 10 years.
(11) Trade receivables include Rs 18,000 due for more than six months.

Solution: (a) Balance sheet of Shweta Ltd. as on 31st March, 2018

	Particulars as on 31st March	Note	
(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	6	11,49,900
	(b) Intangible assets	7	4,05,000
	(c) Non-current investments (Shares at cost)		1,50,000
(2)	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	8	2,72,550
	(c) Cash and Cash equivalents – Cash on hand		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.

(b) 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 Income (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	1,50,000
	(d)Finance costs	10	51,900
	(e)Depreciation & Amortization Expenses [10% of (1,05,000 + 6,000)]		11,100
	(f)Other Expenses	11	3,17,550
	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

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.	**Property, Plant and 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		
	Accumulated Depreciation Account: Opening Balance-given in Trial Balance 45,000	1,56,000	
	Depreciation for the year:		
	On Opening WDV at 10% i.e.		
	(10% x 1,05,000) 10,500		
	On additional purchase during the year		
	at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors		
	(a) Debt outstanding 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 Balance amount	6,000	1,50,000
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	51,900
11.	**Other Expenses**		
	Payment tothe auditors	18,000	
	Selling expenses	2,37,300	
	Technical knowhow written of (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x 50%)	2,250	3,17,550

Working Note: Calculation of Sundry Debtors-Other Debts

Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonoured	4,500
	1,54,800
Less: Bad Debts written off – 50% 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

2. The following is the trial balance of Omega Limited as on 31.3.2012

	Debit		Credit
Land at cost	220	Equity capital [shares of Rs. 10 each)	300
Plant and machinery at cost	770	10% debentures	200
Trade receivable	96	General reserves	130
Inventories [31.3.2012]	86	Profit & loss a/c	72
Bank	20	Securities premium	40
Adjusted purchases	320	Sales	700
Factories expenses	60	Trade payables	52
Administration expenses	30	Provision depreciation	172
Selling expenses	30	Suspense a/c	4
Debenture interest	20		
Interim dividend paid	18		
	1,670		1,670

Additional information:

(1) The authorised share capital of the company is 40,000 shares of Rs 10 each.
(2) The company on the advice of independent valuer wish to revalue the land at Rs 3,60,000.
(3) Declared final dividend@10% on 2nd April 2012.
(4) Suspense a/c of Rs 4,000 represents cash received for the sale of some of the machinery on 1.4.11. The cost of machinery was Rs 10,000 and the accumulated depreciation thereon being Rs 8,000.
(5) Depreciation is to be provided on plant & machinery at 10% cost.

You are required to prepare omega limited's balance sheet as on 31.3.2012 statement of profit & loss for the year ended 31.3.2012 as per Schedule III. Ignore previous year figure &taxation.

Solution: **Balance Sheet as at 31st March, 2012**

Particulars	*Note No.*	*(Rs. in 000)*
Equity and Liabilities		
1. Shareholders' funds		
a Share capital	1	300
b Reserves and Surplus	2	500
2. Non-Current liabilities		
A Long term borrowings	3	200

3. Current liabilities		
Trade Payables		52
Total		**1082**
Assets		
1. Non-current assets		
A Property, Plant and Equipment	4	880
2. Current assets		
A Inventories		86
B Trade receivables		96
C Cash and cash equivalents		20
Total		**1082**

Statement of Profit and Loss for the year ended 31st March, 2012

	Particulars	*Notes*	(Rs. *in 000)*
I	Revenue from operations		700
II	Other Income	5	2
III	**Total Income**		**702**
IV	Expenses:		
	Purchases		320
	Finance costs	6	20
	Depreciation (10% of 760)		76
	Other expenses	7	120
	Total Expenses		**536**
v.	**Profit (Loss) for the period** (III – IV)		**166**

Notes to accounts **(Rs. *in 000)***

1. Share Capital				
Equity share capital				
Authorized				
40,000 shares of Rs. 10 each				400
Issued & subscribed & called up				
30,000 shares of Rs. 10 each				300
Total				**300**
2. Reserves and Surplus				
Securities Premium Account				40
Revaluation reserve				140
General reserve				130
Profit & loss Balance				
Opening balance	72			
Profit for the period	166	238		
Less: Appropriations				
Interim Dividend		(18)		220
				500
3. Long term borrowing				
10% Debentures				200
4. Property, Plant and Equipment				
Land				
Opening balance			220	
Add: Revaluation adjustment			140	
Closing balance				360
Plant and Machinery				
Opening balance		770		
Less: Disposed off		(10)		
		760		

Less: Depreciation (172-8+76)	(240)	
Closing balance		520
Total		880

5. **Other Income**

Profit on sale of machinery:		
Sale value of machinery	4	
Less: Book value of machinery (10-8)	(2)	2

6. **Finance costs**

Debenture interest	20

7. **Other expenses:**

Factory expenses	60
Selling expenses	30
Administrative expenses	30
	120

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

3. **On 31st March, 2018, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 2018.**

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
Unpaid Dividend		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	**1,76,24,000**	**1,76,24,000**

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

(1) 50,000 fully paid equity shares were allotted as consideration for land.
(2) The cost of assets were:
Building 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) includes:
Loan taken from Nixes Bank (Amount repayable within one year Rs. 4,80,000) Rs. 13,80,000
Loan taken from Directors Rs. 8,50,000
(8) Bills Receivable for Rs. 1,60,000 maturing on 15th June, 2018 has been discounted.
(9) Short term borrowings includes:
Loan from Naya bank Rs. 1,16,000 (Secured)
Loan 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 2018 as required under Part - I of Schedule III of the Companies Act, 2013. You are not required to give previous year figures.

Solution:

SR Ltd.

Balance Sheet as on 31st March, 2018

		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 borrowings	3	42,66,000
3		Current liabilities		
	a	Short-term borrowings	4	9,40,000
	b	Trade Payables		8,13,000
	c	Other current liabilities	5	2,04,000
	d	Short-term provisions	6	3,80,000
		Total		1,76,09,000
Assets				
1		Non-current assets		
		Property, Plant and Equipment	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
	Total		79,85,000
2.	Reserves and Surplus		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss account	35,000	9,76,000
	Securities premium		15,00,000
	Surplus (Profit & Loss A/c)	5,80,000	
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	Long-term borrowings		
	Secured: Term Loans		
	Loan from Public Finance Corporation [repayable after 3 years (26,30,000 - Rs. 1,34,000 for interest accrued but not due)] Secured by hypothecation of land		24,96,000
	Unsecured		
	Bank Loan (Nixes bank) 9,00,000		
	(Rs 13,80,000-Rs. 4,80,000 repayable within 1year)		
	Loan from Directors 8,50,000		
	Others 20,000		17,70,000
	Total		42,66,000
4.	Short-term borrowings		
	Loan from Nixes bank repayable within one year (Current maturity of Long term borrowing)	4,80,000	
	Loan from Naya bank (Secured)	1,16,000	
	Loan from Directors	48,000	
	Others	2,96,000	9,40,000
5.	Other current liabilities		
	Unpaid dividend	70,000	
	Interest accrued but not due on borrowings	1,34,000	2,04,000
6.	Short-term provisions		
	Provision for taxation		3,80,000
7.	Property, Plant and Equipment		
	Land		25,00,000

	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	Inventories		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	Trade receivables		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	Cash and cash equivalents		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000
11.	Contingent Liabilities and Commitments (to the extent not provided for)		
	Contingent Liabilities:		
	Bills discounted but not matured		1,60,000

4. Due to inadequacy of profits during the year ended 31st March, 2013, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	Rs.
17,500 9% Preference shares of Rs. 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs. 10 each, fully paid up	80,00,000
General Reserves as on 1.4.2012	25,00,000
Capital Reserves as on 1.4.2012	3,00,000
Revaluation Reserves as on 1.4.2012	3,50,000
Net profit for the year ended 31st March, 2013	3,00,000

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

Solution: Amount that can be drawn from reserves for 10% dividend

10% dividend on Rs. 80,00,000		Rs. 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilized from reserves		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. 12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III: The balance of reserves after drawl Rs. 18,42,500 (Rs. 25,00,000 - Rs. 6,57,500) shall not fall below 15 % of its paid up capital ie. Rs. 14,62,500 (15% of Rs. 97,50,000]
Since all the three conditions are satisfied, the company can withdraw Rs. 6,57,500 from accumulated reserves.

5. Alpha Ltd. provides you the following information :

(1) Raw material stock holding period	: 3 months
(2) Work – in- progress holding period	: 1 month
(3) Finished goods holding period	: 5 months
(4) Debtors collection period	: 5 months

You are required to compute the operating cycle of Alpha Ltd. What would happen if the trade is payables of the company are paid in 13 months – whether these should be classified as current or non-current liability?
Solution: According to Schedule III to the Companies Act, 2013 "An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents".
Therefore, operating cycle of Alpha Ltd. will be computed as under:
Raw material stock holding period + Work – in – progress holding period + Finished goods holding period + Debtors collection period
= 3 + 1+ 5 + 5 = 14 months
A Liability shall be classified as current when it is expected to be settled in the Company's normal operating cycle. Since the operating cycle of Alpha Ltd. is 14 months, trade payables expected to be paid in 13 months should be treated as current liability.

6. Sagar Ltd. has issued convertible bonds for ₹ 65 crores which are due to mature on 30th September, 2018.
While preparing financial statements for the year ending 31st March, 2018, company expects that bond holders will not exercise their option of converting bonds to equity shares. How should the company classify the convertible bonds as per the requirements of Schedule-Ill to the Companies Act, 2013 as on 31st March, 2018?
Also state, whether classification of convertible Bonds as per Schedule-III to the Companies Act will change if the company expects that convertible bond holders will convert their holdings into equity shares of Sagar Ltd.
Solution: Schedule III to the companies Act, 2013 provides that:
"A liability should be classified as current when it satisfies any of the following criteria:
(a) it is expected to be settled in the company's normal operating cycle;
(b) it is held primarily for the purpose of being traded;
(c) it is due to be settled within twelve months after the reporting date; or
(d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments and do not affect its classification."
In the present situation, Sagar Ltd. does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date, hence Sagar Ltd. should classify the FCCBs as current liabilities as on 31st March 2018.
The position will be same even when the bond holders are expected to convert their holdings into equity shares of Sagar Ltd. Expectations cannot be called as unconditional rights. Thus, in this situation also, Sagar Ltd. should classify the FCCBs as current liabilities as on 31st March 2018.

CHAPTER 24 AS 1- DISCLOSURE OF ACCOUNTING POLICIES

1. Accounting Policies means specific
   - ➢ accounting principles (e.g. providing deprecation) and
   - ➢ methods(e.g. WDV & SLM)of applying such principles adopted by an enterprise in the preparation and presentation of financial statements.

   ⇒ Accounting principle means solution of accounting problems.

2. The disclosure of the significant accounting policies as such should form part of the Financial Statements and the significant accounting policies should normally be disclosed in one place.

3. Selection of Accounting Policy: In particular, major considerations that govern selection of a particular policy are:

   (A) Prudence: The exercise of prudence in selection of accounting policies ensure that
   (i) profits are not overstated (ii) losses are not understated
   (iii) assets are not overstated & (iv) liabilities are not understated.

   (B) Substance over form: Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely by their legal form.

   (C) Materiality: Financial statements should disclose all 'material items, i.e. the items the knowledge of which might influence the decisions of the user.

4. Fundamental Accounting Assumption: These are three

   a) Going Concern: assumption means it is assumed that entity will continue its operation forever; there is no necessity to liquidate its operation.

   b) Consistency: means accounting policy are forever and there is no necessity to change such policy.

   c) Accrual assumption: means charging of income & expenditure on periodic basis

   Note: These assumptions should not disclose if followed. In case these are not being followed, the fact should be disclosed.

5. The management of entity can also apply alternative accounting policy in different circumstances in which enterprises operate in case where the situation is of diverse and complex nature.

6. Areas in respect of which different accounting policies may be adopted by different enterprises.
   (i) Methods of depreciation, depletion and amortisation.
   (ii) Treatment of expenditure during construction.
   (iii) Valuation of inventories.
   (iv) Treatment of goodwill.
   (v) Valuation of investments.
   (vi) Valuation of fixed assets including revaluation.
   (vii) Basis of Accounting i.e. Historical Cost or Current Cost.
   (viii) Policies relating to depreciation of fixed assets
   (ix) Translation of foreign currency transactions or items
   (x) Treatment of Government Grant
   (xi) Recognition of liability for retirement benefit.
   (xii) Treatment of preliminary or capital issue expenses.

7. In case there is any change in accounting policy which has a material effect then:
   - it should be disclosed in financial statement.
   - The amount by which any item in the financial statement is affected by such change should be disclosed to the extent amount is ascertainable
   - If amount is not ascertainable wholly or in part then facts should be disclosed.

PRACTICAL QUESTIONS

1. In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to Rs. 1,63,000 (on the basis of FIFO method).
   The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to Rs. 1,95,000.
   Discuss disclosure requirement of change in accounting policy as per AS-1.
   Solution: As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
   Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:
   'The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014-15, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs. 16,000.

2. State whether the following statements are 'True' or 'False'. Also give reason for your answer.
   (1) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
   (2) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
   (3) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
   (4) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.
   (5) There is no single list of accounting policies which are applicable to all circumstances.
   Solution:
   (1) **False:** As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.
   (2) **False:** As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.
   (3) **True:** To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.
   (4) **False:** Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
   (5) **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.

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

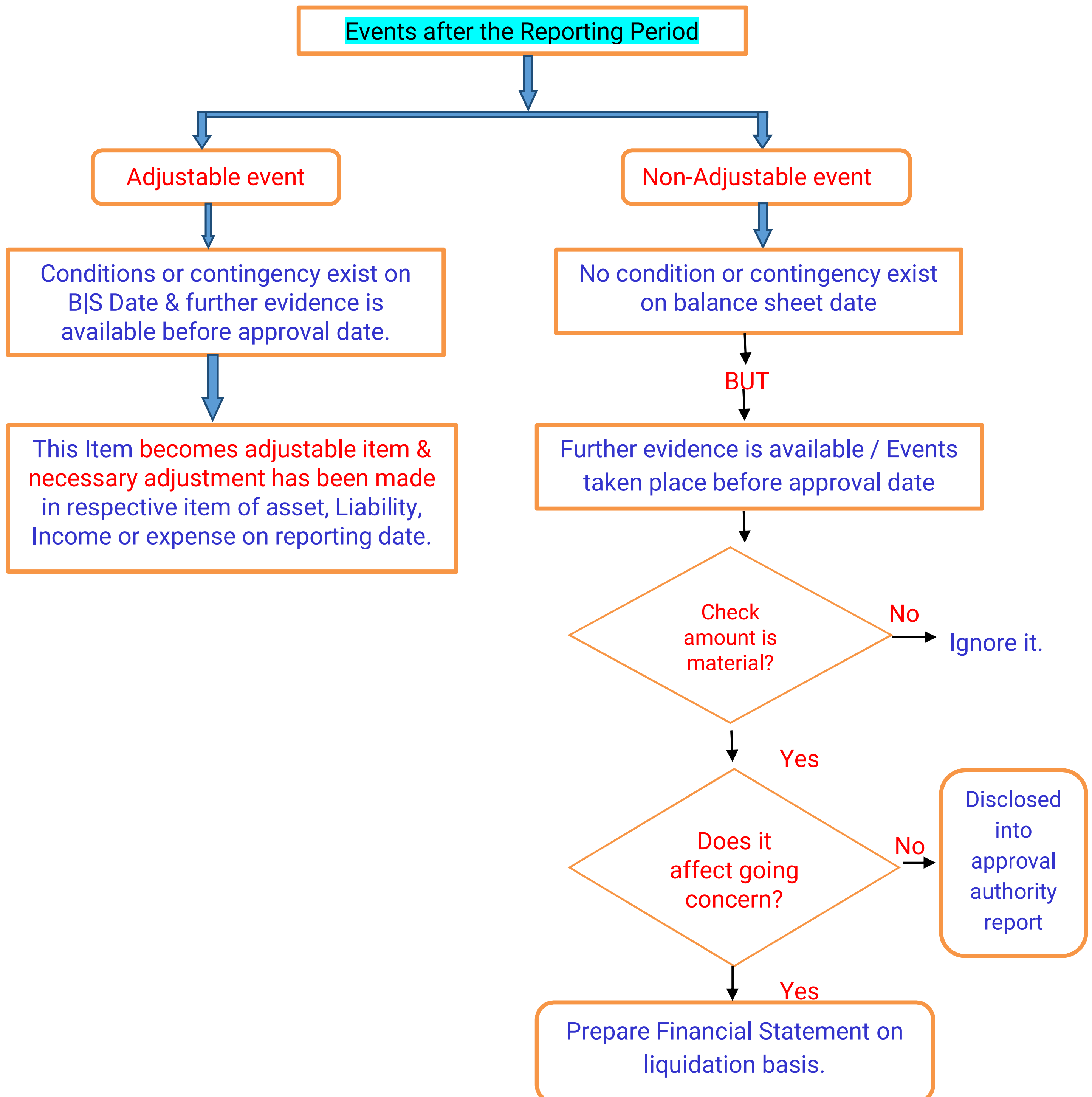
   Solution : Para 17 of AS-1 'Disclosure of Accounting Policies' recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

   Also as per para 10 of the AS 1, 'accrual' is one of the fundamental accounting assumptions.

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

CHAPTER 25 AS 4-CONTINGENCIES & EVENT OCCURRING AFTER BALANCE SHEET DATE

1. Event occurring after Balance sheet date: These are those events which
   (A) Are occurred after B/S date but before approval date of financial statement and
   (B) Such event may be favourable or unfavourable and
   (C) Such event should be significant



2. Contingency: is a condition or Situation, the ultimate outcome of which Gain/ loss which will be determine or known only on the occurrence or Non-occurrence of certain events which are not-within the control of entity. Contingency are of two types
   (A) Contingency which do not give any outflow of resources: Such Contingency are covered under AS-4. For example provision for doubtful on debtor / B/R
   (B) Contingency which Give outflow of resources in future: There contingency are covered under AS-29

3. Proposed dividend: If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognise those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.

PRACTICAL QUESTIONS

1. With reference to AS 4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet date in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5 th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10 th April, 10 days after the year end claiming damages of ₹ 20 lakhs.

(iii) It sends a proposal to sell an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.

(iv) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.

(v) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

Solution: According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. ―Contingencies‖ used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is non-adjusting in nature.

(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the co mpany's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

(iii) In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a non-adjusting event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.

(iv) As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an adjusting event occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.

(v) Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a non-adjusting event and no disclosure is required in the report of the Approving Authority.

2. During the year 2012-2013, Raj Ltd. was sued by a competitor for Rs. 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of Rs. 10lakhs in its financial statements for the year ended 31st March, 2013. On 18th May, 2013, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of Rs. 14 lakhs. The

financial statements were prepared by the company's management on 30th April, 2013, and approved by the board on 30th May, 2013.

Solution: As per para 8 of AS 4 “Contingencies and Events Occurring After the Balance Sheet Date, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information material y affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 2012-13 for which the provision was also made by it, the decision of the Court on 18th May, 2013, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by Rs. 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 2013, it would be considered as post reporting period i.e. event occurred after the approval of the financial statements. In that case, no adjustment in the financial statements of 2012-13 would have been required.

3. AS 4 prescribes that 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 amount relating to conditions existing at the Balance sheet date-generally called adjusting events. “Proposed Dividend” is shown and adjusted in the Balance Sheet even if it is not an adjusting event as per AS 4 because it is proposed by the Board of Directors of the company after the Balance sheet date.

Keeping this in view, is it not a violation of AS 4 to show proposed dividends as current liabilities and provisions? Comment.

Solution: As per para 8.5 of AS-4, There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividend are not recognised as a liability at the balance sheet date because no obligation exist at that time unless a statute requires otherwise. Such dividends are disclosed in notes.

Further as per Para 14 of AS-4 If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognise those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.

So in the given question proposed dividend shall be disclosed into notes to account.

CHAPTER 26

AS 5-NET PROFIT OR LOSS FOR THE PERIOD, PPI & CHANGES IN ACCOUNTING POLICIES

The objective of this accounting standard is special disclosure of some specific items into P&L A/c. These items are of following types

(A) Ordinary activity: These are principal revenue generating activity and ancillary to it.

(i) Disclosure: These activity should be disclosed separately if either these size or nature or both all material.

(ii) Example of ordinary activities which nature is material
- (a) Decline in the value of inventory to NRV as well as reversal;
- (b) Any Profit or loss on sale of fixed assets/Long term investments;
- (c) legislative changes having retrospective application;
- (d) litigation settlements;
- (e) Creation of provision;
- (f) Reversal of provision.

(B) Extra-ordinary Activity: These Activity are those activity which not ordinary Activity
Disclosure: All extra ordinary activity should be disclosed separately. E.g.
- (a) Any loss due to failure of commitment
- (b) Any loss due to fraud.
- (c) Loss due to enemy attack, flood, fire etc.
- (d) Refund of Govt. Grant.
- (e) Attachment of property of the enterprise by government

(C) Prior Period items: Prior period item are those income or expenses which are recorded in current year but pertain to earlier years but not recorded in the earlier years due to any error or omission whether intentionally or unintentionally.

(i) Disclosure: Prior period item should be disclosed always separately.

(ii) Example of items which are considered as prior period item
- (a) Wrong calculation of deprecation.
- (b) Wrong recording of Inventory.
- (c) Not recording or excess/less/double recording of any income or expenses in earlier year.
- (d) Wrong valuation of Inventory etc.

(iii) Examples of items which are not considered as prior period items
- (a) Increase in salary with retrospective effect
- (b) Retrospective raising demand of VAT by Delhi Govt.

(D) Change in Accounting Estimate: In case there is any change in accounting estimate due to new information, the effect of such change will be taken on prospective Basis. In case there is any change in accounting estimate but amount is not quantify then such change will be disclosed into Notes to A/c and mentioned that amount is not quantified.
E.g. Estimate Life of assets is change, change into rate of provision, provision for doubtful debts etc.

(E) Change in Accounting policy

(i) Meaning: Accounting policy are accounting principal and methods of applying those principal. Accounting principal means solution of accounting problem. (AS-1)

(ii) When Accounting policy can be changed: in the following cases
   (a) Any change in law or accounting standard
   (b) For true & fair view of financial statement
   (c) For better presentation of financial statement.

(iii) In case there is any change in accounting policy which has a material effect then:
   - it should be disclosed in financial statement.
   - The amount by which any item in the financial statement is affected by such change should be disclosed to the extent amount is ascertainable
   - If amount is not ascertainable wholly or in part then facts should be disclosed.

(iv) Example: Change in cost formula in measuring the cost of inventories.

Notes:
(i) The option of an accounting policy for event or transaction that different substance from previously occurring event to transaction will not be considered as change in accounting policy
(ii) In case it is not possible to identify whether change in accounting estimate or policy assume change in accounting estimate.

PRACTICAL QUESTIONS

1. Shama was working with ABC Ltd. drawing monthly salary of Rs. 25,000 per month. She went on maternity leave with pay for 7 months i.e. from 1-01-2017 to 31-7-17. Her salary for 3 months was not provided for in financial statements for F.Y. 2016-17 due to omission. When she joined after leave period, the whole salary for 7 months was paid to her. You are required to:
   (i) Pass the necessary journal entries in F.Y. 2017-18 to record the above transaction as per accounting standard-5 and state reason for the same.
   (ii) Would the treatment have been different, if Shama was terminated on 01-01-2017 and was reinstated in service by the court w.e.f. 01-08-2017 with instruction to pay Shama salary for the intervening period i.e. 1-01- 2017 to 31-07-2017.

Solution: As per AS 5 "Net Profit or Loss for the Period", Prior Period Items and Changes in Accounting Policies, the term 'prior period items', refers to 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 nature and amount of prior period items should be separately disclosed in the statement of profit and loss so that their impact on the current profit or loss can be perceived. Hence, in this case salary paid to Shama for 3 months i.e 1.1.2017 to 31.3.2017 Rs. 75,000 will be classified as prior period item in FY 2017-18 and following journal entry shall be passed:

(i) Journal entry in FY 2017-18

Particulars		Dr. (Rs)	Cr. (Rs)
Salary A/c (Rs 25,000 x 4)	Dr.	1,00,000	
Prior period item (Rs 25,000 x 3)	Dr.	75,000	
To Bank A/c			1,75,000
(Salary related to 7 months paid out of which 3'months' salary is prior period item)			

Alternative Entry

Particulars		Dr. (Rs)	Cr. (Rs)
Salary A/c (prior period item)	Dr.	75,000	
To Bank A/c			75,000
(Salary related to 3 months i.e. January, 2017 to March 2017 paid in 2017-2018)			
Salary A/c	Dr.	1,00,000	
To Bank A/c			1,00,000
(Salary related to 4 months paid on 1.8.2017 for April to July, 2017)			

(ii) AS 5 inter alia states that the term 'prior period items' does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period. Accordingly, in the second case though Shama was terminated on 1.1.2017 i.e. in 2016-2017, yet she was reinstated due to court's order in 2017-2018, with the instruction by the court to pay the salary for the intervening period i.e. with retrospective effect from January, 2017. The adjustment of salary of Rs. 75,000 (for January 2017 to March, 2017) would not be considered as prior period item and will be accounted for in the books as current year expense. Thus the entire amount of Salary of Rs. 1,75,000 for January, 2017 to July, 2017 is a current year expense only.

Salary A/c (Rs 25,000 x 7)	Dr.	1,75,000	
To Bank A/c			1,75,000

(Salary related to 7 months paid i.e. for the period 1.1.2017 to 31.7.2017)

2. A company signed an agreement with the Employees Union on 1.9.2007 for revision of wages with retrospective effect from 30.9.2006. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2007-08?
Solution: It is given that revision of wages took place on 1st September, 2007 with retrospective effect from 30.9.2006. Therefore wages payable for the half year from 1.10.2006 to 31.3.2007 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of Rs. 7,50,000 (for 1½ years @ Rs. 5,00,000 per annum) should be included in current year's wages.
It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per para 12 of AS 5 (Revised), 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.

3. During the year 2001-2002, a medium size manufacturing company wrote down its inventories to net realizable value by Rs. 5, 00,000. Is a separate disclosure necessary?
Solution: Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Para 12 of AS 5 (Revised in 1997) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies states that:
"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."
Circumstances which may give to separate disclosure of items of income and expense in accordance with para 12 of AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

4. Closing stock for the year ending on 31.03.2010 is Rs. 50,000 which includes stock damaged in a fire in 2008-09. On 31.3.2009, the estimated NRV of the damaged stock was Rs. 12,000. The revised estimate of NRV of damaged goods amounting Rs. 4,000 has been included in closing stock of Rs. 50,000 as on 31.03.2010.
Find the value of closing stock to be shown in the profit & loss account.
Answer: The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per para 25 of AS 5 'Net Profit or Loss the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. It is presumed that the loss by fire in the year ended 31.3.2009, i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item. Therefore, in the year 2009-10, revision in accounting estimate should also be classified as extra-ordinary item in the profit and loss account and closing stock should be shown excluding the value of damaged stock.

Value of closing stock for the year 2009-10 will be as follows:	₹
Closing Stock (including damaged goods)	50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	46,000

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

Solution: Classification of given items is as follows:

S. N.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

6. Explain whether the following will constitute a change in accounting policy or not as per AS 5.
   (i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.
   (ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organistaion. Such employees will get pension of Rs. 20,000 per month.
   Earlier there was no such scheme of pension in the organization.
   (iii) Till the previous year the machinery was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

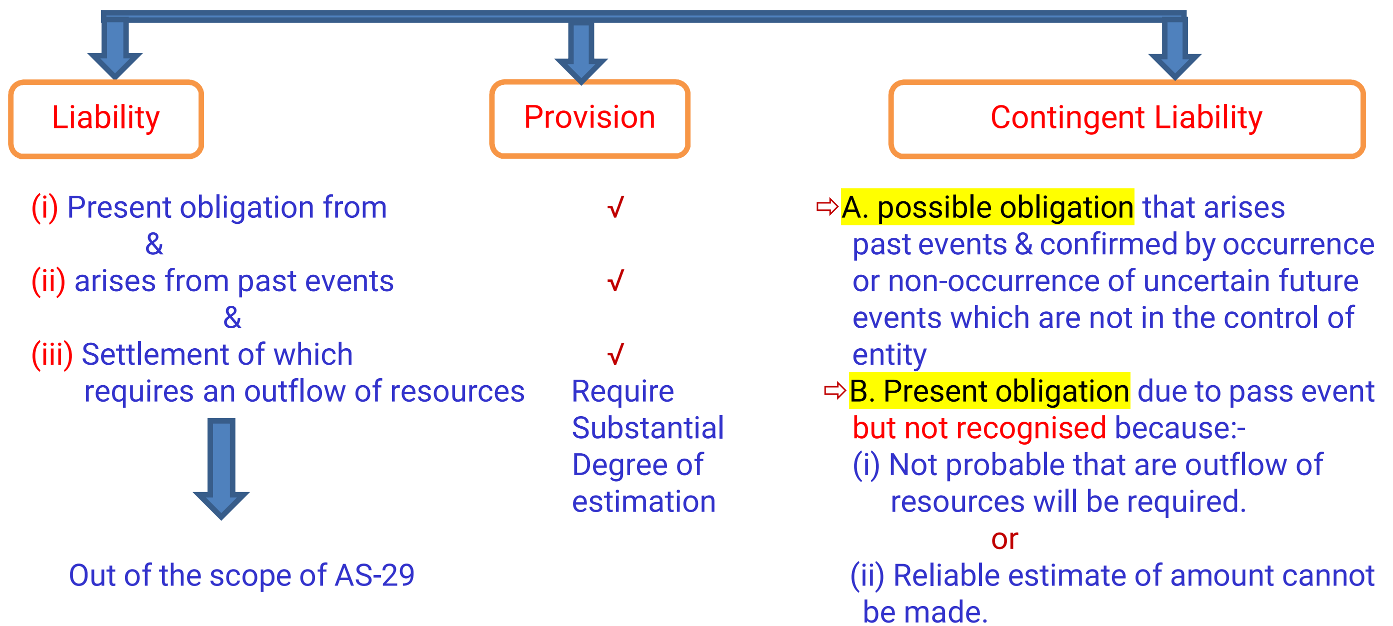
Solution: As per para 31 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy

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

(iii) Change in useful life of machinery from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

CHAPTER 27 AS 29: PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS



1. Definitions and accounting treatment:

A) A Provision is a liability which can be measured only by using a substantial degree of estimation.
   - A provision should be recognised when:
   (a) An enterprise has a present obligation as a result of a past event;
   (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
   (c) A reliable estimate can be made of the amount of the obligation.

   If these conditions are not met, no provision should be recognised.

B) An Obligating event is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

C) A Contingent liability is:
   a. 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

   b. A present obligation that arises from past events but is not recognised 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.

   Note: An enterprise should not recognise a contingent liability but should be disclosed.

   # No provision or disclosure of contingent liability is required in case likelihood of an outflow of resources is remote

F) A Contingent asset: usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise.
If expected benefit due to past events is:
- Virtual certain: then the related asset is not a contingent asset and its recognition is appropriate.
- Probable: then the related assed is a contingent asset.
  - ✓ A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority.
- Remote likelihood: ignored.

G) Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.
Examples of executory contracts include:
a. Employee contracts in respect of continuing employment;
b. Contracts for future delivery of services such as gas and electricity;
c. Obligations to pay local authority charges and similar levies; and
d. Most purchase orders.

2. Reimbursements: An, enterprise with a present obligation may be able to seek reimbursement of part or all of the expenditure from another party.
(i) The reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.
(ii) If entity cannot deny any obligation then recognize provision amount & asset shall be recorded only if there is virtual certainty. Amount of recognized asset cannot exceed provision amount.
(iii) Net off is not allowed of asset & liability recorded in balance sheet.
(iv) Net off is allowed in P&L A/C for recognized exp. & Income.
(v) In some cases, the entity will not be liable for the costs in question if the 3rd party fails to pay. In such a case the entity has no liability for those costs and they should not be included in the provision.

3. An 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least of
(a) net cost of execution the contract or
(b) any compensation or penalties arising from failure to fulfill it.
Recognition Criteria will be same as of recognition provision.

4. Future Operating Losses: do not meet the definition of a liability & the general recognition criteria; therefore, provisions should not be recognized for future operating losses.

5. Restructuring: is a programme that is planned and controlled by management, and materially changes either:
(a) the scope of a business undertaken by an entity; or
(b) the manner in which that business is conducted.

(i) A provision for restructuring costs is recognised only when the recognition criteria for provisions. No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement.

(ii) A constructive obligation to restructure arises only when
   (a) an entity has detailed formal plan for restructuring; and
   (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

(iii) 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 entity.

(iv) 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.

6. In case warranty: Company create provision if guarantee given by company because
   - there is a present obligation and
   - There is a past event (Sale of goods is a past events).

PRACTICAL QUESTIONS

1. An Engineering goods company provides after sales warranty for 2 years to its customers. 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: 2% provision
   More than 1 year: 3% provision

   The Company has raised invoices as under:

Invoice Date	Amount (Rs.)
19th January, 2011	40,000
29th January, 2012	25,000
15th October, 2012	90,000

Calculated the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March 2013 Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013

Solution: Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities & Contingent Assets'

As at 31st March, 2012 = ₹ 40,000 x .02 + ₹ 25,000 x .03
= ₹ 800 + ₹ 750
= ₹ 1,550

As at 31st March, 2013 = ₹ 25,000 x .02 + ₹ 90,000 x .03 = ₹ 500 + ₹ 2,700 = ₹ 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2013

	₹
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on 1.4.2012	(1,550)
Amount debited to profit and loss account	1,650

Note: No provision will be made on 31st March, 2013 in respect of sales amounting ₹ 40,000 made on 19th January, 2011 as the warranty period of 2 years has already expired.

2. With reference to AS-29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10% arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

(ii) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and at 31st Dec. 2019 it goes into Liquidation. (Balance Sheet date 31-3-19)

Solution:

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date.

10% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 2019. Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

3. 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.

Solution: 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.

4. At the end of the financial year ending on 31st December, 2005, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	**Loss (Rs.)**
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Lose (Low damages)	40%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

Solution: According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 X 10 + ₹ 72,000 X 5) as contingent liability.

CHAPTER 28 INTRODUCTION OF AS & IND AS AND FRAMEWORK

INTRODUCTION OF AS & IND AS

1. Accounting Standards: are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects

- recognition,
- measurement,
- presentation and
- disclosure

of accounting transactions in the financial statements.
Accounting Standards are "Principle Based" and not ruled based.

Regulatory Framework of Accounting Standards in India

A) Company AS Rule 2021: Companies are classified into only two levels, viz., (i) Non-SMC Companies and (ii) Small and Medium Companies, for brevity referred to as SMCs.

(i) Small and Medium Companies (SMC's)

a) The equity or debt securities of the company are not listed or not in the process of listing on any stock exchange, whether in India or outside India.
b) The company is not a bank or financial institution or insurance company.
c) The company's turnover (excluding other income) does not exceed Rs. 250 crores in the immediately preceding accounting year.
d) The company does not have borrowing (including public deposits) exceeding Rs. 50 crores at any time during the immediately preceding accounting year, and
e) The company is not a holding company or subsidiary of a non-SMC company.

(ii) Non- SMC's:- Company other than SMC's

B) Accounting Standard pronouncements by ICAI

Level I: Enterprise
(a) Entities whose securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.
(b) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.
(c) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees Rs. 250 crore in the immediately preceding accounting year.
(d) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of Rs. 50 crore at any time during the immediately preceding accounting year.
(e) Holding and subsidiary entities of any one of the above.

Level II : Enterprises
a) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds Rs. 50 crore but does not exceed Rs. 250 crore in the immediately preceding accounting year.

b) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of Rs. 10 crore but not in excess of Rs. 50 crore at any time during the immediately preceding accounting year.

c) Holding and subsidiary entities of any one of the above.

Level III Entities:

(a) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees 10 crore but does not exceed rupees 50 crore in the immediately preceding accounting year.

(b) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees 2 crore but does not exceed rupees 10 crore at any time during the immediately preceding accounting year.

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

Level IV: Enterprises: Other than Level I Enterprise, Level II Enterprise and Level III Enterprise.

Exemptions or Relaxations from Accounting Standards:

(i) For SMCs as defined in the Notification

Full Exemption (Not applicable on AS)	3,17
Partial Exemption on AS	15
Disclosure Exemption on AS	19,20,28,29
Applicable AS only when any transaction taken place or reporting is required	21,23,27 and 25

(ii) For Level II, III and IV Entities

Particulars	Level II Entities	Level III Entities	Level IV Entities
Full Exemption (Not applicable on AS)	3,17,20	3,17,18,20,24	3, 17, 18, 20, 24, 28
Partial Exemption on AS	15	15	15, 22
Disclosure Exemption on AS	19,28,29	10,11,19,28,29	10,11,13,19,26,29
Applicable AS only when any transaction taken place or reporting is required	21,23,27 and 25	21,23,27 and 25	14, 21,23,27 and 25

2. Indian Accounting Standards are a set of accounting standards notified by the Ministry of Corporate Affairs which are converged with International Financial Reporting Standards (IFRS) (IND AS is notified by ~~NACAS~~ / NFRA on 25th Feb 2011.) (NFRA=National Financial Reporting Authority U/s 132)

Current position / situation of applicability of Ind AS:

(1) IND AS shall be applicable on every *Indian company or NBFC*:

- ➢ whose net worth is 250 crores or more (in accordance with stand alone audited financial statement of the company) as on the last day of immediately proceeding year; or
- ➢ Listed Company or in the process of listing.

(+) Holding company, subsidiary company, joint venture or associate of any company covered above.

(2) Voluntary Adoption: Any Indian company (except banking companies, insurance companies, or NBFCs) may voluntarily adopt IND AS.

(3) There is no applicability of Ind AS on banking company or insurance company (even on voluntary basis).

(4) Once IND AS is applicable on any company then it is mandatory for the company to follow IND AS forever i.e. permanently.

(5) There is no concept of exemption or relaxation in case of IND AS.

(6) IND AS was applicable to mutual funds from 01/04/23

Note: The company on which IND AS are not applicable shall follow companies (Accounting Standards) Rule, 2021 as amended from time to time.

FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

1. Qualitative characteristics of the financial statements (FS) which improve the usefulness of the information furnished therein: The framework suggests that the financial statements (FS) should observe and maintain the following qualitative characteristics as far as possible within limits of reasonable cost/ benefit.
   (1) Understandability: FS should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities.
   (2) Relevance: 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.
   (3) Materiality: Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.
   (4) 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 (a) are faithfully represented; (b) reported in terms of their substance and economic reality not merely on the basis of their legal form; (c) neutral, i.e. free from bias; (d) Prudence is exercised in reporting and (e) Completeness.
   (5) Comparability: 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.
   (6) True and Fair View: Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise.

2. Elements of Financial Statements. Items of financial statements can be classified in five broad groups depending on their economic characteristics:
   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.

3. Measurement bases:

   (1) Historical Cost: Historical cost means acquisition price.

(2) Current Cost: It gives an alternative measurement basis. Assets/Liabilities 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/settle the obligation currently.

(3) Realisable (Settlement) Value: As per realisable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.

(4) Present Value: Under PV convention, assets/ Liabilities are carried at present value of future net cash flows generated/expected to be required to settle by the concerned assets/liabilities respectively in the normal course of business.

4. Users of financial statements: Investors, Potential investor, Employees, Lenders, Supplies/Creditors, Customers, Government & Public etc.

5. Fundamental Accounting Assumptions:
   (1) Going Concern: assumption means it is assumed that entity will continue its operation forever; there is no necessity to liquidate its operation.
   (2) Consistency: means accounting policy are forever and there is no necessity to change such policy.
   (3) Accrual assumption: Accrual means charging of income & expenditure on periodic basis.

   Note: These assumptions should not disclose if followed. In case they are not being followed these should be disclosed.

6. Components of financial statements: A complete set of financial statements normally consists of a Balance Sheet, a Statement of Profit and Loss and a Cash Flow Statement together with notes, statements and other explanatory materials that form integral parts of the financial statements.

   A) Balance Sheet portrays value of economic resources controlled by an enterprise. It also provides information about liquidity and solvency of an enterprise.

   B) Statement of Profit and Loss presents the result of operations of an enterprise for an accounting period, i.e., it depicts the performance of an enterprise, in particular its profitability.

   C) Cash Flow Statement shows the way an enterprise has generated cash and the way they have been used in an accounting period and helps in evaluating the investing, financing and operating activities during the reporting period.

   D) Notes and other statements present supplementary information explaining different items of financial statements.

7. Capital maintenance: is a theoretical concept which tries to ensure that excessive dividends are not paid to shareholders in times of changing prices. This concept can be classified as follows:
   A. Physical capital maintenance (PCM): (Also known as Operating capital maintenance) It sets aside profits in order to allow the business to continue to operate at current levels of activity. In practice, this tends to mean adjusting opening capital by specific price changes hitting the business, rather than general.
   B. Financial capital maintenance (FCM): It sets aside profits in order to preserve the value of shareholders' funds in either
      (i) At historical cost/Monetary terms: We can measure the increase in monetary terms; OR
      (ii) Constant purchasing power (real financial capital): Inflation over time makes comparisons difficult so constant purchasing power adjusts for general indices of inflation e.g. retail prices index (RPI).

PRACTICAL QUESTIONS

1. A company with a turnover of Rs. 225 crores and borrowings of Rs. 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.

Solution: 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-

(i) 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;

(ii) which is not a bank, financial institution or an insurance company;

(iii) whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;

(iv) which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and

(v) 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 Rs. 225 crores which does not exceed Rs. 250 crores but borrowings of Rs. 51 crore are more than Rs. 50 crores, it is not a small and medium sized company (SMC). The exemptions available to SMC are not available to this company.

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

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

Additional information:

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

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

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

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

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

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

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

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

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

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

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

	Case (i)	Case (ii)		Case (i)	Case (ii)
To Opening Stock	30,000	30,000	By Sales	4,50,000	4,50,000
To Purchases	4,00,000	4,00,000	By Closing Stock	32,000	40,000
To Expenses	14,900	14,900	By Trade payables	-	600
To Depreciation	13,000	5,000			
To Provision for doubtful debts	2,000	6,000			
To Deferred cost	2,500	10,000			
To Loan penalty	-	2,500			
To Net Profit (b.f.)	19,600	22,200			
	4,82,000	4,90,600		4,82,000	4,90,600

Balance Sheet as at 31st March, 20X2

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

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.

Solution: 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

4. A trader commenced business on 01/01/20X1 with Rs. 12,000 represented by 6,000 units of a certain product at Rs. 2 per unit. During the year 20X1 he sold these units at Rs. 3 per unit and had withdrawn Rs. 6,000. Let us assume that the price of the product at the end of year is Rs. 2.50 per unit. In other words, the specific price index applicable to the product is 125. The average price indices at the beginning and at the end of year are 100 and 120 respectively.

You are required to compute the Capital maintenance under all three bases ie.

(i) Historical costs,
(ii) Current purchasing power and
(iii) Physical capital maintenance.

Solution: Financial Capital Maintenance at historical costs

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

Financial Capital Maintenance at current purchasing power

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

Physical Capital Maintenance

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

CHAPTER 29 ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES

1. Meaning of Branch: It is an establishment which is an expansion of the business (known as head office). Branch can either do the same business as of head office or a separate line of business. For the concept of Branch there must be a head office.

2. Types of Branches:

   (A) Dependent Branch: It is the branch whose books of A/c are maintained by head office.

   (B) Independent Branch: It is the branch which maintain their own books of A/c separately.

   (C) Foreign Branch: It is a branch which is situated outside India. These branches are independent branches because these branches are maintained their own of books of A/c.

3. This chapter shall be divided into 3 parts
   (A) Independent Branch
   (B) Foreign Branch
   (C) Dependent Branch

4. Independent Branch: Following steps are applied
   Step 1: Pass rectified / adjustment entries in the books of Head office & branch respectively and cross tally their outstanding balance.
   Step 2: Prepare branch trading and P & L A/c and Head office Trading and P & L A/c. Generally these accounts are prepared in columnar form with an additional column of total.
   Step 3: Prepare Branch Balance Sheet & head office balance sheet in columnar form.
   Step 4: Pass consolidated Journal entry / Consolidation of branch Assets, liabilities and profits with Head office at year end after finalisation of branch books of accounts.

Transactions	Books of Branch	Books of Head Office
1. On transfer of Asset of of Branch	Head Office A/C Dr XXX To Asset A/C XXX	Asset A/C XXX To Branch A/c XXX
2. On transfer of Liability of Branch	Liabilities A/c Dr XXX To Head Office A/c XXX	Branch A/C XXX To Liabilities A/c XXX
3. On transfer of P&L A/c balance of branch	P&L A/C Dr XXX To head office A/c XXX	Branch A/c Dr XXX To P& L A/c XXX

Step 5: Adjust Journal Entry of Step 4 in the Balance Sheet of H.O. prepared under Step 3.
Step 6: Deconsolidation Journal Entries on first day of next year

Transactions	Books of HO	Books of Branch
1. On transfer of Asset of Branch	Branch A/C Dr XXX To Asset A/C XXX	Asset A/C Dr. XXX To HO A/c XXX
2. On transfer of Liability of Branch	Liabilities A/c Dr XXX To Branch A/c XXX	HO A/C Dr. XXX To Liabilities A/c XXX

Some Important Points

(1) Preparation of stock A/c: Sometimes question does not give information about either the stock of branch or of head office or of both. In that case following steps are applied.
    Step 1: Calculate cost price, invoice price# & sale price of head office or branch or both.
    # Here invoice price means the price on which head office transfer goods to branch i.e. head office cost price +profit charged by H.O. from branch.
    Step 2: Prepare stock account of branch at branch cost price and of HO at HO cost.

(2) Treatment of shortage / Abnormal loss of stock: Abnormal loss is not a trading loss so
- It shall be credited into Trading A/c at cost
- It is a loss, so it shall be charged into P&L account
- In case any recovery of claim from insurance company than it shall be credited into P & L A/c

(3) Closing Stock = Opening Stock + Purchases + Direct expenses – Abnormal Loss - cost of goods sold.

(4) Treatment of Stock reserve:

(i) Meaning: stock Reserve means unrealized profit on unsold stock.

(ii) When Stock reserve is to be calculated: In case
(a) H.O. transferred goods to branch at invoice price i.e. cost + profit; and
(b) Such Stock remains unsold with Branch.

(iii) Amount of Stock Reserve =
Stock held with branch received from head office (including Goods in Transit) X Profit ratio of H.O.#

Here, Profit ratio of head office shall be on the basis of sale price,
G/P Ratio of HO = (Gross Profit / Sale) X 100
OR
In case G/P Ratio is Given on the Basis of Cost price, then it shall be calculated on the basis of sale price i.e. G/P Ratio of HO = (Gross Profit / Sale) X 100

(5) Incorporation of Trial balance of branch: Sometimes question requires incorporation of Trial balance in that case we incorporate income and expenditure of branch instead of P & L A/c of branch.
- Assets and liabilities shall be incorporated as well usual.

Journal entries

SN	Transactions	Books of branch	Books of Head Office
1	On transfer of assets.	Head Office A/c Dr. xxx To Asset A/c xxx	Assets A/c Dr. xxx To Branch A/c xxx
2	On Transfer of Liabilities	Liability A/c Dr. xxx To Head Office A/c xxx	Branch A/c Dr. xxx To Liability A/c xxx
3	On Transfer of branch income (credit side of Trading) ➢ From Trading A/c	Trading A/C Dr. xxx To Head office A/C xxx (Sale xxx Goods sent to HO xxx Purchase Return xxx Goods returned To HO xxx Closing Stock xxx Goods in transit xxx)	Branch A/c Dr. xxx To Branch Trading A/C xxx (Sale xxx Goods sent to HO xxx Purchase Return xxx Goods returned To HO xxx Closing Stock xxx Goods in transit xxx)
4	On transfer of branch expenses from trading A/c	Head Office A/C Dr xxx To Trading A/C xxx (Opening Stock xxx Purchases xxx Goods received from HO xxx Sale Returned xxx Direct Expenses xxx)	Branch Trading A/c Dr xxx To Branch A/C xxx (Opening Stock xxx Purchases xxx Goods received from HO xxx Sale Returned xxx Direct Expenses xxx)
5	Branch gross Profit Or gross loss shall be in corporate with Branch P&L A/c		Branch Trading A/C Dr. XXX To Branch P&L A/c XXX
6	On Transfer Of Branch income from Branch P& L A/c	P & L A/c Dr. xxx To Head office A/C xxx (Indirect Income)	Branch A/c Dr. xxx To P&L A/c xxx (indirect Income)

7	On Transfer of Branch Expenses from Branch P&L A/C	Head office A/c Dr. xxx To P&L A/c xxx (Indirect expenses e.g. Salary, rent etc.)	P& L A/c Dr. xxx To Branch A/c xxx (Indirect expenses e.g. Salary, rent etc.)
8	H.O incorporates/credited profit of branch into general P&L A/C		Branch P&L A/C Dr. xxx To P& L A/c xxx

(6) Multiple Branches /H.O. has more than one branch

- In case Head office has more than one Branch and these branches do any transaction between them, then all transaction shall be routed through H.O.
- At the end of particular period (either month, quarter, half year or year etc. depending on the sizes & nature of business), Head office pass a single entry to reconcile the entries passes by branches.
- This technique save time & cost.

(7) Incomplete information in Branch books: Sometime H.O. has desired that profitability of the branch shall be kept secret from the branch staff.
For this purpose head office hold back some key information from the branch e.g. cost of good sent to branch (only sale price available to branch)
In such kind of case all information of branch is not available for the purpose of preparation of financial statement of branch.
In such a case for closing books of accounts of the branch, the branch will simply transfer various revenue accounts (i.e. Income and Expenditure accounts) to Head office without drawing up a Trading and P&L A/c

It means: For incorporation of expenses & incomes, following entries are journalised.

Transactions	Books of branch	Books of H.O.
(1)On transfer of income by branch	Sales A/c Dr xxx Other income Dr xxx To H.O. A/c xxx	Branch A/c Dr. xxx To sale A/c xxx To Other Income A/c xxx
(2)On transfer of expenses by branch	H.O A/c Dr xxx To purchases xxx To direct Expenses xxx To Indirect Expenses xxx	Purchases A/c Dr xxx Direct Expenses A/c Dr xxx Indirect Expenses A/c Dr xxx To Branch A/c xxx

Note: Sometimes any asset account is maintained by head office in that case if any expenses incurred by branch on such asset or acquired such asset by branch then such asset shall be transferred by branch to head office.

5. Foreign Branches: Foreign branches are of two types:
   A. Indian H.O and foreign Branch
   B. Foreign H.O and Indian Branch

A. Indian H.O and Foreign Branch: Following steps are applied
Step 1: Pass rectified/adjustment entry in the books of head office in Indian currency and in the books of branch in foreign currency.
Step 2: Convert foreign currency trial balance into Indian currency TB by applying following rules.

Nature of Transaction	Conversion Rate
Fixed Asset, Depreciation & Accumulated Depreciation	On transaction Date
All Asset and liabilities other than mentioned above	Closing rate
All income & expenditures	Average rate - for exam purpose
Any transaction between H.O. & Branch and balance of H.O.	As per H.O. Records

Note: Any Difference in the Converted Trial Balance shall be considered as "Foreign Exchanges Gain / Loss" which shall be transferred into P&L A/c of Branch.

Step 3: Remaining steps will be same as in case of independent Branch.

Some Important Points:

(1) In Case question requires branch A/c (it means it is required in the books of H.O) then prepared Branch A/c in Indian Currency except otherwise specified.

(2) In case Branch stock is missing then prepare branch stock account in foreign currency at branch cost. Convert branch stock into Indian currency by using closing date.

(3) Calculation of branch manager Commission:

Case I: Branch manager is entitled for a Commission @% on Branch profit including FED / including effect of FED: Calculate net profit of branch in Indian currency (HO currency) after taking effect of FED and calculate commission on such net profit.

Case 2: Branch manager is entitled for a Commission@% on Branch Profit excluding FED / excluding effect of FED: Calculate Net profit of Branch in Indian currency (HO Currency) without taking effect of FED and calculate Commission on such net profit.

Case 3: Branch manager is entitled for a Commission on branch profit
Step 1: Calculate branch net profit in foreign currency.
Step 2: Calculate manager's commission on net profit calculator in step 1 in foreign currency.
Step 3: Convert branch manager foreign currency commission into Indian currency by using closing rate.

Journal Entry

Branch manager Commission A/c (In branch P & L A/c)	Dr.	xxx	
To Commission Payable A/c (in branch B/S)			xxx
(Being branch manager Commission payable)			

(4) In case there is any pending or adjustment entry required in the books of branch, then
Step 1: First pass rectified / adjustment entries
For example: Recognition of prepaid expenses and outstanding exp.

(A) On recognition of outstanding expenses

Expenses A/c	Dr	xxx	
To outstanding expenses A/c			xxx

(B) On recognition of Prepaid expenses

Prepaid expenses A/c	Dr	xxx	
To expenses A/C			xxx

Step 2: After that take effect of such entries into branch Trial balance (in foreign currency) before conversion.
Step 3: After that convert foreign currency trial balance into Indian currency trial balance.

⇒ Converted Trial Balance

Particulars	Dr.	Cr.
Expenses (As Given in TB + O/S Exp. – Prepaid Exp.)	xxx (Avg Rate)	
Prepaid expenses	xxx (Closing Rate)	
Outstanding Expenses		xxx (Closing Rate)

B. Foreign H.O and Indian Branch: Following steps are applied,
Step 1: Pass rectified/adjustment entry in the books of Indian branch in Indian currency (i.e. ₹)
Step 2: Convert Indian currency Trial balance into head office currency Trial balance (i.e. foreign currency) by applying same rule as already discussed.
Step 3: Remaining steps will be same as already discussed in Indian independent branch.

Some Important Points:
(1) In case branch stock is missing then prepare branch stock account in Indian currency at Branch cost and convert closing stock in foreign currency by using closing rate.

(2) In case question required Branch Account then it is prepared in head office books so it shall be prepared in foreign currency except otherwise specified

6. Role of AS 11 in foreign branch: As per AS-11 Foreign Operations are of two types.

(A) Integral foreign operation: These operations are an integral part of main activity of entity. In simple word, it is an extension of business of entity in abroad e.g. foreign branch, sale office etc. Rule of conversion of integral foreign operation: Already discussed.

(B) Non-integral foreign operation (NIFO): These operations are not integral part of entity. Rather these businesses are independent and having separate autonomy. E.g. Foreign subsidiary, foreign joint venture or foreign associates. Rule of conversion of Non-integral foreign operation:

Nature of Transaction	Conversion Rate
All assets and liabilities (including fixed asset and accumulated depreciation)	Closing rate
All income & expenditures	Transaction rate (Average rate – for exam purpose)
Any transaction between H.O. & Branch and balance of H.O.	As per H.O. Records

Note: Any difference in the converted Trial Balance shall be transferred to "Foreign currency Translation Reserve" (FCTR) account which is capital in nature and shown under the head," Reserve & Surplus" in balance sheet.

Exam Note: In case question is silent whether branch is integral or non-integral always assume that branch is integral and write about this assumption.

7. In the following two cases stock reserve is not calculated
Case 1: Where head office transfers goods to branch at cost price only.
Case 2: When HO transfer goods to branch at invoice price (i.e. cost price + profit) and such stock is sold by branch till year end. (It means no stock available with branch which was received on invoice price from HO)

8. Dependent Branch: Under dependent branch there are 4 methods to calculate profit of Branch
(A) Debtor method
(B) Final account method / Trading account method
(C) Stock and debtor method
(D) Wholesale Branch

(A) Debtor method: For the purpose of calculation of profit of branch H.O. prepares Branch Account

Branch Account

Particulars		(Rs.)	Particulars	(Rs.)
To Sundry Assets b/d			By Sundry liabilities b/d	
-Fixed Assets	XXX		-Creditors	XXX

-Stock XXX		-outstanding expenses		XXX
- Debtors XXX		By Cash received from Branch		XXX
- Bank & Cash XXX		By Goods returned by Branch		XXX
- Prepaid Expenses XXX	XXX	By Sundry Assets c/d		
To Goods sent to Branch	XXX	-Fixed Assets	XXX	
To Cash Sent to Branch for expenses	XXX	-Stock	XXX	
To Sundry Liabilities c/d - Creditors XXX - Outstanding Expenses XXX	XXX	-Debtors -Bank & cash -Prepaid Expenses	XXX XXX XXX	XXX
To Net Profit c/d	XXX			
	XXX			XXX

Some Important Points:

(1) **Under debtor method for examination purpose:** HO can prepare following additional accounts:
- (a) Branch Stock Account: is prepared only when either opening stock or closing stock is missing.
- (b) Branch Debtor Account: This account is prepared only when either opening balance or closing balance or collection from debtor is missing.
- (c) Branch Cash and Bank Account: This account is prepared only when either opening balance or closing balance or collection from debtor or remittance to Head Office is missing.

(2) **Treatment of normal loss or abnormal loss under Debtor Method**
- (a) **Normal loss:** is a part of cost per unit so no separate treatment is required.
- (b) **Abnormal loss:** is automatically adjusted in branch stock, so no separate treatment is required. However, in case any recovery from Insurance company as insurance claim, then it is credited into Branch Account as collection from Branch on account of Insurance claim.

(3) In case H.O sells goods to customers through branch then H.O. earns profit at 2 stages;
Stage 1 Profit: In case H.O. transfers goods to branch at invoice price (i.e. cost price + profit) then difference between invoice price & cost price is called stage 1 profit.

Stage 2 Profit: In case branch sells goods to customers at invoice price plus profit (i.e. sale price) then difference between invoice price and sale price is called stage 2 profit.

⇒ In Branch A/c only, Stage 2 profit is calculated so for the purpose of calculation of total profit of branch (stage 1 + stage 2) we have to adjust reserve (stage 1 profit) in Branch Account as follows:
- (i) Opening stock reserve and reserve on goods sent to branch shall be credited into Branch A/c
- (ii) Closing stock Reserve and reserve on goods returned by branch shall be debited into Branch Account.

Note: The above adjustment shall be done only when head office transfers goods to branch at invoice price.

Stock reserve shall be calculated only on that stock which was purchased by branch from head office at invoice price. No stock reserve shall be calculated on the stock which was directly purchased by Branch.

(B) **Final account / Trading account method:** under this method H.O. prepares branch Trading and P&L account at the cost price of the head office.
Note: Under Final Account method following additional ledger accounts are prepared depending on the information given in question.

(i) Branch Stock Account: At invoice price of branch
(ii) Branch debtor A/c
(iii) Branch Cash and Bank account.

(C) Stock and Debtors method: This method shall be applied where more control is required by head office. Under this method profits of branch are calculated at 2 stages
Stage 1 Profit: Profit earned by HO from Branch: In this case HO transfers goods to Branch at invoice price (i.e. cost price + profit) then difference between invoice price and cost price is called Stage 1 Profit.
✓ For the purpose of calculation of Stage 1 profit: H.O. prepare Branch Adjustment A/c.

Stage 2 Profit: For this purpose, Head Office prepares Branch P & L A/c which includes profit and loss at Branch as well as stage 1 Profit.

Under Stock and Debtor method following ledgers account are prepared

Branch Stock Account (At Invoice Price)

Particulars	(Rs.)	Particulars	(Rs.)
To balance b/d	XXX	By cost of Goods Sold	XXX
To Goods Sent to Branch A/c	XXX	By Shortage / abnormal loss A/c	XXX
To Sale Return A/C	XXX	By Goods return to Head Office A/c	XXX
		By Balance c/d	
		-Stock In Hand	XXX
		-GIT	XXX
	XXX		XXX

Branch Debtor A/c

Particulars	(Rs.)	Particulars	(Rs.)
To Balance b/d	XXX	By Bank A/C	XXX
To Sale A/c	XXX	By B/R A/C	XXX
To B/R - Dishonored	XXX	By Bad Debts A/c	XXX
To Cheque Dishonored	XXX	By Discount A/C	XXX
		By Sale Return A/C	XXX
		By Balance c/d	XXX
	XXX		XXX

Branch Adjustment A/c (Stage 1 profit)

Particulars	(Rs.)	Particulars	(Rs.)
To Goods Returned to Head Office – Reserve / Loading	XXX	By opening Stock – Reserve / Loading	XXX
To closing Stock including GIT – Reserve / Loading	XXX	By Goods Sent to Branch A/c – Reserve / Loading	XXX
To Shortage / abnormal loss – Reserve / Loading	XXX		
To Profit t/f to Branch P&L A/C	XXX		
	XXX		XXX

Branch Cash & Bank A/c

Particulars	(RS).	Particulars	(RS.)
To Balance b/d	XXX	By H.O A/C	XXX
To sale A/c (cash)	XXX	By Expenses	
To Debtor A/c	XXX	- H. O.	XXX
To H.O A/c	XXX	- Branch	XXX
		By Balance c/d	XXX
	XXX		XXX

Branch Expenses Account

Particulars	(Rs.)	Particulars	(Rs.)
To Cash & Bank A/C	XXX	By Branch P&L A/C	XXX
To Depreciation A/C	XXX		
To Bad Debts A/C	XXX		
To Discount A/C	XXX		
To Expenses Incurred by H.O on Behalf of Branch	XXX		
	XXX		XXX

Branch P & L A/C

Particulars	Rs.	Particulars	Rs.
To Shortage / Abnormal Loss (Net of Reserve)	XXX	By Surplus(excess of Sale Price over Invoice Price)	XXX
To Branch Expenses A/C	XXX	By Profit Transferred from Branch Adjustment A/C	XXX
To Net Profit C/D	XXX		
	XXX		XXX

Goods sent to Branch A/C

Particulars	Rs.	Particulars	Rs.
To Branch adjustment A/c (Reserve)	XXX	By Branch Stock A/c – At Invoice Price	XXX
To Purchase A/c – Transfer	XXX		
	XXX		XXX

Some Important Points:

(1) Balance in Stock A/c
- (i) In case any Debit balance in stock account and question gives information regarding closing stock, then such debit balance shall be considered as shortage.
- (ii) In case any credit balance in stock account then it shall be considered as surplus (i.e. excess of actual sale Price over normal sale price / invoice price).

(2) No requirement of preparing branch cash account
- ➢ In case H.O. incurred expenses on behalf of branch or cash sent by head office for expenses of branch; and
- ➢ all collection directly sent by branch to head office.

(D) Wholesale Branch Method: This method is being followed where less control is required. Under this method profit of branch at branch or by branch is calculated. For this purpose, stock & debtor method is being followed and following ledge account are prepared;
- (i) Branch stock account: For the purpose of calculation of surplus or deficiency/shortage
- (ii) Branch debtor account: Prepared if information is available.
- (iii) Branch cash account: Prepared if information available.
- (iv) Branch expenses A/c
- (v) Branch profit or loss account.

9. Stock reserve A/c: Sometimes question requires stock reserve Account

Stock Reserve Account

Particulars	Rs.	Particulars	Rs.
To Profit & Loss A/c (opening Stock Reserve)	XXX	By Balance b/d	XXX
To Balance c/d	XXX	By Profit & loss A/C(Closing Stock Reserve)	XXX
	XXX		XXX

PRACTICAL QUESTIONS

1. KP Ltd. manufactures a range of goods which it sells to wholesale customers only from its head office. In addition, The H.O. transfers goods to a newly opened branch at factory cost plus 15%. The branch then sells these goods to the general public on only cash basis.

   The selling price to wholesale customers is designed to give a factory profit which amounts to 30% of the sales value. The selling price to the general public is designed to give a gross margin (i.e., selling price less cost of goods from H.O.) of 30% of the sales value.

   The company operates from rented premises and leases all other types of fixed assets. The rent and hire charges for these are included in the overhead costs shown in the trial balances.

   From the information given below, you are required to prepare for the year end 31st December, 2002 in columnar form.

   (a) A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

   (b) A Balance Sheet as on 31st December, 2002 for the entire business.

	H.O.		Branch	
	Rs.	Rs.	Rs.	Rs
Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1-2002				
Raw materials	1,800			
Finished goods	13,000		9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen's Salaries	22,500		6,200	
Other administrative & Selling overheads	12,500		2,300	
Inter-unit accounts	5,000			2,000
Capital		50,000		
Sundry Creditors		13,000		
Provision for Unrealized Profit in stock		1,200		
Sales		2,00,000		65,200
Goods sent to branch		46,000		
Goods Received from H.O.			44,500	
	3,10,200	**3,10,200**	**67,200**	**67,200**

Notes:

(1) On 28th December, 2002 the branch remitted Rs. 1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also on the same date, the H.O. dispatched goods to the branch invoiced at Rs. 1,500 and these too have not yet been entered into the branch books. It is the company's policy to adjust items in transit in the books of the recipient.

(2) The stock of raw materials held at the H.O. on 31st December, 2002 was valued at Rs. 2,300.

(3) You are advised that:

   (a) There were no stock losses incurred at the H.O. or at the branch.

   (b) It is the company's practice to value finished goods stock at the H.O. at factory cost.

   (c) There was no opening or closing stock of work-in-progress.

(4) Branch employees are entitled to a bonus of Rs. 156 under a bilateral agreement.

Solution:

In the books of KP

Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

	H.O. ₹	Branch ₹	Total ₹		H.O. ₹	Branch ₹	Total ₹
To Opening stock of finished goods	13,000	9,200	22,200	By Sales	2,00,000	65,200	2,65,200
To Material consumed (W.N.1)	34,500	-	34,500				

Particulars	H.O.	Branch	Total	Particulars	H.O.	Branch	Total
To Wages	1,08,500	-	1,08,500	By Goods Sent to Branch	46,000	-	-
To Factory Overheads	39,000	-	39,000				
To Goods from H.O.		46,000		By Closing stock including transit (W.N.2)	15,000	9,560 (Bal Fig)	24,560
To Gross Profit c/d (W.N.3)	66,000 (Bal Fig)	19,560	85,560				
	2,61,000	74,760	2,89,760		2,61,000	74,760	2,89,760
To Admn. Salaries	13,900	4,000	17,900	By Gross Profit b/d	66,000	19,560	85,560
To Salesmen Salaries	22,500	6,200	28,700				
To Other Admn. & selling Overheads	12,500	2,300	14,800				
To Stock Reserve (W.N.4)	47	-	47				
To Bonus to Staff	-	156	156				
To Net Profit	17,053	6,904	23,957				
	66,000	19,560	85,560		66,000	19,560	85,560

Balance Sheet as on 31st Dec., 20X1

		₹	H.O. ₹	Branch ₹	Total ₹		H.O. ₹	Branch ₹	Total ₹
Capital			50,000	-	50,000	Fixed Assets	-	-	-
Profit:	H.O.	17,053				Current Assets:			
	Branch	6,904	23,957		23,957	Raw material	2,300		2,300
Trade Creditors			13,000		13,000	Finished Goods	15,000	9,560	23,313*
Bonus Payable				156	156	(Less Stock Res.)			
H.O. Account*				10,404		Debtors	37,000	-	37,000
Stock Reserve (W.N.4)			1,247			Cash (including transit item)	23,500	1,000	24,500
						Branch A/c	10,404**		
			88,204	10,560	87,113		88,204	10,560	87,113

*9,560 × 100/115 i.e., (8,313 + 15,000) = ₹ 23,313 or (15,000 + 9,560) – 1,247 (Stock reserve)
** (5,000 + 6,904) – 1500 = ₹ 10,404.

Working Notes:

(1) Material consumed
Opening raw material + Raw Material Purchased – Closing raw material
= 1,800 + 35,000 - 2,300 = 34,500

(2) Closing stock at head office
(a) Calculation of total factory cost = Material consumed + Wages + Factory overhead
= 34,500 + 1,08,500 + 39,000 = 1,82,000
(b) Cost (factory cost) of goods sold = Sales – Gross profit
= 2,00,000 – 2,00,000 x 30% = 1,40,000
(c) Stock transferred to branch = 46,000 x 100/115 = 40,000
(d) Closing stock = 13,000 (Opening Stock) + 1,82,000 – 1,40,000 – 40,000 = 15,000

(3) Gross profit of Branch = Sales x Gross profit ratio
= 65,200 x 30% = 19,560

(4) **Closing stock reserve** = 9,560 x 15/115 = 1,247
Charge to profit and loss = 1,247 – 1,200 (existing) = 47

2. On 31st March, 2000 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow:

Debit Balance	Rs. In Lacs
Furniture and equipment	18
Depreciation of Furniture	2
Salaries	25
Rent	10
Advertising	6
Telephone, Postage and Stationery	3
Sundry Office expenses	1
Stock on 1st April, 1999	60
Goods Received from Head Office	288
Debtors	20
Cash at Bank and in hand	8
Carriage Inwards	7
	448
Credit Balance	
Outstanding Expenses	3
Good Returned to Head Office	5
Sales	360
Head Office	80
	448

Additional Information: Stock on 31st March, 2000 was valued at Rs. 62 lacs on 29th March, 2000. The Head Office dispatched goods costing Rs. 10 lacs to its branch. Branch did not receive these before 1st April, 2000. Hence the figure of goods received from head office does not include these goods, Also the head office has charged the branch Rs, 1 lac for centralized services for which the branch has not passed the entry.

You are required to:

(1) Pass Journal Entries in the books of the Branch to make the necessary adjustments.

(2) Prepare Final Accounts of the Branch including Balance Sheet, and

(3) Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial balance.

Solution:

(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 receivedby branch before 1st April, 20X2)			
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, 20X2

		₹ in lacs		₹ in lacs
To Opening Stock		60	By Sales	360
To Goods received from Head Office	288+10		By Closing Stock including transit	72
Less: Returns	(5)	293		
To Carriage Inwards		7		
To Gross Profit c/d		72		
		432		432
To Salaries		25	By Gross Profitb/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 (centralised services)	1		
To Net Profit Transferred to Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 20X2

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	115	Goods in Transit		10
Outstanding Expenses		3	Debtors		20
			Cash at bank and inhand		8
		118			118

(iii) **Books of Head Office**

Journal Entries

		Dr. (₹)	***Cr. (₹)***
Branch Trading Account	Dr.	365	
To Branch Account			365
(The total of the following items in branch trial balancedebited to branch trading account: ₹in lacs Opening Stock 60 Goods received from Head Office 288 Goods purchased but not received 10 Carriage Inwards 7)			
Branch Account	Dr.	437	
To Branch Trading Account			437
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows: ₹in lacs Sales 360 Closing Stock 62 Goods in transit 10 Goods returned to Head Office 5)			
Branch Trading Account			
To Branch Profit and Loss Account	Dr.	72	
(Gross profit earned by branch credited to Branch Profit&Loss A/c)			72
Branch Profit and Loss Account	Dr.	48	
To Branch Account			48
(Total of the following branch expenses debited to Branch P & L A/c: ₹in lacs Salaries 25 Rent 10 Advertising 6 Telephone, Postage & Stationery 3 Sundry Office Expenses 1 Head Office Expenses 1 Depreciation on furniture 2)			

Particulars		Dr.	Cr.
Branch Profit & Loss Account	Dr.	24	
To Profit and Loss Account			24
(Net profit at branch credited to general Profit & LossA/c)			
Branch Furniture & Equipment	Dr.	18	
Branch Stock	Dr.	62	
Branch Debtors	Dr.	20	
Branch Cash at Bank and in Hand	Dr.	8	
Goods in Transit	Dr.	10	
To Branch			118
(Incorporation of different assets at the branch in H.O.books)			
Branch	Dr.	3	
To Branch Outstanding Expenses			3
(Incorporation of Branch Outstanding Expenses in H.O.books)			

3. Pass necessary journal entries in the books of Independent Branch of a company, wherever required, to rectify or adjust the following;
   (i) Income of Rs 2,800 allocated to the Branch by Head Office but not recorded in the Branch books.
   (ii) Provision for doubtful debts, whose are kept by the Head Office, not provided earlier for Rs 1,000.
   (iii) Branch Paid Rs 3,000 as salary to a Head Office Manager, but the amount paid has been debited by Branch to Salaries Account.
   (iv) Branch incurred travelling expenses of Rs 5,000 on behalf of other Branches, but not recorded in the books of Branch.
   (v) A remittance of Rs.1, 50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.
   (vi) Head Office allocates Rs 75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.
   (vii) Head Office collected Rs 30,000 directly from Branch Customer. The intimation of the facts has been received by the Branch till now.
   (viii) Goods dispatched by the Head Office amounting to Rs 10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

Solution:

Books of Branch

Journal Entries

	Particulars		Amount in **Rs.** Dr.	Cr.
(i)	Head Office Account	Dr.	2,800	
	To Income Account A/c			2,800
	(Being the income allocated by the Head office not recorded earlier, now recorded)			
(ii)	Provision for Doubtful Debts A/c	Dr.	1,000	
	To Head Office Account			1,000
	(Being the provision for doubtful debts not provided earlier, now provided for)			
(iii)	Head Office Account	Dr.	3,000	
	To Salaries Account			3,000
	(Being rectification of salary paid on behalf of Head Office)			
(iv)	Head Office Account	Dr.	5,000	
	To Cash Account			5,000
	(Being expenditure incurred on account of other branch, now recorded in books)			

(v)	No entry in Branch Books is required.		
(vi)	Expenses Account Dr. To Head Office Account (Being allocated expenses of Head Office recorded)	75,000	75,000
(vii)	Head Office Account Dr. To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)	30,000	30,000
(viii)	Goods –in- transit Account Dr. To Head Office Account (Being goods sent by Head Office still in-transit)	10,000	10,000

4. AFFIX Ltd. of Calcutta has a branch at Delhi to which the goods are supplied from Calcutta but the cost thereof is not recorded in the Head Office books. On 31st March, 2006 the Branch Balance Sheet was as follows:

Liabilities	*Rs.*	*Assets*	*Rs.*
Creditors Balance	40,000	Debtors Balance	2,00,000
Head Office	1,68,000	Building Extension A/c closed by transfer to H.O. A/c	
		Cash at Bank	8,000
	2,08,000		2,08,000

During the six months ending on 30-9-2006, the following transactions took place at Delhi.

	Rs.		*Rs.*
Sales	2,40,000	Manager's Salary	4,800
Purchases	48,000	Collections from Debtors	1,60,000
Wages paid	20,000	Discounts allowed	8,000
Salaries (inclusive of advance of Rs. 2,000)	6,400	Discount earned	1,200
		Cash paid to Creditors	60,000
General Expenses	1,600	Building Account (further payment)	4,000
Fire Insurance (paid for one year)	3,200	Cash in Hand	1,600
Remittance to H.O.	38,400	Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-2006. Also give journal entries in the Delhi books.

Solution: **Journal Entries**

		Dr.	Cr.
2012		Dr.	Cr.
30 Sept.		Rs.	Rs.
(i) Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance A/c)			
(ii) Prepared Insurance A/c	Dr.	1,600	
To Fire Insurance A/c			1,600
(Six months premium transferred to the Prepaid Insurance A/c)			
(iii) Head Office Account Dr.		88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
(iv) Sales Accounts Dr.		2,40,000	
Discount Earned A/c Dr.		1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			

	Dr.	Cr.
(v) Head Office Account Dr.	4,000	
To Building Account		4,000
(Transfer of amounts spent on building extension to H.O. A/c)		

Head Office Account

2012		Rs.	2012		Rs.
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries (Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 2012

Liabilities	**Rs.**	**Assets**	**Rs.**
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600
		Building Extension A/c transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

	Rs.			**Rs.**
To Balance b/d	8,000	By Wages		20,000
To Collection from Debtors	1,60,000	By Salaries		6,400
		By Insurance		3,200
		By General Exp.		1,600
		By H.O. A/c		38,400
		By Manager's Salary		4,800
		By Creditors		60,000
		By Building A/c		4,000
		By Balance c/d		
		Cash in Hand	1,600	
		Cash at Bank	28,000	29,600
	1,68,000			1,68,000

Debtors Account

	Rs.		Rs.
To Balance b/d	2,00,000	By Cash Collection	1,60,000
To Sales	2,40,000	By Discount (allowed)	8,000
		By Balance c/d	2,72,000
	4,40,000		4,40,000

Creditors Account

	Rs.		Rs.
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000

5. The Washington branch of XYZ Limited, Mumbai sent the following trial balance as on 31st Dec., 2007:

	$	$
Head office A/c	_	22,800
Sales	_	84,000
Debtors and creditors	4,800	3,400
Machinery	24,000	_
Cash at bank	1,200	_
Stock, 1 January, 2007	11,200	_
Goods from H.O.	64,000	_
Expenses	5,000	_
	1,10,200	1,10,200

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

	Rs.		Rs.
To Balance b/d	8,10,000	By Cash	28,76,000
To Goods sent to branch	29,26,000	By Balance c/d	8,60,000
	37,36,000		37,36,000

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired on 31st January, 2002, when $ 1.00 = Rs. 40.

Rates of exchange were:

1st January, 2007	$ 1.00	=	Rs. 46
31st December, 2007	$ 1.00	=	Rs. 48
Average	$ 1.00	=	Rs. 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Solution:

(i) Branch Trading and Profit & Loss A/c (in Dollars) for the year ended 31st December, 2012

Particulars	**$**	**Particulars**	**$**
To Opening stock	11,200	By Sales	84,000
To Goods from H.O.	64,000	By Closing stock (W.N.2)	8,000
To Gross profit c/d	16,800		
	92,000		92,000
To Expenses	5,000	By Gross profit b/d	16,800
To Depreciation	2,400		
To Manager's commission (W.N.1)	470		
To Net profit c/d	8,930		
	16,800		16,800

(ii) (a) Converted Branch Trial Balance (into Indian Currency)

Particulars	**Rate per $**	**Dr. (Rs.)**	**Cr. (Rs.)**
Machinery	40	9,60,000	_
Stock January 1, 2012	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate		47,000	_
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		Rs. 3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 2012

	Rs.		Rs.
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from head Office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		43,32,000
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on Rs. 9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		8,90,800

(c) Branch Account

	Rs.			Rs.
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	*Less:*		8,64,000
To Creditors	1,63,200	Depreciation	(96,000)	
To Outstanding		By Closing stock		3,84,000
Commission	22,560	By Debtors		2,30,400
		By Cash at bank		57,600
	15,36,000			15,36,000

Working Notes:

1. Calculation of manager's commission @ 5% on profit

i.e. 5% of $[16,800 – (5,000 + 2,400)]

= $9,400 X 5/100 = $ 470

Manager's commission in Rupees = $ 470 × Rs. 48 = Rs. 22,560

2. Calculation of closing stock

	$
Opening stock	11,200
Add: Goods from head office	64,000
	75,200
Less: Cost of goods sold (at invoice price) i.e.100/125 X 84,000 =	(67,200)
Closing stock	8,000

Closing stock in Rupees = $ 8,000 x Rs. 48 = Rs. 3,84,000

Note: Manager is entitled to commission on profits earned at the end of the year.

6. M/s Rani & Co. has head office at Singapore and branch at Delhi (India). Delhi Branch is an Integral foreign operation of M/s Rani & Co. Delhi branch furnishes you with its trial balance as on 31st March, 2019 and the additional information given thereafter:

	Dr. (Rs. '000)	Cr. (Rs. '000)
Stock on 1st April, 2018	600	
Purchases and sales	1,600	2,400
Sundry debtors and creditors	800	600
Bills of exchange	240	480
Wages and salaries	1,120	
Rent, rates and taxes	720	
Sundry charges	320	
Computers	600	
Bank balance	520	
Singapore office A/c		3,040
	6,520	**6,520**

Additional information:

(a) Computers were acquired from a remittance of Singapore Dollar 12,000 received from Singapore head office and paid to the suppliers. Depreciate computers at the rate of 40% for the year.

(b) Closing stock of Delhi branch was Rs. 15,60,000, on 31st March, 2019.

(c) The rates of exchange may be taken as follows:

(i) On 1.4.2018@ Rs. 50 per Singapore Dollar

(ii) On 31.3.2019 @ Rs. 52 per Singapore Dollar

(iii) Average exchange rate for the year @ Rs. 51 per Singapore Dollar

(iv) Conversion in Singapore Dollar shall be made upto two decimal accuracy.

(d) Delhi branch account showed a debit balance of Singapore Dollar 59,897.43 on 31-3-2019 in the Head office books and there were no items pending for reconciliation.

In the Books of Head Office, you are required to prepare:

(i) Revenue statement for the year ended 31st March, 20019 (in Singapore Dollar)

(ii) Balance Sheet as on that date. (in Singapore Dollar)

Solution:

Books of Head Office

(i) Trading and P & L A/c/(Revenue statement) for the year ended 31st March, 20019

Particulars	Amount	Particulars	Amount
To opening Stock	12,000.00	By Sales	47,058.82
To Purchases	31,372.55	By Closing Stock	30,000.00
To Wages and Salaries	21,960.78	(15,60,000/52)	
To Gross Profit c/d	11,725.49		
	77,058.82		**77,058.82**
To Rent, rates and taxes	14,117.65	By Gross Profit b/d	11,725.49
To Sundry charges	6,274.51	By Net Loss c/d	13,466.67
To Depreciation on Computers	4,800.00		
	25,192.16		**25,192.16**

(ii) Balance Sheet as at 31-03-2019

Liabilities		Amount	Assets	Amount
Singapore office A/c	59,897.43		Computers	7,200.00
Less: Net Loss	(13,466.67)	46,430.76	Stock	30,000.00
Creditors		11,538.46	Debtors	15,384.61
B/P		9,230.77	B/R	4,615.38
			Bank balance	10,000.00
		67,199.99		**67,199.99**

Working Note: Converted Trial Balance

Particulars	₹ '000'		Conversion rate	Singapore Dollar	
	Dr.	Cr.		Dr.	Cr.
Stock on 1st April, 2018	600	-	1/50	12,000.00	-
Purchases and sales	1,600	2,400	1/51	31,372.55	47,058.82
Sundry debtors and creditors	800	600	1/52	15,384.61	11,538.46
Bills of exchange	240	480	1/52	4,615.38	9,230.77
Wages and salaries	1,120	-	1/51	21,960.78	-
Rent, rates and taxes	720	-	1/51	14,117.65	-
Sundry charges	320	-	1/51	6,274.51	-
Depreciation on Computers (600 X 40%)	240		12,000 X 40%	4,800.00	-
Computers (600 – 240)	360	-	12,000 - 4,800	7,200.00	-
Bank balance	520	-	1/52	10,000.00	-
Singapore office A/c	-	3,040	H.O. Books	-	59,897.43
Total	6,520	6,520		1,27,725.48	1,27,725.48

7. An Indian company Moon Star Ltd. has a branch at Verginia (USA). The Branch is a non–integral foreign operation of the Indian Company. The trial Balance of the Branch as at 31th March, 2012 is as follows:

	Dr.	Cr.
Office equipments	48,000	
Furniture and fixtures	3,200	
Stock,(April 1, 2011)	22,400	
Purchases	96,000	
Sales		1,66,400
Goods Sent from (H.O)	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, rates and taxes	800	
Insurance	400	
Trade expenses	400	
Head Office A/c		45,600
Sundry debtors	9,600	
Sundry creditors		6,800
Cash at bank	2,000	
Cash at hand	400	
US $	**2,18,800**	**2,18,800**

The following further information's are given:
(1) Salaries outstanding-$ 400.
(2) Depreciate Office equipment and Furniture and Fixtures @ 10% p.a. at written down value.
(3) The Head Office sent goods to Branch for Rs. 15,80,000.
(4) The Head Office shown an amount of Rs. 20,50,000 due from Branch.
(5) Stock on 31th March, 2013 - $ 21,500
(6) There were no transit items either at the start or at the end of the year.
(7) On April 1,2010 when the fixed assets were purchased the rate of exchange was Rs.43 to one $. On April1, 2011, the rate was Rs. 47 per $. On March 31, 2012 the rate was Rs. 50 per $. Average Rate during the year was Rs. 45 to one $.

Prepare:
(a) Trial balance incorporating adjustments given converting dollars into rupees.
(b) Trading, Profit and Loss Account for the year ended 31st March,2012 and Balance Sheet as on date depicting and net position of the Branch as would appear in the books of Indian company for the purpose of incorporating in the main Balance Sheet.

Solution: **In the books of Moon Star**

Trial Balance (in Rupees) of Verginia (USA) Branch as on 31st March, 2012

	Dr.	Cr.	Conversion	Dr.	Cr.
	US $	US $	rate	Rs.	Rs.
Office Equipment	43,200		50	21,60,000	
Depreciation on Office	4,800		50	2,40,000	
Equipment	2,880		50	1,44,000	
Furniture and fixtures	320		50	16,000	
Depreciation on furniture and	22,400		47	10,52,800	
fixtures	96,000		45	43,20,000	
Stock (1st April, 2011)		1,66,400	45		74,88,000
Purchases	32,000			15,80,000	
Sales	400		45	18,000	
Good sent from H.O.	3,600		45	1,62,000	
Carriage inward		400	50		20,000
Salaries (3,200 + 400)	800		45	36,000	
Outstanding salaries	400		45	18,000	
Rent, rate and taxes	400		45	18,000	
Insurance		45,600			20,50,000
Trade expenses	9,600		50	4,80,000	
Head Office A/c		6,800	50		3,40,000
Trade debtors	2,000		50	1,00,000	
Trade creditors	400		50	20,000	
Cash and bank					4,66,800
Cash in hand	2,19,200	2,19,200		1,03,64,800	1.03,64,800
Exchange gain (bal. fig.)					

(b) **Trading and Profit and Loss Account of Verginia Branch for the year ended 31st March, 2012**

	Rs.		Rs.
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	2, 40,000		

	Rs.		Rs.
equipment			
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11, 02,200		
	15, 92,200		15,92,200

Balance Sheet of Verginia Branch
as on 31st March, 2012

Liabilities	Rs.	Rs.	*Assets*	Rs.	Rs.
Head Office A/c	20, 50,000		Office Equipment	24, 00,000	
Add : Net profit	11,02,200	31,52,200	*Less* : Depreciation	(2,40,000)	21,60,000
Foreign Currency Translation Reserve		4, 66,800	Furniture and fixtures	1, 60,000	
Trade creditors	3, 40,000		*Less*: Depreciation	(16,000)	1, 44,000
Outstanding salaries		20,000	Closing stock		10, 75,000
			Trade debtors		4, 80,000
			Cash in hand		20,000
			Cash at bank		1, 00,000
		39, 79,000			39, 79,000

8. Pawan, of Delhi has a branch at Jaipur. Goods are invoiced to the branch at cost plus 25%. The branch is instructed to deposit the receipts everyday in the head office account with the bank. All the expenses are paid through cheque by the head office except petty cash expenses which are paid by the Branch.
From the following information, you are required to prepare Branch Account in the books of Head office:

	Rs.
Stock at invoice price on 1.4.2012	1,64,000
Stock at invoice price on 31.3.2013	1,92,000
Debtors as on 1.4.2012	63,400
Debtors as on 31.3.2013	84,300
Furniture & fixtures as on 1.4.2012	46,800
Cash sales	8,02,600
Credit sales	7,44,200
Goods invoiced to branch by head office	12,56,000
Expenses paid by head office	2,64,000
Petty expenses paid by the branch	20,900
Furniture acquired by the branch on 1.10.2012 (payment was made by the branch from cash sales and collection from debtor	5,000

Depreciation to be provided on branch furniture & fixtures @ 10% p.a. on WDV basis.

Solution:

In the Books of Pawan Delhi (Head Office)
Jaipur Branch Account

	Rs.		Rs.
To Opening balances:		By Branch stock reserve	32,800
Branch stock A/c	1,64,000	By Bank A/c (W.N.4)	15,00,000
Branch debtors A/c	63,400	By Goods sent to branch A/c (Loading)	2,51,200
Branch furniture A/c	46,800		
To Goods sent to branch	12,56,000	By Closing Balance:	
To Bank A/c (branch expenses)	2,64,000	Branch stock A/c	1,92,000
To Branch stock reserve A/c	38,400	Branch debtors A/c	84,300
To Profit and loss A/c (Bal.Fig.)	2,74,570	Branch furniture A/c (W.N.2)	46,870
	21,07,170		21,07,170

Working Notes:

1. Depreciation on furniture	Rs.
10% p.a. on ,46, 800	4,680
10% p.a. for 6 months on ,5, 000	250
	4,930

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2. Closing balance of branch furniture as on 31.3.2013

	Rs.
Branch furniture as on 1.4.2012	46,800
Add: Acquired during the year	5,000
	51,800
Less: Depreciation (W.N.1)	(4,930)
Branch furniture as on 31.3.2013	46,870

3. Collection from branch debtors

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	63,400	By Bank A/c (Bal.Fig.)	7,23,300
To Sales	7.44,200	By Balance c/d	84,300
	8,07,600		8,07,600

4. Cash remitted by the branch to head office

Cash sales + Collection from debtors – Petty expenses – Furniture acquired by branch

Rs. 8,02,600 + Rs. 7,23,300 (W.N. 3) – Rs. 20,900 – Rs. 5,000 = Rs. 15,00,000

9. M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch Expenses are paid direct from head office and the Branch has to remit all cash received into the Head Office Bank Account.
From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit under Stock and Debtors Method'.
Branch does not maintain any books of account, but sends weekly returns to the Head Office.

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

Solution: **Bangalore Branch Stock Account**

Particulars		*Amount (₹)*	*Particulars*		*Amount (₹)*
To	Balance b/d	4,50,000	By	Goods sent to branchA/c (Returns)	90,000
To	Goods sent to branch A/c	45,00,000	By	Bank A/c (Cash sales)	15,00,000
To	Branch debtors A/c (Returns)	60,000	By	Branch debtors A/c (credit sales)	27,00,000
To	Branch adjustment A/c (Surplus over invoice price)*	1,80,000	By	Balance c/d	9,00,000
		51,90,000			51,90,000

***Alternatively, this may directly be transferred to Branch P&L A/c without routing it through Branch Adjustment Account.**

Bangalore Branch Adjustment Account

Particulars		Amount (₹)	Particulars		Amount (₹)
To	Stock reserve - 20% of ₹ 9,00,000 (closing stock)	1,80,000	By	Stock reserve - 20% of ₹ 4,50,000 (Opening stock)	90,000
To	Branch profit & lossA/c (Gross profit)	9,72,000	By	Goods sent to branch A/c – 20% of ₹ 44,10,000 (45,00,000 – 90,000)	8,82,000
			By	Branch stock A/c	1,80,000
		11,52,000			11,52,000

Branch Profit & Loss Account

Particulars		Amount (₹)	Particulars		Amount (₹)
To	Branch expenses A/c	6,30,000	By	Branch adjustmentA/c (Gross Profit)	9,72,000
To	Branch debtors A/c (Discount)	45,000			
To	Branch Debtors A/c (Bad debts)	30,000			
To	Net profit (transferred to Profit & Loss A/c)	2,67,000			
		9,72,000			9,72,000

Branch Expenses Account

Particulars		Amount (₹)	Particulars		Amount (₹)
To	Bank A/c (Rent, rates & taxes)	1,35,000	By	Branch profit and lossA/c (Transfer)	6,30,000
To	Bank A/c (Salaries, wages& bonus)	4,50,000			
To	Bank A/c (Office expenses)	45,000			
		6,30,000			6,30,000

Branch Debtors Account

Particulars		Amount (₹)	Particulars		Amount (₹)
To	Balance b/d	5,40,000	By	Bank A/c	24,00,000
To	Branch stock A/c	27,00,000	By	Branch profit and loss A/c (Bad debts and discount)	75,000
			By	Branch stock A/c (Sales returns)	60,000
			By	Balance c/d (bal. fig.)	7,05,000
		32,40,000			32,40,000

Goods sent to Branch Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Branch stock A/c	90,000	By Branch stock A/c	45,00,000
To Branch adjustment A/c	8,82,000		
To Purchases A/c	35,28,000		
	45,00,000		45,00,000

10. Following is the information of the Jammu branch of Best Ltd., New Delhi for the year ending 31st March, 2010 from the following:
    (1) Goods are invoiced to the branch at cost plus 20%.
    (2) The sale price is cost plus 50%.
    (3) Other information:-

Stock as on 01.04.2009	2,20,000
Goods sent during the year	11,00,000
Sales during the year	12,00,000
Expenses incurred at the branch	45,000

Ascertain:
(i) The profit earned by the branch during the year.
(ii) Branch stock reserve in respect of unrealized profit.

Solution: (i) Calculation of profit earned by the branch In the books of Jammu Branch

Trading Account and Profit and Loss Account

Particulars	Amount	Particulars	Amount
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit (Bal fig)	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit
= ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

	₹	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	**₹**	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less: Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

11. Arnold Ltd. Delhi, trades in Ghee and Oil. It has a branch at Lucknow. The company despatches 25 tins of Oil @ Rs. 1,000 per tin and 15 tins of Ghee @ Rs. 1,500 per tin on 1st of every month. The branch incurs some expenditure which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

		Delhi Rs.	Lucknow Rs.
Purchases	Ghee	14,75,000	-
	Oil	29,32,000	-
Direct expenses		3,83,275	-
Expenses paid by H.O.		-	14,250

Sales	Ghee	18,46,350	3,42,750
	Oil	27,41,250	3,15,730
Collection during the year (including Cash Sales)		-	6,47,330
Remittance by Branch to Head Office		-	6,13,250

(Delhi)		
Balance as on:	1-1-2005	31-12-2005
Stock : Ghee	1,50,000	3,12,500
Oil	3,50,000	4,17,250
Debtors	7,32,750	-
Cash on Hand	70,520	55,250
Furniture & Fittings	21,500	19,350
Plant/Machinery	3,07,250	7,73,500

(Lucknow)		
Balance as on:	**1-1-2005**	**31-12-2005**
Stock : Ghee	17,000	13,250
Oil	27,000	44,750
Debtors	75,750	-
Cash on Hand	7,540	12,350
Furniture & Fittings	6,250	5,625
Plant/Machinery	-	-

Addition to Plant/Machinery on 1-1-2005 Rs. 6,02,750.

Rate of Depreciation: Furniture / Fittings @ 10% and Plant / Machinery @ 15% (already adjusted in the above figures).

The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of Rs. 2000 p.m. General expenses incurred by H.O. Rs. 24,000.

Prepare Branch Account in the head office books and also prepare the company's Trading and Profit and Loss A/c (excluding branch transactions).

Solution:

In the books of Arnold

Lucknow Branch Account

	Rs.		Rs.
To Balance b/d		By Bank (Remittance to H.O.)	6,13,250
Opening stock:		By Balance c/d	
Ghee	17,000	Closing stock:	
Oil	27,000	Ghee	13,250
Debtors	75,750	Oil	44,750
Cash on hand	7,540	Debtors (W.N. 1)	86,900
Furniture & fittings	6,250	Cash on hand (W.N. 2)	12,350
To Goods sent to Branch A/c		Furniture & fittings	5,625
Ghee	2,70,000		
Oil	3,00,000		
To Bank (Expenses paid by H.O.)	14,250		
To Branch Manager commission (Rs. 58,335 × 1/11)	5,303		
To Net Profit transferred to General P & L A/c	53,032		
	7,76,125		7,76,125

Trading and Profit and Loss account for the year ended 31st December, 2012

(Excluding branch transactions)

	Rs.		Rs.
To Opening Stock:		By Sales:	
Ghee	1,50,000	Ghee	18,46,350
Oil	3,50,000	Oil	27,41,250
To Purchases:		By Closing Stock:	
Ghee 14,75,000		Ghee	3,12,500

Less: Goods sent to Branch	(2,70,000)	12,05,000	Oil	4,17,250
Oil	29,32,000			
Less: Goods sent to Branch	(3,00,000)	26,32,000		
To Direct Expenses		3,83,275		
To Gross Profit		5,97,075		
		53,17,350		53,17,350
To Manager's Salary		24,000	By Gross Profit	5,97,075
To General Expenses		24,000	By Branch Profit transferred	53,032
To Depreciation				
Furniture @ 10%	2,150			
Plant & Machinery @ 15% (W. N. 3)	1,36,500	1,38,650		
To General Manager's Commission @ 10% (*i.e.*, 4,63,457 × 1/11)		42,132		
To Net profit		4,21,325		
		6,50,107		6,50,107

Working Notes:

(1) Memorandum Branch Debtors Account

	Rs.		Rs.
To Balance b/d	75,750	By Cash Collections (including Cash Sales)	6,47,330
To Sales (including Cash Sales)		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		7,34,230

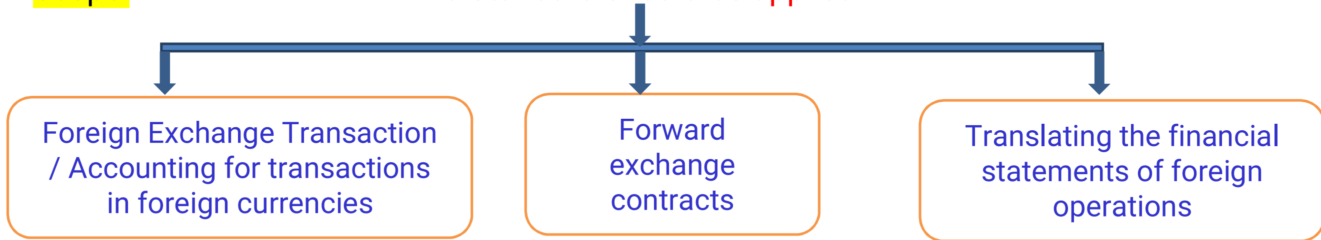
(2) Memorandum Branch Cash Account

	Rs.		Rs.
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350
	6,54,870		6,54,870

(3) Depreciation on Plant & Machinery = 3,07,250 x 15% + 6,02,750 x 15% = ₹1,36,500

CHAPTER 30 AS 11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

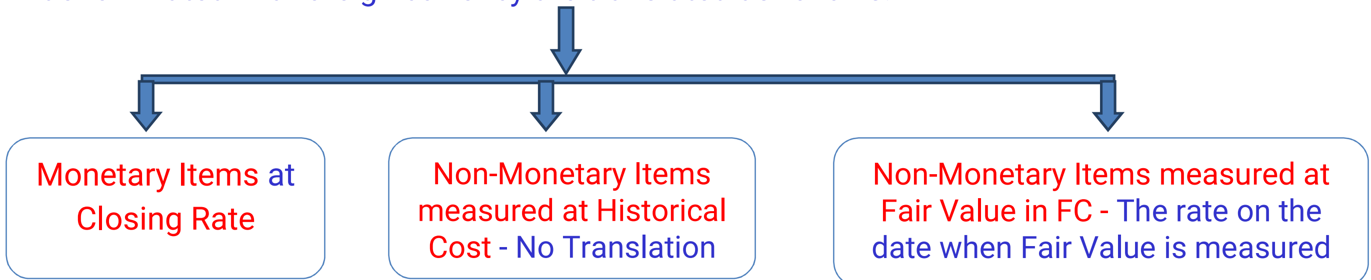
1. Scope: This Standard should be applied



2. Foreign currency transaction: shall be recorded in reporting currency as follows:

   A. Initial Recognition at the Transaction Date: by translation in the entity's reporting currency at the exchange rate on the transaction date.

   B. Subsequent Recognition: at the end of each reporting Period. All assets and liabilities denominated in a foreign currency are translated as follows:



Any differences arising on the settlement or translate on reporting date of monetary items should be recognised as foreign exchange difference

Treatment of foreign exchange difference: Transfer into P & L A/c except in a case where entity follows Para-46 / 46A

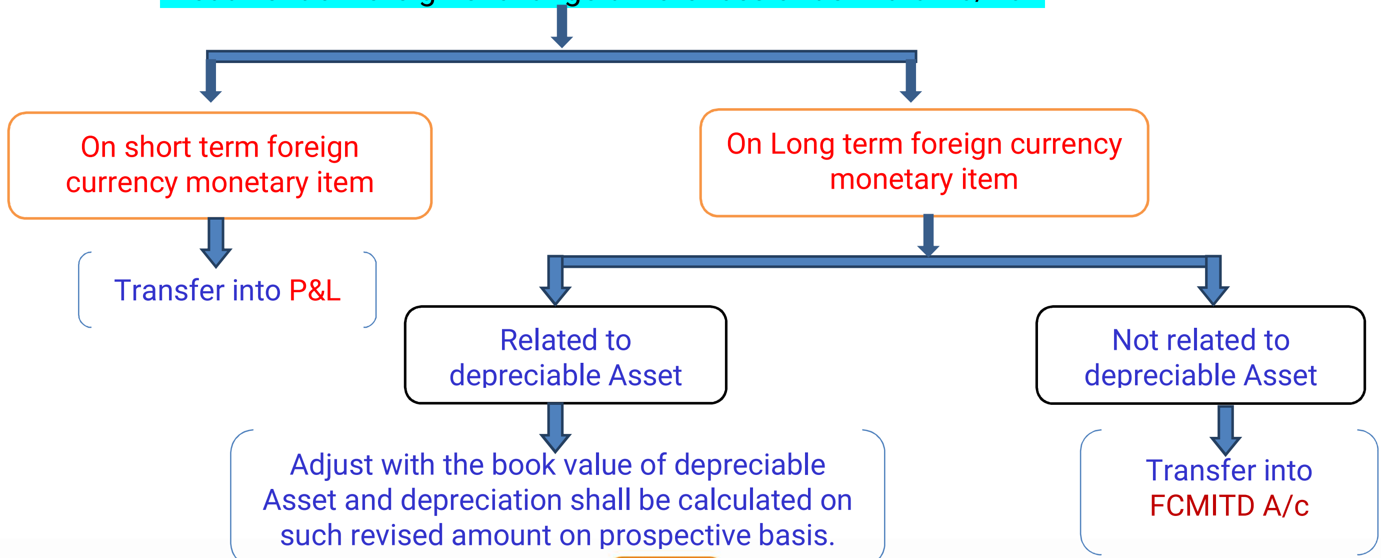
Monetary items are money held and assets and liabilities

✓ to be received or paid in fixed or determinable amounts of money. E.g. cash, receivables and payables.

Non-monetary items are assets and liabilities other than monetary items.

E.g. Share capital, fixed assets, inventories and investments in equity shares.

Treatment of foreign exchange differences under Para-46/46A



Notes:

(1) Application of Para 46/46A is optional for the entity. If the above option is exercised, disclosure should be made.

(2) Presentation of Foreign Currency Monetary Item Translation Difference Account(FCMITDA): As per the Council of ICAI, the balance of FCMITDA should be shown on the "Equity and Liabilities" side of the balance sheet under the head 'Reserves and Surplus' as a separate line item.

3. Forward exchange contract: means an agreement to exchange different currencies at a forward rate. Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.

(i) Not intended for Trading purpose: An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the amount of the reporting currency required or available at the settlement date of a transaction.
The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract.

(ii) For intended for Trading purpose: In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

4. Foreign Operations: Foreign Operations are of two types

(A) Integral foreign operation (IFO): These operations are an integral part of main activity of entity. In simple word, it is an extension of business of entity in abroad. e.g. foreign branch, sale office etc. Rule of conversion of integral foreign operation:

Nature of Transaction	Conversion Rate
Fixed Asset, Depreciation & Accumulated Depreciation	On transaction Date
All Asset and liabilities other than mentioned above	Closing rate
All income & expenditures	Transaction rate (Average rate – for exam purpose)
Any transaction between H.O. & Branch and balance of H.O.	As per H.O. Records

Note 1: Any Difference in the Converted Trial Balance shall be considered as "Foreign Exchanges Gain / Loss" which shall be transferred into P&L A/c of Branch.

Note 2: 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.

(B) Non-integral foreign operation (NIFO): These operations are not integral part of entity. Rather these businesses are independent and having separate autonomy. E.g. Foreign subsidiary, foreign joint venture or foreign associates. Rule of conversion of Non-integral foreign operation:

Nature of Transaction	Conversion Rate
All assets and liabilities (including fixed asset and accumulated depreciation)	Closing rate
All income & expenditures	Transaction rate (Average rate – for exam purpose)
Any transaction between H.O. & Branch and balance of H.O.	As per H.O. Records

Note: Any difference in the converted Trial Balance shall be transferred to "Foreign currency Translation Reserve" (FCTR) account which is capital in nature and shown under the head," Reserve & Surplus" in balance sheet.

PRACTICAL QUESTIONS

1. A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2005, when the exchange rate was Rs.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, 2005 when the exchange rate was Rs.47 per US Dollar. However, on 31st March, 2005, the rate of exchange was Rs.48 per US Dollar. The company passed an entry on 31st March, 2005 adjusting the cost of raw materials consumed for the difference between Rs.47 and Rs.43 per US Dollar. In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.
Solution: 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. Sundry creditors is a monetary item, hence should be valued at the closing rate i.e, Rs.48 at 31st March, 2005 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs.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, 2005 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs.48 and Rs.47 per USD. Hence, the accounting treatment adopted by the company is incorrect.

2. ABC Ltd. borrowed US $ 5,00,000 on 01/01/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2017	1 US$ =	₹ 68.50
31/03/2017	1 US $ =	₹ 69.50
31/07/2017	1 US $ =	₹ 70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.
Solution: **Journal Entries in the Books of ABC Ltd.**

Date	Particulars	₹ (Dr.)	₹ (Cr.)
Jan. 01, 2017	Bank Account (5,00,000 x 68.50) Dr.	342,50,000	
	To Foreign Loan Account		342,50,000
Mar. 31, 2017	Foreign Exchange Difference Account Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 x (69.50-68.50)]		5,00,000
Jul. 31, 2017	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

3. Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2012, 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.
Solution

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 falling the year 2012-13; therefore loss to be recognized (30,000/3) x 2 = Rs. 20,000.Rest Rs. 10,000 will be recognized in the following year.

4. Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = Rs. 47.10 when exchange rate was US$ 1 = Rs. 47.02. On 31st December when he closed his books exchange rate was US$ 1 = Rs. 47.15. On 31st January, he decided to sell the contract at Rs. 47.18 per dollar. Show how the profits from contract will be recognized in the books

Solution: Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit and Loss Account.

Sale Rate	Rs. 47.18
Less: Contract Rate	(Rs. 47.10)
Premium on Contract	Rs. 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	Rs. 8,000

5. Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was Rs. 56 per US $ and the rate as on 31st March, 2020 Rs. 62 per US $. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards.

Solution:

(i) Interest for the period 2019-20 = US $ 10 lakhs x 4% × Rs. 62 per US $ = Rs. 24.80 lakhs

(ii) Increase in the liability towards the principal amount=US $ 10 lakhs × Rs.(62 - 56)=Rs.60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × Rs. 56 x 10.5% = Rs. 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= Rs. 58.80 lakhs - Rs. 24.80 lakhs = Rs. 34 lakhs.

Therefore, out of Rs. 60 lakhs increase in the liability towards principal amount, only Rs. 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 58.80 lakhs being the aggregate of interest of Rs. 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 Rs. 34 lakhs. Hence, Rs. 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 “Borrowing Costs” and the remaining Rs. 26 lakhs (60-34) would be considered as the exchange difference to be accounted for as per AS 11 “The Effects of Changes in Foreign Exchange Rates”.