CA-INTERMEDIATE

ADVANCED ACCOUNTING

GROUP-1

MODULE-2

NEW COURSE

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Dedicated to

BABA VISHAN PURI JI MAHARAJ

BABA LAKSHMAN PURI JI MAHARAJ

CONTENTS

ACCOUNTING STANDARD:1

DISCLOUSRE OF ACCOUNTING POLICIES

CONCEPT : 1

What are Accounting Policies?

1. Accounting Policies refer to – (a) the specific accounting principles and (b) the methods of applying those principles, adopted by the enterprise in the preparation and presentation of Financial Statements.
2. Example: Inventory is valued at Cost or Net Realisable Value, whichever is lower. This is principle. Cost can be determined either by First in First (FIFO) method or Weighted Average Cost (WAC) or other suitable methods.

CONCEPT : 2

Why should Accounting Policies be disclosed?

Accounting Policies should be disclosed in the Financial Statement for the following reasons

1. Better Understanding of Financial Statements: The view presented in the Financial Statements can be significantly affected by the accounting policies followed in their preparation and presentation. Disclosure enables proper understanding of the information presented in Financial Statements.
2. Inter-Firm Comparison: The accounting policies followed vary from enterprise to enterprise. Meaningful comparison of Financial Statements can be facilitated by appropriate disclosure of policies.
3. Compliance with Law: Disclosure of some accounting policies is required by law, for example, in the case of Companies, disclosure is mandatory.
4. ICAI Requirements: The ICAI has also provided guidelines for disclosure of significant accounting policies through AS-1, in order to bring uniformity in disclosure.

CONCEPT: 3

What are the purposes of AS-1?

1. To promote better understanding of Financial Statements, through the disclosure of significant accounting policies, and the manner in which accounting policies are disclosed in the Financial Statements.

2. To facilitate a more meaningful comparison between Financial Statements of different enterprises.
3. To bring uniformity in the disclosure of accounting policies by different enterprises, and ensure standards in the nature and degree of disclosure.

CONCEPT: 4

Write short notes on Fundamental Accounting Assumptions & their disclosure requirements. (Para 9, 10).

The fundamental accounting assumptions are –

1. Going Concern: The enterprise is normally viewed as a Going Concern, i.e. as continuing I operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of operations.
2. Consistency: The accounting policies are consistent from one period to another.
3. Accrual: Revenues and costs are accrued, i.e. recognized as they are earned or incurred and recorded in the Financial Statements of the periods to which they relate, and not when money is received or paid.

Disclosure Requirements:

If the above assumptions are followed	If the above assumptions are not followed
Disclosure is not required, since their acceptance and use are assumed.	Disclosure is necessary specifying that the general accounting assumptions are not followed.

QUESTION 1

Vinayak Chemicals Ltd. a Government Company, is engaged in production of fertilizers and various nitrogenous chemicals. As per the Company's accounting policy, expenses incurred upto ₹ 25,000 relating to future period an expenses in the current year.

The Statutory Auditors of the Company, opinion that the Company has not complied with AS- 1 which prescribes accrual basis of accounting. Does the aforesaid accounting policy of the Company violate the provisions of AS-1?

SOLUTION :

1. Nature of Information: Information is material if its mis-statement (i.e. omission or erroneous statement), could influence the economic decisions of users, Materiality depends on the size and nature of the item, judged in the particular circumstances

of its mis-statement. Materiality provides a cut-off point than merely a primary qualitative characteristic of the information.

2. Materiality: The selection and application of an accounting policy depends on materiality. AS-1 require that "Financial Statements should disclose all materials items, i.e. items the knowledge of which might influence the decisions, of the users of the Financial Statements. Accrual is one of the basic assumptions, hence materiality in refer into accrual concept is important.

3. Applicability of AS: AS are intended only for items which re material. Whether the sum of ₹ 25,000 is material or not, in respect of each item, or in the aggregate, would depend upon the facts of the case and that would provide the basis for its accounting treatment.

4. *Conclusion: The appropriateness of accounting policy depends on the considerations of materiality determined by the Auditor based on his professional judgement. The accounting policy would be proper, provided it does not cross the threshold of materiality.*

QUESTION 2

Write short notes on the choice available in accounting policies (Para 12 to 15)

OR

There is no single list of accounting policies that are applicable to all situations. Comment.

OR

Indicate any three areas in respect of which different accounting policies may be adopted by different enterprises.

OR

"Recognizing the need to harmonize the diverse Accounting Policies and Practices, Accounting Standards are framed. Give examples of areas in which different accounting policies may be adopted by enterprises.

SOLUTION :

1. Alternative accounting policies: The differing circumstances in which enterprises operate and the situation of diverse and complex economic activities of the Company has given rise to acceptability of alternative accounting principles and methods of applying those principles.

2. Decision Making: The choice of the alternative principles and methods calls for considerable judgement by the Management of the enterprise.

3. Reduction in alternatives: Various Statements issued by ICAI, together with the measures of Government, other regulatory agencies and progressive managements have reduced the number of acceptable alternatives, particularly for corporate enterprises

However, the availability of alternative accounting policies can at best be reduced not eliminated as different enterprises operate in different circumstances.

4. Illustrative List of areas of alternative accounting policies:
   (a) Methods of Depreciation, depletion and amortisation.
   (b) Conversion or translation of Foreign Currency items.
   (c) Recognition of profit on long-term contracts.
   (d) Valuation of (i) Inventories, (ii) Investments and (iii) Fixed Assets

CONCEPT : 5

What are the major considerations which govern the selection and application of accounting policies?

1. True and Fair View: The primary consideration in the selection of Accounting Policies by an enterprise is that the Financial Statements prepared and presented should represent a true and Fair View as under:-

In the case of the Balance Sheet	Of the State of Affairs of the enterprise as on a certain date.
In the case of Profit & Loss Account	Of the Profit or Loss for the period ended on that date.

2. Factors: To select and apply an accounting Policy, the following points are considered:-

Principle	Example
(a) Prudence: Prudence implies that Profits are not anticipated, they are recognized only when realized, through not necessarily in cash. However, provision is made for all known liabilities and losses, even if the amount is not certain and is only a best estimate, based on available information.	* Provision for Doubtful Debts, Provision for Discount on Debtors, etc. are based on prudence. The Accountant does not anticipate future gains, but provides for all known liabilities and losses.

	* If Stock is always valued at cost, and NRV reduced below cost, then anticipated loses (NRV<Cost) will be ignored. However, if the Stock is always valued at Market Price, it will mean that anticipated gains (NRV>Cost) is accounted. To avoid this, Stock is valued at Cost or NRV, whichever is lower.
(b) Substance over Form: This means that the accounting treatment and presentation in Financial Statements, of transactions and events, should be governed by their substance and not merely by the legal form.	* Ganesh Ltd. enters into an agreement with Vikky Ltd. for sale of goods at ₹2,50,000 to be re-purchased in the next financial year for ₹2,75,000. This is not a trading transaction, and effectively reflects a financing transaction, with the goods as underlying security/asset. This should be recorded only as a financing transaction.
	* In case of an asset required on Hire Purchase, ownership is not transferred till last instalment is paid. However, the asset is shown in the books of the Hire Purchaser.
(c) Materiality: Financial Statements should disclose all materials items, i.e. the knowledge of which might influence the decisions of the users of Financial Statements.	* Payment of penalties/fines for violation of law should be disclosed separately, even if the amount is negligible. It should not be clubbed together with "Office Expenses" or "Miscellaneous Expenses".

QUESTION 3

Write short notes on the concept of Prudence.

SOLUTION :

1. Meaning: As per AS-1, Prudence is one of the major considerations governing the selection and application of accounting of policies.
2. Profit Recognition: As per the concept of Prudence, profit is not recognized to have been earned till – (a) it is realized in ash, or (b) a third party has legally become liable to pay the amount. Thus, till the time an amount becomes recoverable from an outsider, profit is not deemed to be earned. Hence, it is not proper to record a sale unless the

third party has committed itself to paying the price, and only on the happening of this will the profit be said to have arisen.

3. Loss Provisioning: In case of losses if it is reasonably certain that a loss will arise on the transaction already entered into, such loss should be immediately recognized.

QUESTION 4

Vakrathunda Ltd. sold its Building to another Company for ₹ 60 Lakhs on 18th January and gave possession of the property to the Buyer Company. However, documentation and legal formalities are pending. Due to this, Vakrathunda Ltd. has not recorded the sale, and has shown the amount received, as an Advance. The Book Value of the Building as at the end of the current financial year is ₹ 25 Lakhs. Do you agree with this treatment? If not, explain reasons therefore.

SOLUTION "

Hint: Refer to the concept of Substance over Form given above.

- Analysis: In the above case, the economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred, although legal title is not yet transferred.
- *Conclusion: The seller Company, Vakrathunda Ltd. should record the sale and recognize Profit ₹ 35 Lakhs in P&L A/c. and also de-recognize the Asset (Building) in its Books, in the current financial year of sale.*

CONCEPT :6

Disclosure Requirements

Indicate the requirements with regard to Disclosure of Accounting Policies as per AS-1 (Para 24-27). OR

Briefly enumerate the guidelines issued by the ICAI on "Disclosure of Accounting Policies".

1. Disclosure of Accounting Policies (Para 18) : All significant accounting policies adopted in the preparation and presentation of Financial Statements should be disclosed to facilitate better understanding of the Financial Statements.
2. Place of Disclosure (Para 19, 20): Disclosures should form part of the Financial Statements. It should be disclosed at one place, instead of being scattered over several Statements, Schedules and Notes.
3. Change in Accounting Policies: Change in an accounting policy should be disclosed –
   (a) When such change has a material effect in the current period, and
   (b) When such change is reasonably expected to have a material effect in later periods.

4. Manner of Disclosure:

Effect in Current Period	Expected Effect in later periods
(a) The impact of change on the Profit/ Loss and the Balance Sheet items in current period should be quantified, to the extent ascertainable.	(a) The fact of such change, and
(b) Where quantification is not possible, either wholly or in part, the fact of such change having a material effect should be disclosed.	(b) The fact that it is likely to have effect in later periods, Should be appropriately disclosed, in the period in which the change is adopted.

5. Disclosure of Accounting Assumptions: Fundamental Accounting Assumptions, viz. Going Concern, Consistency and Accrual, if followed, need not be disclosed. Even if one of them is not followed, the fact should be disclosed.
6. Disclosure is not a Remedy: Disclosure of Accounting Policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

QUESTION 5

Gajamukh Ltd. had accounted for its liability towards Retirement Benefits of its Employees on cash basis, and had disclosed the same in the Notes on Accounts. Since, it has not followed the fundamental accounting assumption of 'Accrual' the Auditors want to qualify the report. The Company feels that a Qualified Audit Report is not necessary, since AS-1 simply requires a disclosure if a fundamental accounting assumption has not been followed Comment.

SOLUTION :

Conclusion: Mere disclosure is not sufficient and hence the Auditor should qualify his report in this case.

QUESTION 6

Is there any specific disclosure under AS-1 for a Company in Liquidation?

SOLUTION :

1. For a Company in liquidation, the fundamental accounting assumption of Going Concern is apparently not valid.
2. The Carrying Amounts of assets and liabilities would reflect the Realisable value.
3. The information should be disclosed by the Company under AS-1 on Disclosure of Accounting Policies.

QUESTION 7

Company follows the following policy for retirement benefits:

Contribution to pension fund is made based on actuarial valuation at the year end in respect of employees who have opted for pension scheme. Contribution to the gratuity fund is made based on actuarial valuation at the year end Leave encashment is accounted for on Pay AS YOU GO Method Comment.

SOLUTION :

As per AS-1 : The "Accrual" is fundamental accounting assumptions, therefore, any accounting policy cannot be contrary to fundamental accounting assumption. Policy followed for leave encashment on the basis of 'PAY AS YOU GO' is not in accordance with accrual assumptions. Therefore, the accounting policy as regards leave encashment is not correct, in fact it is contrary to AS-15 'Employee Benefits'.

QUESTION 8

JJ Ltd. manufactures a special type of computer. This company has a software division for developing programme with respect to specialized area such as medical imaging. During the year ended 31st March 2010 the company manufactured a prototype computer to be used for demonstrating the medical imaging software programme and not for sale. The cost of manufacturing of prototype computer was ₹ 50 Lakhs. The amount was included in fixed production overheads of hardware division. Comment.

SOLUTION :

Cost of prototype computer, which is manufactured by the JJ Ltd. and is not meant for sale, should not be included in fixed production overheads. Accounting policy is necessary to write off the cost of these prototype computers and same to be disclosed.

QUESTION 9

UFC Company is engaged in the business of financial services and is undergoing right liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. UFC 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 from the due date to date of repayment was effected 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. Is that correct?

SOLUTION :

AS-1 recognizes 'prudence' as one of the major consideration governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profit are not anticipated but recognised only when realized 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.

Accrual is one of the fundamental accounting assumptions as per AS-1. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be placed in a disadvantageous position by 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 therefore should be accrued to the event of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting.

QUESTION 10

Draft the accounting policies to be disclosed in the financial statement for the following items:

(a) Revenue recognition – sales of goods

(b) Depreciation

(c) Inventories

SOLUTION :

(a) Sales are recognised when goods are invoiced and dispatched to customers and are recorded inclusive of excise duty and net of trade discounts and sales tax.

(b) Depreciation is charged on straight line method based on useful life specified in Schedule II of the Companies Act, 2013 except for the following assets in respect of which depreciation is charged at the rates mentioned below:-

(i)	Kutcha Roads	47.50%
(ii)	Enabling works	20%

(c) Inventories are valued as under:

Poultry for livestock breeding	At cost
Raw material and packing materials	At cost or net realizable value, whichever is lower.
Work-in-process	At cost or net realizable value, whichever is lower.

QUESTION 11 (AS1)

Describe briefly the term "Accounting policies".

SOLUTION :

Accounting policies refers to

a. The specific accounting principles (e.g., lower of cost and net realizable value as the basis of valuation of inventories) as well as

b. The methods of applying those principles (e.g., cost formula such as FIFO applied in calculating the cost of inventories)

c. Adopted by an enterprise in the preparation and presentation of financial statements.

QUESTION 12 (AS-1)

Indicate any three areas in respect of which different accounting policies may be adopted by different enterprises.

[CA Inter, May 1995 (3 Marks)]

OR

Enumerate various areas in which different policies could be adopted.

[CA Final, May 1992 (4 Marks)]

OR

Mention any six areas in which different accounting policies may be adopted by different enterprises.

[CA Final, May 1995 (6 Marks)]

SOLUTION :

Major Areas in which different accounting policies may be adopted by different enterprises includes:

- Methods of depreciation, depletion and amortisation, e.g., WDV method, SLM
- Treatment of expenditure during construction, e.g., capitalization, written off, deferment

- Conversion or translation of foreign currency items, e.g. average rate, TT
- Valuation of inventories, e.g. FIFO, weighted average method
- Treatment of goodwill, e.g., capitalization method, super profit method
- Valuation of investments, e.g. lower of cost and fair value
- Treatment of retirement benefits, e.g., Pay-as-you-go
- Recognition of profit on long-term contracts, e.g. proportionate completion method
- Valuation of fixed assets, e.g., historical cost, revalued amount
- Treatment of contingent liabilities, e.g., provision, discloser, no treatment

QUESTION 13(AS1) [CA INTER MAY 2001, NOV. 1994 (4 MARKS)]

Write a short note on fundamental accounting assumptions.

SOLUTION :

Fundamental Accounting Assumptions

The following have been generally accepted as fundamental accounting assumptions: —

a. **Going Concern**

An enterprise is considered as a going concern if it is able to continue in operation for the foreseeable future, generally a period not to exceed one year and also have no intention or necessity of liquidation or of curtailing the

b. **Consistency**

c. **Accrual**

Revenues and costs are recognised as and when they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

QUESTION 14(AS1)

What are the major considerations, which govern the selection and application of accounting policies?

[CA Inter Nov 1995 (6 Marks)]

OR

What are the major considerations governing the Accounting Policies?

[CA Final Nov. 1992(6 Marks)]

SOLUTION :

Considerations in the Selection of Accounting Policies

The primary consideration is that the financial statements should represent a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended on that date.

The major considerations governing the selection and application of accounting

a. **Prudence**

Due to 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.

b. **Substance over Form**

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form e.g., in a finance lease transaction, the lessor in substance funding the transactions whereas the risk and reward incidence attached to the ownership of assets is passed to the lessee. Therefore, it is recorded in the books of lessee as fixed assets and in the books of lessor as receivables.

c. **Materiality**

Items the knowledge of which might influence the decisions of the user of the financial statements

Part II of Schedule VI of the Companies Act, 1956 requires that any expenses exceeding 1% of revenue or ₹ 5000 whichever is higher, shall be shown separately. Similarly, an item of 10% or more of value of raw material consumed shall be shown separately.

QUESTION 15 (AS1)

Write a short note on discloser of accounting policy.

[CA PE-II Level May 2003, Nov 2002 (4 Marks)] [CA Inter Nov 1999, May 1999 (4 Marks)]

OR

Indicate the requirements with regard to discloser of accounting policies.

[CA Inter, May 1995 (4 Marks)]

OR

'Discloser of significant accounting policy adopted in the preparation and presentation of the financial statements enhance the intangibility of financial statements.' Discuss.

[CA Final Nov. 1995, Nov. 1992 (5 Marks)]

OR

Briefly describe, the requirements of Accounting Standard-1 in regard to discloser of significant accounting policies.

[CA Final May 1995, Nov 1994, May 1991 (8 Marks)]

OR

Indicate the requirements with regard to discloser of accounting policies. Can disclosure of accounting policies or of changes therein remedy a wrong or inappropriate treatment of the item in the accounts?

SOLUTION :

Discloser of accounting policies

a. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed normally in one place.

b. Such disclosure should form part of the financial statements

c. Any change in the accounting policies having a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed.

d. If having material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable, e.g. cost formula used for inventory valuation is changed from FIFO to weighted average method, it may increase or decrease the reported profit.

   If amount is not ascertainable, the fact should be indicated, e.g., incidence of excise duty on the finished goods has been provided and the valuation of finished goods has been increased accordingly. However, it has no impact on the profit or on the net current assets.

e. If the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are not followed, the fact should be disclosed.

f. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

QUESTION 16 (AS1) [CA INTER, NOV 2002 (4 MARKS)]

Inventories of a car manufacturing company include the value of items, required for the manufacturing of a model-which was removed from the production line five years back, at cost price. As a company auditor how would you react on the above situations?

SOLUTION :

Inventory valuation: AS-2 on "Valuation of Inventories" provides that the cost of inventories may not be recoverable if those inventories are damaged, have become wholly or partially obsolete, or if their selling prices have declined. Accordingly, the auditor should examine whether appropriate allowance has been made for the defective, damaged, obsolete and slow-moving inventories in determining the net realizable value.

In this case, items required for the manufacture of a model, which has been withdrawn from the production line five years ago, are included in the stock at cost price resulting in overstatement of inventory and profit. As it appears from the facts given that the net realizable value of these items is likely to much lower than the cost necessary to write down the inventory to "net realizable value" if the items of inventories become wholly or partially obsolete. Under the circumstance, the auditor should qualify the report appropriately.

QUESTION 17

ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up to 31.3.2005.

The company wants to provide during the year ending 31.3.2006 based on technical evaluation.

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

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

SOLUTION :

No, the decision of making provision for non-moving stock on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of the company requires that provision for non-moving stock should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material. The disclosure can be made for such change in the following line by notes to accounts in the annual accounts of ABC Ltd. for the year 2005-2006.

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceeding years. Had the same method been followed as in the previous year, the profit for the year and corresponding effect on the year end net assets would have been higher by ₹ 1,00,000.

QUESTION 18

Comment on the appropriateness of the following accounting policies. Where inappropriate, give reasons.

(a) Amount of exchange differences arising on translation on Balance Sheet date is taken to profit and loss account excepting in case of gain on current assets and liabilities in a country from where, on account of restrictions, the ability of the overseas unit is seriously impaired in transferred funds. In addition, as a matter of abundant prudence, gain on long-term liabilities is held as a reserve in order to meet only translation loss that may arise in one or more subsequent periods.

(b) Construction contracts entered into on or after 1st April 2003, and the entire duration of which falls within one single accounting year are accounted for an completed contract method, and all other construction contracts are accounted for an percentage of completion method.

(c) In the area of construction contracts, revenue from fixed price construction contracts is recognised on the percentage of completion method, measured by reference to the percentage of labour hours incurred up to the reporting date, to estimated total labour hours for each contract.

(d) Effective 1st April 2003, the Company has adopted and applied the prescriptions under AS-26 (Intangible Assets), and expenses incurred on intangible items from the said date are recognised as intangible Assets, only if future economic benefits from such items flow to the enterprise and the costs are measurable. Keeping materiality of items in view, all expenses recognised as Intangible Assets are written off, where the initial cost of recognised is ₹ 5,000 or less, even if they do not meet the criteria.

(e) The company have prepared and reported segment information in conformity with the accounting policies adopted for preparing and presenting financial statements of the company as a whole. In the case of assets, which are used jointly by two business segments, values are apportioned between the two on a rational and realistic basis, while the joint revenues, which do not pertain to either, are taken on Head Office account.

SOLUTION :

Evaluation of accounting policies :-

(a) Inappropriate, Unrealised gains on long term liabilities cannot be held as a reserve, but should be credited to P&L from year to year.

(b) Inappropriate. Even in cases where the contract duration is less than one single accounting year, it is essential to adopt only Percentage Completion method. Such a need arises, for Interim Financial Reporting (AS 25 - where an interim period as treated as an accounting period, shorter than one full accounting year).

(c) Appropriate.

(d) Appropriate, However, an item to be recognised as an intangible asset, should pass both (a) definition and (b) recognition criteria. The policy talks only about recognition criteria. Further, the policy cannot cite, materiality and value being less than ₹ 5000 as reasons for write off, in cases where an item cannot be in the first place recognised as an Intangible Assets.

(e) Inappropriate, in the case of assets, which are used jointly by two business segments, values can be apportioned between the two only if the revenues generated from the assets are similarly apportioned.

QUESTION 19

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

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

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

QUESTION 20

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

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

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

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

QUESTION 21

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

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

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

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

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

SOLUTION :

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

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

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

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

QUESTION 22

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

SOLUTION :

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

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

QUESTION 23 (CA INTER MAY 2022 5 MARKS)

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

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

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

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

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

SOLUTION :

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

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

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

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

QUESTION 24 (CA INTER MAY 2023)

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

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

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

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

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

NOTES

ACCOUNTING STANDARD: 4
EVENTS AFTER BALANCE SHEET

QUESTION 1 (NOV 2009)

In preparing the Financial Statements of Santhanam Ltd. for the year ended 31st March, 2009, you come across the following features. State with reasons, how you would deal with them in the Financial Statements -

The Company invested ₹ 560 lakhs in April, 2009 in the acquisition of another Company doing similar business, the negotiations for which had started during the current Financial Year.

SOLUTION :

The acquisition of the other company is a transaction which consummated only in April 2009 and hence it will not appear in the balance sheet as on 31.3.09. However, as per para 15 of AS - 4, disclosures should be made in the report of Board of Directors.

QUESTION 2 (JUNE 2009)

While preparing its final accounts for the year ended 31st March 2009, a company made a provision for bad debts @ 5% of its total debtors. In the last week of February 2009, a debtor for 2 lakhs had suffered heavy loss due to earthquake. The loss was not covered by any insurance policy. In April 2009, the debtor became bankrupt. Can the cokmpany provide for full loss arising out o finsolvency of debtor in teh final accounts for year ended 31st March, 2009 ?

SOLUTION :

According to AS-4 "contingencies and Events occurring after the Balance Sheet date", assets and liabilities should be adjusted for events occurring after the balance sheet date, that provide additiional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, the earthquake had occurred before 31.3.09 and the loss was confirmed by bankruptcy after 31.3.2009, So, full provision for insolvency loss should be made in final accounts for year ended 31.3.09.

QUESTION 3 (FINAL NOV 2003)

While preparing its final accounts for the year ended 31st March 2003, a company made a provision for the bad debts @ 5% of its total Debtors. In the last week of February 2003 a debtor for ₹ 2 lakhs had suffered heavy loss due to a earthquake; the loss was not covere by any insurance policy. In April 2003, the debtor became bankrupt. Can the company provide for the full loss arising out

SOLUTION :

As per the AS - 4, adjustments of assets and liabilities is to be made for events occuring after Balance Sheet date that provide some additional evidence that assist in estimation of amounts relating to conditions existing on Balance Sheet date.

QUESTION 4 (FINAL MAY 1995)

State your view on the following :

After the close of the accounting year of XYZ Co. Ltd., there was a severe earthquake. As a result of which, a portion of the building and the rolling mill was destroyed. The extent of the damage was beyond repair. The company's resources were inadequate to fund the replacement of the assets so destroyed.

SOLUTION :

The auditor should assess whether the 'going concern' assumption still holds valid. If it is valid then it is non-adjusting event. AS-4, requires disclosures of nature of event, an estimate of financial impact or statement that such an estimate cannot be made in the report of approving authority.

QUESTION 5 (AUDITING MAY 2000)

As an auditor state your views on the following situations :

VV Ltd. had announced a voluntary retirement plan for its employees on January 2000. The Scheme is scheduled to close on June 30, 2000. The Scheme envisaged an initial lumpsum payment of a maximum of ₹ 2 lacs, and monthly payments over the balance period of service of employees coming under the plan. 200 employees opted for the scheme, as on March 31, 2000. Total lump-sum payment, for these employees, would be ₹ 250 lacs, and the aggregate of future payments, to them would amount to ₹ 1,500 lacs. However, payment had not been made to the employees under the Scheme, up to March 31, 2000, nor the company made any provision in its accounts, towards any liability under the Scheme. Comment.

SOLUTION :

AS 4 will apply. Adjusting event. Appropriate provision to be made.

QUESTION 6 (AUDITING)

The account of ABC Ltd., for the year ended 31st March, 2001, was approved by the BOD of the Co. 19th May 2001. The Director recommenced a dividend @ 10%. However, the Directors feel that this need not be disclosed in the accounts of the Co. for the year ended 31st March 2001 since it does not provide any additional information to the condition prevailing on the date BalanceSheet i.e. on 31st March 2001. Do you agree with the BOD of ABC Ltd. ?

SOLUTION :

If an item is statutorily required to be shown in the financial statements, assets and liabilities are adjusted for such events occurring after the balance sheet date. But as per recent amendment proposed dividend is now not a liability but it should be disclosed in notes to accounts only.

QUESTION 7 (FINAL NOV 2005)

ABC Ltd. could not recover ₹ 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalised for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.

The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of ₹ 10 lakhs in the books of account for the year ended 31st March, 2005

SOLUTION :

As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of ₹ 10 lakhs according to para 8 of AS 4.

QUESTION 8

A limited company closes its accounting year on 30th June 1998. Accounts for that period were considered and approved by BOD on 20th August 1998. The company was engaged in laying pipeline for an oil company, deep beneath the earth. While doing the boring work, on 1.9.1998, it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lacs. Explain how the item will be dealth with for the accounting year ended 30th June 1998.

SOLUTION :

In this case the incidence, which was expected to push up cost, became evident after the date of approval of the balance sheet. So that was not any 'event occurring after the balance sheet date'. If the cost-push up is believed to be material, this may be mentioned in the Directors' Repot. (Even if the contract is profitable after taking into account the additional cost, it woule be prudent to disclose the fact of increase in the cost of the contract in the directors' report).

QUESTION 9

In preparing the financial statement of R Ltd. for the year ended 31st March, 1998, you come across the following information. State with reasons, how you would deal with them in the financial statements.

The company invested ₹ 100 lakhs in April, 1998 in the acquisition of another company doing similar business, the negotiations for which had started during the financial year.

SOLUTION :

Non-adjusting event. Disclosure needed

STUDY MATERIAL QUESTIONS

QUESTION 10

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 20X1 was detected only in May, 20X1. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1. Decide.

SOLUTION :

As per AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognise the loss amounting ₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 20X1.

QUESTION 11

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.

SOLUTION :

AS 4 (Revised) "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 20X1-20X2.

The fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the report of the approving authority for financial year20X1-X2 to enable users of financial statements to make proper evaluations and decisions.

QUESTION 12

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss.

SOLUTION :

As per AS 4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 20X1.

QUESTION 13

In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements:

The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.

SOLUTION :

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date.

However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 20X1. The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 100 lakhs in April, 20X1 for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

QUESTION 14

A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

SOLUTION :

AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above-mentioned definition and requirements given in AS 4 (Revised). In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.

QUESTION 15

While preparing its final accounts for the year ended 31st March, 20X1 a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February, 20X1 a trade receivable for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 20X1 the trade receivable became a bankrupt. Can the company provide for the full loss arising out of insolvency of the trade receivable in the final accounts for the year ended 31st March, 20X1?

SOLUTION :

As per Accounting Standard 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 20X1. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 20X1, then this would have been treated as non-adjusting event and only disclosure required as per AS 4 (Revised), would have been sufficient.

QUESTION 16

During the year 20X1-20X2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2.

SOLUTION :

As per AS 4 (Revised), adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as

An adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

QUESTION 17

The financial statements of Alpha Ltd. for the year 20X1-20X2 were approved by the Board of Directors on 15th July, 20X2. The following information was provided:

(i) A suit against the company's advertisement was filed by a party on 20th April,20X2 claiming damages of ₹ 25 lakhs.

(ii) The terms and conditions for acquisition of business of another company had been decided by March, 20X2. But the financial resources were arranged in April, 20X2 and amount invested was ₹ 50 lakhs.

(iii) Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 20X2, was detected on 16th July, 20X2.

With reference to AS 4, state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date.

SOLUTION :

(i) Non-adjusting event: Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 20th April after the balance sheet date. As per AS 4, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. Hence, it will have no effect on financial statement and will be a non- adjusting event.

(ii) Adjusting event: In the given case, terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 20X2. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31^{st} March 20X2.

(iii) Non-adjusting event: Only those events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure. In the given case, as the theft of cash was detected on 16^{th} July, 20X2 ie after approval of financial statements, no adjustment is required.

QUESTION 18 (JULY 21 5 MARKS)

Surya Limited follows the financial year from April to March It has provided the following information.

(i) A suit against the Company's Advertisement was filed by a party on 5^{th} April, 2021, claiming damages of ₹ 5 lakhs,

(ii) Company sends a proposal to sell an immovable property for ₹ 45 lakhs in March 2021, The book value of the property ₹ 30 lakhs as on year end date, However, the deed was registered on 15^{th} April.2021

(iii) The terms and conditions for acquisition of business of another company have been decided by the end of March 2021, but the financial resources were arranged in April 2021, The amount invested was ₹ 50 Lakhs,

(iv) Theft of cash amounting to ₹ 4 lakhs was done by the Cashier in the month of March 2021 but was detected on the next day after the Financial Statements have been approved by the Directors.

Keeping in view the provisions of AS-4, you are required to state with reasons whether the above events are to be treated as Contingencies, Adjusting Events or Non-Adjusting Events occurring after Balance sheet date.

QUESTION 19

A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

SOLUTION :

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognise the gain of ₹ 20 lakhs in its profit and loss account. The building should be derecognized in the financial statements.

QUESTION 20 (CA INTER DEC. 2021 EXAMS 5 MARKS)

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.2021):

1. Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
2. On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.
3. One building got damaged due to occurrence of fire on 23.05.221. Loss was estimated to be ₹ 81,00,000.

SOLUTION :

(i) If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statements for financial year ended 31 st March, 2021 and declaration of dividend is non-adjusting event.

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes if such events relate to conditions existing at the balance sheet date. In the given case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus loss amounting ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

(iii) AS 4 states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ₹ 81 lakhs should be disclosed in the report of the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

QUESTION 21 (CA INTER NOV 2022 5 MARKS)

MN Limited operates its business into various segments. Its financial year ended on 31st March, 2022 and financial statements were approved by their approving authority on 15th June, 2022. The following material events took place:

(i) On 7th April, 2022, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 15 crores would be fully covered by the insurance company.

(ii) A claim for damage amounting to ₹ 12 crores for breach of patent had been received by the entity prior to the year end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

(iii) A major property was sold (it was included in the balance sheet at ₹ 37,50,000) for which contracts had been exchanged on 15th March, 2022. The sale was completed on 15th May, 2022 at a price of ₹ 39,75,000.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of MN Limited for the year ended 31st March, 2022 as per AS 4.

SOLUTION :

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(i) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of note in the financial statements.

(ii) On the basis of evidence provided, the claim against the company will not succeed. Thus, 12 crores should not be provided in the account but should be disclosed by means of a contingent liability with full details of the facts as per AS 29. Provision can be made for legal fee expected to be incurred to the extent that they are not expected to be recovered if the amount can be ascertained.

(iii) The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended on 31 3.2022 and the profit on sale of property ₹ 2,25,000 would be considered.

ACCOUNTING STANDARD: 5

NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS & CHANGES IN ACCOUNTING POLICIES.

QUESTION 1

Akara Ltd. has a vacant land measuring 10,000 sq. mts. which it had no intention to use in the future. The Board of Directors decided to sell the land to tide over its liquidity problems. The Company made a profit of ₹ 5 Lakhs by selling the said land. There was a fire in the Factory and a part of the unused Factory Shed valued at ₹ 4 Lakhs was destroyed. The Fire loss was set off against the Profit from Sale of Land and a Profit of ₹ 1 Lakh was disclosed as Net Profit from sale of Assets. Do you agree with the treatment and disclosure? If not, state your views.

SOLUTION :

1. **Analysis:** Selling of Land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business and which are both material and expected not to recur frequently or regularly. Thus, these are Extraordinary items.
2. **Disclosure:** Extraordinary items of the enterprise during the period should be disclosed in the statement of Profit and Loss as a part of the Net Income. The nature and amount of each such item should be separately disclosed, in a manner that their relative significant an defect on the current operating results of the period can be perceived.
3. **Conclusion:** Disclosing Net Profit by setting off Fire Losses against Profit from Sale of Land is not correct. As per AS-5, Profit on Sale of Land, and Loss due to Fire should be disclosed separately.

QUESTION 2

Aashsraya Limited had provided for Doubtful Debts to the extent of ₹ 23 Lakhs 3 years back. This amount had since been collected in the current financial year. Another Debt of ₹ 25 Lakhs had been identified to be doubtful during the current financial year. The Company made an additional provision of ₹ 2 Lakhs during the year. The Profit and Loss account for the current year disclosed in Debit side-Provision for Doubtful Debts ₹ 2 Lakhs. Give your views on whether the above treatment is proper.

SOLUTION :

1. **Analysis:** Recovery of Bad Debt and Provision for new Bad Debt are ordinary activities, but reversals of provisions require separate disclosure under AS-5.
2. **Conclusion:** The Company's treatment of netting-off the reversal ₹ 23 Lakhs and current year additional provision ₹ 25 Lakhs, and showing the Net Debit of ₹ 2 Lakhs in P&L Account, is wrong and improper.

QUESTION 3

While finalizing an audit you have to decide whether it is necessary to disclose Receivables written-off or Advance written back as a separate item in the Financial Statements. How will you proceed?

SOLUTION :

1. **Analysis:** Receivables written-off and Advances written back, constitute separate items of Expenditure and Income respectively and prima facie should not be netted off.
2. **Conclusion:** Considering – Materiality aspect as per AS-1, netting off is not possible and separate disclosure is required in the above case.

QUESTION 4

Insurance Claim of ₹ 2 Lakhs received, stands included under Miscellaneous Income. Comment.

A sum of ₹ 10,00,000 is received from an Insurance Company in respect of a claim for loss of goods in transit costing ₹ 8,00,000. The amount is credited to Purchases A/c. State the duty of the Auditor in this regard.

SOLUTION :

1. **Analysis:** Money received from the Insurance Company is against a specific loss, and it has to be adjusted only against that loss. It should not be included under Miscellaneous Income (or netted off against Purchases).
2. **Conclusion:** The following matters should be reviewed by the Auditor in this regard – Amount received from Insurance Company should be adjusted against the loss, and the shortfall (Compensation less Value of Loss) should be charged off to P&L A/c.

QUESTION 5

A loss of ₹ 2,00,000 on account of embezzlement of cash was suffered by the Company and it was debited to Salary Account Comment.

SOLUTION :

1. **Analysis:** Embezzlement of Cash during the course of business is a 'Business Loss'. It is a business hazard which can occur once in a while.
2. **Treatment:** Loss due to embezzlement of Cash cannot be merged with any other head. Being a material item it should to be disclosed under a distinct head in the P&L A/c. and certainly not under "Salary A/c."

QUESTION 6

A Manufacturing Company has written down its inventories to NRV by ₹7,00,000 during the financial year. State whether separate disclosure is required under AS-5.

SOLUTION :

Hint: Refer examples of separate disclosure of Income/Loss from Ordinary Activities given above.

Conclusion: Writing down of Inventories to NRV is a specific example under AS-5, for items requiring separate disclosure. Hence, this should be disclosed separately under a distinct head.

QUESTION 7

Agasthya Ltd. makes provision for expenses worth ₹ 7,00,000 for the year ending 31.03.20X1 but the actual expenses during the year ending 31.03.20X2 comes to ₹9,00,000 against provision made during the last year. State with reasons, whether difference of ₹ 2,00,000 is to be treated as Prior Period Item as per AS-5.

SOLUTION :

- Only errors or omissions in the previous year are recognized in the current year as Prior Period Items.
- Changes in Estimate is neither an error nor an omission, and hence do not qualify as a Prior Period Item.

QUESTION 8

How will you distinguish a change in an Accounting Estimate from a change in the Accounting Policy? Does the former need any disclosure?

Give two examples each of Change in Accounting Policy and Change in Accounting Estimate.

SOLUTION :

Particulars	Accounting Estimate	Accounting Policy
1. Meaning	Accounting Estimates refer to Financial Statement items, which cannot be measured with precision, but can be estimated based on informed judgements.	A Policy refers to an accounting principle and the method of applying that principle.
2. Examples	(a) Change in the estimate of Provision for Doubtful Debts on Sundry Debtors. (b) Change in the estimate of Useful Life of Fixed Assets.	(a) Change of Method of Depreciation from WDV to SLM and vice-versa. (b) Change in cost Formula in measuring the Cost of Inventories.
3. Frequency	Change in Accounting Estimate is a routine mater in accounting which is substantially based on estimates, e.g. estimate of Bad Debts is made on the basis of information at subsequent date, i.e. insolvency of a Debtor known afterwards.	Change in Accounting Policy is infrequent and amounts to almost a permanent change in the basis of accounting in the concerned area. For example, the accounting policy for valuation of stock may be changed from fifo to weighted average
4 Change	A change in Accounting Estimate arises due to – * change in circumstances on which the estimate was based, or * availability of new information, etc.	A change in Accounting Policy is possible only for – * ensuring statutory compliance, or * ensuring compliance with another AS, or * more appropriate presentation of the Financial Statements.
5. Effect	The accounting picture may not get substantially altered by the change in the Accounting Estimate.	A change in Accounting Policy, generally, has a far reaching, material and long-term effect.

6. Disclosure	The nature and amount of a change in Accounting Estimate which has a material effect in the current period or expected material effect in future should be disclosed in the Financial Statements.	A change in Accounting Policy which has a material effect should be disclosed, along with the impact of and adjustments resulting from that change in the current period Financial Statements.

QUESTION 9

Akalya Ltd. provided ₹ 25 Lakhs for inventory obsolescence in the last year. In the subsequent year, it was determined that some 50% of such stock was usable. The Company wants to adjust the same through Prior Period Adjustment Account as the provisions was made in the earlier year. State your views.

SOLUTION :

1. **Prior Period Item:** Write-back of provision made in respect of inventories in the earlier year does not constitute Prior Period Adjustment since it is not an error or omission relating to prior period Financial Statements. It merely involves making estimate based on prevailing circumstances when these Financial Statements were being prepared.
2. **Revision of Estimate:** An estimate may have to be revised – (a) if changes occur in the circumstances on which the estimate was based (b) or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an Extra-Ordinary Item or a Prior Period Item.
3. **Analysis:** In the given case, revision of the estimate of obsolescence does not make the resulting amount of ₹ 125 Lakhs as a Prior Period Item or an Extra- Ordinary item.
4. **Conclusion:** Since the amount involved is material it requires separate disclosure to understand the financial position and performance of the enterprise.

QUESTION 10

Finished Goods costing worth ₹10 Lakhs were damaged due to floods in July 2012. These goods were included in the Closing Stock as on 31st March 2013, at an estimated Realizable Value of ₹ 4 Lakhs. These goods, ultimately, could be sold for ₹ 3 Lakhs only in the accounting year 2013-14. The difference of ₹ 1 Lakh is debited to Prior Period Expenditure in the accounting year 2013-14. Is this treatment correct?

SOLUTION :

Hint: Refer meaning of Prior Period Items and Changes in Accounting Estimates as given above.

1. **Analysis:** There is no error or omission in the Prior Period, in this case. It is a case of change in accounting estimates as to the estimated NRV of damaged item which have changed when the damaged goods have been finally sold.
2. **Conclusion:** The difference of ₹ 1 Lakh is not a Prior Period Item. Hence, debiting it to Prior Period Expenditure in the accounting year 2013-14 is a wrong accounting treatment.

QUESTION 11

Ambica Ltd. prior to receipt of their Management Consultants' suggestions, has been valuing its stock consistently by adding Factory Overheads to its Prime Cost. The Consultants had recommended a better procedure, which would ensure a fair allocation of overheads. The Company intends to adopt the new procedure but is unwilling to accept the fact that it is a change in the basis of accounting. Comment.

SOLUTION :

Conclusion: it's a prior period item because Prime cost never includes factory overheads

QUESTION 12

During the financial year 20X1 – 20X2. Aparna Ltd. revised its wages with retrospective effect from 1st Jan. 20X1. This would cost the Company an additional liability of ₹ 2,50,000 per annum. What is the treatment for the above in the accounts for the year ending 31.3.20X2?

Discuss the nature of classification and disclosure requirement in the Statement of Profit and Loss, when a Company pays arrears of bonus for the earlier year(s) as a result of settlement with workers in the current year.

Arati Ltd. signed an agreement with its Employees Union for revision of wages in June 2013. The wage revision is with retrospective effect from 1.4.2010. The arrear wages upto 31.3.2013 amounts to ₹ 80 Lakhs. Arrears of wages for the period from 1.4.2012 to 30.6.2012 (being the date of agreement) amounts to ₹ 7 Lakhs. Decide whether a separate disclosure of arrear wages is required.

SOLUTION :

Analysis – Aparna Ltd.

1. **Nature:** Payment of Arrears of Bonus for earlier years as a result of settlement of the dispute in the current year, is a event in the ordinary course and relates to normal activities of business. Although abnormal in amount of infrequent in nature, it is not an Extraordinary Item under AS-5.

2. **Not a Prior Period Item:** This amount is not a Prior Period Item, as it does not arise out of errors or omission in the preparation of Financial Statements of one of more prior periods.

3. **Treatment:** Additional Liability for wages of ₹ 3,12,550 (₹ 2,50,000 x 15/12 months, i.e. for fifteen months) should be included in current year's wages for financial year 20X1-20X2.

4. **Disclosure:** As per AS-5, when items of income and expenses within profit/loss from ordinary activities are of such size, the nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, they should be disclosed separately. Separate disclosure of such expense is required since it may be relevant to users of Financial Statements, in understanding the financial position and performance of the enterprise.

Note: The answers to the other questions/parts can be given on similar lines.

QUESTION 13

Ananya Ltd. as part of overall cost cutting measure, announced a Voluntary Retirement Scheme (VRS) to reduce its employee strength. During the first half year, the Company paid a compensation of ₹ 72 Lakhs to those who availed the scheme. The Chief Accountant has reflected this payment as part of regular Salaries and Wages paid by the Company. Is this correct?

SOLUTION :

1. **Analysis:**

   (a) VRS Payments as an overall cost cutting measure is covered by the meaning of 'Ordinary activities" and not extraordinary activities.

   (b) The nature and the amount involved make it a material item requiring separate disclosure.

2. **Conclusion:**

   (a) **Disclosure:** 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. Hence the VRS payment, should be shown separately in the Profit & Loss Account so that its impact on the operating results during the previous year can be perceived.

   (b) **Not Salaries and Wages:** VRS payments should not be reflected as Salaries, and Wages paid since they do not form part of regular Salaries and Wages given to Employees. The treatment given by the Company is not proper.

QUESTION 14

Ashraya Ltd. has taken a Group Gratuity Policy from an insurance Company. During a certain financial year, it received a communication from the said Insurance Company informing that premium amount for the previous accounting year was less charged by ₹ 75 Lakhs on account of arithmetical error on the part of Insurance Company. Ashraya Ltd. paid the sum of ₹ 75 Lakhs during the current accounting year by debiting the same to Prior Expenses. Explain

SOLUTION :

Prior Period Items: Prior Period Items are income or expenses which arise in the current period as a result of errors or omission in the preparation of the Financial Statements of one or more prior periods. In this case, there has been arithmetical mistake of ₹ 75 Lakhs in computing the amount of premium, for the previous accounting year.

Analysis: In this case, there was no error or omission on the part of the Ashraya Ltd. and the error was on the part of the Insurance Company. But, it is the Management of the Ashrya Ltd. which is responsible for preparation of Financial Statements.

Conclusion:

(a) The expenditure of ₹ 75 Lakhs is a Prior period Item and should be debited to Prior Period Expense. Hence, the accounting treatment given by the Management is appropriate.

(b) The Auditor should ensure that the nature of mistake, i.e. Insurance Premium as well as amount of ₹ 75 Lakhs has been disclosed separately in such a manner that its impact on the current Profit or Loss can be perceived.

QUESTION 15

Ayushi Ltd. creates a provision for Doubtful Debts 2% of Debtors. However, in the current financial year, the Company felt that since some Debtors are un-collectible, an additional provision of ₹ 5 Lakhs should be made to the provision in respect of debts due in the previous year. What disclosure is required under AS-5 ? Is this an Extraordinary item or Prior Period Item? Would you answer be different if the provision were changed from 2%to 12% Instead of additional provision of ₹ 5 Lakhs?

SOLUTION :

1. **Estimate:** Creating a provision for Doubtful Debts at 2% on Debtors is an accounting estimate. An Accounting Estimate may have to be revised – (a) if there are changes in circumstances on which the estimate was based, or (b) as a result of new information, more experience, or subsequent developments.
2. **Disclosure of Change in Accounting Estimates:** The effect of a change in an accounting estimate should be included in the determination of Net Profit or Loss in –

(a) The period of the change, if the change affects the period only, e.g. Bad Debts.

(b) The period of the charge and future periods, if the change affects both, e.g. Useful Life of assets.

3. **Conclusion:** The above disclosure is sufficient in both cases i.e. additional provision of ₹5,00,000 and change in provisioning from 2% to 12%. The change in provisioning is neither an Extraordinary Item nor a Prior Period Item.

QUESTION 16

Overseas Oil Corporation's oil wells were damaged in a war in November. Claim was preferred with the Insurance Companies for total loss. Pending settlement by the Insurance Companies neither any provision nor any disclosure has been made by the Company in its accounts. Comment.

SOLUTION :

1. **Nature:** In the given case the oil wells have been damaged and the amount of insurance claim in respect thereof is not determinable till the end of the accounting year. The resultant loss should be provided for in the accounts. The provision for loss should be reduced by the probable recovery through insurance claim, provided the claim is reasonably certain to be received.
2. **Disclosure:** Also, under AS-5, since the loss is not expected to recur frequently or regularly, it should be disclosed as an Extraordinary Item.

QUESTION 17

During the course of the last 3 years a Company owning and operating Helicopters lost 4 Helicopters. The Company Accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write back to P&L A/c. as Prior Period Item. Is he correct in his proposal?

SOLUTION :

1. As per AS-5, Prior Period Items as those material charges or credits which arise in the current period as a result of errors or omissions in the preparation of Financial Statements of one or more periods.
2. The write back of the balance of Maintenance provision, no longer required due to crash of the helicopters, is not a Prior Period Item as there was no effort in the preparation of the previous periods Financial Statements.
3. The amount so written back should be disclosed as an EXCEPTIONAL Item as per AS-5.

QUESTION 18 NOV.2014 (4 MARKS)

Give two examples of each of the following items:

Question	Example
(i) Change in Accounting Policy	• Change of Method of Depreciation from WDV to SLM or vice versa. • Change in Cost Formula in measuring the cost of Inventories.
(ii) Change in Accounting Estimate	• Change in the estimate of Provision for Doubtful Debts on sundry Debtors. • Change in the estimate of useful Life of Fixed Assets
(iii) Extra Ordinary Items	• Attachment of Property of the Enterprise. • An Earthquake etc.
(iv) Prior Period Items	• Omission of Income or Expenditure of prior periods rectified now. • Incorrect Rate of Depreciation in prior period, rectified now.

QUESTION 19 MAY 2015 4 MARKS

A Company desires to make provision in respect of its non-moving or slow moving items of stock. The following information is available (amounts ₹ in Lakhs).0

Particulars	Current Year	Previous Year
Value of Closing Stock	169	105
Provision based on No of Issues during the year	4.50	4.00
Provision based on products technically	5.50	4.25

The Company has been making provision based on number of issued. However, from this year, the Management has decided to make provision based on technical evaluation.

Explain whether such change will amount to change in 'Accounting Policy'. Also draw a suitable Note, if in your view the proposed change requires the same to be given in the Financial Statement of the Current year.

SOLUTION :

1. **Analysis:**

   (a) **Changes:** The Company's accounting policy requires that provision should be made in respect of non-moving stocks. The method of estimating the provision can be changed based on new developments, additional information, etc. if a more prudent estimate of the amount can be made.

   (b) **Nature:** The decision to make provision for non-moving stock on the basis of technical evaluation is only a change in accounting estimate, and does not amount to a change in accounting policy.

   (c) **Materiality:** The change in the amount of required provision is ₹ 1,00,000 which is only 0.59% of the Total Stock Value, and is hence not material.

2. **Conclusion:**

   (a) Change in Provision from Number of issues to technical evaluation will not result in any change in accounting policy, as there will only be a change in accounting estimate.

   (b) The Company should be able to demonstrate reasonably that provision made on the basis of technical evaluation provides more satisfactory results than the provision based on Number of Issues. In such case, the Company can change the method of provision.

STUDY MATERIAL & PAST EXAMINATION QUESTIONS (SELF READING)

QUESTION 20

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.

SOLUTION :

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20 X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20 X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period.

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5.

QUESTION 21

(i) During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?

(ii) A company signed an agreement with the Employees Union on 1.9.20X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?

SOLUTION :

(I) "When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value.

(II) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for $1\frac{1}{2}$ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

QUESTION 22

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

SOLUTION :

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

QUESTION 23

Explain whether the following will constitute a change in accounting policy or not as per AS 5.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organisation.

SOLUTION :

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

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

QUESTION 24 (JAN 2021 5 MARKS)

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

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items

(v)	Capitalization of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

QUESETION 25

A company (Z Ltd.) is engaged in the business of providing consultancy services. A few days back, it received a notice from GST department raising a demand of GST on consultancy services provided by it for ₹ 500,000. Recently Z Ltd. paid the demand. In the books, the payment is recorded as an extraordinary expenditure.

Whether payment of tax demand raised by the taxation authority can be recognised as an extraordinary item?

SOLUTION :

No, payment of tax cannot be recognised as an extraordinary item.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" an extraordinary item is income or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

In the given case, providing consultancy service is an ordinary activity of Z Ltd. Thus, GST paid pursuant to the demand raised by GST department is also a part of an ordinary activity of Z Ltd. Recognising such payments as an extra-ordinary item is contrary to AS 5.

QUESTION 26 (CA INTER MAY 2022 5 MARKS)

TQ Cycles Ltd. is in the manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the Government enhanced the minimum wages payable to workers with retrospective effect from the 1st January, 2022. Due to this legislative change, the additional wages for the period from January 2022 to March 2022 amounted to ₹ 30 lakhs. The management asked the Finance manager to charge ₹ 30 lakhs as prior period item while finalizing financial statements for the year 2022-23. Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra-ordinary item in the Profit and loss account for the financial year 2021-22.

Discuss with reference to applicable Accounting Standards.

SOLUTION :

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances which though related to prior periods, are determined in the current period.

It is given that revision of wages took place in April, 2022 with retrospective effect from 1st January, 2022. Therefore, wages payable for the period from 1 01.2022 to 31.3.2022

cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. The full amount of wages payable to workers will be treated as an expense of current year and it will be charged to profit & loss account for the year 2022-23 as normal expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. Therefore, finance manager is incorrect in treating increase as extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Therefore, additional wages liability of ₹ 30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31 stMarch, 2023.

QUESTION 27 (CA INTER NOV 2022 5 MARKS)

The Accountant of Shiva Limited had sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policies or change in Accounting Estimates for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of AS 5:

(i) Provision for doubtful debts was created @3% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 4%.

(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till 31st March, 2020 the furniture was depreciated on straight line basis over a period of 5 years. From the Financial year 2020-2021, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March 2021, there was change in cost formula in measuring the cost of inventories.

SOLUTION :

(i) In the given case, company has created 3cer% provision for doubtful debts till 31st March, 2020. Subsequently from 1st April, 2020, the company revised the estimates based on the changed circumstances and wants to create 4% provision. Thus, change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous transaction, will neither be treated as change in an accounting policy nor change in accounting estimate.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is neither a change in accounting policy nor a change in accounting estimate.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

NOTES

ACCOUNTING STANDARD: 7
CONSTRUCTION CONTRACTS

QUESTION 1

Sambu Ltd. negotiates with Indian Oil, for construction of "Franchise Retail Petrol Outlet Stations" Based on proposals submitted to different Zonal Offices of Indian Oil, the final approval for one outlet each in Behapora Salem, Vadodara and Warrangal is awarded to Sambu Ltd. Agreement (in single document) is entered into with Indian Oil for ₹ 25 Lakhs. The agreement lays down values for each of the four outlets (₹ 44 + 66 + 80 + 55 Lakhs) in addition to individual completion time. Comment whether Sambhu Ltd. will treat it as a single contract or four separate contracts.

SOLUTION :

- **Analysis:** Here, each Outlet is submitted as a separate proposal to different Zonal Office, 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 only one document of contract.
- **Conclusion:** Four separate Contract Accounts have to be recorded and maintained in the books of Sambu Ltd. for each contract, principles of revenue and cost recognition have to be applied separately, and Net Income determined for each assets as per AS-7.

QUESTION 2

Nandi, a Contractor, has just entered into a contract with a Local Municipal Body for building a Flyover. As per the contract terms, Nandi was receive an additional ₹ 2 Crores, if the construction of the Flyover were to be finished within a period of two years of the commencement of the contract. Nandi wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Give your views on the above.

SOLUTION :

1. **Analysis:** Incentive payments are included in Contract Revenue when the contract is sufficiently advanced that it is probable that the specified performance standards will be met and the amount of the incentive payment can be measured reliably.
2. **Conclusion:** In the above case the, the contract is not even begun. The Contractor should not recognize Incentive Income.

QUESTION 3

Contractors Ltd. have recognized Contract Revenue on a contract awarded in the current financial year. The target date of completion is 5 years. The Contractor provides for Incentives for early completion of at the rate of ₹ 1000 per day, subject to a maximum of ₹ 300,000. The company has included this amount in the Contract Revenue (in the first year of contract) on the ground that based on the previous experience in similar contract, it is confident of completing the contract in 4 years. The Company's past track record shows that the Company was able to complete such contacts well in time and earn incentives. Comment on the Company's accounting policy.

SOLUTION :

1. Past Track Record is not a criteria for recognition of Incentive Payments Receivable for early completion of contract.
2. In the above case, the contract is not sufficiently advanced, i.e. first year only and its normal time of completion in 4-5 years. Hence, the recognition criteria of Incentive Payments as per AS-7 and not satisfied. Inclusion of Incentive Payments Receivable in the current year as part of Contract Revenue is not proper.

QUESTION 4

Viswakrma Ltd. undertook a Construction Contract for ₹ 50 Crores in April. The cost of construction was initially estimated at ₹35 Crores. The contract is to be completed in 3 years. While executing the contract, the Company estimated the cost of completion of the contract at ₹ 53 Crores. Can the Company provide for the expected loss in the books of accounts for the year ended 31st March?

SOLUTION :

1. **Provision:** As per AS-7, an Expected Loss on Construction Contract should be recognized as Expense immediately.
2. **Conclusion:** The Loss of ₹ 3 Crores (53 Crores – 50 Crores) should be recognized immediately by Viswakarma Ltd. in the current Financial year.

QUESTION 5

Mayan Construction Company accounted for a Contract entered into with a Government Department on Completed Contract Method and that with a Private Sector Company on Percentage of Completion Method. Both the Contracts were for development of a Township State your views on the above.

SOLUTION :

1. **Principles:** Revenue & Costs associated with a Construction Contract should be recognized as revenue and expenses respectively by reference to the stage of completion of the Contract activity at the reporting date.
2. **Analysis:** In the given case, the Construction Company accounts for the Contract with Government Department on Completed Contract Method and for the Contract with Private Sector Company, on Percentage Completion Method.
3. **Conclusion:** In view of the requirements of AS-7, the Contractor should use only Percentage of Completion Method for recognizing revenue and expenditure of both the Construction Contracts. So use of Completed Contract Method for the Contract with Government Department is not correct.

QUESTION 6

Compute the percentage of completion and the Contract Revenues and costs to be recognized from the following data.

- Contract Price – ₹ 75 Lakhs
- Materials issued – ₹ 18 Lakhs of which Materials costing ₹ 3 Lakhs is still lying unused at the end of the period.
- Labour paid for workers engaged at site ₹ 12 Lakhs (Rs 2 Lakhs is still payable)
- Specific Contract Costs – ₹ 6 Lakhs, Sub-Contract Costs for work executed – ₹ 5 Lakhs, Advances paid to Sub-Contractors – ₹ 3 Lakhs.
- Cost estimated to be incurred to complete the Contract – ₹ 30 Lakhs

SOLUTION :

Here, the Proportionate Cost Method will provide a realistic estimate of stage of completion. This is calculated as under:-

Particulars	Computation	Amount
Materials Cost incurred on the Contract (net of Closing Stock)	₹ 18(-) ₹3	15 Lakhs
Add: Labour Costs incurred on the Contract (Paid + Payable)	₹ 12 + ₹2	14 Lakhs
Specific Contract Costs	Given	6 Lakhs
Sub-Contract Costs (advances should not be considered)	Given	5 Lakhs

Costs Incurred Till Date Add: Further Costs to be incurred	Given	40 Lakhs 30 Lakhs
Total Contract Costs		70 Lakhs
Hence, Percentage of Completion based on Cost $= \frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}}$	$\frac{40}{70}$	57.14%
Contract Revenue to be recognized (as per Para 21) Less: Contract Costs to be recognized (as per Para 21)	57.14% x ₹75 as per computer	42.86 Lakhs 40.00 Lakhs
Therefore, Contract Profit		2.86 Lakhs

QUESTION 7

Write short notes on Recognition of Expected Losses (Para 35 and 36).

SOLUTION :

1. When it is probable that Total Contract Costs will exceed Total Contract Revenue, the Expected Loss should be recognized as an Expense immediately.
2. The amount of such a loss is determined irrespective of –
   (a) Whether or not work has commenced on the Contract.
   (b) The Stage of Completion of Contract activity, or
   (c) The amount of profits expected to arise on other Contracts, which are not treated as a single Construction Contract inaccordance with Para 8.

QUESTION 8

A Company took a Construction Contract for ₹ 100 Lakhs in January, it was found that 80% of the Contract was completed at a cost of ₹ 92 Lakhs on the closing date i.e. 31st March. The Company estimates further expenditure of ₹ 23 Lakhs to completing the Contract. The Expected Loss would be RS. 15 Lakhs. Can the Company recognize the loss in the Financial Statements prepared for the year ended 31st March?

SOLUTION :

The Company should recognize ₹ 15 Lakhs as an Expense immediately.

QUESTION 9

Unknown construction contractor has undertaken a bridge construction contract, in respect of which details has been given below:

(i) Initial amount of revenue ₹ 9,000 lakhs

(ii) Initial estimate of contract costs ₹ 8,000 lakhs

(iii) Contract duration - 3 years

	Amount in ₹ lakhs		
		Years	
	1st	2nd	3rd
Estimated contract costs	8,050		
Increase in contract revenue		200	
Estimated additional contract costs		150	
Cost incurred upto the reporting date	2,093	6,168	8,200

At the end of year 2, costs incurred include ₹ 100 lakhs for standard materials stored at the site to be used in year 3 to complete the project. You are required to calculate the profit/loss to be recognised in the Profit and Loss Account at the end of the each of three years.

QUESTION 10

Certain Ltd. has signed at 31st Dec. the Balance Sheet date, a contract where the Total Revenue is estimated at ₹ 15 Crore and Total Cost is estimated at ₹ 20 Crores. No work began on the contract is the Contractor required to give an accounting effect for the year ended 31st December?

SOLUTION :

There is an Expected Loss of ₹ 5 Crores (20 Crores – 15 Crores) Such loss should be recognized in the Profit and Loss Statement as per AS-7, even though work has not commenced.

QUESTION 11

A Contractor entered into a contract for building roads for ₹ 2 Crores. After completing 60% of the contract he came to know that the cost of completing the contract would be ₹ 2.40 Crores. The Accountant transferred ₹ 0.24 Crores. i.e. 60% of total Loss of 0.40 Crores to P&L Account in the current year. Give your views on the above.

SOLUTION :

The Company should recognise ₹ 0.4 Crores as an Expense immediately, irrespective of the percentage of completion.

QUESTION 12

An amount of ₹ 9,90,000 was incurred on a contract work upto 31st March. Certificates have been received to date to the value of ₹ 12,00,000 against which ₹ 10,80,000 has been received in cash. The cost of work done but not certified amounted to ₹22,500. It is estimated that by spending an additional amount of ₹ 60,000 (including Provision in Contingencies) the work can be completed in all respects in another two months. The agreed Contract Price of the work is ₹ 12,50,000. Compute a conservative estimate of the Profit to be taken to the P&L A/c. as per AS-7.

SOLUTION :

Particulars	
Total Cost = Cost incurred till Date + Estimated Additional Cost = 9,90,000 + 60,000	10,50,000
% of completion based on Cost $= \frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{9,90,000}{10,50,000}$	94.29%
Contract Revenue to be recognized (1250,000 x 94.29%)	11,78,625
Less: Contract Cost incurred till date	9,90,000
Contract Profit	1,88,625

QUESTION 13

A Company undertakes a number of Contracts. Following particulars are extracted in respect of certain loss-making Contracts. Determine the amount of Expected Loss that should be recognized in the accounts for the year.

Contract	A	B	C	D
Contract Price	15.00	12.50	87.50	10.00
Cost incurred till date	12.00	10.90	2.50	6.00
Costs expected to be incurred to complete the Contract	4.00	3.60	88.00	4.00

SOLUTION :

Computation of Expected Loss (₹ in Lakhs)

Contract	A	B	C	D
1. Contract Price(given)	15.00	12.50	87.50	10.00
2. Cost incurred till date(given)	12.00	10.90	2.50	6.00
3. Further Costs to be incurred to complete the Contract	4.00	3.60	88.00	4.00
4. Total contract Costs(2) + (3)	16.00	14.50	90.50	10.00
5. Expected Loss on Contract (1)-(4)	1.00	2.00	3.00	Nil
6. Percentage of Completion based on costs $= \frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}}$	75%	75.17%	2.76%	60%
7. Contract Revenue recognized (1)x(6)	11.25	9.40	2.42	6.00
8. Contract Costs recognized (as per 2)	1200	10.90	2.50	6.00
9. Contract Profit/(Loss) (7) - (8)	(0.75)	(1.50)	(0.08)	Nil
10. Expected Loss to be recognized (as per 5)	1.00	2.00	3.00	Nil
11. Additional Provision required (9)-(10)	0.25	0.50	2.92	Nil

Note: The amount of such a loss is determined irrespective of- (a) Whether or not work has commenced on the Contract. (b) The stage of completion of Contract activity, or (c) The amount of profits expected to arise on other Contracts, which are not treated as a single Construction Contract in accordance with Para 8.

QUESTION 14

On 31st October 20X1, Bharat Construction Co. Ltd. undertook a Contract to construct a Flyover for ₹ 215 Crores. On 31st March 20X2, the Company found that the Work is Certified for ₹ 100 Crores and work to be Certified is for ₹ 35 Crores. Prudent estimates of additional cost for Completion was ₹90 Crores. What amount should be charged to Revenue in the Financial Accounts for the year ended 31st March 20X2 as per AS-7?

SOLUTION :

Particulars	₹ in Crores
1. Contract Price (given)	215.00
2. Cost incurred till date (Work Certified +Work to be certified)	135.00
3. Further Costs to be incurred to complete the Contract	90.00
4. Total Contract Costs (2) + (3)	225.00
5. Expected Loss on Contract (1)-(4)	(10.00)
6. Percentage of Completion based on Costs = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}}$	60%
7. Contract Revenue recognised (1) x (6)	129.00
8. Contract Costs recognised (as per 2)	135.00
9. Contract Profit/(Loss) (7) –(8)	(6.00)
10.Expected Loss to be recognised (as per 5)	10.00
11.Additional Provision required (9)-(100	4.00

QUESTION 15

The following data is given for a financial period in respect of various contacts undertaken by Daksha Ltd. (in ₹ Lakhs)

Contract	A	B	C	D	E	F
Costs incurred till date	40.00	10.00	6.00	75.00	40.00	120.00
Recognised Profits	6.00	Nil	Nil	Nil	8.00	11.00
Recognised Losses	Nil	2.00	1.00	13.00	Nil	Nil
Progress Billings	36.00	5.00	7.00	70.00	30.00	114.00

Determine the amount to be shown in the Balance Sheet for the above.

SOLUTION :

Amount due from/to customer=Contract Costs+Recognised Profits-Recognised Losses-Progress Billings.

- If the above amount is positive, it will be shown as an Amount due from Customers i.e. an Asset.
- If the above amount is negative, it will be shown as an Amount due to Customers i.e. a Liability.

Contract	A	B	C	D	E	F
1. Costs incurred till date	40.00	10.00	6.00	75.00	40.00	120.00
2. Recognised Profits	6.00	Nil	Nil	Nil	8.00	11.00
3. Recognised Losses	Nil	2.00	1.00	13.00	Nil	Nil
4. Progress Billings	36.00	5.00	7.00	70.00	30.00	114.00
5. Net Amount (1+2-3-4)	10.00	3.00	(2.00)	(8.00)	18.00	17.00
6. Nature	Asset	Asset	Liability	Liability	Asset	Asset

QUESTION 16

Sankar Ltd. undertook a Contract for building a Crane for ₹ 10 Lakhs. An on 31st March of a financial year, it incurred a cost of ₹ 1.50 Lakhs and expects that ₹9 Lakhs more will be required for completing the crane. Discuss the treatment of the above under AS-7.

SOLUTION :

- Percentage of Completion $= \frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{₹\ 1.50}{₹\ 10.50} = 14.29\%$
- Total Expected Loss to be provided for, as per Para 35 = Contract Price (-) Total Costs = Rs . 0.50 Lakhs.

Contract Revenue as per Para 21= 14.29% of ₹10 Lakhs	=	1.43 Lakhs
Less: Contract Costs	=	1.50 Lakhs
Loss on Contract	=	0.07 Lakhs
Less: Further provision required in respect of Expected Loss	=	0.43 Lakhs (Bal. Figure)
Expected Loss recognised per Para 35	=	0.50 Lakhs

QUESTION 17

Pinaki & Co a Firm of Contractors obtained a Contract for Construction of bridges across the river Revathi. The following details are available in the records kept for the year ending 31st March. (information in ₹ Lakhs)

Total Contract Price	1,000	Progress Payment Received	400
Costs incurred till date	605	Progress Payment to be Received	140
Estimated further cost to Completion	495		

The Firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS-7.

SOLUTION :

* Percentage of Completion = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{₹\ 605}{₹\ 1100} = 55\%$

* Total Expected Loss to be provided for, as per Para 35 = Contract Price (-) Total Costs = ₹ 100 Lakhs

Contract Revenue as per Para 21 = 55% of ₹ 1000 Lakhs = 550 Lakhs

Less: Contract Costs as per Para 21 = 605 Lakhs

Loss on Contract = 55 Lakhs

Less: Further provision required in respect of Expected Loss (Bal. Figure) = 45 Lakhs

Expected Loss recognised as per Para 35 = 100 Lakhs

Amount due from/to customers = Contract Costs + Recognized Profits (-) Recognised Losses (-) Progress Billings =605+Nil (-) 100 (-) 540 = (35) Lakhs

Amount due to Customers.

This amount of ₹ 35 Lakhs will be shown in the Balance Sheet as a Liability.

Note: Progress Billings = Payments Received + Payments billed but not received.

The relevant disclosures under AS-7 are as follows -

₹in Lakhs

Particulars	Computation	Amount
(a) Contract Revenue		550
(b) Contract Expenses		605
(c) Expected Losses	(as provided for above)	45
(d) Recognised Profits Less Recognised Losses	(Current Loss 55 + Expected Loss 45)	(100)
(e) Progress Billings	(400+140)	540
(f) Retentions	(billed but not received from Contractee)	140
(g) Gross Amount due to Customers	(as calculated above)	35

QUESTION 18

Vishwakarma Ltd. undertook a contract to construct a building for ₹85 Lakhs. At the end of the financial year, the Company found that it had already spent ₹ 64,99,000 on Construction. Prudent estimate of the additional cost for completion was ₹ 32,01,000. What is the additional provision for foreseeable loss which must be made in the final accounts for the year ended 31st March?

SOLUTION :

- Estimated Total Contract Costs = Cost till date + Further Costs – ₹64,99,000 + ₹ 3201,000 = ₹ 97,00,000
- Percentage of Completion = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{₹\ 64.99}{₹\ 97.00} = 67\%$
- Total Expected Loss to be provided for = Contract Price (-) Total Costs = ₹85 (-) ₹ 97 = ₹ 12,00,000

Contract Revenue as per Para 21 = 67% of ₹ 85 Lakhs	= ₹ 56,95,000
Less: Contract Costs	= ₹ 64,99,000
Loss on Contract	= Rs 8,04,000
Less: Further provision required in respect of Expected Loss (Bal. Figure)	= ₹ 3,96,000
Expected Loss recognised as per Para 35	= ₹ 12,00,000

QUESTION 19

Nilakanta Construction Co. Ltd. undertook a contract on 1st January to construct a building for ₹ 80 Lakhs. The Company found on 31st March that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹31,50,000.

What amount should be charged to Revenue and what amount of Contractor Value to be recognized as Turnover in the accounts for the year ended 31st March as per provisions of AS-7?

SOLUTION :

Estimated Total Contract Costs = Cost till date + Further Costs = ₹58,50,000 + ₹31,50,000 = ₹ 90,00,000

Percentage of Completion = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{₹\ 58.50}{₹\ 90.00} = 65\%$

Total Expected Loss to be provided for – Contract Price (-) Total Costs

= ₹ 80 (-) ₹ 90 = ₹ 10,00,000

Contract Revenue as per Para 21 = 60% of ₹ 80 Lakhs
= ₹ 52,00,000 (Contract Revenue to be recognized)

Less: Contract Costs as per Para 21 = ₹58,50,000 (Contract Exp. to be recognized)

Loss on Contract = ₹ 6,50,000

Less: Further provision required in respect of expected Loss = ₹350,000 (Bal.Fig.)

Expected Loss recognized as per Para 35 ₹ 10,00,000

(Loss on Contract to be recognized)

QUESTION 20

Pasupati Construction Company Limited undertook a contract a building for ₹3 Crores on 1st September 2012. On 31st March 2013, the Company found that it had already spent ₹ 1 Crore 80 Lakhs on the construction. Prudent estimate of additional cost of completion was ₹ 1 Crore 40 Lakhs. What amount should be charged to revenue in the final accounts for the year ended on 31st March 2013, as per the provisions of AS-7?

SOLUTION :

- Estimated Total Contract = Costs till date + Further Costs = 180+140= ₹320 Lakhs.
- Percentage of Completion = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{₹\ 180}{₹\ 320} = 56.25\%$
- Total Expected Loss to be provided for = Contract Price Less Estimated Total Costs = 300 (-) 320 = ₹ 20 Lakhs.

Contract Revenue as per Para 21 = 56.25% of ₹ 300 Lakhs = ₹ 168.75 Lakhs
(Contract Revenue to be recognized)

Less: Contract Costs as per Para21 = ₹ 180.00 Lakhs
(Contract Exp. to be recognized)

Loss on Contract = ₹ 11.25 Lakhs

Less: Further provision required in respect of Expected Loss = ₹ 8.75 Lakhs (Bal. Figure)

Expected Loss recognized as per Para 35 = ₹ 20.00 Lakhs
(Loss on Contract to be recognized)

QUESTION 21

From the following data, show P&L A/c. (Extract) as would appear in the books of a Contractor under AS-7.

Particulars	₹ in Lakhs
Contract Price (Fixed)	480.00
Cost Incurred to Date	300.00
Estimated Cost to Complete	200.00

SOLUTION :

* Percentage of Completion = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{300}{300 + 200} \times 60\%$

- Total Expected Loss to be provided for, as per Para 35= Contract Price – Total Costs = 480 – 500 = ₹ 20 Lakhs

Contract Revenue as per Para 21 = = 288 Lakhs

60% of ₹ 480 Lakhs (Contract Revenue tobe recognized)

Less: Contract Costs as per Para 21 = 300 Lakhs

(Contract Expenses to be recognized)

Loss on Contract = 12 Lakhs

Less: Further provision required in respect of expected Loss = 8 Lakhs (Bal. Figure)

Expected Loss recognised as per Para 35 = 20 Lakhs

(Loss on Contract to be recognized).

QUESTION 22

Hara Ltd. undertook a thee year Contract for a total price of ₹57,50,000. The Contract Costs are estimated to be ₹ 46,57,500. From the following information, you are required to identify the revenues and costs in each of the three years.

Particulars	Year 1 (Rs,)	Year 2 (Rs,)	Year 3 (Rs,)
Cumulative Contracts Costs incurred to date	17,25,000	41,40,000	46,57,500
Estimated Cost yet to be incurred at year end	34,50,000	4,60,000	Nil

SOLUTION :

Basic Calculations: **(Amount in ₹)**

Particulars	As at Year 1	As at Year 2	As at Year 3
(a) Contract Price/Contract Revenue	57,50,000	57,50,000	57,50,000
Cost till date	17,25,000	41,40,000	46,57,500
Estimated costs to complete	34,50,000	4,60,000	Nil
(b) Total Contract Costs	51,75,000	46,00,000	46,57,500
(c) Estimated Total Profit	5,75,000	11,50,000	10,92,000
(d) Percentage of Completion = $\frac{\text{Cost till date}}{\text{Total Contract Costs}}$	$\frac{17,25,000}{51,75,000}$ = 33.33%	$\frac{41,40,000}{46,00,000}$ = 90%	100%

The Contract Revenues, Costs and Profits recognised in each of the three years are given below:- (₹)

Year	Particulars	Upto reporting date	Already recognised in previous years	Recognised during current year
1.	Contact Revenue	57,50,000x33.33%= 19,16,667	Nil	19,16,667
	Contract Costs	Given 17,25,000	Nil	17,25,000
	Contract Profits	1,91,667	Nil	1,91,667
2.	Contract Revenue	57,50,000x90% = 51,75,000	19,16,667	32,58,333
	Contract Costs	41,40,000	17,25,000	24,15,000
	Contract Profits	10,35,000	1,91,667	8,43,333
3.	Contact Revenue	Full = 57,50,000	51,75,000	5,75,000
	Contract Costs	Full = 46,57,500	41,40,000	5,17,500
	Contract Profits	10,92,500	10,35,000	57,500

QUESTION 23

M/s. Highway Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in years. The contract Price was estimated at ₹ 150 crores. Upto 31.03.2014,the Company incurred ₹ 120 Crores on the construction.

The Engineers involved in the project estimated that a further ₹ 45 Crores would be incurred to complete it. What amount should be charged to revenue for the year 2013-2014 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

SOLUTION :

Estimated Total Contract Costs = Cost till date + Further Costs

= ₹ 120.00 + ₹ 45.00 = ₹ 165.00 Crores.

Percentage of Completion = $\frac{\text{Cost incurred till date}}{\text{Estimated Total Costs}} = \frac{₹\ 120.00}{₹\ 165.00} = 72.73\%$

Total Expected Loss to be provided for = Contract Price (-) Total Costs

= ₹150 (-) ₹ 165 = ₹ 15 Crores.

Contract Revenue as per Para 21 = 72.73% of ₹ 150 = ₹109.10 Crores

(Contract Revenue to be recognized)

Less: Contract Costs as per Para 21 = ₹ 120.00 Crores

(Contract Expense to be recognized).

Loss on Contract = ₹ 10.10 Crores

Less: Further provision required in respect of expected Loss = ₹ 4.10 Crores (Bal Figure)

Expected Loss recognized as per Para 35 = ₹ 15.00 Crores

(Loss on Contract to be recognized)

Profit & Loss A/c. (extract) for the year ended 31.03.2014

Particulars	**₹ Crores**	**Particulars**	**₹ Crores**
To Contract Cost	120.00	By Contract Revenue	109.10
To Provision for Loss	4.10	By Net Loss	15.00
Total	124.10	Total	124.10

STUDY MATERIAL & PAST EXAMINATION QUESTIONS (SELF READING)

QUESTION 24 (CA INTER MAY 2019) (5 MARKS)

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹ 50 Lakh ₹ 60 Lakh and ₹ 75 Lakh respectively. Agreement also lays down the completion time for each unit.

Comment, with reference to AS- 7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2018, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provisions of AS-7?

SOLUTION:

(i) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, Mr. AP Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

(ii)

	₹ in lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) ×100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 2018 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs.

	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

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

The amount of expected loss will be computed (2.60 x 31.72%).

QUESTION 25 (CA INTER NOV 2020) (5 MARKS)

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

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

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

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

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

SOLUTION:

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

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

Revenue to be recognised = 20,00,000 × 46.24%

= ₹ 9,24,800

Year 2

Actual expenditure	= 4,75,000
Future Expenditure	= 4,00,000
Expenditure incurred in Year 1	= 8,60,000
	17,35,000

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

Revenue to be recognized (cumulative)	= 20,00,000 × 76.95%
	= 15,39,000
Less : Revenue recognized in Year 1	= (9,24,800)
Revenue to be recognized in Year 2	= ₹ 6,14,200

Year 3

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

Note: Calendar year has been considered as accounting year.

QUESTION 26

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

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

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

SOLUTION:

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

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

(NOTE: WE HAVE CALCULATED TOTAL LOSS WITHOUT BREAKUP OF ACTUAL LOSS UNDER PARA 22 & EXPECTED LOSS UNDER PARA. IF STUDENT CAN ALSO SHOW THE BREAK UP OF PARA 22 AND PARA 35)

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

This is 55% (605/1100 x 100) of total costs of construction.

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

(d) Amount due from/to customers = (Contract costs + Recognised profits – Recognised Losses) – (Progress payments received + Progress payments to be received)

= (605 + Nil – 100) – (400 + 140) ₹ in lakhs

= [505 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

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

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

	₹ in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

QUESTION 27

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

SOLUTION:

	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	(85,00,000)
Total foreseeable loss	12,00,000

According to AS 7, the amount of ₹ 12,00,000 is required to be recognised as an expense.

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

Proportion of total contract value recognised as turnover:

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

(NOTE: WE HAVE CALCULATED TOTAL LOSS WITHOUT BREAKUP OF ACTUAL LOSS UNDER PARA 22 & EXPECTED LOSS UNDER PARA TO SAVE TIME IN EXAMS. STUDENT CAN ALSO SHOW THE BREAK UP OF PARA 22 AND PARA 35 AS WE DID IN CLASS)

QUESTION 28 (STUDY MATERIAL) (PARA 22 & PARA 35)

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7.

SOLUTION:

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

Cost of Construction	₹	₹
Material used		71,00,000
Labour Charges paid	36,00,000	
Add: Outstanding on 31.03.20X2	2,00,000	38,00,000
Hire Charges of Plant		10,00,000
Other Contract cost incurred		15,00,000
Cost incurred upto 31.03.20X2		1,34,00,000
Add: Estimated future cost		33,50,000
Total Estimated cost of construction		1,67,50,000
Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
Revenue recognized (80% of 1,50,00,000)		1,20,00,000
Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less: Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
Loss to be provided for		3,50,000

QUESTION 29

AB contactors enters into a contract on 1st January 20X1 with XY to construct a 5- storied building. Under the contract, AB is required to complete the construction in 3 years (i.e., by 31st December 20X3). The following information is relevant:

Fixed price (agreed) ₹ 5 crore

Material cost escalation (to the extent of 20% of increase in material cost) Labour cost escalation (up to 30% of increase in minimum wages)

In case AB is able to complete the construction in less than 2 years and 10 months, it will be entitled for an additional incentive of ₹50 lakh. However, in case the construction is delayed beyond 3 years and 2 months, XY will charge a penalty of

₹20 lakh. At the start of the contract, AB has a reason to believe that construction will be completed in 2 years and 8 months. Assume that the construction was actually completed in 2 years 9 months.

Labour cost was originally estimated to be ₹1.20 crore (based on initial minimum wages). However, the costs have increased by 25% during the construction period.

Material costs have increased by 40% due to shor t-supply. The total increase in material cost due to the 40% escalation is ₹80 lakh.

You are required to suggest what should be the contract revenue in above case?

Assume that in year 20X2, XY has requested AB to increase the scope of the contract. An additional floor is required to be constructed and there is an increase in contract fee by ₹ 1 crore.

AB has incurred a cost of ₹ 20 lakh for getting the local authority approvals which it will be entitled to claim from XY in addition to the increase in the fixed fee.

Also measure the total contract revenue in this case.

QUESTION 30 (PERCENTAGE COMPLETION METHOD)

X Ltd. commenced a construction contract on 01-04-20X1. The fixed contract price agreed was ₹ 2,00,000. The company incurred ₹ 81,000 in 20X1-X2 for 45% work and received ₹79,000 as progress payment from the customer. The cost incurred in 20X2-X3 was ₹89,000 to complete the rest of work. Show the extract of the Profit and Loss Account and Customer's Account for the related years.

QUESTION 31

PQ & Associates undertakes a construction contract the details of which are provided below:

Total Contract Value	₹ 40 lakh
Costs incurred to date	₹ 3 lakh
Estimated future costs of completion	₹ 30 lakh
Work completed	10%

The work has started some time ago and there is an uncertainty with respect to the outcome of the contract due to expected changes in regulations. PQ is certain that it would be able to recover the costs incurred to date.

QUESTION 32

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.

During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1: ₹ 52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)

Year 3: ₹ 205 crore.

You are required to calculate:

(a) Stage of completion for each year.

(b) Profit to be recognised for each year.

NOTES

ACCOUNTING STANDARD – 15 RETIREMENT BENEFITS

(IAS 19 & IND AS 19)

QUESTION 1

As on 1st April, 2008 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 2008 the plan paid out benefits of ₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 2009 the fair value of plan assets was ₹ 1,50,000.ww

On 1st April, 2008 the company made the following estimates, based on its market studies, understanding and prevailing prices.

	%
Interest & dividend income, after tax payable by the fund	9.25
Realised & unrealized gains on plan assets (after tax)	2.00
Fund administrative costs	1.00
Expected Rate of Return	10.25

You are required to find the expected and actual returns on pan assets.

QUESTION 2

An enterprises discontinues a business segment and employees of the discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the enterprise has defended with a fair value of ₹ 820 an unrecognized past service cost of ₹ 50. The curtailment reduces the net present value of the obligation by ₹ 100 to ₹ 900.

Of the previously unrecognized past service cost, 10% relates to the part of the obligation that was eliminated trough the curtailment .

Show the effect of the curtailment.

QUESTION 3

An Employee Roshan has joined a Company XYZ Ltd. in the year 2013. 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 salary of the Employees for each completed year of service. If the Employee refers after completing minimum 5 years of service. The salary of Roshan is expected to grow at 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.

What is the amount the Company should charge in its Profit & Loss A/c. 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, 0794 0.857, 0.926.1)

SOLUTION :

1. Accounting for Salary: salary paid every year is an expense pertaining to the year, and debited in the statement of Profit and Loss in the same year.

Year	Computation (Salary increase every year by 10%)	Salary Expense debited to P&L
2013	given	₹ 14,90,210
2014	₹ 14,90,210+10%	₹ 16,39,231
2015	₹ 16,39,231+10%	₹ 18,03,154
2016	₹ 18,03,154 + 10%	₹ 19,83,470
2017	₹19,83,470+10%	₹ 21,81,816

2. Accounting for Ex-gratia: Ex-gratia paid is in relation to service rendered, Hence, the cost of ex-gratia will be amortised over the period of service.

   - Ex-gratia at the end of year 5 = ₹ 21,81,816 x 25% x 5 completed years =₹27,22227,270.
   - Hence cost attributable to every year = (₹27,27,270) / 5 YEARS = ₹ 5,45,454

   Using the PVF at 8% given in the question, the Current Service Cost and Interest Cost are computed as under- (amts.in ₹)

Year	Opening Balance	Current Service Cost (Investment made at year end)	Interest Cost = Opening Balance x 8%	Closing Balance
2013	-	₹545,454x0.735=400,908	Nil	4,00,908
2014	4,00,908	₹545.454x0.794=433,090	400,908x8% = 32,072	8,66,070
2015	8,66,070	₹545,454x0.857=467,454	866,070x8%=69,285	14,02,810
2016	14,02,810	₹545,454x0.926=505,090	14,02,810x8% = 1,12,224	20,20,125

2017	20,20,125	₹545,454x1.000 = 545,454	20,20,125x8%= 1,61,610	27,27,189

QUESTION 4

The following data apply to 'X' Ltd. Defined benefit pension plan of the year ended 31.3.09 calculate the actual return on plan assets.

-	Benefits paid	2,00,000
-	Employer contribution	2,80,000
-	Fair market value of plan assets on 31.3.09	11,40,000
-	Fair market value of plan asset as on 31.03.08	8,00,000

QUESTION 5

A company reports the following information regarding pension plan assets. Calclate the fair value of plan assets.

	Amount (₹)
Fair market value of plan asset (beginning of year)	7,00,000
Employer contribution	1,00,000
Actual return on plan assets	50,000
Benefit payments to retires	40,000

SOLUTION :

Fair market value ₹ 8,10,000

QUESTION 6

Induga 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. In this, if the benefits re-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.

Assuming the following :

(a) Immediately before the curtailment, based on current actuarial assumption, the gross obligation was estimated at ₹ 2,000.

(b) The fair value of plan assets on the date was estimated at ₹ 1,700.

(c) The unamortized past service cost was ₹ 60.

(d) Curtailment reduces the obligation by ₹ 200, which is 10% of the gross obligation.

Induga Ltd. estimates the share of unamortized service cost that relates to the part of the obligation that is eliminated at 10% of ₹ 60 or at ₹ 6. Calculate the gain form cuntailment.

QUESTION 7

A lumpsum benefit, equal to 1% of final salary for each year of service, is payable on termination of service. The salary in year 1 is ₹ 10,000 and is assumed to increase at 7% (compound) each year resulting in ₹ 13,100 at the end of year 5. The discount rate used is 10% per annum. Show under the projected unit credit method the amount of obligation.

QUESTION 8

An enterprise operates a pension plan that provides a pension of 2% of final salary for each year of service. The benefits become vested after five years of service. On 1 January, 2007 the enterprise improves the pension to 2.5% of final salary for each year of service starting from 1 January, 2003. At the date of the improvement, the present value of the additional benefits for service from 1 January, 2003 to 1 January, 2007 is as follows :

Employees with more than five years' service at 1.1.2007	₹ 150
(Benefit already vested)	
Employees with less than five years' service at 1.1.2007	₹ 120
(Average period until vesting : three years)	
	₹ **270**

Discuss the treatment of Employee benefit as per AS - 15.

SOLUTION :

The enterprise recognize 150 million immediately becasue these benefits are already vested. Enterprise should recognize 120 million on straight line basis over three year from 1st January 2007.

QUESTION 9

Jakarta Airlines has a post-retirement medical benefits scheme to its employees. As per the scheme, employees who have put in 20 years of service are eligible for post retirement medical benefit. There are 8000 employees on 31.3.2003 who were eligible for post-retirement benefit scheme. All the post-retirement medical expenses will be borne by the Company itself, as Company has not taken any post-retirement medical scheme from any insurance company. During the year, Company has actually paid ₹ 3 crores to retired employees as medical expenses. No provision for accrual liabilities of retirement medical expenses for the eligible 8000 employees has been made. Comment upon the accounting treatment whether it is in accordance with AS-15.

SOLUTION :

The scheme introduced by the Company, is for post-retirement medical benefits.

If the predominant characteristics of these benefits are the same as those of PF, Superannuation, Pension, or Gratuity benefit, i.e., if such a retirement benefit is in the nature of either a defied benefit scheme, or a defined contribution scheme, as defined in the Standard, then, a provision for such a scheme should be made.

In the instant case, the "predominant characteristics" of the medical benefit scheme are in the with the benefit scheme covered by AS 15, and hence a suitable provision to cover the liabilities in respect of 8000 employees should be made.

QUESTION 10

Devasthanams Ltd. makes a regular contribution of ₹ 18 lacs, under a defined benefit scheme. Actuarial valuation revealed a shortfall of ₹ 24 lacs. Remaining service lives of participating employees is 4 years. Applying the norms under AS 15, provide the proper accounting treatment for this situation. Also state the treatment, if an amount of ₹ 4 lacs included in the shortfall, were to relate to employees already retired.

SOLUTION :

An actuarially determined past service cost arises on the introduction of retirement benefit scheme for existing employees or on the making of improvements to an existing scheme etc. This cost gives the employees credit for benefit of services rendered before the occurrence of one or more of these events.

As per AS-15(R), the entire shortfall should be recognised immediately in Profit and Loss. The option of spread over (Corridor approach) as in IAS is not applicable.

QUESTION 11

On December 31, 2010, an entity's balance sheet includes a pension liability of $1.2 million. Management has made the decision to adopt IAS 19 as of January 1, 2001, for the purpose of accounign for employee benefits. At that date, the present value of the obligation under IAS 19 is calculated at $14.6 million and the fair value of plan assets is determined at $11.0 million. On January 1, 1996, the entity had improved pension benefits (cost for nonvested benefits amounted to $1.6 million, and the average remaining period at that date, until vesting, was 8 years).

SOLUTION :

The transitional liability is calculated as follows :

	$'000
Present value of the obligation	1,46,000
Fair value of plan assets	(11,000)
Past service cost to be recognised in later periods (1.6 x 3/8)	(600)
Transitional liability	3000
Liability already recognized	1200
Increase in liability	1800

The entity might (in terms of the transitional provisions of IAS 19) choose to recognize the transitional liability of $1.8 million either immediately or recognize it as an expense on a straight-line basis upto 5 years. The choice is irrevocable. In future such transitional arragements are dealt with by IFRS 1.

QUESTION 12

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay. During the travel. Alternatively employees can claim a lump-sum amount equal to one month pay last drawn.

The company's contentions in this matter are :

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

QUESTION 13

What are the types of Employees benefit and what is the objective of Introduction of this Standard i.e. AS-15 ?

SOLUTION :

Type of employee benefits :

(i) short-term employee benefits e.g. wages, salary, bonus payable within 12 months from end of period, medical care, housing etc.

(ii) post-employment benefits such as gratuity, pension, other retirement benefits

(iii) other long-term employee benefits such as profit-sharing bonuses, long-service leave, long-term disability benefits which are not payable wholly within 12 months from end of period.

(iv) termination benefits.

Objective of AS 15 :

The objective of this standard is to prescribe the accounting and disclosure for employee benefits. The standard requires an enterprise to recognise :

(i) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(ii) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

QUESTION 14

The Company has entered into a wage agreement in May, 2008 whereby the labour union has accepted a revision in wage from June, 2007. The agreement provided that the hike till May, 2008 will not be paid to the employees but settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2008. The company seek your advise by finalising for the year ended 31st March, 2008.

SOLUTION :

This comes under the category of Termination benefits under AS-15. Such expense should-be recognized as an expense immediately. If amount falls due after 12 months from Balance Sheet date, it should discounted for the purpose of recognizing expense and corresponding liability.

QUESTION 15

What are the kinds of employees covered in the revised AS 15 and whether a formal employer employee relationship is necessary or not, for benefits to be covered under the Standard?

SOLUTION :

The Standard does not define the term “employee”. Paragraph 6 of the Standard states that ‘an employee may provide services to an enterprise on a full time, part time, permanent, casual or temporary basis and the term would also include the whole-time directors and other management personnel. The Standard is applicable to all forms of employer employee relationships. There is no requirement for a formal employer employee relationship. Several factors need to be considered to determine the nature of relationship.

Generally, 'outsourcing contracts' may not meet the definition of employer - employee relationship. However, such contracts need to be carefully examined to distinguish between a "contract of service" and a "contract for services". A 'contract for services' implies a contract for rendering services, e.g., professional or technical services which is subject to limited direction and control whereas a 'contract of service' implies a relationship of an employer and employee, and the person is obliged to obey orders in the work to be performed and as to its mode and manner of performance.

QUESTION 16

Entity XY is required to pay salary of ₹ 2 crore for the year 20X1-X2. It actually paid a salary of ₹ 1.90 crore up to 31st March 20X2, and balance in April 20X2. Determine the actual costs to be recognized in the year 20X1-X2 and any amounts to be shown through balance sheet.

SOLUTION

Total expense for the year (20X1-X2)	₹ 2 crore
Amount to be shown under liability (unpaid)	₹ 2 crore – 1.90 ₹crore
	= ₹ 10 lakhs

QUESTION 17

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.

ACCOUNTING STANDARD 18: RELATED PARTY DISCLOSURES

QUESTION 1 (GOOD QUESTION)

Will transactions with Related Parties, for services provided/received free of cost, be required to be disclosed?

Adhiram Ltd. has a Corporate Communications Department, which centralizes the Pubic Relations functions for the whole group of Adhiram Ltd. and its Subsidiaries. No charges are however, levied by Adhiram Ltd. on its Subsidiaries and accordingly, these transactions are not given accounting recognition. Would these constitute Related Party Transactions requiring disclosure under AS-18 in the Separate Financial Statements of Adhiram Ltd.?

SOLUTION :

1. **Principle:** As per AS-18, a Related Party Transaction is 'a transfer of resources or obligations between related parties, regardless of whether or not a price is charged".
2. **Conclusion:** In the given example, there is a transfer of resources from Adhiram Ltd. to its Subsidiaries even though no price is charged for the same. These transactions would require disclosure under AS-18 in the Separate Financial Statements of Adhiram Ltd.

QUESTION 2

Bhima Ltd. sold to Arjun Ltd. goods having a Sale Value of rs. 25 Lakhs during a Financial Year. Mr. Strength, the Managing Director and Chief Executive of Bhima Ltd. owns nearly 100% of the Capital of Arjun Ltd. The Sales were made to Arjun Ltd at the normal Selling Price of Bhima Ltd. The Chie Accountant of Bhima Ltd. does not consider that these Sales should be treated any differently from any other sale made by the Company despite being made to a Controlled Company, because the sales were made at normal and, that too, at arms length price. Comment.

SOLUTION

1. Principle – 1 : Related Party Relationship covers the following relationships -
   (a) Enterprises that control the Reporting Enterprise.
   (b) Enterprises that are controlled by the Reporting Enterprise, or
   (c) Enterprises that are under common control with the Reporting Enterprise (this includes Holding Companies, Subsidiaries and fellow Subsidiaries).

2. **Principle -2:** Further, S – 18 is applicable irrespective of whether or not the transactions with related parties are made at arm's length prices.
3. **Analysis:** Hence, in the given case, Bhima Ltd. has Related Party Relationship with Arjun Ltd. since both the Companies under the common control of a single person (Mr. Strength).
4. **Conclusion:** Hence, Bhima Ltd. should disclose the information required under AS-18 in relation to as Sales to Arjun Ltd. during the entire Financial year.

QUESTION 3

A husband and wife are controlling 34% of voting power in Mathura Limited. They have a separate Partnership Firm, which supplies the main Material to the Company. The Management says that the above transaction need not be disclosed. How will you deal with the above situation?

SOLUTION :

1. **Related Party Relationship:** The definition of Related Party Relationship covers "Enterprises owned by the Directors or Major Shareholders of the Reporting Enterprise."
2. **Significant Influence:** Significant Influence is presumed to exist, if an investing party holds 20% or more of the voting power of the Enterprise (Such holding may be direct or indirect through Intermediaries).
3. **Disclosure:** AS-18 requires disclosure if there have been transactions between Related Parties, irrespective of whether or not the transaction have been entered into at arm's length prices.
4. **Conclusion:** In the instant case the individuals hold 34% of the voting power in the Company, and hence have a significant influence. Disclosure is required as per AS-18.

QUESTION 4

Strong Ltd. holding 60% of the Equity Shares in Weak Ltd. purchased goods worth Rs. 60 Lakhs from Weak Ltd. during the Financial year. The Managing Director of Strong Ltd. is of the opinion that it is normal business activity and there is no need to disclose the same in the final accounts of the Company. Give your views of the above.

SOLUTION :

1. Strong Ltd. is the Holding Company of Weak Ltd., as is holds more than 50% of the voting power of Weak Ltd. and thus should be treated as Related Parties as per AS-18.
2. As per AS-18, in the case of Related Party Transactions following facts should be disclosed -

(a) Related Party Relationship, Name and Nature of Relationship.

(b) If there is transaction between the Related Parties then a description of the Nature of Transaction, Volume of the Transaction outstanding at the Balance Sheet date etc.

3. In the instant case, since there is Related Party Transaction, the contention of the Managing Director of Strong Ltd is not correct. The Auditor should insist to make proper disclosure as required by AS-18 and if the Management refuses, the Auditor should express a qualified opinion.

QUESTION 5 (GOOD QUESTION)

A Firm of a Father and Son received Rs. 2 Lakhs towards job work done for Rama Ltd. during the year ended 31st March. The total Job Work Charges paid by Rama Ltd. during the year are over Rs. 50 Lakhs. The father is a Managing Director of Rama Ltd. having substantial holding. The Managing Director told the Auditor that since he is not involved in the activities of the Firm, and since the amount paid to it is insignificant there is no need to disclose the transaction He further contended that such a payment made in the last year was not disclosed. Is the M.D. right in his approach?

SOLUTION :

1. **Principles:**

(a) Parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making decisions.

(b) As per AS – 18, Significant Influence is said to exist in case the investing party has 20% or more voting power in the Enterprise.

2. **Analysis and Conclusion:** In the above case, the Managing Director of Rama Ltd. is a Partner in the Firm with his son, and the Firm has been paid Rs. 2Lakhs as Job Work Charges. The Managing Director has a substantial holding in the Firm. The Managing Director is also a Key Management Personnel of Rama Ltd. Hence, there is a Related Party relationship & transaction requiring disclosure under AS-18.

QUESTION 6

Is a Non-Executive Director on the Board of Directors of a Company, a Key Management Person?

Can a Non-Executive Director be considered as a Related Party, when he participates in the financial and/or operating policy decisions of the Reporting Enterprise?

Vamana Ltd. has two Non-Executive Directors in its Board. State whether AS-18 is applicable if – (1) A, a Non-Executive Director is in a position to exercise significant influence by virtue of owning an interest in the voting power in the Company. (2) B, a Non-Executive Director does not enjoy the authority and responsibility for planning, directing and controlling the activities of the Company.

SOLUTION :

1. **Principles: AS-18 applies to Non-Executive Director as under:**

AS-18 not applicable	As-18 applicable
(a) A Non-Executive Director of a Company should not be considered as Key Management Person under AS-18 by virtue of his merely being a Director, directing and controlling the activities of the Reporting Enterprise. (b) AS-18 should not be applied in respect of a Non-Executive Director even if be participates in the financial and/ or operating policy decision, of the Enterprise (Note: Mere participation is different from authority to plan/ direct/control).	A Non-Executive Director would be covered by AS-18 if he is a Key Management Person when – (a) he has the authority and responsibility for planning, directing and controlling the activities of the Reporting Enterprise, or (b) he is in a position to exercise or significant influence by virtue of owning an interest in the voting power.

2. **Conclusion for Vamana Ltd.'s case:** Disclosure under AS-18 will be required only for Director A, and not for Director B.

QUESTION 7 (GOOD QUESTION)

Arun Ltd. owns 60% of the voting power of Baskar Ltd. which in turn owns 60% voting interest in Chandru Ltd. Karuna Ltd. owns the remaining voting share in Chandru Ltd. and is considered to exercise significant influence over Chandru Ltd. During the reporting period, Karuna Ltd. enters into transactions in the ordinary course of business with Arun Ltd. Would Karuna Ltd. be a Related Party of Arun Ltd.?

SOLUTION :

1. **Analysis:** Karuna Ltd. is not related to Arun Ltd. as it – (a) neither controls nor is controlled by Arun Ltd. (b) does not exercise significant influence over Arun Ltd. or is not so influenced by it.
2. **Conclusion:** Hence, Arun Ltd. and Karuna Ltd. are not considered as related party for the purpose of AS-18.

QUESTION 8

A Ltd. owns 30% of the Equity Capital of B Ltd. B Ltd. in turn owns 35% of the Equity Capital of C Ltd. and 40% of Equity Capital in D Ltd. Answer the following questions -

(1) Is B Ltd. a Related Party to A Ltd.?

(2) Is C Ltd. a Related Party to A Ltd.?

(3) Are C Ltd. and D Ltd. are Related Parties?

SOLUTION

1. Associates and Joint Ventures of the Reporting Enterprise are Related Parties. Since A Ltd. holds more than 20% of the voting power in B Ltd. by virtue of this, it has substantial interest and significant influence in B Ltd. So B Ltd. is an Associate, and hence is Related Party to A Ltd.
2. An Associate of an Associate is not a Related Party. Only in the case of a Holding Company, a Subsidiary of a Subsidiary (Sub-Subsidiary) also becomes a Related Party.
   (i) B Ltd. Is an associate of A Ltd. Due to which both are related parties.
   (ii) C Limited is not a direct Associate of A limited due to which both are not related parties.
   (iii) C Ltd. and D Ltd. are Co-Associates, Co-Subsidiaries become Related Parties because of common control. In the case of Co-Associates, this common control is missing, and therefore, they are not Related Parties.

QUESTION 9

Is an Associate of an Associate a Related Party?

Anand Ltd. owns 30% of Share Capital of Bhanu Ltd. while Bhanu Ltd. own 25% of Share Capital of Chandni Ltd. Would Chandni Ltd. be considered a Related Party in the Financial Statements of Anand Ltd.?

SOLUTION :

1. **Principle:** Para 3(b) of AS-18 refers to "Associates and Joint Ventures of the Reporting Enterprise and the investing party or Venturer of which the Reporting Enterprise is an Associate or a Joint Ventrue" as a Related Party relationship.
2. **Intermediaries:** "Intermediaries" is confined to only Subsidiary Enterprises and not associates.
3. **Conclusion:** In the above case, Chandni Ltd. is not a Related Party of Anand Ltd. An Associate of an Associate cannot be regarded as a Related Party only by virtue of this relationship.

QUESTION 10

In respect of a Key Supplier who is dependent on the Company for its existence and the Company enjoys influence over the prices of the Supplier (which may not be formally demonstrable), can the Supplier and the Company be considered to be Related Parties?

SOLUTION :

1. **Principle:** AS-18 states that "a single customer, Supplier, Franchiser, Distributor or General Agent with whom an enterprise transacts or significant volume of business merely by virtue of the resulting economic dependence" would not be deemed to be Related Parties.
2. **Conclusion:** As the conditions for being classified as a Related Party are not satisfied in the above case, the Supplier cannot be said to be related to the Company.

QUESTION 11 (GOOD QUESTION)

Should Related Parties be identified as at the Reporting Date for the purposes of AS-18?

Ram Ltd. held 70% of Share Capital of Ayodha Ltd. During the year Ram Ltd. sold 60% of the Shareholding in Ayodhya Ltd there were transactions between Ram Ltd. and Ayoudhya Ltd. before and after the sale of holding by Ram Ltd. should all the transactions between the parties be disclosed?

SOLUTION :

1. **Principle:** Refer question above.
2. **Conclusion:** Ram Ltd. has to disclose the nature of relationship and also the details of the transactions that happened during the existence of Related Party Relationship, even if the relationship does not exist on the Balance Sheet date.

QUESTION 12 (GOOD QUESTION)

Rajkumar, a relative of Key Management Personnel, received remuneration of Rs. 2,50,000 for his services in the Company for the period from 1st January to 30th June. On 1st July, he left the service. Should the relative be identified as at the closing date, i.e. on 31st December for the purposes of AS-18?

SOLUTION :

1. **Principle:** As per AS-18 "Related Party Disclosures"-
   (a) Relative of the Key Management Personnel is considered as a Related Party Relationship.
   (b) Even if Related Party Relationship existed for one day during the Financial Year, all the transactions that took place between the parties during the entire year should be disclosed.

2. **Conclusion:** In the above case, Remuneration paid to Rajkumar should be disclosed under AS-18, for the period for which he was the Director, even if the relationship did not exist on the Balance Sheet date.

QUESTION 13

Rama Ltd. exercises significant influence in the operating decision of Lakshman Ltd. During a certain financial year, there was no transaction between the Companies. The parties feel that there is no need to give related party disclosure in the Financial Statements for the year. Comment.

SOLUTION :

1. **Principle:** AS-18 requires disclosure of name of the Related Party and nature of the Related Party Relationship where control exists, irrespective of whether or not there have been transactions between the related parties.
2. **Analysis and Conclusion:**

   The above requirements are applicable to situations 'where control exists" and does not extend to cases of significant influence. Since there are no transactions at all between the Related Parties, in the above case, the question of disclosure under AS-18 does not arise. Hence, the Company's viewpoint is correct.

QUESTION 14

Akash Ltd. (the Reporting Enterprise) is a wholly owned subsidiary of PQ Pic. UK, XYZ is another wholly-owned subsidiary of PQ Pic. UK Would the relationship between Akash Ltd. and XYZ Inc. be required to be disclosed in Akash's Financial Statements, pursuant to Para 21, even if no transaction have been undertaken during the reporting period between these enterprises?

SOLUTION :

1. **Principle:** AS-18 requires disclosure of name of related party and nature of relationship where control exists, irrespective of whether or not there have been transactions.
2. **Existence of Control:** The use of the words "where control exists" implies that disclosure of relationship in the Financial Statements is required only if control exists. *While AS-18 includes Fellow Subsidiaries as a Related Party relationship, there is no existence of control between them.*
3. **Conclusion:** In the above case if none of the conditions of control is satisfied, the relationship between Akash Ltd. and XYZ Inc. USA would not require disclosure in the Financial Statements of Akash Ltd.

QUESTION 15

Is the basis of pricing required to be disclosed under AS-18?

SOLUTION :

1. **Principle:** S-18 does not require a specific disclosure of the basis of pricing of all transactions entered into with related parties.
2. **Understanding:** AS-18 states that "*Any other elements of the Related Party Transactions necessary for an understanding of the 'Financial Statements" should be disclosed.*
3. **Example:** A Ltd. and B Ltd. are related parties as per AS-18. 60% of A Ltd.'s annual sales are made to B Ltd., at a fixed price realizing a margin of 5% from such sales. The Normal Gross Margin derived from the balance 40% sales made by A Ltd. to unrelated parties is 45%. In this case, the disclosure in the Financial Statements may include a reference that the transaction has been entered into "under terms of arrangement, as a result of which prices are lower than those with unrelated parties".

STUDY MATERIAL & PAST EXAMINATION QUESTIONS (SELF READING)

QUESTION 16 (CA INTER NOV 2018) (5MARKS)

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

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

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

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

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

SOLUTION :

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

Hence, Mr. Sumit a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2018 as he received remuneration forhis services in the company from1st April,2017 to 30th June, 2017and this period comes under the reporting period.

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

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

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

QUESTION 17 (CA INTER MAY 2019) (5MARKS)

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

(i) Maya Ltd. holds 61 % shares of Sheetal Ltd.

Sheetal Ltd. holds 51 % shares of Fair Ltd.

Care Ltd. holds 49% shares of Fair Ltd.

(Give your answer - Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.)

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

SOLUTION :

(i) (a) Reporting entity- Maya Ltd.

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

(b) Reporting entity- Sheetal Ltd.

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

(c) Reporting entity- Fair Ltd.

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

(d) Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

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

QUESTION 18

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

SOLUTION:

Reporting entity- A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related par Reporting entity- B Ltd.
- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party Reporting entity- O Ltd.
- A Ltd. (holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party Reporting entity- Z Ltd.
- O Ltd. (associate) is a related party

QUESTION 19 (CA INTER JULY 21 PAPER) (5 MARKS)

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

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

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

SOLUTION :

(i) Mr. Happy is not a related party for the company because he does not power of Planning, Directing & Controlling because he is managing the busiess in lieu of a fixed amount but Policy making powers are lying with the directors of company which indicates that Mr.Happy is just an employee for the company but not the key management.

(ii) As per the provisions of AS 18, Shri Bhanu was a KMP for 3 months in current year. It indicates that he was in relation with company for the said period. So the company should disclose the amount of paid remuneration as related party transaction in its report till the period in which he was in relation with company. There is no need to show any relationship with shree bhanu after 30.6.2020.

QUESTION 20

Consider a scenario wherein:

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

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

SOLUTION :

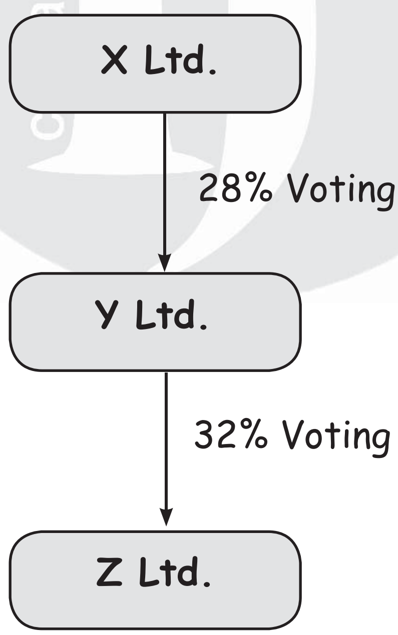
Yes – in relation to A Ltd. (the reporting enterprise), C Ltd. is a related party under AS-18. This is because A Ltd. indirectly controls C Ltd.

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

QUESTION 21

Consider a scenario wherein:

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



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

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

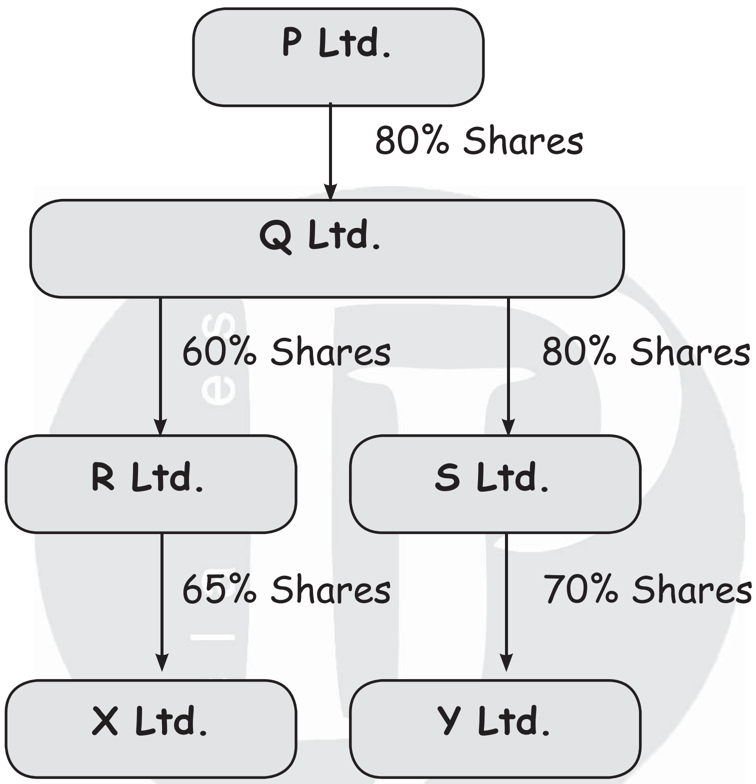
The question is: Whether Z Ltd. is to be treated under AS-18 as a party related to X Ltd.?

SOLUTION :

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

QUESTION 22

Consider the following organization structure related to P Ltd.



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

SOLUTION :

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

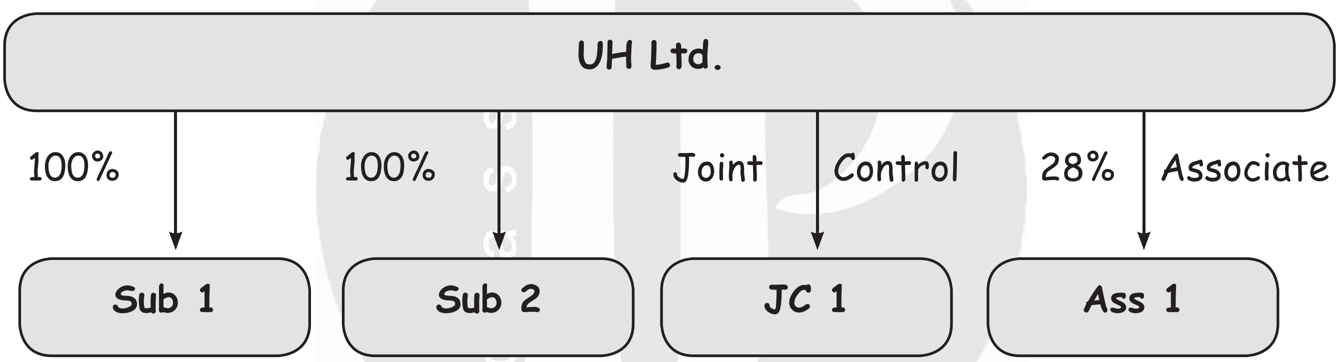
Party Name	Relationship under AS-18
P Ltd.	• P Ltd. has indirect control on R Ltd. (through Q Ltd.) • Hence R Ltd. is related to P Ltd.
Q Ltd.	• Q Ltd. has direct control of R Ltd. • Hence R Ltd. is related to Q Ltd.
S Ltd.	• R Ltd. and S Ltd. are under common control of Q Ltd. • Hence R Ltd. is related to S Ltd.

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

QUESTION 23

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

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



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

SOLUTION :

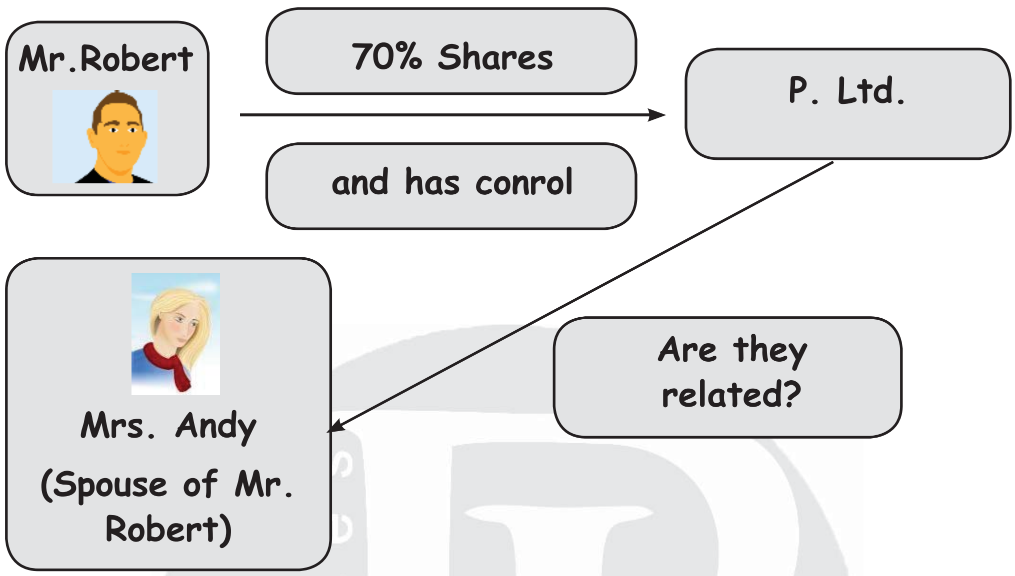
The following table identifies the related party relationships for each of the entities in the Group:

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

QUESTION 24

Consider a scenario wherein:

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



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

SOLUTION :

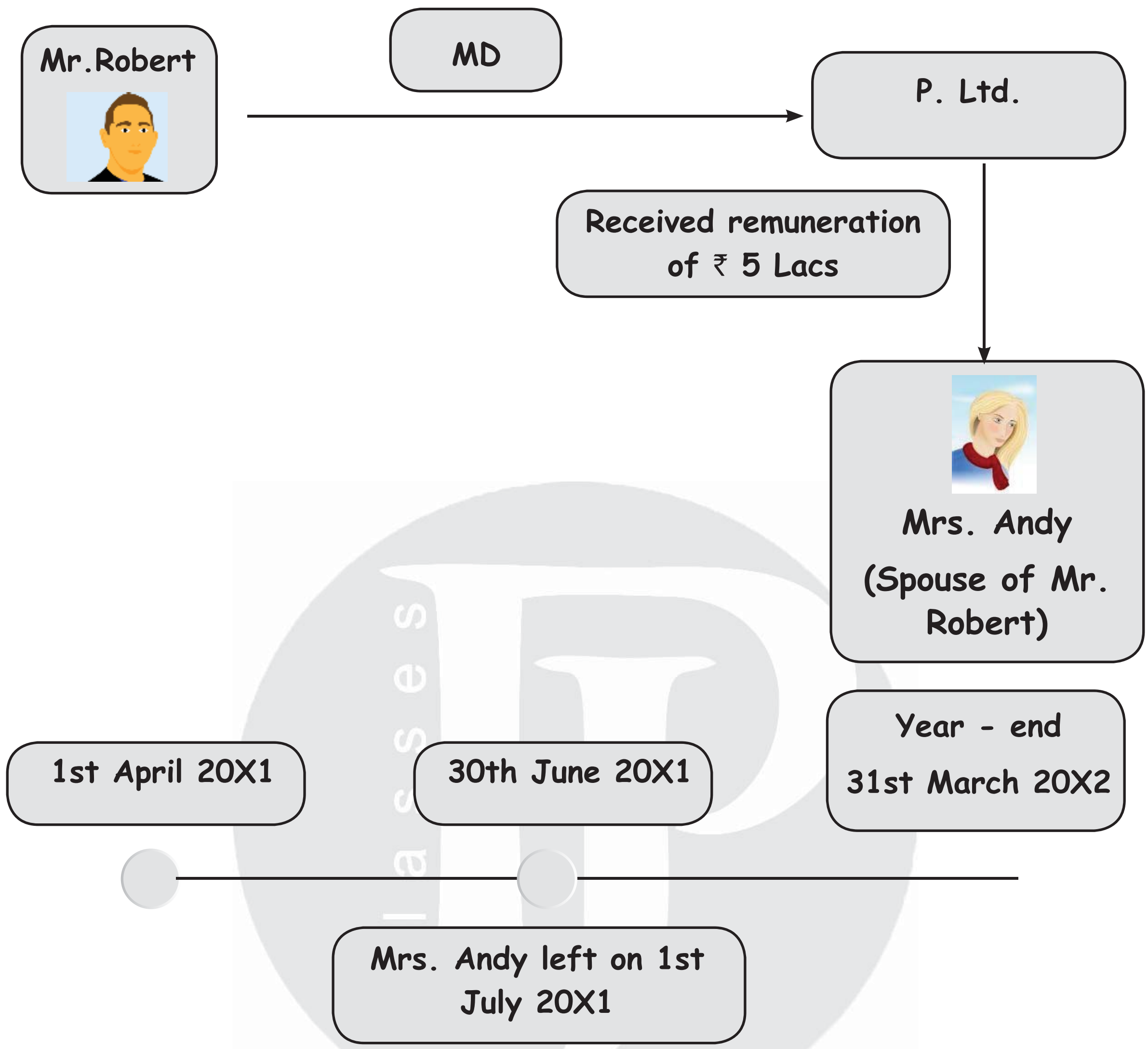
Yes – Andy is a related party to P Ltd., in view of the requirements of AS-18.

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

QUESTION 25

Consider a scenario wherein:

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



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

SOLUTION :

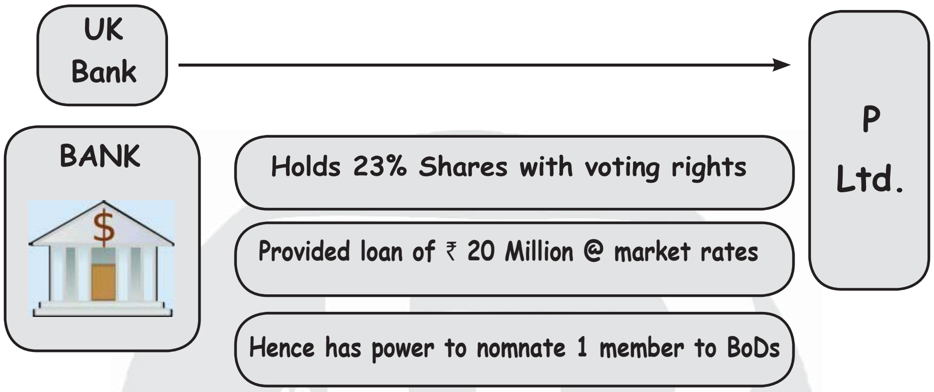
Yes – This is because as per AS-18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

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

QUESTION 26

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.)

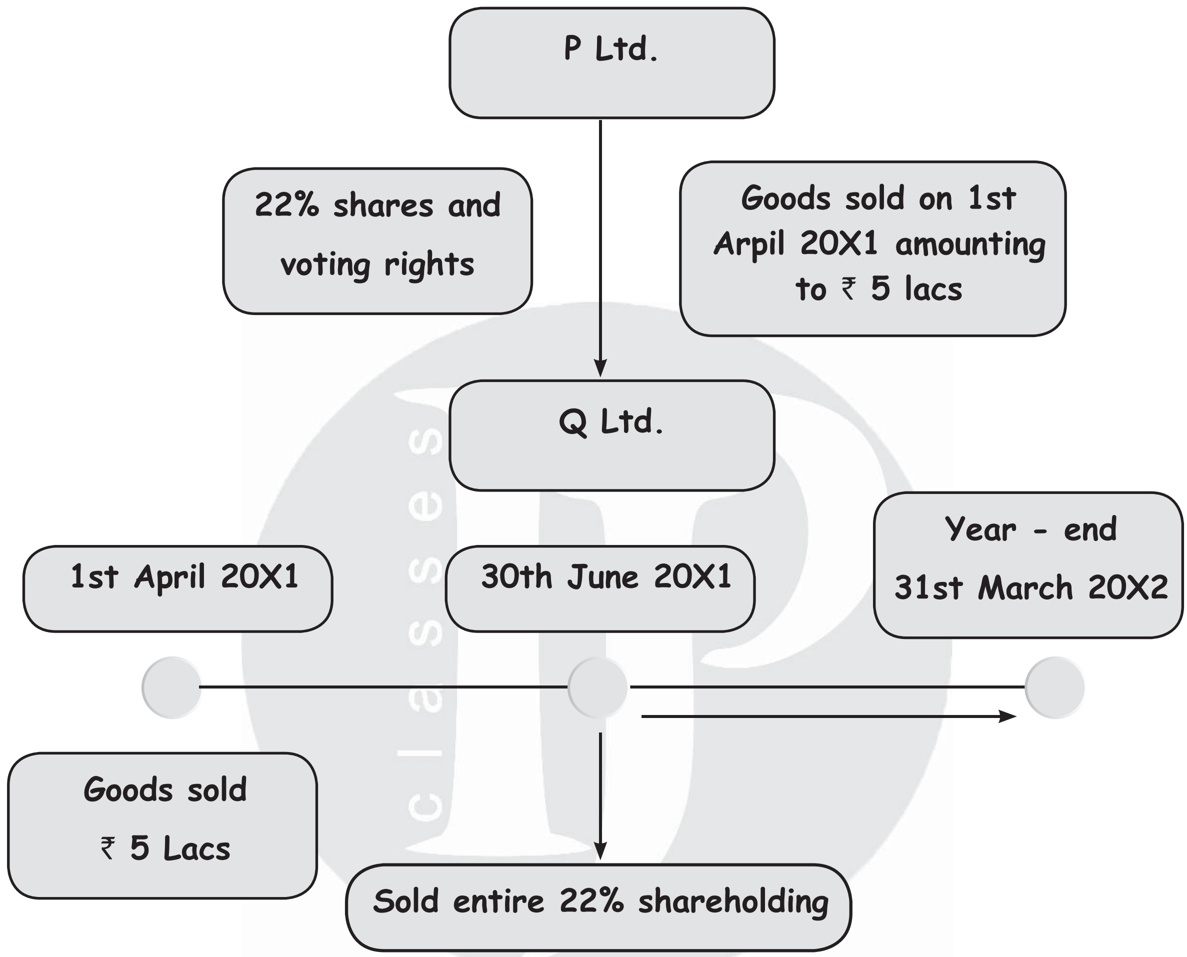
Accordingly, for P Ltd. (the reporting enterprise), the UK Bank is a related party and it will be required to disclose the transactions with UK Bank in its financial statements.

QUESITON 27

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.

QUESTION 28

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

SOLUTION :

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

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

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

QUESTION 29

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

SOLUTION :

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

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

(i) The name of the transacting related party;

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

(iii) A description of the nature of transactions;

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

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

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

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

QUESTION 30

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

SOLUTION :

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

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

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

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

QUESTION 31

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

SOLUTION :

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

QUESTION 32

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

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

SOLUTION :

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

QUESTION 33

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

SOLUTION :

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

QUESTION 34

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

M Ltd. holds 61 % shares of S Ltd.

S Ltd. holds 51 % shares of F Ltd.

C Ltd. holds 49% shares of F Ltd.

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

SOLUTION :

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

QUESTION 35 (CA INTER MAY 2023)

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

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

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

ACCOUNTING STANDARD-19
LEASE ACCOUNTING (IAS-17 & IND AS- 17)

QUESTION 1

ABC Limited leases out an equipment whose fair value as on 1.1.2001 is ₹12 lakhs (at the inception of lease). The agreed lease rental is ₹4 lakhs per annum for a period of 4 years. Expected unguaranteed residual value at the end of lease term is ₹30,000. What is the implicit rate of interest.

QUESTION 2 (AUDIT PAPER)

Y Limited wishes to obtain a machine tool costing ₹20 lakhs by way of lease. The effective life of the machine tool is 12 years but the company requires it only for the first five years. It enters into an agreement with R Limited for a lease rental of ₹2 lakhs per annum.

The finance director of Y Limited is not sure about the treatment of these lease rentals and hence requests your assistance in proper disclosure of the same. For calculation purposes, the implicit rate of interest may be taken at 15%. Discount factors: 0.87, 0.76, 0.66, 0.57, and 0.50

QUESTION 3

ABC Limited has taken an item of equipment on lease. The lease agreement is for a period of ten years, which is approximately equal to the useful life of the equipment. The lessee enjoys the option to buy the asset at the end of 10 years at ₹25,000 whereas the estimated residual value of the asset is ₹20,000. should this lease be classified as finance lease.

QUESTION 4

From the information given below, determine whether the lease is a financial or an operating lease.

Lessor's cost of the leased asset	₹80,000
Fair value of the leased asset on 1.1.2002	₹80,000
(inception of the lease)	

The lease is for 4 years and the rentals, which have to be paid in advance at the beginning of each year, are ₹40,000, ₹25,000 and ₹15,000 and ₹10,000 respectively. The estimated residual value of the leased assets at the end of the lease term is 5% of the cost of the asset to the Lessor. The Lessor expects a return of 18% on investment.

QUESTION 5

An enterprise acquires a machinery on lease from a leasing company (the lessor) on January 20X0. The lease term covers the entire economic life of the machinery. I.e., 3 years. The fair value of the machinery on January 1, 20X0 is ₹2,35,500. The lease agreement requires the lessee to pay an amount of₹1,00,000 per year beginning December 31, 20X0. The lessee has guaranteed a residual value of ₹17,000 on December 31, 20X2 to the lessor. The lessor, however, estimates that the machinery would have a salvage value of only ₹3500 on December 31, 20X2. The interest rate implicit in the lease is 16 per cent.

Please show at what amount there will be recognition of an asset and a liability in the books of Lessee.

QUESTION 6

R Limited (The Lessee) acquired a machinery on lease from S Limited (the Lessor) on January 1, 2000. The lease term covers the entire economic life of the machinery i.e., 3 years. The fair value of the machinery on January 1, 2000 is ₹3,50,000. the lease agreement requires the Lessee to pay an amount of ₹1,50,000 per year beginning December 31, 2000. The Lessee has guaranteed a residual value of ₹11,400 on December 31, 2002 to the Lessor. The Lessor however estimates that the machinery will have a salvage value of only ₹10,000 on December 31, 2002. The implicit rate of interest is 15% p.a. Compute the value of machinery to be recognized by the Lessee and also the finance charges every year on the basis of AS 19.

QUESTION 7

An enterprise acquires a machinery on lease from a leasing company (the lessor) on January 20X0. The lease term covers the entire economic life of the machinery. I.e., 3 years. The fair value of the machinery on January 1, 20X0 is ₹2,35,500. The lease agreement requires the lessee to pay an amount of ₹1,00,000 per year beginning December 31, 20X0. The lessee has guaranteed a residual value of ₹17,000 on December 31, 20X2 to the lessor. The lessor, however, estimates that the machinery would have a salvage value of only ₹3500 on December 31, 20X2. The interest rate implicit in the lease is 16 per cent.

Please show a table of apportionment of lease payment into finance charge and outstanding liability.

QUESTION 8

Indentify asset and liability to be recognized at the inception of lease in the books of lessee :-

Fair value of the leases asset is ₹16lacs

Lease term – 4years

Agreed Lease rental – ₹5lacs per annum

Guaranteed residual value - ₹1lac

Expected residual value- ₹3lacs.

IRR : 14.97%

QUESTION 9

Date of Lease 1st April, 2001. Accounting year is financial year. Cost of leased asset ₹60,000. Annual rent ₹35,000, ₹16,000, ₹8000, ₹4500 payable in the beginning of the year. Interest rate implicit 14%. Residual value at the end of 4th year ₹3000. Statutory depreciation 40% WDV. Prepare the books of Lessee (assuming that this is the lease in the nature of finance lease.)

QUESTION 10

Using the data given below please prepare a table in the books of lesser for decomposition between finance income and receivable under finance lease.

Fair value of the leases asset is ₹16 lacs

Lease term – 4years

Agreed Lease rental – Rus.5 lacs per annum

Guaranteed residual value - ₹1lac

Expected residual value- ₹3 lacs.

Implicit rate: 14.97%

QUESTION 11

Date of Lease 1st April, 2001. Accounting year is financial year. Cost of leased asset ₹ 60,000. Annual rent ₹35,000, ₹16,000, ₹8000, ₹4500 payable in the beginning of the year. Interest rate implicit 14%. Residual value at the end of 4th year ₹3000. Prepare the books of Lesser assuming that this is the lease in the nature of finance lease

QUESTION 12

An asset is leased out for a period of 5 years out of its useful life of 10 years. The lease arrangement has been classified as operating lease. The agreed annual lease rental is ₹ 10 lacs. The fair value of the leased out asset at the inception of lease is ₹50 lacs. The lessor incurred ₹1lac initial direct cost. The lessor follows straight-line depreciation and assumes 14% incremental borrowing cost.

Annual straight-line depreciation charge ₹5 lacs.

QUESTION 13

Ramesh takes on oil tanker on lease for a four year period for which period he heas secured a contract with oil India to transport oil from Chennai to Neyveli. The contract was entered into on 1.1.1999 and the rentals agreed are ₹60000, ₹50000, ₹40000, and ₹30000 respectively. His other expenses and income from operating the tanker are given below:

	1999	2000	2001	2002
Diesel and oil	10,000	16,000	18,000	16,000
Driver's salaries	20,000	21,000	21,000	22,000
Administrationover.	10,000	10,000	13,000	14,000
Hire paid by oil India	90,000	95,000	1,00,000	96,000

Show how Ramesh would treat this transaction in the financial statements prepared for the year 2002.

QUESTION 14

AB Limited owns a machinery, original cost of which is ₹100 lacs, useful life 10 years, expected residual value ₹10 lacs. The company charges depreciation using reducing balance method. The company has decided to sale this machinery at the beginning of 6^{th} year at ₹40 lacs to DQ Limited. The buyer leases the machine back to AB Limited for a lease term of 5 years @ ₹10 lacs lease rentals per annum and guaranteed residual value of ₹1 lac at the end of the lease term. Lessee's incremental borrowing rate is 13.5% per annum.

Book Value of Asset 31.62 Lacs & Dep. @ 50.97% on WDV Basis.

QUESTION 15

A manufacturer offers outright sale as well as lease arrangement. Normal selling price of a machine along with normal trade credit of three months is ₹20 lacs. The lease term covers substantially the whole useful life of the machine at an uniform lease rental of ₹6 lacs per annum. The useful life of the machine is estimated at 5 years. Normal cost of sale is ₹16 lacs. Residual value is assumed to be negligible. How should the total profit be distinguished between normal profit and finance income? (Note: IRR is 15.24%)

QUESTION 16 (CA FINAL NOV 2004) (8MARKS)

A Ltd. leased a machinery to B Ltd. on following terms:

- Fair value of the machinery=20lakhs
- Lease term 5years
- Lease rental per annum 5lakhs

- Guaranteed residual value 1lakh
- Expected residual value 2 lakhs
- Internal rate of return 15%

Depreciation is provided on straight line method at 10% per annum. Ascertain unearned finance income and necessary entries may be passed in the books of lessee in the first year.

QUESTION 17 (CA FINAL MAY 2005) (REFER Q.29)

An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair market value of the equipment are ₹ 3,00,000. The amount will be paid in 3 instalments and at the termination of lease Lessor will get back the equipment. The Unguaranteed Residual Value at the end of 3 years is ₹ 40,000. The Internal Rate of Return (IRR) of the investment is 10%. The Present Value of annunity factors of Re. 1 due at the end of 3rd year on 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.

Calculate Unearned Finance Income.

QUESTION 18 (CA FINAL NOV 2007)

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of the machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. Guaranteed Residual Value (GRV) is ₹ 22,000 on expiry of the lease. Implicit Rate of Return (IRR) is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machine to be considered by Lessee Ltd. and the interest (Finance Charges) in each year.

QUESTION 19 NOV.2014 5 MARKS

A Machine having expected useful life of 6 years, is leased for 4 years. Both the Cost and the Fair Value of the Machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, Lessor will get back the Machinery. The Unguaranteed Residual Value at the end of the 4^{th} year is rs.70,000. The IRR of the investment is 10%. The Present value of Annuity Factor of ₹ 1 due at the end of 4^{th} IRR is 10% IRR is 3.169. The Present Value of ₹ 1 due at the end of 4thyear at 10% Rate Interest is 0.683.

Compute the Unearned Finance Income.

SOLUTION

Computation of Unearned Finance Income

Particulars	₹
Annual Lease Payments $= \dfrac{\text{PV of Lease Payments}}{\text{Annuity Factor for 3 years at 10\%}} = \dfrac{\text{Rs. } 6{,}52{,}190}{3{,}169}$	2,05,803 p.a.
Total Lease Rentals for the Lease Period = ₹2,05,803 p.a. x 4 years = MLP Add: Residual Value	8,23,212 70,000
Gross Investment in the Lease Less: Present Value of MLP & URV = (6,52,190 + 47,810) (See note)	8,93,212 (7,00,000)
Unearned Finance Income	1,93,212

Note: PV of MLP & URV equals the Fair Value/Cost of Equipment at the inception of the lease = ₹7,00,000.

QUESTION 20 CA FINAL MAY 2015 5 MARKS

X Ltd. has leased an equipment over its useful life that costs ₹ 74655100 for a three year lease period. After the lease term, the asset would revert to the Lessor. You are informed that :-

(i) The estimated Unguaranteed Residual Value would be ₹ 1 Lakh only.

(ii) The Annual Lease Payments have been structured in such a way that the sum of their Present Values together with that of the Residual Value of the asst will equal the cost thereof.

(iii) Implicit Interest Rate is 10%.

You are required to ascertain the Annual Lease Payment and the Unearned Finance Income. PV Factor @ 10% for year 1 to 3 are 0.909, 0.826 and 0.751 respectively.

SOLUTION

1. **Computation of Annual Lease Payment:** Let Annual Lease Payment/Rentals (ALR) be "P".
   - PV of MLP + PV of URV = Cost of Asset = ₹ 7,46,55,100.

- So, (₹ P x Annuity Factor for 3 years @ 10%) + (₹1,00,000 x PV Factor for 3rd year at 10%) = ₹ 7,46,55,100.
- So, (2,487 x ₹ P) + (₹1,00,000 x 0.7513) = ₹7,46,55,100.
- Therefore, P = s. 299,87,925.

2. Computation of Unearned Finance Income

(a) MLP (₹2,99,87,925x3 Years) + URV (₹1,00,000) + ₹8,99,63,775 + ₹1,00,000	₹9,00,63,775
(b) PV of MLP & URV = Cost/Fair Value of the Asset at the time of inception of lease.	₹7,46,55,100
(c) Unearned Finance Income (a) – (b)	₹1,54,08,675

STUDY MATERIAL QUESTIONS (SELF READING)

QUESTION 21

Classify the following into either operating or finance lease:

(i) Lessee has option to purchase the asset at lower than fair value, at the end of lease term;

(ii) Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee;

(iv) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".

SOLUTION:

(i) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

QUESTION 22

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

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

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

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

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

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

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

Hence income recognised in years 1, 2 and 3 will be as:

Year 1 ₹ 26,000,

Year 2 ₹ 32,500 and

Year 3 ₹ 39,000.

(iii) **Depreciation for three years of lease**

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

Depreciation for year 1 is ₹ 20,000, year 2 = 25,000 and year 3 = 30,000.

(**NOTE:** IN THIS QUESTION, WE HAVE NOT APPLIED SLM BECAUSE WE HAVE OTHER INFORMATION AS A BASIS WHICH CAN BE USED AS SYSTEMATIC ALLOCATION)

QUESTION 23 (CA INTER MAY 19)(5MARKS)

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹ 11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each year, lessee pays ₹ 3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹ 70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹ 25,000. The implicit rate of return is 10% p.a. and present value factors at 10% are : 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19.

SOLUTION:

According to para 11 of AS 19 “Leases”, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee.

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

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @10%)	Present value ₹
1	3,50,000	0.909	3,18,150
2	3,50,000	0.826	2,89,100
3	3,50,000	0.751	2,62,850
4	4,20,000*	0.683	2,86,860
Total	14,70,000		11,56,960

Present value of minimum lease payments ₹ 11,56,960 is more than fair value at the inception of lease i.e. ₹ 11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹ 11,50,000 as per AS 19.

QUESTION 24 (CA INTER NOV 19) (5 MARKS)

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

(1) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.

(2) Lessee has option to purchase the asset at lower than fair value at the end of lease term.

(3) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.

(4) Present Value (PV) of Minimum Lease Payment (MLP) = "X". Fair value of the asset is "Y". And X = Y.

(5) Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.

SOLUTION:

(i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.

QUESTION 25

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

Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000

Lease rent = ₹ 6,25,000 p.a. at the end of year

Guaranteed residual value = ₹ 1,25,000

Expected residual value = ₹ 3,75,000

Implicit interest rate = 15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

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

SOLUTION :

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

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

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

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

QUESTION 26

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

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

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

Ascertain Unearned Finance Income.

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.

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

Gross investment = Minimum lease payments + Unguaranteed residual value

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

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

= ₹ 43,00,000 (a)

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

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

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

QUESTION 27

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

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

(b) Fair value is ₹ 60 lakhs.

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

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

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

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

SOLUTION :

Following will be the treatment in the given cases:

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

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

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

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

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

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

QUESTION 28

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

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years of lease.

SOLUTION :

(i) **Annual lease rent**

Total lease rent

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

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

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

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

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

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

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

Year 2 ₹ 32,500 and

Year 3 ₹ 39,000.

(iii) **Depreciation for three years of lease**

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

QUESTOIN 29

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000.

The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. The Lessee has guaranteed a residual value of ₹ 22,000 on expiry of the lease to the Lessor. However, Lessor Ltd., estimates that the residual value of the machinery will be only ₹ 15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year.

SOLUTION :

As per para 11 of AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Computation of Value of machinery:

Present value of minimum lease payment = ₹ 6,99,054 (See working note below)

Fair value of leased asset = ₹ 7,00,000

Therefore, the recognition will be at the lower of the two i.e. 6,99,054

Working Note - Present value of minimum lease payments:

Annual lease rental × PVIF+ Present value of guaranteed residual value

= ₹ 3,00,000 × (0.869 + 0.756 + 0.657) + ₹ 22,000 × 0.657

= ₹ 6,84,600 + ₹ 14,454 = 6,99,054

Computation of finance charges:

Year	Finance charge	Payment	Reduction in outstanding liability	Outstanding liability
1st Year beginning	–	–	–	6,99,054
End of 1st year	1,04,858	3,00,000	1,95,142	5,03,912
End of 2nd year	75,587	3,00,000	2,24,413	2,79,499
End of 3rd year	41,925	3,00,000	2,58,075	21,424

QUESTION 30

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

(i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 years.

(ii) The Fair market value is also ₹ 10,00,000

(iii) The property reverts back to the lessor on termination of the lease.

(iv) The unguaranteed residual value is estimated at ₹ 1,00,000 at the end of the year 2011.

(v) 3 equal annual payments are made at the end of each year.

(vi) Consider IRR = 10%.

The present value off ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513. The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

State whether the lease constitute finance lease and also calculate unearned finance income.

SOLUTION :

Computation of annual lease payment:

Particulars	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of unguaranteed residual value	
(₹ 1,00,000 x 0.7513)	75,130
Present value of lease payments	
(₹ 10,00,000 - ₹ 75,130)	9,24,870

Present value of annuity for three years is 2.4868	
Annual lease payment [9,24,870/2.4868]	3,71,911.70

Classifiation of lease:

Parameter 1:

The present value of lease payment i.e., ₹ 9,24,870 which equals 92.48% of the fair market value i.e., ₹ 10,00,000.

The present value of minimum lease payments substantially covers the fair value of the leased asset

Parameter 2:

The lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years).

Therefore, it constitutes a finance lease.

Computation of Unearned Finance Income:

Particulars	₹
Total lease payments (₹ 3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	1,215,735
Less: Present value of lease payments and residual value i.e. Net Investment (₹ 75,130 + ₹ 9,24,870)	(10,00,000)
Unearned finance income	**2,15,735**

QUESTION 31

X Ltd. sold machinery having WDV of ₹ 300 lakhs to Y Ltd. for ₹ 400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease.

Give your comments in the following situations:

(i) Sale price of ₹ 400 lakhs is equal to fair value.

(ii) Fair value is ₹ 450 lakhs.

(iii) Fair value is ₹ 350 lakhs and the sale price is ₹ 250 lakhs.

(iv) Fair value is ₹ 300 lakhs and sale price is ₹ 400 lakhs.

(v) Fair value is ₹ 250 lakhs and sale price is ₹ 290 lakhs.

SOLUTION :

Accounting Treatment:

S. No.	Particulars	Accounting Treatment
(i)	When sale price of ₹400 lakhs is equal to fair value	X Ltd. should immediately recognize the profit of ₹ 100 lakhs (i.e. 400 – 300) in its books.
(ii)	When fair value is ₹ 450 lakhs	Profit of ₹ 100 lakhs should be immediately recognized by X Ltd.
(iii)	When fair value of leased machinery is ₹ 350 lakhs & sales price is ₹ 250 lakhs	Then loss of ₹ 50 lakhs (300 – 250) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payment.
(iv)	When fair value is ₹ 300 lakhs & sales price is ₹ 400 lakhs	Then, profit of ₹ 100 lakhs is to be deferred and amortized over the lease period.
(v)	When fair value is ₹ 250 lakhs & sales price is ₹ 290 lakhs	Then the loss of ₹ 50 lakhs (300-250) to be immediately recognized by X Ltd. in its books and profit of ₹ 40 lakhs (290-250) should be amortized/ deferred over lease period.

QUESETION 32 (CA INTER DEC. 2021 5 MARKS)

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost of ₹ 2,25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years lease

SOLUTION :

(i) Annual lease rent

Total lease rent

= 130% of ₹ 2,25,000 x Output during lease period/ Total output

= 130% of ₹ 2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = ₹ 1,46,250

Annual lease rent = ₹ 1,46,250 / 3 = ₹ 48,750

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

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹ 39,000,

Year 2 ₹ 48,750 and

Year 3 ₹ 58,500.

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 2,25,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is ₹ 30,000, year 2 = 37,500 and year 3 = 45,000.

NOTES

ACCOUNTING STANDARD: 21
CONSOLIDATION OF ACCOUNTS

CONSOLIDATED BALANCE SHEET

QUESTION 1 (SIMPLE CONSOLIDATION)

H Ltd. acquires all the shares of S Ltd. on 1.1.98. From the Balance Sheet given below prepare a consolidated Balance Sheet:

Liabilities	H Ltd.	S Ltd.	Assets	A Limited	B Limited
Share capital :			Land and building	4,00,000	2,70,000
Shares of ₹10 each	8,00,000	3,00,000	Plant and machinery	2,00,000	1,00,000
Creditors	3,50,000	1,60,000	Furniture and fixtures	50,000	20,000
Bills payable	40,000	20,000	Investment in shares	5,00,000	
Reserve on 1.4.97	2,10,000	40,000	Of S Ltd.		
Profit and loss account₹	50,000	30,000	Stock	1,50,000	80,000
			Debtors	1,00,000	60,000
			Bank balance	50,000	20,000
	14,50,000	5,50,000		14,50,000	5,50,000

The profit and loss account of S Ltd. had a credit balance of ₹6,000 on 1.4.97.

QUESTION 2 (TIME RATIO CONSOLIDATION)

On 31.3.1996 the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Liabilities	H Limited	S Limited	Assets	H Limited	S Limited
Share capital	8,00,000	2,00,000	Fixed assets	5,50,000	1,00,000
General Reserve	1,50,000	70,000	Investments in S	2,80,000	
Profit and Loss	90,000	55,000	Ltd. (75%)		
Creditors	1,20,000	80,000	Stock	1,05,000	1,77,000
			O. current Assets	2,25,000	1,28,000
	11,60,000	4,05,000		11,60,000	4,05,000

Draw a consolidated Balance Sheet as at 31.3.1996 after taking into consideration the following information:

(a) H Ltd. acquires the shares on 31st July 1995.

(b) S Ltd. earned a profit of ₹45000 for the year ended 31.3.1996.

QUESTION 3 (INTER COMPANY BALANCES & UNREALISED PROFITS)

From the Balance Sheet and information given below, prepare consolidated Balance Sheet:

Liabilities	H Limited	S Limited	Assets	H Limited	S Limited
Share capital 10)	5,00,000	1,00,000	Fixed assets	4,00,000	60,000
Profit and Loss	2,00,000	60,000	Stock	3,00,000	1,20,000
Reserves	60,000	30,000	Debtors	75,000	85,000
Bills payable	-	15,000	Bills receivable	20,000	-
Creditors	1,10,000	60,000	Shares in S Ltd. (7500 at cost)	75,000	-
	8,70,000	2,65,000		8,70,000	2,65,000

Additional information:

(a) The bills accepted by S Ltd. are in favour of H Ltd.

(b) The stock of H Ltd. includes ₹25,000 bought from S Ltd. at a profit to later of 20% of sales

(c) All the profits of S Ltd. has been earned since the shares were acquired by H Ltd. but there was already the reserve of ₹30,000 at that date.

QUESTION 4 (SIMPLE CASE OF BONUS)

H Ltd. acquired 20,000 (4/5th) equity shares of S Ltd. of ₹100 each on 31.3.1995. The summarized Balance Sheet of H Ltd. and S Ltd. at 31.3.1996 were as follows:

Liabilities	H Limited	S Limited	Assets	H Limited	S Limited
Share capital (100)	80,00,000	25,00,000	Fixed assets	70,00,000	25,00,000
			Current assets	40,00,000	20,00,000
General Reserve	30,00,000	5,00,000	20,000 shares in S Ltd.	30,00,000	-
Profit and Loss	10,00,000	10,00,000			
Creditors	20,00,000	5,00,000			
	1,40,00,000	45,00,000		1,40,00,000	45,00,000

S Ltd. had the credit balance of ₹ 5,00,000 in the reserves and ₹ 2,00,000 in the profit and loss account when H Ltd. acquired the shares in S Ltd. S Ltd. issued bonus shares @ 1 for 5 shares held out of pre acquisition profits. This is not shown in above Balance Sheet of S Ltd. prepare consolidated Balance Sheet.

SOLUTION :

PRE ACQ. PROFITS: 2,00,000, POST ACQ.(PL) 8,00,000, MINORITY:8,00,000, COC: GOODWILL 4,40,000, CONSOLIDATED PL: 16,40,000, B/S TOTAL: 1,59,40,000

(**Hint:** Bonus has been assumed out of accumulated general reserve)

QUESTION 5 (SIMPLE CASES)

From the following data, determine in each case:

(a) Cost of Control

(b) Minority interest at the date of acquisition of shares and consolidation

(c) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own profit and loss account to be ₹2,00,000 in each case.

Cases	Company	% of shares acquired	Cost	Date of acquisition 1.1.1999		Profit and Loss Account (31.12.1999)
				Share Capital	Profit and Loss a/c	
1	A	90%	1,40,000	1,00,000	50,000	70,000
2	B	85%	1,04,000	1,00,000	30,000	20,000
3	C	80%	56,000	50,000	20,000	20,000
4	D	100%	1,00,000	50,000	40,000	55,000

QUESTION 6

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 1999 for ₹1,40,000. The issued capital of ABC Ltd. on 1st January 1999 was ₹1,00,000 and the balance in Profit and Loss Account was ₹60,000.

For the year ending on 31st December 1999 ABC Ltd. has earned a profit of ₹20,000 and at the same time, declared and paid a dividend of ₹30,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January 1999 and 31st December 1999.

QUESTION 7

H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹ 4,80,000 on 1.7.2016 the capital of S Ltd. consisted of 5,000 shares of ₹ 100 each paid. The Profit & Loss Account of this company for 2016 showed on opening balance of ₹ 1,25,000 and profit for the year was ₹ 3,00,000. At the end of the year, it declared a dividend of 40% Record the entry in the books of H Ltd. in respect of the dividend.

Assume calendar year as financial year.

QUESTION 8 (INTER COMPANY BALANCES)

Anthony and co. Ltd. acquired 8000 shares of Canning and co. on 1st January, 1989 .The following are the balance Sheets of the companies as at 31st December, 1989.

Liabilities	Anthony & Co. Ltd.	Canning Co. Ltd.	Assets	Anthony Co. Ltd.	Canning Co. Ltd.
Equity shares of					
₹ 100 each	20,00,000	10,00,000	Land & Building	5,00,000	3,00,000
General Reserve		Plant &			
1 January, 1989	4,00,000	2,00,000	Machinery	5,00,000	6,00,000
Profit & Loss a/c		Stock	1,50,000	1,00,000	
1 January, 1989	1,00,000	60,000	Sundry Debtors	1,00,000	1,20,000
Sundry Creditors	1,00,000	1,00,000	Shares of Canning Ltd.	10,00,000	------
Profit for the year 1989	2,00,000	80,000	Bills receivable	80,000	10,000
Bills payable	30,000	10,000	Cash and Bank Balances	5,00,000	3,20,000
	28,30,000	14,50,000		28,30,000	14,50,000

1. Bills Receivable of Anthony and co. Ltd. include R.10000 accepted by canning and co. Ltd.
2. Sundry debtors of Anthony and Co. Ltd. include ₹50000 due from Canning and Co. Limited.
3. Stock of Canning and Co. Ltd. includes goods purchased from Anthony and co. Ltd. for ₹60000which were invoiced by Anthony and co. Ltd. at a profit of 25% on cost.

Prepare a consolidated Balance sheet of Anthony and co. Ltd. and subsidiary canning and co. Ltd.

QUESTION 9 (CONCEPT OF REVALUATION)

The Summarized Balance Sheets of A Ltd. and B Ltd. as on 31st December, 1996 are as follows:

Liabilities	A Ltd.	B Ltd	Assets	A Ltd.	B Ltd.
Equity shares of 100					
Each	1800000	900000	Goodwill at cost	375000	112500
Share premium a/c	270000	----	Plant less Depreciation	1080000	675000
Capital reserve			Furniture less Depre.	195000	85500
(opening)	120000	90000	Stock at cost	270000	180000
General Reserve (1.1.96)	225000	150000	Trade investments	------	37500
Profit and loss a/c 1.1.96	600000	120000	7200 shares in sub.	810000	-----
Profit for the year 1996	240000	75000	Balance at Bank	150000	45000
Creditors	525000	165000	A Ltd.		48000
B Ltd.	40500		Debtors	940500	316500
	3820500	1500000		3820500	1500000

You are required to prepare the consolidated balance sheet of A Ltd. and its subsidiary B Ltd. as on 31st December, 1996, together with the working notes after giving effect to the following relevant information:

(i) Plant of B Ltd. was to be revalued on 1st January, 1996 at ₹810000, Fixtures at ₹75000 and Trade investments were deemed to be valueless. There were no transactions of purchase or sale of these assets during the year 1996. The directors wish to give effect to the above revaluation in the consolidated accounts.

(ii) Depreciation has been provided for the year 1996 on plant 10 percent and on fixtures at 5 percent.

(iii) The stock of B Ltd. included ₹60000 goods purchased from A Ltd. who have invoiced these goods at cost plus 25 per cent.

(iv) A cheque of ₹7500 from A Ltd. to B Ltd. was in transit as on 31st December 1996.

(v) A Ltd. acquired the shares in B Ltd. on 1st January, 1996.

QUESTION 10 (CONCEPT OF BONUS ISSUE & RECTIFICATION)

A Ltd. acquired 8000 shares of ₹10 each in Omega Ltd. on 31st December, 1994. The summarized Balance Sheet of the two companies as on that date were as follows:

	A Ltd.	Omega Ltd.
	₹	₹
Share Capital:		
30,000 Shares of ₹10 each	3,00,000	-----
10,000 Shares of ₹10 each	-----	1,00,000
Capital Reserve	-----	52,000
General Reserve	25,000	5,000
Profit & Loss Account	38,200	18,000
Loan from Omega Ltd.	2,100	-----
Bills Payable (including ₹500 to A Ltd.)	------	1,700
Creditors	17,900	5,000
Note on the Balance Sheet of A Ltd.:		
There is a contingent liability for bills		
discounted of ₹1,000		
	3,83,200	1,81,700
Fixed Assets	1,50,000	1,44,700
Investments in Omega Ltd. at cost	1,70,000	------
Stock-in-hand	40,000	20,000
Loan to A Ltd.	------	2,000
Bills Receivable (including ₹200		
from Omega ltd) 1,200	------	
Debtors	20,000	10,000
Bank	2,000	5,000
	3,83,200	1,81,700

You are given the following information:

(a) Omega Ltd. made a bonus issue on 31st December, 1994 of one share for every two shares held, reducing the capital reserve equivalently, but the transaction is not shown in the above Balance Sheets.

(b) Interest receivable (₹100) in respect of the loan due by A Ltd. to Omega Ltd. has not been credited in the account of Omega Ltd.

(c) The directors decided that the fixed assets of Omega Ltd. were over valued and should be written down by ₹5,000.

Prepare the Consolidated Balance Sheet as at 31st December, 1994, showing your workings.

QUESTION 11 (CONCEPT OF DIVIDEND PAID)

On 1st January, 1987, A Ltd. acquired 8000 shares of ₹10 each of B Ltd. at ₹90,000.

The respective balance sheets on 31st December, 1989 are given below:-

Liabilities	A Limited	B Limited	Assets	A Limited	B Limited
Share capital			Fixed assets	60,000	1,10,000
(₹10 each)	1,00,000	1,00,000	Investments	1,00,000	15,000
Reserve	40,000	26,000	Debtors	25,000	20,000
Profit and Loss	36,000	35,000	Stock	30,000	40,000
Creditors	71,000	48,000	Bank	32,000	24,000
	2,47,000	2,09,000		2,47,000	2,09,000

Addition Information:-

(a) At the time of acquiring shares B Ltd. had ₹24,000 in Reserve and ₹15,000 in P & L A/c.

(b) B Ltd. paid 10% dividends in 1987, 12% in 1988, 15% in 1989 for 1986, 1987 and 1988 respectively. All dividends received have been credited to the P & L A/c of A Ltd.

(c) One bonus share for 5 fully paid shares held has been declared by B Ltd. out of pre-acquisition reserve on 31st December,1989. No effect has been given to that in the above accounts.

(d) On 1st January 1987 Building of B Limited., which stood in the books at ₹50,000 was revalued at ₹60,000 but no adjustment has been made in the books. Depreciation has been charged @ 10% p.a. on reducing balance method.

(e) In 1989 A Ltd. purchased from B Ltd. goods for ₹10,000 on which B Ltd. made a profit of 20% on sales, 25% of such goods are lying unsold on 31st December 1989.

Prepare the consolidated balance sheet as at 31st December, 1989.

QUESTION 12 (CORRECT % OF HOLDING CALCULATION)

(Q.84 NOV 2016)

The following are the Balance Sheets of H Limited and S Limited as on 31st March, 1984:-

Liabilities	H Limited	S Limited
Share capital:		
Equity shares of ₹100 each	10,00,000	7,00,000
Reserve and surplus:		
General reserve	2,00,000	3,00,000
Profit and Loss Account	3,00,000	3,00,000
Current liabilities	5,00,000	9,00,000
	20,00,000	22,00,000
Assets:		
Fixed assets	8,00,000	9,00,000
Investment in S Limited	5,00,000	—
Current Assets	7,00,000	13,00,000
	20,00,000	22,00,000

The following further information is furnished:-

(1) H Limited acquired 3,000 shares in S Limited on 1.4.1983 when the Reserve and surplus position of S Limited was as under:

(a) General reserve ₹5,00,000

(b) Profit and Loss Account ₹2,00,000

(credit balance)

(2) On 1.10.83 S Limited issued 2 shares for every 5 shares held, as bonus shares at a face value of ₹100 per share. No entry is made, in the books of H Limited for the receipt of these bonus shares.

(3) On 30.6.83 S Limited declared a dividend , out of pre-acquisition profits 20% and H Limited credited the receipt of dividend to its profit and loss account.

(4) S Limited owed H Limited ₹1,20,000 for purchase of stock from H Limited. The stock is held by S Limited on 31.3.84.

(5) H Limited transferred a machine to S Limited for ₹1,00,000. The book value of the machine to H Limited was ₹75,000.

Prepare the consolidated Balance Sheet as at 31st March 1984.

QUESTION 13

The following are the Balance Sheets of H Limited and S Limited as on 31st December 1981:-

Liabilities	H Limited	S Limited
Share capital:		
Equity shares of ₹100 each	10,00,000	5,00,000
Reserve and surplus:		
General reserve	1,00,000	1,50,000
Profit and Loss Account	1,60,000	1,50,000
Current liabilities	4,40,000	2,00,000
	17,00,000	10,00,000
Assets:		
Fixed assets	4,80,000	2,50,000
Investment in S Limited	5,00,000	—
Current Assets	7,20,000	7,50,000
	17,00,000	10,00,000

The following further information is furnished:-

(1) H Limited acquired 3,000 shares in S Limited on 1.1.981 when the Reserve and surplus position of S Limited was as under:

(a) General reserve ₹2,50,000

(b) Profit and Loss Account ₹1,20,000
(credit balance)

(2) On 1.7.81 S Limited issued 1 share for every 4 shares held, as bonus shares at a face value of ₹100 per share. No entry is made, in the books of H Limited for the receipt of these bonus shares.

(3) On 30.6.81 S Limited declared a dividend, out of pre-acquisition profits 25% and H Limited credited the receipt of dividend to its profit and loss account.

(4) S Limited owed H Limited ₹50,000 for purchase of stock from H Limited. The entire stock is held by S Limited on 31.12.81 H Limited made profit of 25% on cost.

(5) H Limited transferred a machine to S Limited for ₹1,00,000. The book value of the machine to H Limited was ₹80,000.

Prepare the consolidated Balance Sheet as at 31st December , 1989.

SOLUTION :

% OF HOLDING 75%, PRE ACQ. PROFITS 1,70,000, POST ACQ. PROFITS 1,30,000, MINORITY 2,00,000, COC (CAPITAL RES.77,500), CONS. PL 1,52,500, B/S TOTAL 21,20,000

QUESTION 14

From the following summarised balance sheets of H Ltd. and its subsidiary S Ltd. drawn up at 31st March, 2017, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and profit and Loss Account of S Ltd. stood at ₹ 25,000 and ₹ 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April, 2016.

(ii) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,0000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 respectively on April, 2016 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10% furniture 15%]

Summarised Balance Sheet of H Ltd. as on 31st March, 2017

	H Ltd.	S. Ltd.	Assets	H Ltd.	S Ltd.
	₹	₹		₹	₹
Equity and liabilities					
Shareholders' funds share capital			Fixed assets Machinery	3,00,000	90,000
Shares of ₹ 100 each	6,00,000	1,00,000	Furniture	1,50,000	17,000
Reserves	2,00,000	75,000	Other non-current assets	4,40,000	1,50,000
Profit and loss			Non- current Investments		
Account	1,00,000	25,000	Shares in Ltd.:		
Trade payables	1,50,000	57,000	800 shares at ₹ 200 each	1,60,000	–
	10,50,000	2,57,000		10,50,000	2,57,000

QUESTION 15

A Limited acquired 8000 shares of ₹100 each in B Limited on 30th September 1991. The summarized Balance Sheet of the two companies as on 31.3.1992 were as follows:

	A Limited	B Limited
Share capital: 30,000 shares of ₹100 each	30,00,000	
10,000 shares of ₹100 each		10,00,000
Capital reserve		5,50,000
General reserve	3,00,000	50,000
Profit and Loss account	3,82,000	1,80,000
Loan from B Limited	21,000	
Bills payable (including ₹5000 to A Limited)		17,000
Creditors	1,79,000	70,000
Note: on the Balance Sheet of A Limited there is a contingent liability for bills discounted of ₹6,000		
	38,82,000	18,67,000
Fixed assets	15,00,000	14,47,000
Investment in B Limited at cost	17,00,000	
Stock in hand	4,00,000	2,00,000
Loan to A Limited		20,000
Bills receivable (including ₹5000 from B Limited)	12,000	
Debtors	2,50,000	1,80,000
Cash and bank balance	20,000	20,000
	38,82,000	18,67,000

You are given the following information:

(1) B Limited made a bonus issue on 31.3.1992 of one share for every two shares held reducing the capital reserve equivalently but the accounting effect to this has not been given in the above Balance Sheet.

(2) Interest receivable for the year (₹1,000) in respect of the loan due by A Limited to B Limited has not been credited in the books of B Limited.

(3) The credit balance in Profit and Loss account of B Limited as on 1.4.1991 was ₹21,000.

(4) The directors decided on the date of the acquisition that the fixed assets of B Limited were over valued and should be written down by ₹50,000. Consequential adjustments on depreciation is to be ignored.

Prepare the consolidated Balance Sheet as at 31st March 1992 showing your workings.

SOLUTION :

PRE ACQ. PROFITS:1,51,000, POST ACQ. PROFITS 80,000, MINORITY 3,46,200, COC GW:3,79,200, B/S TOTAL 43,53,200, CONSOLIDATED PL 4,46,000

(Hint: PL balance in B Ltd. After rectification of interest will be 1,81,000)

QUESTION 16

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 2017 at a cost of ₹ 70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 2017:

	₹ in lakhs
Fixed Assets	120
Investments	55
Current Assets	70
Loans & Advances	15
15% Debentures	90
Current Liabilities	50

The following revaluations have agreed upon (not included in the above figures):

Fixed Assets Up by 20%

Investments Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 2017, Exe Ltd. purchased the shares of Zed Ltd. @ ₹ 20 per share.

Calculate the amount of goodwill/ capital reserve on acquisition of shares of Zed Ltd.

SOLUTION:

Revalued net assets of Zed Ltd. as on 31st March, 2017

	₹ in lakhs	₹ in lakhs
Fixed Assets [120 X 120%]		144.0
Investments [55 X 90%]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5
Less: 15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity/ Net Worth		138.5
Exe Ltd.' s shares of net assets (70% of 138.5)		96.95
Exe Ltd.' cost of acquisition of shares of Zed Ltd.		
(₹ 70 lakhs – ₹ 7 lakhs*)		63.00
Capital reserve		33.95

*total Cost of 70% Equity of Zed Ltd.	₹ 70 lakhs
Purchase price of each share	₹ 20
Number of shares purchased [70 lakhs/ ₹ 20]	3.5 lakhs
Dividend @ 20% on 10 i.e. ₹ 2 per share	₹ 7 lakhs

Since dividend received is for per-acquisition period, it has reduced from the cost of investment in the subsidiary company.

(Assumption: Face Value per share 10)

QUESTION 17 (CONCEPT OF INTERIM DIVIDEND)

On April 1,1980 A Limited paid ₹1,10,000 for 90% of the issued capital of B Limited. The assets and liabilities of the two companies as at March 31,1981 were as follows:

	A Limited	B Limited
Fixed assets	94,000	96,000
Current assets	30,000	18,000
Investment at cost	1,56,000	
Goodwill	20,000	6,000
	3,00,000	1,20,000
Issued share capital (₹1 each fully paid)	1,80,000	60,000
General reserve (April 1,1980)	45,000	20,000
Profit and Loss account (March 31,1981)	36,000	20,500
Current liabilities	39,000	9,500
6% Debentures held by A Limited		10,000
	3,00,000	1,20,000

On April 1,1980 the opening credit balance of A Limited's Profit and Loss account was ₹26,000. Out of this balance a 10% dividend was paid subsequently.

(2) The Profit and Loss account B Limited showed the following:

		₹
Balance b/f on April 1,1980		22,000
Net profit for the year ended March 31,1981		12,000

		34,000
Less- Dividend paid –		
Final for the year ended March 31,1980	9,000	
Interim for the half year ended September 30,1980	4,500	
	--------	13,500

Balance c/f on March 31,1981		20,500
		---------

(3) Included in the stock in trade of B Limited at valance date were goods purchased from A Limited for ₹6000 on which there was a profit of 50% on cost of A Limited.

(4) All dividends received by A Limited have been correctly recorded in the books of account.

Prepare a consolidated Balance Sheet as at March 31,1981 and show your workings.

QUESTION 18 (CONCEPT OF NEGATIVE MINORITY)

A Limited acquired 70% of equity shares of B Limited as on 1st January 1993 at a cost of ₹10,00,000 when B Limited had an equity capital of ₹10,00,000 and reserves and surplus of ₹80,000. Both the companies follow calendar year as the accounting year. In the four consecutive years B Limited fared badly and suffered losses of ₹2,50,000, 4,00,000, ₹5,00,000 and ₹1,20,000 respectively. Thereafter in 1997 B Limited experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 1998 and 1999 B Limited recorded annual profits of ₹1,00,000 and ₹1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.

QUESTION 19 (RTP MAY 2022)

From the following information of Beta Ltd. and its subsidiary Gamma Ltd. drawn up at 31st March, 2021, prepare a consolidated balance sheet as at that date:

	Beta Ltd.	Gamma Ltd.
	₹	₹
Share Capital:		
Shares of ₹ 100 each	15,00,000	2,50,000
Reserves	5,00,000	1,87,500
Profit and Loss Account	2,50,000	62,500
Trade Payables	3,75,000	1,42,500
Property, plant and Equipment:		
Machinery	7,50,000	2,25,000
Furniture	3,75,000	42,500
Other non-current assets	11,00,000	3,75,000
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at ₹ 200 each	4,00,000	

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020.

Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Gamma Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

SOLUTION :

Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd. as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		15,00,000
(b) Reserves and Surplus	1	8,61,500
(2) Minority Interest (W.N.5)		1,20,375
(3) Current Liabilities		
(a) Trade Payables	2	5,17,500
Total		29,99,375
II. Assets		
(1) Non-current assets		
(a) (i) Property, Plant & Equipment	3	14,94,375
(ii) Intangible assets	4	30,000
(b) Other non- current assets	5	14,75,000
Total		29,99,375

Notes to Accounts

				₹
1.	Reserves and Surplus			
	Reserves		5,00,000	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition reserves (W.N.3)		1,00,000	6,00,000
	Profit and Loss Account		2,50,000	
	Add: 4/5th share of Gamma Ltd.'s post-acquisition profits (W.N.4)		11,500	2,61,500
				8,61,500
2.	Trade Payables			

	Beta Ltd.		3,75,000	
	Gamma Ltd.		1,42,500	5,17,500
3.	Property, Plant & Equipment			
	Machinery			
	Beta Ltd.		7,50,000	
	Gamma Ltd.	2,50,000		
	Add: Appreciation	1,25,000		
		3,75,000		
	Less: Depreciation	(37,500)	3,37,500	
	Furniture			
	Beta Ltd.		3,75,000	
	Gamma Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,37
4.	Intangible assets			
	Goodwill [WN 6]			30,000
5.	Other non-current assets			
	Beta Ltd.		11,00,000	
	Gamma Ltd.		3,75,000	14,75,00

Working Notes:

1.	Pre-acquisition profits and reserves of Gamma Ltd.	₹
	Reserves	62,500
	Profit and Loss Account	37,500
		1,00,000
	Beta Ltd.'s = 4/5 × 1,00,000	80,000
	Minority Interest = 1/5 × 1,00,000	20,000
2.	Profit on revaluation of assets of Gamma Ltd.	
	Profit on Machinery ₹ (3,75,000 – 2,50,000)	1,25,000
	Less: Loss on Furniture ₹ (50,000 – 37,500)	12,500
	Net Profit on revaluation	1,12,500
	Beta Ltd.'s share 4/5 × 1,12,500	90,000

	Minority Interest 1/5 × 1,12,500	22,500
3.	Post-acquisition reserves of Gamma Ltd.	
	Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500)	1,25,000
	Beta Ltd.'s share 4/5 × 1,25,000	1,00,000
	Minority interest 1/5 × 25,000	25,000
4.	Post -acquisition profits of Gamma Ltd.	
	Post-acquisition profits (Profit & loss account balance less pre- acquisition profits = ₹ 62,500 – 37,500)	25,000
	Add: Excess depreciation charged on furniture @ 15%	
	on ₹ 12,500 i.e. (50,000 – 37,500)	1,875
		26,875
	Less: Under depreciation on machinery @ 10%	
	on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
	Adjusted post-acquisition profits	14,375
	Beta Ltd.'s share 4/5 × 14,375	11,500
	Minority Interest 1/5 × 14,375	2,875
5.	Minority Interest	
	Paid-up value of (2,500 – 2,000) = 500 shares	
	held by outsiders i.e. 500 × ₹ 100	50,000
	Add: 1/5th share of pre-acquisition profits and reserves	20,000
	1/5th share of profit on revaluation	22,500
	1/5th share of post-acquisition reserves	25,000
	1/5th share of post-acquisition profit	2,875
		1,20,375
6.	Cost of Control or Goodwill	
	Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 × ₹ 100	2,00,000
	Add: 4/5th share of pre-acquisition profits and reserves	80,000
	4/5th share of profit on the revaluation	90,000
	Intrinsic value of shares on the date of acquisition	3,70,000
	Price paid by Beta Ltd. for 2,000 shares	4,00,000
	Less: Intrinsic value of the shares	(3,70,000)
	Cost of control or Goodwill	30,000

QUESTION 20 (RTP NOV. 2022)

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Equity Share Capital – Authorised	5,000	3,000
Issued and subscribed in Equity Shares of ₹ 10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account (Cr. Balance)	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
Plant and Machinery	2,541	2,450
Furniture and Fittings	615	298
Investment in the Equity Shares of S Ltd.	1,500	-
Inventory	983	786
Trade receivables	820	778
Cash and Bank Balances	410	102
Sundry Advances (Dr. balances)	260	190

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the following balances stood in the books of S Ltd.:

General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 633 thousand.

(b) On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of ₹ 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.

(d) On 31st March, 2021, the Inventory of S Ltd. included goods purchased for ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

(e) Details of Trade payables and Trade receivables:

	1. H Ltd. (₹ in 000's)	2. S Ltd. (₹ in 000's)
3. Trade payables		
4. Bills Payable	5. 124	6. 80

7. Sundry creditors	8. 487	9. 427
10.	a. 611	12. 507
11. Trade receivables		
13. Debtors	14. 700	15. 683
16. Bills Receivables	17. 120	18. 95
	19. 820	20.778

Prepare a consolidated Balance Sheet as on 31st March, 2022.

SOLUTION :

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd.
as at 31st March, 2022

Particulars	Note No.	(₹ in 000's)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(b) Reserves and Surplus	2	3,063
(2) Minority Interest (W.N.6)		1,560
(3) Current Liabilities		
Trade payables	3	1,118
Short term provisions	4	482
Total		**10,223**
II. Assets		
(1) Non-current assets		
PPE	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade receivables	7	1,598
(c) Cash and cash equivalents	8	512
(d) Short term loans and advances	9	450
Total		**10,223**

Notes to Accounts

			(₹ in 000's)	(₹ in 000's)
1.	Share Capital			
	Authorised share capital			
	5 lakhs equity shares of ₹ 10 each			5,000
	Issued, Subscribed and Paid up			
	4 lakhs equity shares of ₹ 10 each fully paid			4,000
2.	Reserves and surplus			
	Capital Reserve (Note 5)		679.8	
	General Reserve		928	
	Profit and Loss Account:			
	H Ltd.	₹ 1,305		
	Add: Share in S Ltd	₹ 340.20		
		₹ 1,645.20		
	Less: Dividend wrongly credited	₹ (180)		
		₹ 1,465.20		
	Less: Unrealised profit (50 X 1/5)	₹(10)	1,455.20	3,063
3.	Trade payables			
	H Ltd.		611	
	S Ltd.		507	1,118
4.	Short -term provisions			
	Provision for Taxation H Ltd.	₹ 220		
	S Ltd.	₹ 180	400	
	Other Provisions H Ltd	₹ 65		
	S Ltd.	₹ 17	82	482
5.	PPE			
	Plant and Machinery			
	H Ltd.	₹ 2,541		
	S Ltd.	₹ 2,450	4,991	
	Furniture and fittings			
	H Ltd.	₹ 615		

	S Ltd.	₹ 298	913	5,904
6.	Inventories			
	Inventory H Ltd.	₹ 983		
	S Ltd.	₹ 786	1,769	
	Less: Unrealised profit (₹ 50 x 1/5)		(10)	1,759

Working Notes:

Share holding pattern

Particulars	Number of Shares	% of holding
a. S Ltd.		
(i) Purchased on 01.04.2021	90,000	
(ii) Bonus Issue (90,000/5 x 3)	54,000	
Total	1,44,000	60% (1,44,000 /2,40,000*x 100)
b. Minority Interest	96,000	40%

*2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022

1. S Ltd. General Reserve

		(₹ in 000)			(₹ in 000)
To	Bonus to equity share-holders (2,400 × 3) / 8	900	By	Balance b/d	1,500
			By	Profit and Loss A/c	
To	To balance c/d	690		(Balancing figure)	90
		1,590			1,590

2. S Ltd.'s Profit and Loss Account

		(₹ in 000)			(₹ in 000)
To	General Reserve	90	By	Balance b/d	633
To	Dividend paid on 14.7.2021 (1,500 × 20) / 100	300	By	Net Profit for the year (Balancing figure)	567*
To	Balance c/d	810			
		1,200			1,200

* Out of ₹ 5,67,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

3. Distribution of Revenue Profits

	₹ in '000
Revenue Profit as above	567.00
Share of H Ltd. (60%)	340.20
Share of Minority shareholders (567– 340.20)	226.80

4. Computation of Capital Profits

	₹ in 000	₹ in 000
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		(900)
		600
Profit and Loss Account balance on the date of acquisition	633	
Less: Dividends paid	(300)	333
		933
Share of H Ltd. (60%)		559.80
Share of Minority shareholders		373.20

5. Computation of Capital Reserve

		₹ in '000
60% of share capital of S Ltd.		1,440
Add: Share of H Ltd. in the capital profits as in working note (4)		559.80
		1,999.80
Less: Investments in S Ltd.	1,500	
Less: Dividends received out of pre- acquisition profits (₹ 300 × 60) / 100	(180)	(1,320)
		679.80

6. Calculation of Minority Interest

	₹ in '000
40% of share capital of S Ltd.	960.00
Add: Share of Revenue Profits (Note 3)	226.80
Share of Capital Profits (Note 4)	373.20
	1,560.00

QUESTION 21 (MTP MARCH 2022)

H Ltd. and its subsidiary S Ltd. give the following information as on 31st March, 2021:

	H Ltd. (₹)	S Ltd. (₹)
Share Capital		
Equity Share Capital (fully paid up shares of ₹ 10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Cr. Balance in Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
Non-Current Assets		
Property, Plant and Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ ₹ 20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2020. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹ 50,000 and ₹ 30,000 respectively.

Machinery (book value ₹ 2,00,000) and Furniture (book value ₹ 40,000) of S Ltd. were revalued at ₹ 3,00,000 and ₹ 30,000 respectively on 1st April,2020 for the purpose of fixing the price of its shares (rates of depreciation on W.D.V basis: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹ 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing ₹ 55,000 (cost to H Ltd.) purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet of H Ltd. with its subsidiary as at 31st March, 2021.

SOLUTION :

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital (1,20,000 equity shares of ₹ 10 each)		12,00,000
(b) Reserves and Surplus	1	8,16,200
(2) Minority Interest (W.N.4)		99,300
(3) Current Liabilities		
(a) Trade Payables	2	4,10,000
Total		**25,25,500**
II. Assets		
(1) Non-current assets		
(i) Property, plant and equipment	3	13,10,500
(ii) Intangible assets	4	24,000
(2) Current assets		
(i) Inventories	5	3,25,000
(ii) Trade Receivables	6	6,70,000
(iii) Cash at Bank	7	1,96,000
Total		**25,25,500**

Notes to Accounts

				₹
1.	Reserves and Surplus			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3)		84,000	5,19,000
	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3)	21,200		
	Less: Unrealised gain	(4,000)	17,200	2,97,200

				8,16,200
2.	Trade Payables			
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture			
	H. Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation	(4,500)	25,500	4,00,500
				13,10,500
4.	Intangible assets			
	Goodwill [WN 5]			24,000
5.	Inventories			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
				3,25,000
6.	Trade Receivables			
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	
				7,05,000
	Less: Mutual transaction			(35,000)
				6,70,000

7.	Cash and Bank			
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2020

	₹
Machinery	
Revaluation as on 1.4.2020	3,00,000
Less: Book value as on 1.4.2020	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2020	30,000
Less: Book value as on 1.4.2020	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	Furniture
Upward/ (Downward) Revaluation	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	(10,000)	1,500

3. Analysis of reserves and profits of S Ltd. as on 31.03.2021

	Pre-acquisition profit upto 1.4.2020	Post-acquisition profits (1.4.2020 – 31.3.2021)	
	(Capital profits)	General Reserve	Profit and loss account
General reserve as on 31.3.2021	50,000	1,05,000	
Profit and loss account as on 31.3.2021	30,000		35,000
Upward Revaluation of machinery as on 1.4.2020	1,00,000		

Downward Revaluation of Furniture as on 1.4.2020	(10,000)		
Short depreciation on machinery			(10,000)
Excess depreciation on furniture			1,500
Total	1,70,000	1,05,000	26,500

4. Minority Interest

	₹
Paid-up value of (2,00,000 x 20%)	40,000
Add: 20% share of pre-acquisition profits and reserves [(20% of (50,000 + 30,000)]	16,000
20% share of profit on revaluation	18,000
20% share of post-acquisition reserves	21,000
20% share of post-acquisition profit	5,300
	1,00,300
Less: Unrealised Profit on Inventory (55,000 x 10/110) x 20%	(1,000)
	99,300

5. Cost of Control or Goodwill

Cost of Investment		3,20,000
Less: Paid-up value of 80% shares	1,60,000	
80% share of pre-acquisition profits and reserves (₹ 64,000 + ₹72,000)	1,36,000	(2,96,000)
Cost of control or Goodwill		24,000

QUESTION 22 (CA INTER MAY 2019) (10MARKS)

(NEGATIVE MINORITY INTEREST)

H Ltd. acquire 70% of equity share of S Ltd. as on 1st January, 2011 at a cost of ₹ 5,00,000 when S Ltd. had an equity share capital of ₹ 5,00,000 and reserves and surplus of ₹ 40,000.

Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. performed badly and suffered losses of ₹ 1,25,000, ₹ 2,00,000, ₹ 2,50,000 and ₹ 60,000 respectively.

Thereafter in 2015, S Ltd. experienced turnaround and registered an annual profit of ₹ 25,000. In the next two years i.e. 2016 and 2017, S Ltd. recorded annual profits of ₹ 50,000 and ₹ 75,000 respectively.

Show the Minority Interests and Cost of Control at the end of each year for the purpose of consolidation.

SOLUTION :

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	Profit / (Loss)	Minority Interest (30%)	Additional Consolidated P & L (Dr.) or Cr.	Minority's Share of losses borne by H Ltd.		Cost of Control
				₹	Balance	
			-			
At the time of acquisition on 1.1.2011		1,62,000 (W.N.)				
2011	(1,25,000)	(37,500)	(87,500)			1,22,000 (W.N.)
Balance		1,24,500				
2012	(2,00,000)	(60,000)	(1,40,000)			1,22,000
Balance		64,500				
2013	(2,50,000)	(75,000)	(1,75,000)			1,22,000
		(10,500)				
	Loss of minority borne by Holding Co.	10,500	(10,500)	10,500	10,500	
Balance		Nil	(1,85,500)			
2014	(60,000)	(18,000)	(42,000)			1,22,000
	Loss of minority borne by Holding	18,000	(18,000)	18,000	28,500	

	Co.					
Balance		Nil	(60,000)			
2015	25,000	7,500	17,500			1,22,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(7,500)	7,500	(7,500)	21,000	
Balance		Nil	25,000			
2016	50,000	15,000	35,000	(15,000)	6,000	1,22,000
		(15,000)	15,000			
Balance		Nil	50,000			
2017	75,000	22,500	52,500	(6,000)	Nil	1,22,000
		(6,000)	6,000			
Balance		16,500	58,500			

Working Note:

Calculation of Minority interest and Cost of control on 1.1.2011

		Share of Holding Co.	**Minority Interest**
	100%	70%	30%
	(₹)	(₹)	(₹)
Share Capital	5,00,000	3,50,000	1,50,000
Reserve	40,000	28,000	12,000
		3,78,000	1,62,000
Less: Cost of investment		(5,00,000)	
Goodwill		1,22,000	

QUESTION 23 (CA INTER NOV 2019) (10MARKS)

(SAME ACCOUTING POLICIES)

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.

Liabilities	2017-18	2018-19
	Amount in ₹	Amount in ₹
Share Capital		
Issued and subscribed 7500 Equity Shares of ₹ 100 each	7,50,000	7,50,000
Reserve and Surplus		
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Current Liabilities and Provisions		
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000
Provision for Taxation	2,62,000	4,30,000
Assets	15,88,000	23,08,000
Fixed Assets (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment at Cost	-	5,30,000
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500
	15,88,000	23,08,000

Other Information:

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is

required to be reduced by ₹ 5,000 at the end of 2017-2018 and increased by ₹ 12,000 at the end of 2018-2019. (Inventory of 2017-18 has been sold out during the year 2018-19)

(3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

(4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25 ,000 in 2017-18 and ₹ 12,500 in 2018-19 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2017-18, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2017-18.

Restate the balance sheet of MNT Ltd. as on 31st March, 2019 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

QUESTION 24 (CA INTER NOV 2019) (5 MARKS)

From the following data, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	% of Share Owned	Cost	Date of Acquisition		Consolidation date	
				01-01-2018		31-12-2018	
				Share Capital	Profit and Loss A/c	Share Capital	Profit and Loss A/c
				₹	₹	₹	₹
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000
Case-E	N	100%	1,00,000	40,000	40,000	40,000	65,000

SOLUTION:

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2018

B = Profit & loss account balance on 1.1.2018

C = Share capital on 31.12.2018

D = Profit & loss account balance on 31.12.2018

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] ₹	Minority interest as at the date of consolidation [E] X [C + D] ₹
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750
Case E [100-100]	NIL	NIL	NIL

QUESTION 25 (CA INTER NOV 2020) (5MARKS)

H Limited acquired 64000 Equity Shares of ₹ 10 each in S Ltd. as on 1st October, 2019. The Balance Sheets of the two companies as on 31st March, 2020 were as under:

Particulars	H Ltd. (₹)	S Ltd. (₹)
Equities and Liabilities:		
Equity Share Capital: Shares of ₹ 10 each	20,00,000	8,00,000
General Reserve (1st April, 2019)	9,60,000	4,20,000
Profit & Loss Account	2,28,800	3,28,000
Preliminary Expenses (1st April, 2019)	-	(20,000)
Bank Overdraft	3,00,000	-
Bills Payable	-	52,000
Trade Payables	1,66,400	80,000
Total	36,55,200	16,60,000

Assets:		
Land and Building	7,20,000	7,60,000
Plant & Machinery	9,60,000	5,40,000
Investment in Equity Shares of S Ltd.	12,27,200	-
Inventories	4,56,000	1,68,000
Trade Receivables	1,76,000	1,60,000
Bills Receivable	59,200	-
Cash in Hand	56,800	32,000
Total	36,55,200	16,60,000

Additional Information:

(1) The Profit & Loss Account of S Ltd. showed credit balance of ₹ 1,20,000 on 1st April, 2019. S Ltd. paid a dividend of 10% out of the same on 1st November, 2019 for the year 2018-19. The dividend was correctly accounted for by H Ltd.

(2) The Plant & Machinery of S Ltd. which stood at ₹ 6,00,000 on 1st April, 2019 was considered worth ₹ 5,20,000 on the date of acquisition by H Ltd. S Ltd. charges depreciation @ 10% per annum on Plant & Machinery.

Prepare consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2020 as per Schedule III of the Companies Act, 2013.

SOLUTION:

(**HINT:** STUDENTS SHOULD SOLVE THIS QUESTION ON THEIR OWN AS PER CLASS PRESENTATION. IF THEY FIND ANY PROBLEM ONLY THEN THEY SHOUD REFER THE GIVEN SOLUTION)

Consolidated Balance Sheet of H Ltd. and its subsidiary, S Ltd.
as at 31st March, 2020

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	13,07,200
(2) Minority Interest (W.N 4)		2,96,400
(3) Current Liabilities		
(a) Trade Payables	3	2,98,400
(b) Short term borrowings		3,00,000

Total		42,02,000
II. Assets		
(1) Non-current assets		
(i) Property, Plant and Equipment	4	29,34,000
(ii) Intangible assets (W.N.5)		1,60,000
(2) Current assets		
(a) Inventories	5	6,24,000
(b) Trade receivables	6	3,95,200
(c) Cash & Cash equivalents (Cash)	7	88,800
Total		42,02,000

Notes to Accounts

			₹	₹
1.	Share Capital			
	2,00,000 equity shares of ₹ 10 each			20,00,000
2.	Reserves and Surplus			
	Reserves		9,60,000	
	Profit & loss			
	H Ltd.	2,28,800		
	S Ltd. (As per W.N. 3)	1,18,400	3,47,200	13,07,200
3.	Trade Payables			
	H Ltd.		1,66,400	
	S Ltd. (80,000+52,000)		1,32,000	2,98,400
4.	Property, Plant and Equipment			
	Land and building			
	H Ltd.	7,20,000		
	S Ltd.	7,60,000	14,80,000	
	Plant & Machinery			
	H Ltd.	9,60,000		
	S Ltd. (As per W.N. 7)	4,94,000	14,54,000	29,34,000
5.	Inventories			
	H Ltd.		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.**

	₹	₹
Reserve on 1st October, 2019 (Assumed there is no movement in reserves during the year and hence balance as on 1st October, 2019 is same as of 31st March 2020)		4,20,000
Profit & Loss Account Balance on 1st April, 2019	1,20,000	
Less: Dividend paid	(80,000)	40,000
Profit for year:		
Total ₹ 3,28,000		
Less: ₹ 40,000 (opening balance)		
₹ 2,88,000		
Proportionate up to 1st October, 2019 on time basis (₹ 2,88,000/2)		1,44,000
Reduction in value of Plant & Machinery (WN 6)		(50,000)
		5,54,000
Less: Preliminary expenses written off		(20,000)

Total Capital Profit		5,34,000
Holding company's share (5,34,000 X 80%)		4,27,200
Minority Interest (5,34,000 X 20%)		1,06,800

Note: Preliminary expenses as on 1st April, 2019 amounting ₹ 20,000 have been written off.

3. **Revenue profits of S Ltd.**

Profit after 1st October, 2019 (3,28,000 - 40,000)/2		1,44,000
Less 10% depreciation on ₹5,20,000 for 6 months	(26,000)	
Add: Depreciation already charged for 2nd half year on 6,00,000	30,000	4,000
		1,48,000
Holding company's share (1,48,000 X 80%)		1,18,400
Minority Interest (1,48,000 X 20%)		29,600

4. **Minority interest**

Par value of 16,000 shares (8,00,000 X 20%)	1,60,000
Add: 1/5 Capital Profits [WN 2]	1,06,800
1/5 Revenue Profits [WN 3]	29,600
	2,96,400

5. **Cost of Control**

Amount paid for 64,000 shares		12,27,200
Less:		
Par value of shares (8,00,000 X 80%)	6,40,000	
Capital Profits – share of H Ltd. [WN 2]	4,27,200	(10,67,200)
Cost of Control or Goodwill		1,60,000

6. Calculation of revaluation loss on Plant and Machinery of S Ltd. on 1st October, 2019

	₹
Value of plant and machinery as on 1st April,2019	6,00,000
Less: Depreciation for the six months	(30,000)
Value of plant and machinery as on 1st October, 2019	5,70,000
Less: Plant and machinery valued by H Ltd. on 1st October,2019	(5,20,000)
Revaluation Loss	50,000

7. Value of plant & Machinery of S Ltd. On 31st March,2020

Value of machinery on 1st October, 2019	5,20,000
Less: depreciation for next six month	(26,000)
	4,94,000

QUESTION 26 (CA INTER JAN 21 EXAM)

On 31st March, 2020 the summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

	H Ltd.	S Ltd.
	₹	₹
Shareholders' Fund		
Issued and subscribed		
Equity shares of ₹ 10 each	13,40,000	2,40,000
Reserves and Surplus	4,80,000	1,80,000
Profit & Loss Account	2,40,000	60,000
Secured Loans		
12% Debentures	1,00,000	-
Current Liabilities		
Trade Payables	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Total	25,20,000	6,16,800

Assets		
Non-Current Assets		
(a) Property, Plant & Equipment		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
(b) Investments		
Investments in S Ltd.	3,84,000	-
(19,200 shares at ₹ 20 each)		
Current Assets		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000
Total	25,20,000	6,16,800

The following information is also provided to you:

(a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹ 60,000 and ₹ 36,000 respectively.

(b) Machinery (Book value ₹ 2,40,000) and Furniture (Book value ₹ 48,000) of S Ltd were revalued at ₹ 3,60,000 and ₹ 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%).

(c) On 31st March, 2020, Bills payable of ₹ 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.

QUESTION 27

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of ₹ 17 per share. The balance of shares of VR Ltd. are held by a foreign collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:

(a) The shares held by the foreign company will be sold to Variety Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean

40% of the average of pre-tax profits for the last 3 years, which were ₹ 30 lakhs, ₹ 40 lakhs and ₹ 65 lakhs.

(b) The actual cost of the shares to the foreign company was ₹ 5,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable will be deducted from the proceeds and Variety Ltd. will pay it to the Government.

(c) Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after two years.

The above agreement was approved by all concerned for being given effect to on 1.4.20X1. The total assets of VR Ltd. as on 31st March, 20X1 was ₹ 1,00,00,000. It was decided to write down Property, Plant and Equipment by ₹ 1,75,000. Current liabilities of VR Ltd. as on the same date were ₹ 20,00,000. The paid-up share capital of VR Ltd. was ₹ 20,00,000 divided into 2,00,000 equity shares of ₹ 10 each.

Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.

QUESTION 28

A Ltd. acquired 60% shares of B Ltd. @ ₹ 20 per share. Following is the extract of Balance Sheet of B Ltd.:

	₹
10,00,000 Equity Shares of ₹ 10 each	1,00,00,000
10% Debentures	10,00,000
Trade Payables	55,00,000
Property, Plant and Equipment	70,00,000
Investments	45,00,000
Current Assets	68,00,000
Loans and Advances	22,00,000

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of ₹ 60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.

QUESTION 29

A Ltd. and B Ltd. provide the following information:

	₹ '000s	
	A Ltd.	**B Ltd.**
Equity Shares	6,000	5,000

6% Preference Shares	NIL	1,000
General Reserve	1,200	800
Profit and Loss Account	1,020	1,790
Trade Payables	3,850	3,410
Dividend Payable	600	500
Goodwill	100	20
Property, Plant and Equipment	3,850	2,750
Investment	1,620	1,100
Inventory	1,900	4,150
Trade Receivables	4,600	4,080
Cash & Bank	600	400

A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following other information is available:

a. Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands bought forward from the previous year.

b. The General Reserve balance is brought forward from the previous year.

c. The directors of both the companies have declared a dividend of 10% on equity share capital for the previous and current year.

From the above information calculate Pre- and Post-acquisition Profits, Minority Interest and Cost of Control.

QUESTION 30

On 31st March, 20X1, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of ₹ 10 each fully paid	15,00,000
Pre-incorporation profits	30,000
Profit and Loss Account	60,000
Trade payables	1,05,000

P Ltd. and Q Ltd. give the following information on 31st March, 20X3:

	P Ltd. ₹	Q Ltd. ₹
Equity shares of ₹ 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	-
Pre-incorporation profits	-	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	-
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 20X3 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares;

(b) Immediately After issue of bonus shares.

QUESTION 31

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March, 20X1 from the following information:

	H Ltd.	S Ltd.
	₹	₹
PPE	5,00,000	3,00,000
Investments		
(20,000 equity shares of S Ltd.)	2,20,000	
Current Assets	1,55,000	1,00,000
Share capital (Fully paid equity shares of ₹ 10 each)	5,00,000	2,50,000
Profit and loss account	2,00,000	1,00,000
Trade Payables	1,75,000	50,000

H Ltd. acquired the shares of S Ltd. on 31st March, 20X1.

QUESTION 32

H Ltd. and S Ltd. provide the following information as at 31st March,20X2:

	H Ltd.	S Ltd.
	₹	₹
PPE	1,00,000	1,30,000
Investments (8,000 equity shares of S Ltd.)	1,26,000	
Current Assets	74,000	70,000
Share capital (Fully paid equity shares of ₹10 each)	1,50,000	1,00,000
Profit and loss account	50,000	40,000
Trade Payables	1,00,000	60,000

Additional information:

H Ltd. acquired the shares of S Ltd. on 1-7-20X1 and Balance of profit and loss account of S Ltd. on 1-4-20X1 was 30,000.

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 20X2.

QUESTION 33

From the Balance Sheets and information given below, prepare Consolidated Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March. Virat Ltd. holds 80% of Equity Shares in Anushka Ltd. since its (Anushka Ltd.'s) incorporation.

Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March, 20X1

		Note No.	Virat Ltd. (₹)	Anushka Ltd. (₹)
I.	**EQUITY AND LIABILITIES**			
	(1) Shareholder's Fund			
	(a) Share Capital	1	6,00,000	4,00,000
	(b) Reserve and Surplus	2	1,00,000	1,00,000
	(2) Non-current Liabilities			
	Long Term Borrowings		2,00,000	1,00,000
	(3) Current Liabilities			
	(a) Trade Payables		1,00,000	1,00,000
	Total		10,00,000	7,00,000
II.	ASSETS			
	(1) Non-current assets			
	(a) Property, Plant and Equipment		4,00,000	3,00,000

	(b) Non-current investments	3	3,20,000	
	(2) Current Assets			
	(a) Inventories		1,60,000	2,00,000
	(b) Trade Receivables		80,000	1,40,000
	(c) Cash & Cash Equivalents		40,000	60,000
	Total		10,00,000	7,00,000

Notes to Accounts

	Particulars	**(₹)**	**Virat Ltd. (₹)**	**Anushka Ltd. (₹)**
1.	**Share capital**			
	60,000 equity shares of ₹ 10 each fully paid up		6,00,000	--
	40,000 equity shares of ₹ 10 each fully paid up		--	4,00,000
	Total		6,00,000	4,00,000
2.	**Reserves and Surplus**			
	General Reserve		1,00,000	1,00,000
	Total		1,00,000	1,00,000
3.	**Non-current investments**			
	Shares in Anushka Ltd		3,20,000	--

QUESTION 34

a. A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd. sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd. at the financial year end i.e. 31 March 20X1.

b. A Ltd. holds 75% of the equity capital and voting power in B Ltd. A Ltd. purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd. at the financial year end i.e. 31 March 20X1.

Suggest the accounting treatment for the above mentioned transactions in the consolidated financial statements of A Ltd. giving reference of the relevant guidance/standard.

QUESTION 35

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

QUESTION 36

From the following information, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	% of Share owned	Cost	Date of Acquisition 01-01-20X1		Consolidation date 31-12-20X1	
				Share Capital	Profit and Loss A/c	Share Capital	Profit and Loss A/c
				₹	₹	₹	₹
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000

SOLUTION :

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1 C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] ₹	Minority interest as at the date of consolidation [E] X [C + D] ₹
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750

QUESTION 37

A Ltd acquired 1,600 ordinary shares of ₹100 each of B Ltd on 1st July, 20X1. On 31st December, 20X1, the balance sheets of the two companies were as given below:

Balance Sheet of A Ltd. and its subsidiary, B Ltd.
as at 31st December, 20X1

	Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
I.	**EQUITY AND LIABILITIES**			
	(1) Shareholder's Fund			
	(a) Share Capital	1	5,00,000	2,00,000
	(b) Reserve and Surplus	2	2,97 ,200	1,82,000
	(2) Current Liabilities			
	(a) Trade Payables			
	(b) Short term provisions	3	47,100	17,400
	Total		9,24,300	3,99,400
II.	**ASSETS**			
	(1) Non-current assets			
	(a) Property, Plant and Equipment	4	3,90,000	3,15,000
	(b) Non-current Investment	5	3,40,000	
	(2) Current assets			
	(a) Inventories		1,20,000	36,400
	(b) Trade Receivables		59,800	40,000
	(c) Cash & Cash Equivalents	6	14,500	8,000
	Total		9,24,300	3,99,400

Notes to Accounts

		A Ltd. ₹	B Ltd. ₹
1.	**Share Capital**		
	5,000 shares of ₹ 100 each, fully paid up	5,00,000	-
	2,000 shares of ₹ 100 each, fully paid up	-	2,00,000
	Total	5,00,000	2,00,000

2.	**Reserves and Surplus**		
	General Reserves	2,40,000	1,00,000
	Profit & loss	57,200	82,000
	Total	2,97,200	1,82,000
3.	**Short term borrowings**		
	Bank overdraft	80,000	--
4.	**Property plant and equipment**		
	Land and building	1,50,000	1,80,000
	Plant & Machinery	2,40,000	1,35,000
	Total	3,90,000	3,15,000
5.	**Non-current Investments**		
	Investment in B Ltd (at cost)	3,40,000	--
6.	**Cash & Cash equivalents**		
	Cash	14,500	8,000

The Profit & Loss Account of B Ltd. showed a credit balance of ₹30,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 20X1 was considered as worth ₹ 1,80,000 on 1st July, 20X1; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).

Prepare consolidated Balance Sheet as at 31st December, 20X1.

QUESTION 38

On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Balance Sheet of H Ltd.

and its subsidiary S Ltd. as at 31st March, 20X1

	Particulars	Note No.	H. Ltd. (₹ in Lacs)	S. Ltd. (₹ in Lacs)
I.	**EQUITY AND LIABILITIES**			
	(1) Shareholder's Fund			
	(a) Share Capital	1	12,000	4,800
	(b) Reserve and Surplus	2	5,499	3,000
	(2) Current Liabilities			

	(a) Trade Payables	3	1,833	1,014
	(b) Short term provisions	4	855	394
	(c) Other current liabilities (Dividend payable)		1,200	—
	Total		21,387	9,208
II.	**ASSETS**			
	(1) Non-current assets			
	(a) Property, Plant and Equipment	5	9,468	5,486
	(b) Non-current Investment (Shares in S. Ltd.)		3,000	
	(2) Current assets			
	(a) Inventories		3,949	1,956
	(b) Trade Receivables	6	2,960	1,562
	(c) Cash & Cash Equivalents		1,490	204
	(d) Short term loans and advances	7	520	
	Total		21,387	9,208

Notes to Accounts

		A Ltd. ₹	B Ltd. ₹
1.	**Share Capital**		
	Authorized share capital	15,000	6,000
	Equity shares of ₹ 10 each, fully paid up		
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up	12,000	4,800
2.	**Reserves and Surplus**		
	General Reserves	2,784	1,380
	Profit & loss Account :	2,715	1,620
	Total	5,499	3,000
3.	**Trade Payables**		
	Creditors	1,460	854
	Bills Payable	372	160
	Total	1,833	1,014

4.	**Short term provisions**		
	Provision for Taxation	855	394
5.	**Property plant and equipment**		
	Land and building	2,718	—
	Plant & Machinery	4,905	4,900
	Furniture and Fittings	1,845	586
	Total	9,468	5,486
6.	**Trade receivables**		
	Debtors	2,600	1,363
	Bills Receivables	360	199
	Total	2,960	1,562
7.	**Short term loans and advances**		
	Sundry Advances	520	—

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 20X0 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

(b) On 1st April, 20X0, S Ltd. declared a dividend @ 20% for the year ended 31st March, 20X0. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 20X1, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 20X0.

(d) On 31st March, 20X1, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

(e) On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

QUESTION 39 (CA INTER MAY 2022 15 MARKS)

White Ltd. acquired 2,250 shares of Black Ltd. on 1st October, 2020. The summarized balance sheets of both the companies as on 31st March, 2021 are given below:

	White Ltd. (₹)	Black Ltd. (₹)
(I) Equity and Liabilities		
(1) Shareholder's fund		
Share capital (Equity shares of ₹ 100 each fully paid up)	6,50,000	3,00,000
Reserves and Surplus		
General Reserve	60,000	30,000
Profit and loss account	1,50,000	90,000
(2) Current Liabilities		
Trade payables	1,15,000	75,000
Due to White Ltd.		30,000
Total	9,75,000	5,25,000
(II) Assets:		
Non-current assets		
Property, Plant and Equipment	5,80,000	3,51,000
Investments		
Shares in Black Ltd. (2,250 shares)	2,70,000	
Current assets		
Inventories	50,000	1,20,000
Due from Black Ltd.	36,000	
Cash and Cash equivalents	39,000	54,000
Total	9,75,000	5,25,000

Other information:

(i) During the year, Black Limited fabricated a machine, which is sold to White Ltd. for ₹ 39,000, the transaction being completed on 30th March,2021.

(ii) Cash in transit from Black Ltd. to White Ltd. was ₹ 6,000 on 31st March,2021.

(iii) Profits during the year 2020-2021 were earned evenly.

(iv) The balances of Reserve and Profit and Loss account as on 1st April,2020 were as follows:

	Reserves	Profit and Loss A/c
	₹	₹
White Ltd.	30,000	15,000 Profit
Black Ltd.	30,000	10,000 Loss

You are required to prepare consolidated Balance Sheet of the group as on 31st March,2021 as per the requirement of Schedule III of the Companies Act, 2013.

SOLUTION :

Consolidated Balance Sheet of White Ltd. and its Subsidiary Black Ltd.
as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,50,000
(b) Reserves and Surplus	2	2,55,000
(2) Minority Interest	3	1,05,000
(3) Current Liabilities		
(a) Trade Payables	4	1,90,000
Total		12,00,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	9,31,000
(2) Current assets		
(i) Inventory	6	1,70,000
(ii) Cash & cash equivalent	7	99,000
Total		12,00,000

Notes to Accounts

			₹
1.	**Share capital**		
	6,500 equity shares of ₹ 100 each, fully paid up		6,50,000
	Total		6,50,000
2.	**Reserves and Surplus**		

	General Reserves		60,000
	Profit and Loss Account	1,50,000	
	Add: 75% share of Black Ltd.'s post-acquisition profits (W.N.1)	37,500	1,87,500
	Capital reserve (W.N. 5)		7,500
	Total		2,55,000
3.	**Minority interest in Black Ltd. (WN 4)**		1,05,000
4.	**Trade payables**		
	White Ltd.	1,15,000	
	Black Ltd.	75,000	1,90,000
5.	**Property, plant and equipment**		
	White Ltd.	5,80,000	
	Black Ltd.	3,51,000	9,31,000
6	**Inventory**		
	White Ltd.	50,000	
	Black Ltd.	1,20,000	1,70,000
7	**Cash & cash equivalent**		
	White Ltd.	39,000	
	Black Ltd.	54,000	
	Cash in transit	6,000	99,000

Working Notes:

1.	Post-acquisition profits of Black Ltd.	₹
	profits earned during the year = ₹ 90,000 + ₹10,000	1,00,000
	Pre-acquisition profits (1.4.20 to 30.9.20)	50,000
	Post-acquisition profits (1.10.20 to 31.3.21)	50,000
	White Ltd.'s share 75% of 50,000	37,500
	Minority Interest 25% of 50,000	12,500
2.	Pre-acquisition profits and reserves of Black Ltd.	
	Reserves as on 1.4.2020	30,000
	Profit and Loss Account [10,000 (loss as on 1.4.20) +50,000 (6 month Adjusted pre-acquisition profits)]	40,000

		70,000
	White Ltd.'s = (75%) × 70,000	52,500
	Minority Interest= (25%) × 70,000	17,500
3.	Post-acquisition reserves of Black Ltd.	
	Post-acquisition reserves (Total reserves less reserves pre-acquisition = ₹ 30,000 – 30,000)	Nil
4.	Minority Interest	
	Paid-up value of (3,000 – 2,250) = 750 shares	
	held by outsiders i.e. 750 × ₹ 100	75,000
	Add: 25% share of pre-acquisition reserves & Profit	17,500
	25% share of post-acquisition profit	12,500
		1,05,000
5.	Capital Reserve	
	Price paid by White Ltd. for 2,250 shares (A)	2,70,000
	Intrinsic value of the shares-	
	Paid-up value of 2,250 shares held by White Ltd. i.e. 2,250 × ₹ 100 — 2,25,000	
	Add 75% share of pre-acquisition reserves & profit (70,000 x 75%) — 52,500 (B)	2,77,500
Capital reserve (A – B)		7,500

QUESTION 40 (CA INTER NOV 2022 15 MARKS)

H Ltd. and S Ltd. provide the following information as at 31st March,2022:

	H Ltd.₹	S Ltd.₹
Property, Plant and Equipment	2,00,000	2,60,000
Investments (14,000 Equity Shares of S Ltd.)	2,52,000	-
Current Assets	1,48,000	1,40,000
Share capital (Fully paid equity shares of ₹ 10 each)	3,00,000	2,00,000
Profit and loss account	1,00,000	80,000
Trade Payables	2,00,000	1,20,000

Additional information:

H Ltd. acquired the shares of S Ltd. on 1stJuly, 2021 and Balance of profit and loss account of S Ltd. on 1stApril, 2021 was ₹ 60,000. Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 2022.

SOLUTION :

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.

as at 31st March, 2022

		Note No	Amount (₹)
	I Equity and Liabilities		
1	Shareholders' Fund:		
	(a) Share Capital	1	3,00,000
	(b) Reserve and Surplus	2	1,10,500
2	Minority interest	3	84,000
3	Current Liabilities		
	Trade payables	4	3,20,000
	Total		8,14,500
	II Assets		
1	Non-Current Assets:		
	Property, plant and equipment	5	4,60,000
	Intangible Asset	6	66,500
2	Current Assets	7	2,88,000
	Total		8,14,500

Notes to Accounts

		Amount (₹)
1	Share capital	3,00,000
	30,000 Equity Shares @ ₹10 each	
2	Reserve and Surplus	
	Profit and loss account (₹ 1,00,000 + 70% of 9/12 x 20,000 i.e. ₹ 10,500)	1,10,500
3	Minority Interest (W/N 2)	84,000
4	Trade payables	
	H Ltd.	2,00,000
	S Ltd.	1,20,000

		3,20,000
5	Property, plant and equipment	
	H Ltd.	2,00,000
	S Ltd.	2,60,000
		4,60,000
6	Intangible Asset:	
	Goodwill (W/N 3)	66,500
7	Current Assets	
	H Ltd.	1,48,000
	S Ltd.	1,40,000
		2,88,000

Working Notes:

1. Percentage of holding

		No. of Shares	Percentage
Holding Co.	:	14,000	(70%)
Minority shareholders	:	6,000	(30%)
Total Shares	:	20,000	

2. Calculation of Minority Interest

Share capital (30% of ₹ 2,00,000)	60,000	
Share in Profit and loss account (₹ 80,000 X 30%)	24,000	84,000

3. Calculation of Cost of Control (Goodwill)

Cost of Investment	2,52,000
Less: Paid up value of shares (70% of ₹ 2,00,000)	(1,40,000)
Share in pre-acquisition profits	
70% of [60,000+3/12(80,000-60,000)]	(45,500)
	66,500

QUESTION 41 (CA INTER MAY 2023)

H Ltd. acquired 15000 shares in S Ltd. for ₹ 1,55,000 on July 1, 2022. The Balance sheet of the two companies as on 31st March, 2023 were as follows:

	H Ltd. ₹	S Ltd. ₹
Equity and Liabilities:		
Equity Share Capital	9,00,000	2,50,000
(Fully paid shares of ₹ 10 each)		
General Reserve	1,60,000	40,000
Surplus i.e., Balance in Statement of Profit and Loss	80,000	25,000
Bills Payable	40,000	20,000
Trade Creditors	50,000	30,000
Total	12,30,000	3,65,000
Assets		
Machinery	7,00,000	1,50,000
Furniture	1,00,000	70,000
Investment in Equity Shares of S Ltd.	1,55,000	-
Stock-in-Trade	1,00,000	50,000
Trade Debtors	60,000	35,000
Bills Receivable	25,000	20,000
Cash at Bank	90,000	40,000
Total	12,30,000	3,65,000

The following additional information is provided to you:

(i) General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March, 2022.

(ii) Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to ₹ 20,000.

(iii) H Ltd. sold goods to S Ltd. costing ₹ 8,000 for ₹ 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.

(iv) Creditors of S Ltd. include ₹ 4000 due to H Ltd. on account of these goods.

(v) Out of Bills payable issued by S Ltd. ₹ 15,000 are those which have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, ₹ 8000 worth of bills receivable in favor of its creditors.

You are required to draw a consolidated Balance Sheet as on 31st March, 2023.

CONSOLIDATED PROFIT AND LOSS ACCOUNT

QUESTION 42

Given below are the Profit & Loss Account of H Ltd. and its subsidiary Ltd. for the year ended 31st March, 2015:

	H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)
Incomes:		
Sales and other income	5,000	1,000
Increase in Inventory	1,000	200
	6,000	1,200
Expenses:		
Raw material consumed	800	200
Wages and Salaries	800	150
Production expenses	200	100
Administrative Expenses	200	100
Selling and Distribution Expenses	200	50
Interest	100	50
Depreciation	100	50
	2,400	700
Profit before tax	3,600	500
Provision for tax	1,200	200
Profit after tax	2,400	300

Other Information:

H Ltd. sold goods to S Ltd. of ₹ 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative Expenses of S Ltd. include ₹ 5 lacs paid to H Ltd. as consultancy fees. Selling and Distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 2013-2014.

QUESTION 43 (CA INTER NOV 2018) (10MARKS) (CONSOLIDATED P&L)

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 are given below :

₹ in Lakhs

Incomes	**A Ltd.**	**B Ltd.**
Sales and other income	7,500	1,500
Increase in Inventory	1,500	300
Total	9,000	1,800
Expenses		
Raw material consumed	1,200	300
Wages and Salaries	1,200	225
Production expenses	300	150
Administrative expenses	300	150
Selling and distribution expenses	300	75
Interest	150	75
Depreciation	150	75
Total	3,600	1,050
Profit before tax	5,400	750
Provision for tax	1,800	300
Profit after tax	3,600	450
Dividend paid	1,800	225
Balance of Profit	1,800	225

The following information is also given:

(i) A Ltd sold goods of ₹ 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 Profit & Loss Account of A Ltd. and its subsidiary B Ltd. for the year ended on 31st March, 2018

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	8,797
II. Total revenue		8,797
III. Expenses		
Cost of Material purchased/Consumed	3	1,770
Changes of Inventories of finished goods	2	(1,794)
Employee benefit expense	4	1,425
Finance cost	6	225
Depreciation and amortization expense	7	225
Other expenses	5	802
Total expenses		2,653
IV. Profit before Tax(II-III)		6,144
V. Tax Expenses	8	2,100
VI. Profit After Tax		4,044

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	**Revenue from Operations**		
	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	1,500	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	(15)	8,797
2.	**Increase in Inventory**		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealised 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
4.	**Employee benefits and expenses**		1,770
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	**Other Expenses**		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from BLtd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
6.	Finance Cost		802
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortisation		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225
8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	300	2100

Note: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. Alternative answer is possible considering is otherwise.

QUESTION 44 (CA INTER JULY 2021 15 MARKS)

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (₹ In 000)		Y Limited (₹ In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of ₹ 100 each)		2,000		400
7% Preference share capital		-		400
Reserves		600		200
6% Debentures		400		400
Trade Receivables/Trade Payables	160	180	100	120
Profit & Loss A/c balance		40		30
Purchases /Sales	1,000	1,800	1,200	1,900
Wages and Salaries	200		300	
Debenture Interest	24		24	
General Expenses	160		120	
Preference share dividend up to 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
Fixed Assets	2,200		1,580	
Total	5,027	5,027	3,450	3,450

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

- After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being ₹ 1,20,000, one fourth of such goods were still lying in inventory at the end of the year.
- Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Fixed Assets.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021.

QUESTION 45 (CA INTER DEC. 2021 15 MARKS)

Moon Ltd. and its subsidiary Star Ltd. provided the following information for the year ended 31st March, 2021:

Particulars	Moon Ltd (₹)	Star Ltd. (₹)
Equity Share Capital	20,000,000	6,000,000
Finished Goods Inventory as on 01.04.2020	4,200,000	3,010,000
Finished Goods Inventory as on 31.03.2021	8,575,000	3,762,500
Dividend Income	1,680,000	437,500
Other non-operating Income	350,000	105,000
Raw material consumed	13,930,000	4,725,000
Selling and Distribution Expenses	3,325,000	1,575,000
Production Expenses	3,150,000	1,400,000
Loss on sale of investments	262,500	Nil
Sales and other operating income	33,250,000	19,075,000
Wages and Salaries	13,300,000	2,450,000
General and Administrative Expenses	2,800,000	1,225,000
Royalty paid	Nil	50,000
Depreciation	315,000	140,000
Interest expense	175,000	52,500

Other information

- On 1st September 2018 Moon Ltd., acquired 50,000 equity shares of ₹ 100 each fully paid up in Star Ltd.
- Star Ltd. paid a dividend of 10% for the year ended 31st March 2020. The dividend was correctly accounted for by Moon Ltd.
- Moon Ltd. sold goods of ₹ 17,50,000 to Star Ltd. at a profit of 20% on selling price. Inventory of Star Ltd. includes goods of ₹ 7,00,000 received from Moon Ltd.
- Selling and Distribution expenses of Star Ltd. include ₹ 2,12,500 paid to Moon Ltd. as brokerage fees.
- General and Administrative expenses of Moon Ltd. include ₹ 2,80,000 paid to Star Ltd. as consultancy fees.
- Star Ltd. used some resources of Moon Ltd., and Star Ltd. paid ₹ 50,000 to Moon Ltd. as royalty.

Prepare Consolidated Statement of Profit and Loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended 31st March, 2021 as per Schedule III to the Companies Act, 2013.

SOLUTION :

Consolidated statement of profit and loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended on 31st March, 2021

Particulars	Note No.	₹
Revenue from operations	1	5,00,32,500
Other Income	2	23,10,000
Total revenue (I)		5,23,42,500
Expenses:		
Cost of material purchased/consumed	3	2,14,55,000
Changes (Increase) in inventories of finished goods	4	(49,87,500)
Employee benefit expense	5	1,57,50,000
Finance cost	6	2,27,500
Depreciation and amortization expense	7	4,55,000
Other expenses	8	84,32,500
Total expenses (II)		4,13,32,500
Profit before tax (II-III)		1,10,10,000

Notes to Accounts:

			₹	₹
1.	Revenue from operations			
	Sales and other operating revenues1			
	Moon Ltd.		3,32,50,000	
	Star Ltd.		190,75,000	
			523,25,000	
	Less: Inter-company sales		(17,50,000)	
	Consultancy fees received by Star Ltd. from Moon Ltd.		(2,80,000)	
	Royalty received by Moon Ltd. from Star Ltd.		(50,000)	
	Brokage received by Moon Ltd. from Star Ltd.		(2,12,500)	5,00,32,500

2.	Other Income			
	Dividend income:			
	Moon Ltd.	16,80,000		
	Star Ltd.	4,37,500	21,17,500	
	Loss on sale of investments Star Ltd.		(2,62,500)	
	Other Non-operating Income			
	Moon Ltd.	3,50,000		
	Star Ltd.	1,05,000	4,55,000	23,10,000
3.	Cost of material purchased/consumed			
	Moon Ltd.	1,39,30,000		
	Star Ltd.	47,25,000		
		1,86,55,000		
	Less: Purchases by Star Ltd. From Moon Ltd.			
		(17,50,000)	1,69,05,000	
	Direct expenses (Production)			
	Moon Ltd.	31,50,000		
	Star Ltd.	14,00,000	45,50,000	2,14,55,000
4.	Changes (Increase) in inventories of finished goods			
	Moon Ltd.		43,75,000	
	Star Ltd.		7,52,500	
			51,27,500	
	Less: Unrealized profits ₹ 7,00,000 × 20/100		(1,40,000)	49,87,500
5.	Employee benefits and expenses			
	Wages and salaries:			
	Moon Ltd.		1,33,00,000	
	Star Ltd.		24,50,000	1,57,50,000

6	Finance cost			
	Interest:			
	Moon Ltd.		1,75,000	
	Star Ltd.		52,500	2,27,500
7.	Depreciation			
	Moon Ltd.		3,15,000	
	Star Ltd.		1,40,000	4,55,000
8.	Other expenses			
	General & Administrative expenses:			
	Moon Ltd.	28,00,000		
	Star Ltd.	12,25,000		
		40,25,000		
	Less: Consultancy fees received by Star Ltd. from Moon Ltd.	(280,000)	37,45,000	
	Royalty:			
	Star Ltd.	50,000		
	Less: Received by Moon Ltd. Selling and distribution Expenses:	(50,000)	Nil	
	Moon Ltd.	33,25,000		
	Star Ltd.	15,75,000		
		49,00,000		
	Less: Brokerage received by Moon Ltd. from Star Ltd.	(2,12,500)	46,87,500	84,32,500

CONSOLIDATED CASH FLOW STATEMENT

A holding company has to prepare a consolidated cash flow statement if it is required to prepare cash flow statement.

Same as Consolidated Profit and Loss account, the preparation of consolidated Cash flow statement is also not difficult. All the items of Cash flow from operating activities, investing activities and financing activities are to be added on line by line basis and from the consolidated items, inter-company transactions should be eliminated.

Below given is the Consolidated Cash Flow Statement with hypothetical figures:

CONSOLIDATED CASH FLOW STATEMENT

	A Company	(₹ in million)	
		B Company	Total
Cash Flow From Operating Activities			
Change in Reserve	8	2	10
Change in P & L A/c	0	1	1
Proposed Dividend	22		22
Tax Provision	20	1	21
Depreciation	10	5	15
Interest	-10	10	0
	50	19	69
Less: Tax payment	-20	-1	-21
	30	18	48
Working Capital Adjustment	-13	12	-1
(A)	17	30	47
Cash Flow from Investment Activities			
Sale of fixed assets	30	0	30
Purchase of fixed assets	-30	-20	-50
(B)	0	-20	-20
Cash Flow from Financing Activities (C)	-22	-10	-32
Net cash flows (A+B+C)	-5	0	-5

NOTES

ACCOUNTING STANDARD: 22
ACCOUNTING FOR TAXES FOR INCOME

QUESTION 1

A company ABC Limited prepares its accounts annually on 31st March. On 1ST April 2001 it purchases a machine at a cost of ₹1,50,000. The machine has a useful life of three years and an expected scrap value of Zero. Although it is eligible for a 100% first year depreciation allowance for the tax purposes, the straight line method is considered appropriate for accounting purposes. ABC Limited has profits before depreciation and taxes of ₹2,00,000 each year and the corporate tax rate is 40per cent each year.

QUESTION 2

In above illustration, the corporate tax rate has been assumed to be same in each of the three years. If the rate of tax is assumed 40%, 35% and 38% respectively, compute the amount of deferred tax liability?

QUESTION 3

A company ABC Limited prepares its accounts annually on 31st March. The company has incurred a loss of ₹1,00,000 in the year 2001 and made profits of ₹50,000 and 60,000 in year 2002 and 2003 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 2001. It was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set off. It is also assumed that there is no difference between taxable income and accounting income except that set off of loss is allowed in years 2002 and 2003 for tax purpose.

QUESTION 4

Jaishree chemicals Limited showed the accounting income ₹8,00,000 for the year ended on 31.03.2002. in computation of accounting income the following data were considered:-

Gain on revaluation of Asset (Cr. To Profit and Loss account)	₹3,50,000
Depreciation deducted for accounting purpose in excess of depreciation deducted for income tax purpose.	₹50,000
income tax rate	35%.

Compute the provision for income tax and deferred tax liability or asset.

QUESTION 5

Liverpool Limited reported income of ₹90,000 for the financial year 2001-02. compute the provision for income tax and deferred tax asset/liability. The following information are also as follows:-

Rent received in advance	₹16,000
Income from exempted Govt. Bonds	₹20,000
Depreciation deducted for income tax purpose	
In excess of depreciation reported for accounting income.	₹10,000
Income tax rate	35%.

QUESTION 6

Infosys India Limited prepared the following reconciliation of its pre tax financial statement income to taxable income for the financial year 2001-2002. reconciliation is given below:-

Pre tax financial income	₹1,60,000
Non taxable interest received on Govt. Bonds.	₹(5,000)
Long term loss accrual in excess of deductible amount	₹10,000
Depreciation in excess of financial statement account	₹(25,000)

Taxable income	₹1,40,000

Tax rate is 35%.

Compute current tax and deferred tax asset /liability.

QUESTION 7

Liverpool Limited has three financial statement elements for year ended 31.03.2001, the book value and tax basis value is given below:-

	Book value	tax value
Equipment	2,00,000	1,20,000
Prepaid insurance	75,000	Nil
Warranty liability	50,000	Nil

Calculate the deferred tax asset/liability. Tax rate is 40%.

QUESTION 8

The following particulars are stated in the Balance Sheet of Exe Ltd. as on 31.03.2003:

	₹ in lacs
Deferred tax liability	20.00
Deferred tax assets	10.00

The following transactions are reported during the year 2003-04:

(i) Tax rate 50%

(ii) Repairs to plant and machinery ₹100.00lakhs was spread over the period 2003-04 and 2004-05 equally in the books. However, the entire expenditure was allowed for income tax purpose.

(iii) Share issued expenses allowed under section 35D of the income tax act 1961, for the 2003-04 (1/10th of the ₹50.00lakhs incurred in 1999-2000)

(iv) Donations to private trusts made in 2003-04 ₹ 10.00lakhs

(v) Interest to financial institutions to be accounted in the books on accrual basis, but actual payment was made on 31-10-2004 ₹ 20 lakhs

(vi) Items disallowed in 2002-03 and allowed for tax purpose in 2003-04 ₹ 10.00

(vii) Depreciation as per book 50 lakhs

(viii) Depreciation for tax purpose ₹ 30lakhs

Indicate clearly the impact of above items in terms of Deferred tax liability /Deferred tax assets and the balances of Deferred tax liability/Deferred tax assets as on 31.03.2004.

QUESTION 9

The income before depreciation and tax of an enterprise for 15 years is Rs 1000 Lakhs per year, both as per the books of accounts: and for income Tax purposes. The enterprise is subject to 100 % tax holiday for the first 10 years under section 801A. Tax rate is assumed to be 30%. At the beginning of the year 1 the enterprises has purchased one machine for Rs 1500 Lakhs. Residual value is nil. For the accounting purposes, the enterprise follows an accounting policy to provide depreciation on the machine over '15 years on SLM basis. For the tax purpose, the depreciation rate relevant to the machine is 25°fo on WDV bases. Ignore the provisions of section 11 5JB(MAT) in this regard. Calculate Deferred Tax Asset or Liability.

ASI on Accounting Standard issued & ICAI

QUESTION 10 (AUDITING NOV 2022)

As a statutory auditor for the year ended 31st March 2002, how would you deal with the following: S Ltd., a listed company, was incurring heavy losses since the last several years and the industry in which it was functioning was not expected to perform better in the next few years? While finalising the accounts for the year ended 3jst March 2002, the CFO of the company decided to create a deferred tax asset for the tax benefits that would arise in future years from the earlier years losses that had remained- unabsorbed in Income Tax.

SOLUTION :

In the absence of virtual certainty, the creation of deferred tax asset would be incorrect and would therefore require qualification by the auditor or an adverse opinion as appropriate in respect of the true and fair view. Also the auditor will have to qualify compliance with mandatory accounting standards, namely AS-22 '

QUESTION 11 (RTP NOV 2022)

Your client is a full tax free enterprise for the first 10 years and is in the second year of operations. Depreciation timing difference resulting in a deferred tax liability in year I & 2 is ₹ 100 million and ₹ 200 million respectively. From the 3rd year and onwards it is expected that the timing difference would reverse each year by ₹ 5 million. Determine deferred tax liability at the end of 2nd year and the charge to the P&L a/c if any. Assume tax rate @35%.

SOLUTION :

In case of tax free companies, no deferred tax liability is recognised 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 difference that originates 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 the ₹ 100 million, Rs 10 million will reverse in the tax holiday period. Therefore, deferred tax liability will be created on P.s. 60 million at the tax rate of 35%, i.e., ₹ 20 million. In the second year, the entire ₹ 200 million will reverse only after the tax holiday period therefore, deferred tax charge in the profit and loss account will be ₹ 70 million (200*35%) and deferred tax liability in the balance sheet will be P.s. 91 million (70 +21).

QUESTION 12

From the following details of ABC Ltd. for the year ending 31.3.2003, calculate the deferred tax asset/liability and tax expense for the year having regard to the requirements of AS-22:

Book Profit as per MAT	₹ '000
Accounting Profit	700
Taxable Profit	800
Tax Rate	100
MAT Rate	35%
MAT Rate	10%

QUESTION 13 (NOV 2004 - FINAL -AUDI TING-4 MARKS)

Trimurthy Pan Masala was incurring heavy losses in the last several years since it could not withstand the competition in the market. The state in which the Company had its Registered Office and also its major sales, had moved a bill in the State Assembly to ban manufacture and sale of all kinds of Pan Masalas in the State. While finalizing the accounts for the year ended 31 .3.2004, the CFO of the Company created a Deferred Tax Assets for the tax benefits that vouid arise in future year from the earlier years losses that had remained unabsorbed in Income-Tax. Comment.

SOLUTION :

As per Para 17 of AS 22, where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, DTA should be recognized 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 realized. In this case, the Company may not be in a position to carry out its activities on account of the possible banning of its Pan Masala Sales, by the State's legislation. Since the Virtual Certainty condition of Para 1 7 and ASI -9 is not satisfied. The Company should not recognize any D'I'A on the unabsorbed losses. Hence the Company's accounting treatment is improper.

QUESTION 14

Company A has a block of assets with a written down value of ₹ 100,000 on April 1, 20X I for tax purposes. The book value of the assets for accounting purposes is also ₹ 100,000: The assets are depreciated on written down value basis at 25 per cent per annum for both accounting and tax purposes. Of the entire block, assets costing ₹ 5,000 on April 1, 20X1, were sold for P.s. 10,000 on March 31, 20X3. Compute the deferred tax asset/liability assuming tax rate of 40 per cent.

QUESTION 15 (MAY - 2006, MARKS 4)

Million Ltd. is a full tax free enterprises for the first 10 year of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax Liability in years I and 2 is ₹200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by ₹10 lakhs .Assuming tax rate 35% find out the deferred tax liability at the end of the second year and any charge to the profit and loss account.

QUESTION 16 (RTP NOV.-2006)

Classify the following as "Timing Difference" and "Permanent Difference"

(i) Interest on loans payable to Scheduled Banks not paid during current year but accounted as an expenditure in the books.

(ii) Difference in Depreciation rates as per Income Tax and as per Books.

(iii) Unabsorbed losses.

(iv) Revaluation Reserve.

SOLUTION :

Classification of the items into timing and permanent differences is as under

(i) Interest paid to bank is a tithing difference.

(ii) Difference in depreciation rates is a timing difference.

(iii) Unabsorbed losses is a timing difference.

(iv) Revaluation Reserve is a permanent difference.

QUESTION 17

From the given information, you are required to compute the Deferred Tax Assts and Deferred Tax Liability for Ramanujam Limited as on 31st March 2014. The tax rate applicable is 35%.

(i) The Company has charged Depreciation of ₹ 742,900 in its Books of Accounts while as per Income Tax computation, the Depreciation available to the Company is ₹ 8,65,400.

(ii) The Company has made provision for doubtful Debts for ₹ 54,300 during the year.

(iii) The Company has debited Share issue Expenses of ₹ 6,23,500 which will be available for deduction under the Income Tax Act from the next year.

(iv) The expenses of ₹ 7,84,500 has been charged to Profit and Loss Account which are disallowed under the Income Tax Act.

(v) The Company has made Donation of ₹ 2,00,000 which has been debited to Profit and Loss account and only 50% thereof will be allowed as deduction as per Income Tax Law.

SOLUTION

Computation of DTA/DTL (₹)

Description	Adj.	Net Amt.	Nature of Diff.	Treatment	DTA/DTL at 35%
Profit before Tax as per Books		XXX			
Add: Dep. as per Books Less: Dep. as per IT	7,42,900 (8,05,400)	(1,22,500)	Timing	Difference originating in the current year, So Crete DTL	(42,875)
Add: Provision disallowed in IT		(54,300)	Timing	Create DTA	19,005
Add: Share Issue Exp. Disallowed U/s 35D		6,23,500	Timing	Difference originating in the current year, so Create DTA	2,18,225
Add: Expense Disallowed under IT (assumed to be permanent diff)		7,84,500	Permanent	Ignored	NA
Add: Donation (50%of 2 Lakh)		1,00,000	Permanent	Ignored	NA
Total Income		XXX			

QUESTION 18 (CA FINAL NOV.2016) (SAME AS Q.12)

From the following details of ABC Ltd. for the year ending 31.3.2003, calculate the deferred tax asset/liability and tax expense for the year having regard to the requirements of AS-22:

Book Profit as per MAT	₹ '000
Accounting Profit	700
Taxable Profit	800
Tax Rate	100
MAT Rate	35%
MAT Rate	10%

STUDY MATERIAL & PAST EXAMINATION QUESTIONS

QUESTION 19 (CA INTER NOV 20)(5MARKS)

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	₹
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year.

SOLUTION :

Tax as per accounting profit	15,00,000x20%	=	₹ 3,00,000
Tax as per Income-tax Profit	2,50,000x20%	=	₹ 50,000
Tax as per MAT	7,50,000x7.50%	=	₹ 56,250

Tax expense= Current Tax + Deferred Tax

₹ 3,00,000 = ₹ 50,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020 Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

QUESTION 20 (STUDY MATERIAL)

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

liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

SOLUTION

Omega Limited.
Calculation of Deferred Tax Asset/Liability

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

QUESTION 21 (CA INTER JAN 21 EXAM) (5 MARKS)

(SIMILAR TO QUESTION 8)

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31-3-2019 :

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00
The following transactions were reported during the year 2019-20 :	
Depreciation as per accounting records	160.00
Depreciation as per income tax records	140.00
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	20.00
Donation to Private Trust	20.00
Tax rate	30%

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22.

SOLUTION :

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

(1) Difference in Depreciation- Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. It is timing difference for which reversal of Deferred tax liability is required.

Reversal of DTL= ₹ (160 – 140) Lakhs X 30% = ₹ 6 Lakhs

(2) Disallowances, as per IT Act of earlier years- Due to disallowance tax payable for the earlier years was higher on this account. It is responding timing difference which required Reversal of Deferred tax assets.

Reversal of Deferred tax assets = ₹ 20 Lakhs X 30% = ₹ 6 Lakhs

(3) Donations to private trusts is not an allowable expenditure under IT Act. It is permanent difference. Hence, no reversal of tax is required.

QUESTION 22 (STUDY MATERIAL)

Ultra Ltd. has provided the following information:

Depreciation as per accounting records =₹ 4,00,000

Depreciation as per tax records =₹ 10,00,000

Unamortized preliminary expenses as per tax record = ₹ 30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/ liability should be recognized as transition adjustment when the tax rate is 50%?

SOLUTION :

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
Excess depreciation as per tax ₹ (10,00,000 – 4,00,000)	6,00,000
Less: Expenses unamortized in tax records	(30,000)
Timing difference	5,70,000

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50% x 5,70,000 = ₹ 2,85,000

QUESTION 23 (CA INTER JULY 21) 5 MARKS

(SIMILAR TO QUESTION 8)

The following particulars are stated in the Balance sheet of Depp Limited as on 31st March, 2020:

	(₹ In lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020-2021:

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs, There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35 (D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of 70.00 lakhs incurred in 2019-20)

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books, However, the entire expenditure was allowed for income-tax purposes in the year 2020-21

Tax Rate to be taken at 40%

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021,

QUESTION 24

Saras Ltd. closes its books as on 31st March 20X2. They have accrued ₹ 5,00,000 towards GST Liability for the month of March 20X2 by debiting their Profit and loss statement which is expected to be paid off by 21st April 20X2 . As per the provisions of Section 43B of the Income Tax Act, 1961 – Any expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis will be allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 20X2.

SOLUTION :

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act (Section 43B)	Nil
Timing difference	5,00,000

Tax expense is less than the current tax due to timing difference. Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

QUESTOIN 25

ABC Company limited had an investment in Venture Capital amounting ₹ 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:

Portfolio Companies	Amount of investment (₹ in Crores)
Oscar Limited	2
Zee Limited	3
Star Limited	4
Sony Limited	1
Total	10

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 8 Crores have been transferred by Venture Capital to ABC Company Limited.

The accounts manager has received the following additional information from venture capital on 31.03.2020:

(1) 8 Crores has been deducted from the cost of investment and carrying amount of investment as at year end is 2 Crores.

(2) Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 4 Crores.

(3) Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

SOLUTION :

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	Amount (₹ in Crores)
Sales Consideration	8
Cost of Investment	4
Net gain on Sale	4
Tax @ 20%	0.8

As per AS 22, Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Particulars	Amount (₹ in Crores)	Rationale
Taxable Income	4	As per income tax laws
Accounting Income	Nil	As the same is deducted from the cost of investment
Timing Difference	4	

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of ₹ 0.8 Crores and company should recognise only current tax liability of ₹ 0.8 Crores.

QUESTION 26 (CA INTER NOV 2022 5 MARKS)

The following information is furnished in respect of Mohit Limited for the year ending 31st March,2022.

(i) Depreciation as per accounting records ₹ 56,000

Depreciation for income tax records ₹ 38,000

The above depreciation does not include depreciation on new addition.

(ii) A new machinery purchased on 1st April, 2021 costing ₹ 24,000 on which 100% depreciation in allowed in the 1st Year for income tax purpose, whereas straight line method of depreciation is considered appropriate for accounting purpose with a life estimation of 4 years.

(ii) The company has made a profit of ₹ 1,28,000 before depreciation and taxes.

(iv) Donation to private trust during the year is ₹ 15,000 (not allowed under Income tax laws.)

(v) Corporate tax is 40%.

Prepare relevant extract of statement of Profit & Loss for the year ending 31 st March, 2022. Also show the effect of the above items on Deferred Tax Liability/Assets as per AS 22.

SOLUTION :

Statement of profit and Loss for the year ended 31st March, 2022

	₹
Profit before taxes and depreciation	1,28,000
Less: Depreciation (56,000+ 6,000)	62,000
Profit before tax	66,000
Less: Current tax (W.N)	(32,400)
Deferred Tax	Nil
Profit after tax	33,600

Working Note:

Computation of taxable income

	₹
Profit before taxes and depreciation	1,28,000
Less: Depreciation (38,000+ 24,000)	(62,000)
	66,000
Add: Donation*	15,000
	81,000
Current tax (40%)	32,400

Note: The profit of ₹ 1,28,000 given in the question is before depreciation and taxes. It has been considered that this amount is after making adjustment of donation amounting ₹ 15,000.

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

Transactions	Nature of difference	Effect	Amount
(1) Difference in depreciation (old machinery)	Timing difference	Reversal of DTL	₹ 18,000 (56,000 – 38,000) × 40% = (+) ₹ 7,200
(2) Depreciation on new machinery	Timing difference	Creation of DTL	₹ 18,000 (24,000 – 6,000) x 40% = (-) ₹ 7,200
(3) Donation to private trusts	Permanent difference	Not applicable	--
Net Effect of Deferred Tax			NIL

ACCOUNTING STANDARD – 23
ACCOUNTING FOR ASSOCIATES

QUESTION 1

Given below is the information the shareholding/investment pattern of A Limited, B Limited and C Limited:

A Limited	B Limited	C Limited
Investments in 3,00,000 equity shares of B Limited Investments in 1,00,000 equity shares of C Limited	Share capital: 500000 equity shares capital of ₹10 each: ₹50Lacs Investments in 1,00,000 equity shares of C Limited	Share capital: 1000000 shares of ₹10 each : 100Lacs

QUESTION 2

Rainyday Limited acquire 40% of Simpaul Limited's shares on April 2, 2001 the price paid was ₹1,40,000. Simpaul Limited shareholder equity shares are as follows:

Equity shares (paid up)	1,00,000
Share premium	2,50,000
Retained earning	1,00,000
	4,50,000

Further Simpaul Limited reported a net income of ₹50,000 and paid dividends of ₹20,000. Rainyday Limited has subsidiary on 31-03-2002. Calculate the amount at which the investment in Simpaul should be shown in the consolidated Balance Sheet of Rainyday Limited as on 31.03.2002.

QUESTION 3

Ram Limited purchased 30% equity shares of Sham Limited on 01.04.2000 at a cost of ₹5 lakhs. On that date Sham Limited equity fund was as under:

	Amount (₹)
Equity share capital	12,00,000
Reserves and surplus	1,00,000

During the years 2000-2001 and 2001-2002 Sham Limited incurred a loss of ₹10 lakhs and ₹15 lakhs respectively. Ram Limited has a subsidiary and is required to prepare consolidated financial statements, how the investments in associates will be shown in consolidated financial statements of Ram Limited?

QUESTION 4

A Limited acquired 30% of B Limited's voting stock for ₹2,00,000 on April 25, 2001. A Limited's 30% interest in B Limited gave grand the ability to exercise significant influence over B Limited's operating financial policies. During the year 2001-2002, A Limited earned ₹8,00,000 and paid dividends of ₹5,00,000. Calculate:

(a) Value of investment to be shown in separate Balance Sheet of A Limited.

(b) Value of investment to be shown in consolidated Balance Sheet of A Limited when consolidation was done.

QUESTION 5

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was

₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

Paid up Equity Share Capital	₹ 10,00,000
Securities Premium	₹ 1,00,000
Reserve & Surplus	₹ 5,00,000

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

SOLUTION :

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars		₹	₹
Investment in B Ltd.	(A)		15,00,000
Equity Shares		10,00,000	
Security Premium		1,00,000	
Reserves & Surplus		5,00,000	
Net Assets		16,00,000	
45% of Net Asset	(B)		7,20,000
Goodwill (A-B)			7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000

Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 x 45%)	1,35,000
Less: Dividend paid (1,00,000 x 45%)	(45,000)
Carrying Amount of Investment	15,90,000

QUESTION 6

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.

QUESTION 7

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

(i) Separate financial statements of Bright Ltd. as on 31-03-20X2;

(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

(iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

QUESTION 8

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000

Fixed Assets	5,00,000
Investments	2,00,000
II. Current Assets	3,00,000
	10,00,000

During the year ended 31.3.20X2 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.

(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

ACCOUNTING STANDARD – 25
INTERIM FINANCIAL REPORTING (IAS 34 & IND AS 34)

QUESTION 1 (C A FINAL NOV 2008)

On 30.6.2007, Asmitha Ltd. incurred ₹ 2,00,000, Net Loss from disposal of a business segment. Also, on 30.7.2007, the company paid ₹ 60,000 for Property taxes Assessed for the calendar year 2007. How the above transactions should be included in determination of Net Income of Asmitha Ltd. for the six months interim period ended on 30.9.2007.

SOLUTION :

According to Para 10 of AS 25 "Interim Financial Reporting", If an enterprise prepares and presnts a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2007, Asmitha Ltd., would report the entire ₹ 2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since ₹ 60,000 Property Tax payment relates to entire calendar year 2007, ₹ 30,000 would be reported as an expense for six months ended on 30th September, 2007 while remaining ₹ 30,000 would be.

QUESTION 2

An enterprise's financial reporting year ends 30 September and its reports quarterly. Its year as per taxation laws ends 31 March. For the financial year that begins 1 October, Year 1 ends 30 September of Year 2 the enterprise earns rs. 100 lakhs pre-tax each quarter. The estimated weighted average annual income tax rate is 30 per cent in Year 1 and 40 per cent in Year 2. Calculate amount of tax expesne for each quarter.

SOLUTION :

The following tabel shows the amount to income tax expense that is reported in each quarter :

(Amount in ₹ lakhs)

	Quarter Ending 31st Dec. Year 1	Quarter Ending 31st Mar. Year 1	Quarter Ending 30th June Year 2	Quarter Ending 30th Sept. Year 2	Year Ending 30th Sept. Year 2
Tax Expense	30	30	40	40	140

QUESTION 3

How should the following be recognized and measured in the interim financial statements :

(i) Gratuity and other defined benefit schemes

(ii) Year end bonus

(iii) Income-tax expense

(iv) Provisions

(v) Foreign currency translation gains and losses.

SOLUTION :

(i) Gratuity and other defined benefit schemes :- Calculated on a year to date basis by using actuarially determined rate at the end of the prior financial year, adjusting or significant events since that time.

(ii) Year end bonus :- Anticipate only, if there is a legal or other obligation and a reliable estimate can be made.

(iii) Income-tax expense :- Apply estimated average annual effective income-tax rate to the pre-tax income of the interim period.

(iv) Provisions :- Same criteria as is used for year end estimates.

(v) Foreign currency translation gains and losses :- Apply same principles as are applied at year end.

QUESTION 4

ABC India Ltd. has ₹ 1,02,000 net income for the quarter ended 31 December, 2003 including the following items :

(a) ₹ 60,000 extraordinary gain received on July 30, 2003, was allocated equally to the second, third and fourth quarter of financial year 2003-2004.

(b) ₹ 16,000 cumulative effect loss resulting from during change in method of inventory valuation method was recognized on November 2, 2003. Out of this loss ₹ 10,000 relates to the previous quarters.

Compute the profit as per AS-25 for the quarter ended 31st December, 2003 of ABC India Ltd.

QUESTION 5

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.

QUESTION 6

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

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

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

QUESTION 7

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

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

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

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

Ascertain the correct quarterly income.

QUESTION 8

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

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

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

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

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

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

SOLUTION :

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

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

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

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

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

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

QUESTION 9

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.

QUESTION 10

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

SOLUTION :

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

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

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

QUESTION 11

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

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

QUESTION 12

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.

GUIDANCE NOTE ON MEASUREMENT OF INCOME TAX EXPENSE FOR INTERIM FINANCIAL REPORTING IN THE CONTEXT OF AS 25

Income tax expense is an important item of interim and annual financial reports. Hence, correct measurement of income tax expense is very important for reporting purposes. This Guidance Note deal with various aspects in the measurement of income tax expense for the purpose of interim financial reporting.

General principles for recognition and measurement as per AS 25

- An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.
- Requiring an enterprise to follow the same accounting principle in interim financial statement as in its annual financial statements suggest that each interim period may be considered as standalone reporting period.
- 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. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.

Measurement of income tax expense

The various steps involved in the measurement of income tax expense for the purpose of interim financial reports are as below:

Step 1 : Estimate the Annual Accounting Income

- Estimate the annual accounting income.
- Take into account all the probable future events and transactions expected to occur during the financial year.

Such an estimate would be on prudent basis, for eg.- depreciation on expected expenditure on acquisition of fixed assets, profits from sale of fixed assets/investments, etc.

Such future events and transactions should be taken into account only if there is a reasonable certainty that the same would take place during the financial year.

Step 2: Estimate the Net Tax Liability for the Financial Year

- Estimate the taxable income for the year.
- Apply the enacted or the substantively enacted tax rate on the taxable income, to arrive at an estimate of the current tax for the year.
- The estimates of tax liability should be based on the estimated deductions, allowances, etc., provided there is a reasonable certainty for the same.
- Estimate deferred tax assets/liabilities as per AS 22

Special considerations

(a) **Where brought forward losses exist from the previous financial year (when deferred tax asset was not recognised on considerations of prudence as per AS 22):**

In such a situation, for estimating the current tax liability, the brought forward losses would have to be deducted from the estimated annual accounting income.

Since such carried forward losses will get set-off during the year, these would not have any tax consequence in future periods.

(b) **Where brought forward losses exist (when deferred tax asset was recognised on the considerations of prudence as per AS 22):**

In such a situation, current tax would be computed in the same manner as explained in (a) above.

However, in the determination of deferred tax, the tax expense arising from the reversal of the deferred tax asset recognised previously, to the extent of reversal of deferred tax asset in the current year, would also be considered.

Step 3: Calculate the Weighted Average Annual Effective Tax Rate

- Determine the weighted average annual effective tax rate by dividing the estimated tax expense (calculated in Step 2 above) by the estimated annual accounting income (calculated in Step 1 above).
- Where different tax rates are applicable to different portions of the estimated annual accounting income, e.g., normal tax rate and a different tax rate for capital gains, calculate the weighted average annual effective tax rate separately for such portions of estimated annual accounting income.

Step 4: Determine Income Tax Expense for Interim Financial Reports

Apply the weighted average annual effective tax rate to the accounting income for the interim period for determining the income tax expense to be recognised in the interim financial reports.

Note:

Tax expense recognised under AS 25 'Interim Financial Statement' is based on Integral approach ie. the interim period is part of the whole accounting year. According to this approach, the said rate is determined on the basis of the taxable income for the whole year, and applied to the accounting income for the interim period in order to determine the amount of tax expense for that interim period.

QUESTOIN 13

When progressive rates of tax are applicable

Estimated annual income	₹ 1 lakh
Tax Rates:	
On first ₹ 40,000	30%
On the balance income	40%
Estimated income of each quarter is	₹ 25,000
Determine the amount of tax expense to be recognised in each of the quarterly financial reports.	

QUESTION 14

When different rates of tax are applicable to different portions of the estimated annual accounting income

Estimated annual income (inclusive of Estimated Capital Gains (earned in Quarter II) ₹ 20,000)	₹ 1 lakh
Tax Rates On Capital Gains	10%
On other income:	
First ₹ 40,000	30%
Balance income	40%
Estimated income of each quarter is	₹ 25,000

Income of ₹ 25,000 for 2nd Quarter includes capital gains of ₹ 20,000.

Assuming there is no difference between the estimated taxable income and the estimated accounting income, calculate the tax expense for each quarter.

ACCOUNTING STANDARD – 27
FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

QUESTION 1

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied the materials for

₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture. Mr. C met all other expenses of advertising, labour and other incidental expenses which turnout to be ₹ 9,00,000. On 30.06.20X1 each of the venturer agreed to take away one flat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along with the interest and net proceeds were shared by the partners equally.

You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

QUESTION 2

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehicles of ₹ 9,00,000 to be depreciated @ 20% p.a.

They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year.

You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

QUESTOIN 3

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd. agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributed equally. A Ltd. invested 49% of total capital but has equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	Dr. (₹)	Cr. (₹)
Purchases	9,00,000	
Other Expenses	3,06,000	
Sales		13,05,000
Property, Plant and Equipment	6,00,000	
Current Assets	2,00,000	
Unsecured Loans		2,00,000
Current Liabilities		1,00,000
Capital		4,01,000

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

QUESTION 4

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	A Ltd.	B Ltd.	C Ltd.
Share Capital	10,00,000	7,50,000	5,00,000
Reserve & Surplus	18,00,000	16,00,000	12,00,000
Loans	3,00,000	4,00,000	2,00,000
Current Liabilities	4,00,000	2,50,000	1,00,000
Property, Plant and Equipment	30,50,000	26,25,000	19,50,000
Investment in JV	2,50,000	2,50,000	-
Current Assets	2,00,000	1,25,000	50,000

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

QUESTION 5

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSR Limited has been in continuous losses for the last 2 yea₹ JVR Limited is willing to reassess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming yea₹ Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

ACCOUNTING STANDARD – 28
IMPAIRMENT OF ASSETS

QUESTION 1

Mohan Ltd. Gives the following estimates of cash flows relating to fixed asset on 31-12-2000. The discount rate is 15%.

Year	Cash Flow (₹ In lakhs)
2001	2000
2002	3000
2003	3000
2004	4000
2005	2000
Residual value at the end of 2005	500

Fixed asset was purchased on 1-1-1998 for ₹ 20,000 lakhs

Useful Life was 8 years

Residual value estimate ₹ 500 lakhs at the end of 8 years. Net selling price ₹ 10,000 laksh.

Calculate on 31-12-2002

a) Carrying amount at the end of 2000

b) Value in use on 31-12-2000

c) Recoverable amount on 31-12-2000

d) Impairment loss to be recognized for the year ended 31-12-2000

e) Revised carrying amount

f) Depreciation charge for 2001

SOLUTION :

Value in use	₹ 9,513 laksh
Carrying amount on 31-12-2000	₹ 12687 lakhs
Net Selling price as given	₹ 10000
Recoverable amount (higher of 9513 and 10000)	
Impairment loss	₹ 2687

Depreciation charge for 2001-) 10,000-500)/ = 1900

QUESTION 2

A Ltd. Acquired S Ltd business on 31-3-2001 for ₹ 5000 lakhs. The details of acquisition are as under:-

Fair value of identifiable asset 4000 lakhs

Good will (to be amortized in 5 years) 1000 lakhs

The anticipated useful life of acquired assets is 8 years. A ltd uses straight line method of depreciation with nil residual values is anticipated On 31-3-2003 A ltd estimated the significant decline in production due to changed Government policies, the net selling price of identifiable asset is not determinable. The cash flow forecast based on recent financial budget for next 6 years after considering changed Govt. policies are as follows, incremental financing cost is 10% which represent current market assessment of the time value of money.

Year	Cash Flow	Year	Cash Flow
2004	700	07	500
2005	700	08	500
2006	700	09	500

Acquired business is a cash generating unit Required: -

a. Value in use

b. Impairment loss

c. Revised carrying amount assets on 31-32003

SOLUTION :

Impairment lass ₹ 926

Revised carrying amount nil @ 2674

QUESTION 3

On 31-3-1999 A Ltd. acquired B Ltd. for ₹ 600 Lakhs. B Ltd. has three cash generating unit X, Y and Z, net fair values of ₹ 240 lakhs. 160 lakhs and 80 1akh respectively. A Ltd recognize goodwill of ₹ 120 Lakhs. For the accounting year ended 31-3-2003, X unit incurred substantial losses and its recoverable amount is estimated to be ₹ 270 laths Carrying amount of different cash generating units are as under :

X	260 lacs
Y	240 lacs
Z	160 lacs

Good will	24 lacs
Total	684 lacs

Calculated the impairment loss to be recognized in Financial statement if goodwill can be allocated on reasonable and consistent basis to cash generating unit.

QUESTION 4

At the end of 200, enterprise M acquired 100% of enterprise Z for ₹ 3,000 lakhs Z has 3 cash generating units A, B and C with Net fair values of ₹ 1,2000 lakhs, ₹ 800 lakhs and ₹ 400 lakhs respectively M recognizes goodwill of ₹ 600 lakhs (₹ 3,000 lakhs less ₹ 2,400 lakhs that relates to Z.

At the end of 2004, a makes significant losses. Its recoverable amount is estimated to be ₹ 1,350 lakhs. Carrying amounts are detailed below:

A 1300 B 1200 C 800 Goodwill 120

Case II Assume: Goodwill cannot Be allocated on a Reasonable and Consistent Basis and Z recoverable amount is ₹ 3400 lakhs

SOLUTION :

Case I Impairment loss ₹ 10 for Goodwill 120

QUESTION 5

X Ltd., is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.2004. Its balance useful life is 5 years and residual value at the end of 5 years is 5 lakhs. Estimated future cash flow using the plant in next 5 years are:-

For the year ended on Estimated cash flow (₹ in lakhs)

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.2005	50
31.32006	30
31.3.2007	30
31.3.2008	20
31.3.2009	20

Calculate "value in USC" for plant if the discount rate is IO% and also calculate 5 the recoverable amount if net selling price of plant on 31.3.2004 is ₹ 60 lakhs.

SOLUTION :

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.2005	50	0.909	45.45
31.3.2006	30	0.826	24.78
31.3.2007	30	0.751	22.53
31.3.2008	20	0.683	13.66
31.3.2009	20	0.620	12.40
			118.82
Present value of residual price on 31.3.2009 = 5x 0.620			3.10
Present value of estimated cash flow by use of an asset and Residual value, which is called " value in use".			121.92

If net selling price of plant on 31.3.2004 is ₹ 60 lakhs , the recoverable amount will be higher of ₹ 121.92 lakhs (value in use) and ₹ 6.60 lakhs (net selling price), hence recoverable amount is ₹ 121.92 lakhs

QUESTION 6

Hari Ltd. gives following estimates to Cash Flows relating to a Fixed Asset on 31st December 2013. The Discount Rate is 15%.

Year	2014	2015	2016	2017	2018
Cash Flow (₹ in Lakhs)	4000	6000	6000	8000	4000

Residual Value at the end of 2018	₹ 1,000 Lakhs
Fixed Asset purchased on 01.01.2011	₹ 40,000 Lakhs
Useful Life	8 Years
Net Selling Price on 31.12.2018	₹ 20,000 Lakhs

Calculate –

(a) Value in Use on 31.12.2013	(d) Impairment Loss for the year ended 31.12.2013
(b) Carrying Amount at the end of 2013	(e) Revised Carrying Amount on 31.12.2013
(c) Recoverable Amount on 31.12.2013	(f) Depreciation charge for the year 2014.

1. **Computation of Value in Use**

Year	Cash Flow	Discount Rate at 15%	Discounted Cash Flow
2014	₹ 4,000 Lakhs	0.870	₹ 3480 Lakhs
2015	₹ 6,000 Lakhs	0.756	₹ 4,536 Lakhs
2016	₹ 6,000 Lakhs	0.658	₹ 3,948 Lakhs
2017	₹ 8,000 Lakhs	0.572	₹ 4,576 Lakhs
2018	₹4,000 + ₹ 1,000 =₹ 5000 Lakhs	0.497	₹ 2485 Lakhs
Value in use			₹ **19,025 Lakhs**

2. **Computation of Other Particulars**

Particulars	₹ Lakhs
1. Original Cost	40,000
2. Depreciation for years 2011, 2012 & 2013 (40000-1,000) × 3/8	(14,625)
3. Carrying Amount on 31.12.2013 (1-2)	25,375
4. Recoverable Amount (Net Selling Price 20,000 (or) Value in Use 19,025 whichever is higher)	20,000
5. Impairment Loss – Carrying Amount Less Recoverable Amount (3-4)	5,375
6. Revised Carrying Amount = Old Carrying Amount Less Impairment Loss (3-5)	20,000
7. Depreciation Charge for 2014 (20,000 – 1,000) ÷ 5 years	

QUESTION 7

Rajesh Industries Ltd is in the business of manufacturing and export in 2011, the Government put a restriction on export of goods exported by Rajesh Industries Ltd. leading to impairment of its assets. Rajesh Industries acquired at the end of 2007, identifiable assets worth ₹ 400 Lakhs for ₹ 600 Lakhs, the balance belong treated as Goodwill. The useful life of the identifiable asset is 15 years and depreciated on straight-line basis. When Government put the restriction at the end of 2011, the Company recognized the impairment loss by determining the recoverable amount of assets at ₹ 272 Lakhs. In 2013, the "restriction" was withdrawn by the Government and due to this favourable change. Rajesh Industries Ltd. estimates its Recoverable Amount at ₹ 342 Lakhs.

(a) Calculate and allocate Impairment Loss in 2011.

(b) Compute reversal of Impairment Loss and its allocation in 2013.

SOLUTION :

1. **Computation and allocation of Impairment Loss for the year ended 31.03.2011**

(₹ Lakhs)

Particulars	**Goodwill**	**Identifiable Assets**	**Total**
(a) Historical Cost	200	400	600
(b) Accumulated/Amortisation for the period 1.4.2007 to 31.3.2011 (Note)	(160) (200x4/5)	107) (400x4/15)	(267)
(c) Carrying Amount (a) – (b)	40	293	333
(d) Recoverable Amount as on 31.3.2011			272
(e) Impairment Loss			61
(f) Impairment Loss allocated first to Goodwill and balance to other assets	(40)	(21)	(61)
(g) Carrying Amount after Impairment Loss (c) – (f)	Nil	272	272

Note: Amortisation period is 5 years as per AS-14.

Particulars	**Goodwill**	**Identifiable Assets**	**Total**
1. Carrying Amount at the end of 2011 after recognition of Impairment Loss (as above)	Nil	272	272
2. Less: Depreciation /Amoritsation for 2 years	Nil	(49) (272x2/11)	(49)
3. Carrying Amount at the end of 2013 (1) – (2)	Nil	223	223
4. Carrying amount at the end of 2013 had there been no impairment (Cost less accumulated Depreciation)	Nil	240	240

5. Recoverable Amount at the end of 2013 (Given)			342
6. Total Impairment Loss to be reversed (5) – (3)			119
7. Impairment Loss that can be reversed (4) - (3) or (6) whichever is lower			17
8. Revised Carrying Amount at the end of 2013 (3) + (7) This amount should not exceed (4)			240

QUESTION 8

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

Year	**Cash Flow (₹ in lakhs)**
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000
Residual value at the end of 20X6 =	₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-20XX =	₹ 40,000 lakhs
Useful life =	8 years
Net selling price on 31-12-20X1 =	₹ 20,000 lakhs
Calculate on 31-12-20X1:	

(a) Carrying amount at the end of 20X1

(b) Value in use on 31-12-20X1

(c) Recoverable amount on 31-12-20X1

(d) Impairment loss to be recognized for the year ended 31-12-20X1

(e) Revised carrying amount

(f) Depreciation charge for 20X2.

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

QUESTION 9

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹ 60 lakhs.

QUESTION 10

G Ltd., acquired a machine on 1st April, 20X0 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

QUESTION 11

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs?

QUESTION 12

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognized as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognized as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

SOLUTION :

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent of each other and that each magazine title is a separate cash-generating unit.

QUESTION 13

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?

QUESTION 14

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

SOLUTION :

(i) Recoverable amount is higher of value in use ₹ 400 lakhs and net selling price ₹ 375 lakhs.

Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹ 500 lakhs – ₹ 400 lakhs = ₹ 100 lakhs.

(ii) Journal Entries

	Particulars	Dr. Amount (₹ in lakhs)	Cr. Amount (₹ in lakhs)
(i)	Impairment loss account Dr.	100	
	To Provision for Accumulated Impairment Loss Account		100
	(Being the entry for accounting impairment loss)		
(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairment loss to profit and loss account)		

(iii) **Balance Sheet of Venus Ltd. as on 31.3.20X1**

	(₹ in lakhs)
Fixed Asset	
Asset less depreciation	500
Less: Impairment loss	(100)
	400

QUESTION 15

From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset:

Cost of asset	₹ 56 lakhs
Useful life period	10 years

Salvage value	Nil
Current carrying value	₹ 27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹ 12 lakhs
Upward revaluation done in last year	₹ 14 lakhs

QUESTION 16

A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹ 4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹ 25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was ₹ 30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.

Its value in use has been computed at ₹ 35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?

(ii) How much will be the amount of write off for the financial year ended 31st March, 20X2?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 12 lakhs, how would you answer to questions (i) and (ii) above?

(iv) If the value in use was zero and the enterprise were required to incur a cost of ₹ 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

NOTES

ACCOUNTING STANDARD: 29

PROVISIONS,CONTINGENT LIABILITIES & CONTINGENT ASSETS

QUESTION 1 (STUDY MATERIAL)

At the end of the financial year ending on 31st December, 2003, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows :

Particulars	Probability	Loss (₹)
In respect of five cases (Win)	100%	---
Next ten cases (Win)	60%	---
Loss (Low damages)	30%	1,20,000
Loss (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	---
Loss (Low damages)	30%	1,00,000
Loss (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.

QUESTION 2 (GOOD QUESTION)

An enterprise operates an offshore oilfield where its licensing agreement requires it to remove the oilrig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted. Analyse under AS - 29.

QUESTION 3

A reail store has a policy of refunding purchases by dissatisfied customers even though it is under no legal obligation to do so. Its policy of making refunds is generally know. Analyse as per AS - 29.

QUESTION 4

Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2005. The enterprise has not fitted the smoke filters. Analyse under AS - 29.

Case I : At the balance sheet date of 31 March, 2005

Case II : At the balance sheet date of 31 March 2006.

QUESTION 5

The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, retraining of staff has taken with financial services regulation. At the balance sheet date, no retaining of staff has taken place. Analyse as per AS - 29.

QUESTION 6

During 2004-05, Enterprise A gives a guarantee of certain borrowing of enterprise B, whose financial condition at that time is sound. During 2005-06, the financial condition of Enterprise B deteriorates and at 30 September 2005 Enterprise B goes into liquidation. Analyse as per AS-29.

Case I : At 31 March 2005

Case II : AS 31st March 2006

QUESTION 7

After a wedding in 2004-05, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the data of approval of the financial statements for the year 31st March 2005, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31 March 2006, its lawyers advise that, owning to development in the case, it is probable that the enterprise will be found liable.

(a) At 31 March 2005

(b) At 31 March 2006

SOLUTION :

As per AS 29 "Provision, Contingent Assets and Contingent Liabilities" Provision should be made if

- ❖ An enterprise has present obligation as a result of pas events.

- An outflow of resources embodying economic benefits in settlement is probable.
- a reliable estimates can be made.

Case 1 :- An outflow of resources embodying economic benefits is not probable hence no provision is required to be made at 31.3.2005. A note can be given on contingent liabilities.

Case 2 :- An outflow resources embodying economic benefit is now probable and hence provision is required to made at 31.3.06.

QUESTION 8

Rajeev Ltd. was under audit for the year -ended 31st March. An appeal filed by Rajeev Ltd. against the demand of GST of ₹ 26 Crores was pending before the Supreme Court for which neither provision was made nor was disclosed in the Notes to the Financial Statements. On 12th July (i.e. subsequent to the Balance Sheet date), the Auditor came to know through paper reports that the point involved in the appeal of Rajeev Ltd. was adjudicated by the Supreme Court in the case of some other assesse, which is in favor of the Department of GST. The Auditor insisted that provisions be made of ₹ 26 crores in the financial statements. The Management was of the view that since its own case is still pending, no provision is called for. It was also of the view that the event does not have any effect on the financial position of the company on the balance sheet date. Is the Management's view correct ?

SOLUTION :

As per AS 29 "Provision, Contingent Assets and Contingent Liabilities" Provision should be made if

- An enterprise has present obligation as a result of pas events.
- An outflow of resources embodying economic benefits in settlement is probable.
- a reliable estimates can be made.

In the given situation

- Obligation event is excise duty demand is already made on the Company. Hence present obligation exists at the Balance Sheet date.
- Outflow of resources to settle the obligation is probable - Additional evidence arising arising after Balance Sheet date lead to the conclusion that the outflow is probable i.e. more likely than not.
- Reliable estimate of the amount - ₹ 26 crores is the amount of the liability (Given).

Hence the condition for recognition of a provision are satisfied, the provision should be recognized for the year ending 31st March. If the amount is material, separate disclosure is also required. The Management's contention is not tenable.

QUESTION 9

Mini Ltd. took a factory premises on lease on 1.4.07 for ₹ 2,00,000 per month. The lease is operating lease. During March 2008, Mini Ltd. relocates its operation to a new factory buildings. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice.

QUESTION 10

WZW Ltd. is in dispute involving allegation of infringement of patents by a Competitor Company who is seeking damages of a huge sum of ₹ 1000 Lakhs. The Directors are of the opinion that the claim can be successfully resisted by the Company. How would you deal the same in the Annual Accounts of the company?

SOLUTION :

Conditions as to recognition of Provision are not satisfied.

Only a Disclosure Note of Contingent Liability is required.

QUESTION 11 (CA FINAL)

Big and Small Ltd. received a show cause notice in December 2014 from the Central Excise department intending to levy a sum of ₹ 25 Lakhs. The Company replied to the above Notice in January 2015 contending that it is not liable for the proposed levy. No further action was initiated by the Central Excise Department up to the finalization of the audit for the year ended on 31st March 2015. As the Auditor of the Company, how would you deal with this matter in your Report?

SOLUTION :

Hint: Conditions relating to recognition of Provision under AS-29 are not satisfied. Hence no need to report the same.

QUESTION 12

Lucky P Limited has been assessed to Income Tax in which a demand of ₹ 10 Lakhs has been made. The Company has gone in appeal. The Company has deposited ₹ 6.00 Lakhs against the demand, on being pursued by the Department. The Company has been advised by its Counsel that there is 80% chance of losing in respect of one of the ground which may end up confirming the demand of 4.00 Lakhs, while on other ground, there is fair chance of winning the appeal. How the Company should treat the same while preparing the Final Accounts for the year ending 31st March 2015?

SOLUTION :

1. **Recognition:** As per AS-29 a Provision should be recognized if the following conditions are satisfied-

Condition (1)	Condition (2)	Condition (3)
Present obligation as a result of past event	Outflow of Resources to settle the obligation is probable.	Reliable estimate of the amount.
Liability for Income Tax existed on the B/S date, as per the Demand Notice. There is a present obligation.	There will be an outflow of resources to settle the obligation, if the Company does not win the case in appeal.	Tax Liability is ascertained at an amount of ₹10 Lakhs, as per the Demand Notice.

Note: Merely because an appeal has been made, the character of the obligation is not lost.

2. **Provision and Contingent Liability:**

(a) Since all the conditions for recognition of a Provision are satisfied, a Provision for Tax Liability ₹4 Lakhs should be recognized for 2014-2015 since the probability of confirmation of demand for this amount is very high 80%. This will be disclosed as "Short Term Provisions" under Current Liabilities.

(b) For the balance portion of ₹ 6 Lakhs, where there is a fair chance of winning the appeal, the Company should disclose a Contingent Liability, in the Notes to Accounts.

(c) The amount paid as Deposit ₹ 6 Lakhs should be shown as "Other Non-Current Assets" in the Financial Statements, along with a clear description of the nature of item.

QUESTION 13 (STUDY MATERIAL)

EXOX limited is in the process of finalizing its accounts for the year ended 31.3.20x2. The company seeks your advice on the following:

(a) The company's sale tax assessment for the assessment year 20X1-X2 has been completed by 14.2.20X4 with a demand of 2.76 crore. The company paid the entire due under protest without prejudice to its right to appeal. The company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(b) The company has entered into a wage agreement in March 20X2 whereby the labour union has accepted a revision in wage from June 20X1. The agreement provided that the hike till March 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September 20x2.

QUESTION 14 (NOV 2019 5 MARKS)

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.

Less than 1 year: 3% provision

More than 1 year: 2% provision

The company has raised invoices as under :

Invoice Date	Amount (₹)
11th Feb, 2017	60,000
25th Dec, 2017	40,000
04th Oct, 2018	1,35,000

Calculate the provision to be made for warranty under AS-29 as at 31st March, 2018 and 31st March, 2019. Also compute amount to be debited to P & L account for the year ended 31st March, 2019.

SOLUTION :

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2018 = ₹ 60,000 x .02 + ₹ 40,000 x .03

= ₹ 1,200 + ₹ 1,200 = ₹ 2,400

As at 31st March, 2019 = ₹ 40,000 x .02 + ₹ 1,35,000 x .03

= ₹ 800 + ₹ 4,050 = ₹ 4,850

Amount debited to Profit and Loss Account for year ended 31st March, 2019

	₹
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 1.4.2018	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31st March, 2019 in respect of sales amounting ₹ 60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

QUESTION 15 (NOV 2020 5 MARKS)

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.

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 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig.

However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

QUESTION 16 (JULY 21 5 MARKS)

A limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the return of sales:

Time frame of Return from date of purchase	% of cumulative sale
Between 0-1 months	6%
Between 1-2 months	7%
Between 2-3 months	8%

The company has made a sale of 36 lacs in the month of January, 48 lacs in the month of February and 60 lacs in the month of March. The total sales for the financial year have been 400 lacs and cost of sale was 320 lacs. You are required to compute Amount of Provision required and Revenue to be recognised.

QUESTION 17

Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 20X1-20X2 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 20X2-20X3 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 20X1-20X2 financial year. As on balance sheet date (31.3.20X2), the goods were not manufactured, and it was unlikely that Sun Ltd. will be able to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

SOLUTION :

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 20X2 and no profit had accrued for the financial year 20X1-20X2. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.

QUESTION 18

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31 st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

SOLUTION :

As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused, there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

QUESTION 19 (CA INTER MAY 2022 5 MARKS)

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalisation of the accounts for the year ended 31 st March,2022 and needs your advice on the following issues in line with the provisions of AS-29:

(i) On 1stApril,2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March,2022, the company does not provide any provision for replacement of lining of the furnace.

(ii) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalization of the case. There are 70% chances that the penalty may not be levied.

SOLUTION :

(i) A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29. The cost of replacement of lining of furnace is not recognized as a provision because it is a future obligation. Even a legal requirement does not require the company to make a provision for the cost of replacement because there is no present obligation. Even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

(ii) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 70% chances that the penalty may not be levied. Accordingly, Alloy Fabrication Ltd. should not make the provision for penalty. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

However, a provision should be made for remaining 40% fees of the lawyer amounting ₹ 2,00,000 in the financial statements of financial year 2021-2022.

QUESTION 20 (CA INTER NOV 2022 5 MARKS)

At the end of the financial year ending on 31stMarch, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Particulars	Probability	Loss (₹)
In respect of five cases (Win)	100%	—
Next ten cases (Win)	50%	—
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases Win	50%	—
Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29.

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 rel iability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases	=	40% of ₹ 12,00,000 + 10% of ₹ 20,00,000
	=	₹ 4,80,000 + ₹ 2,00,000
	=	6,80,000
Expected loss in remaining five cases	=	30% of ₹ 10,00,000 + 20% of ₹ 21,00,000
	=	₹ 3,00,000 + ₹ 4,20,000
	=	₹ 7,20,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of 1,04,00,000 (₹ 6,80,000 x 10 + ₹ 7,20,000 x 5) as contingent liability.

NOTES

BRANCH ACCOUNTS
PART -1
DEPENDENT BRANCHES

QUESTION 1 (DEBTORS METHOD)

Buckingham Bros. Bombay have a branch at Nagpur. They send goods at cost to their branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the Head Office.

From the following, prepare Nagpur branch account in the books of head office:

Opening balances:- 01-01-1998	
Imprest Cash	2,000
Sundry debtors	25,000
Stock of transferred goods from Head office	24,000
Stock of direct purchases	16,000
Cash sales	45,000
Credit sales	1,30,000
Direct purchases	45,000
Returns from customers	3,000
Goods sent to branch from H.O	60,000
Transfer from H.O for Petty Cash expenses	4,000
Bad debts	1,000
Discount to customers	2,000
Remittances to H.O	
(Received by H.O)	1,65,000
Remittances to H.O	
(Not received by H.O)	5,000
Branch Exp directly paid by H.O	30,000

Closing balances: on 31.12.1998	
Stock: Direct purchases	10,000
Transfer from H.O	15,000
Debtors	?
Imprest cash	?

QUESTION 2 (ALL THREE METHODS)

The Bombay trading company invoiced goods to its Delhi branch at cost. Head office paid all the branch expenses from its bank account except petty cash expenses, which were met by the Branch. All the cash collected by the branch was banked on the same day to the credit of the Head office. The following is a summary of the transactions entered into at the branch during the year ended December 31, 1998.

Stock January 1	7,000
Debtors January 1	12,600
Petty cash January 1	200
Goods sent from H.O	26,000
Goods returned to H.O	1,000
Cash sales	17,500
Credit sales	28,400
Allowances to customers	200
Discount to customers	1,400
Bad debts	600
Goods returned by customers	500
Salaries and wages	6,200
Rent and rates	1,200
Sundry expenses	800
Cash received from sundry debtors	28,500
Stock at end of year	6,500
Debtors at the end of year	9,800
Petty cash at end of year	100

Prepare: (a) Branch account (debtors method), (b) Memorandum Branch Trading and Profit and Loss account to prove the results as disclosed by the branch account and (c) Branch Stock account, branch Profit and Loss account, Branch debtors and Branch Expenses account by adopting the stock and debtors Method.

QUESTION 3 (STOCK & DEBTORS METHOD: GIT)

Harrison Limited, Madras has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December 1998.

Cost of goods sent to branch at cost	2,00,000
Goods received by branch till 31.12.1998 at invoice price	2,20,000
Credit sales for the year @ invoice price	1,65,000
Cash sales for the year @ invoice price	59,000
Cash remitted to head office	2,22,500
Expenses paid by H.O	12,000
Bad debts written off	750
Balances as on 1.1.1998	
Stock (at cost)	25,000
Debtors	32,750
Cash in hand	5,000
Balance as on 31.12.1998	
Stock (at invoice price)	28,000
Debtors	26,000
Cash in hand	2,500

Show the necessary ledger accounts in the books of the head office and determine the profit and loss of the Branch for the year ended 31st December 1998.

QUESTION 4 (STOCK & DEBTORS METHOD)

Sell Well Limited who carried on a retail business opened a branch X on January 1st, 1999 where all sales were on credit basis. All goods required by the branch were supplied from the Head Office and were invoiced to the branch at 10% above cost. The following were the transactions:-

	Jan ₹99	Feb ₹99	March₹99
Goods sent to Branch (purchase price)	40,000	50,000	60,000
Sales as shown by the branch monthly	38,000	42,000	55,000
Cash received from debtors and remitted	20,000	51,000	35,000
Returns to H.O (invoice price to Branch)	1,200	600	2,400

The stock of goods held by the branch on March 31, 1999 amounted to ₹53,400 at invoice to branch.

Record these transactions in the Head Office books, showing balances as on 31st March 1999 and the branch gross profit for the three months ended on that date.

All working should form part of your solution.

QUESTION 5 (STOCK & DEBTORS METHOD)

Hindustan Industries Bombay has a branch in Cochin 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 1998, prepare the accounts in the Head office ledger and ascertain the Branch profit. Branch does not maintain any books of account but sends weekly returns to the head office.

Goods received from Head office at invoice price	6,00,000
Returns to Head office at invoice price	12,000
Stock at Cochin as on 1st Jan, 1998	60,000
Sales in the year-cash	2,00,000
Credit	3,60,000
Sundry debtors at cochin as on 1st January 1998	72,000
Cash received from debtors	3,20,000
Discount allowed to debtors	6,000
Bad debts in the year	4,000
Sales returns at cochin branch	8,000
Rent, rates, Taxes at Branch	18,000
Salaries, wages, Bonus at Branch	60,000

Office expenses	6,000
Stock at branch on 31st December 1998 at invoice price	1,20,000

QUESTION 6 (DEBTORS METHOD)

X Limited Bombay started on 1st January 1988 has two branches at Kanpur and Lucknow. All goods sold at the Branches are received from the Head office invoiced at cost plus 25 per cent. All expenses relating to branches are paid by the Head office. All cash collections are remitted daily to Head-office by the Branches. The following particulars relating to the year ended 31st December, 1988 have been extracted from the weekly statements sent by the branches:

	Kanpur ₹	Lucknow ₹
Credit sales	1,25,200	1,10,000
Cash sales	78,600	85,200
Sales returns	2,300	1,200
Sundry debtors	34,500	23,600
Rent and rates	3,200	4,500
Bad debts	6,000	
Salaries	16,000	18,000
General expenses	2,600	1,500
Goods received from H.O	1,50,000	1,25,000
Advertisement	7,500	5,200
Stock on 31st December 1988	45,000	35,000

You are required to prepare the Branch accounts as they would appear in the books of the Head office.

QUESTION 7 (ABNORMAL LOSSES)

Bombay Traders Limited sends goods its Madras Branch at cost plus 25 per cent. The following particulars are available in respect of the Branch for the year ended 31st March, 1988.

Opening stock at Branch at cost to Branch	80,000
Goods sent to Branch at invoice price	12,00,000

Loss in Transit at invoice price	15,000
Pilferage at invoice price	6,000
Sales	12,19,000
Expenses	60,000
Closing stock at Branch at cost to Branch	40,000
Recovered from insurance company against loss in transit	10,000

Show ledger accounts in the head office books for:-

(a) Branch stock account

(b) Goods sent to branch account

(c) Branch adjustment account

(d) Branch Profit and Loss account

QUESTION 8 (RETAIL BRANCH)

New Textiles Limited operates a number of retails shops to which goods are invoiced at wholesale price, which is cost plus 20%. Shops sell the goods at the list price, which is wholesale price plus 10%. From the following particulars ascertain the profit or loss for 1997 at shop no: 143:

Stock at shop on January 1 1997	15,000
Goods invoiced to shop during 1997	1,40,000
Sale at the shop during the year	1,54,770
Goods destroyed by accident (retail value)	660
Expenses at the shop	7,200

QUESTION 9 (DEBTORS METHOD)

Arnold BROS. Delhi trades in Ghee and Oil. It has a branch at Lucknow. The company dispatches 25 tins of Oil @ ₹1,000 per tin and 15 tins of Ghee @ ₹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 ₹	Lucknow ₹
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:		01/01/1998	31/12/1998
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 and fixtures		21,500	19,350
Plant and machinery		3,07,250	7,73,500
			(LUCKNOW)
Balance as on:		01/01/1998	31/12/1998
Stock:	Ghee	17,000	13,250
	Oil	27,000	44,750
Debtors		75,750	---
Cash on hand		7,540	12,350
Furniture and fixtures		6,250	5,625
Plant and machinery		---	---

Addition to plant and machinery on 1-1-98 ₹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 ₹2000 p.m. General expense incurred by the Head Office ₹24,000.

Prepare the branch account in the head office books and also prepare the company₹s Trading and Profit and Loss account (excluding branch transactions).

QUESTION 10 (NOV 1997) (BRANCH OPENED FOR PURCHASES)

T of Calcutta has a branch at Dibrugarh. The branch does not maintain separate books of accounts. The branch has the following assets and liabilities on 31st August 1997 and 30th September 1997:

	31st August 1997	30th September 1997
Stock of tea	1,80,000	1,50,000
Advance to suppliers	5,00,000	4,50,000
Bank balance	75,000	1,00,000
Prepaid expenses	10,000	12,000
Outstanding expenses	13,000	11,000
Creditors for purchases	3,00,000	to be ascertained

(a) Received by electronic mail transfer ₹10,00,000 from Calcutta head office

(b) Purchased tea worth ₹12,00,000

(c) Sent tea costing ₹12,30,000 to Calcutta freight of ₹80,000 being payable at the destination by the receiver

(d) Spent ₹25,000 on office expenses

(e) Paid ₹3,00,000 as advance to suppliers

(f) Paid ₹6,50,000 to suppliers in settlement of outstanding dues.

In addition, T informs you that the Calcutta office had directly paid ₹3,50,000 to Dibrugarh suppliers by cheques drawn on bank accounts in Calcutta during the month.

T informs you that for the purpose of accounting Dibrugarh branch is not treated as an outsider. He wants you to write the detailed accounts relating to the transactions of the Dibrugarh branch as would appear in the books of Calcutta head office.

QUESTION 11 (MAY 2001) (DEBTORS METHOD)

Widespread ltd. invoices goods to its branch at cost plus 20 %. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding

₹10000 necessary for meeting immediate requirements of cash. On 31.3.2000 the assets at the branch were as follows:

	(₹000)
Cash in hand	10
Trade debtors	384
Stock at Invoice Price	1080
Furniture and Fittings	500

During the accounting year ended 31.3.2001 the invoice price of goods dispatched by the head office to the branch amounted to ₹1 crore 32 lakh. Out of the goods received by it the branch sent back to head office goods invoiced at ₹72,000. Other transactions at the branch during the year were as follows:

	(₹000)
Cash sales	9700
Credit sales	3140
Cash collected by branch from credit customers	2842
Cash discount allowed to debtors	58
Returns by customers	102
Bad debts written off	37
Expenses paid by the branch	842

On 1st January 2001 the branch purchased new furniture for ₹1 lakh for which payment was made by head office through a cheque.

On 31st March 2001 branch expenses amounting to ₹6000 were outstanding and cash in hand was, again ₹10000. Furniture is subject to depreciation @ 16 % per annum on diminishing balances method.

Prepare branch account in the books of head office for the year ended 31st March 2001.

QUESTION 12 (STOCK & DEBTORS: IBT)

Sell well Limited has two branches in Cochin and Bangalore. During the year ended 31st March 1989, goods have been invoiced to the Cochin branch at 20% above cost and to the Banglore branch at 25% above cost. The branches do not maintain complete books of accounts but the following figures are available for the year ended 31st March 1989:-

	Cochin ₹	Bangalore ₹
Opening stock at invoice price	10,000	10,000
Goods sent to branch at cost	50,000	40,000
Amount remitted Branch	80,000	80,000
Amount remitted by Head office	15,000	15,000
Goods returned by branch at invoice price	3,000	
Cash as on 1.4.1988	2,000	1,000
Cash as on 31.3.1989	1,000	500
Goods returned by customer at branch at selling price	5,000	4,000
Expenses at Branch in cash	9,000	3,000

All sales at the branches are for cash. During the year Cochin branch purchased fixed assets worth ₹4,000 and this amount is included in the figure of branch expenses. Cochin branch transferred to the Bangalore branch stock costing ₹5000 during the year. The Bangalore branch remitted ₹2000 to the Cochin branch also during the year. There was a closing stock of ₹24000 valued at invoice price at the Cochin Branch. There was no closing stock at the Bangalore branch. The branch stock adjustment account in the head office books showed the following position as on 1st April, 1988:-

For Cochin:-₹2500(cr.) For Bangalore-₹2,000(cr.)

Prepare branch stock account, branch adjustment account. Goods sent to Branch account, cash accounts of Branches and Profit and Loss account of branches in the books of Head office books ignoring depreciation.

QUESTION 13 (NOV 1992) (BRANCH FINAL A/CS)

M/s Bright & Co. with its head office in Madras invoiced goods to its branch at Bombay at 20% less than the catalogue price which is cost plus 50%, with instructions that cash sales were to be made at invoice price and credit sales at catalogue price. Discount on credit sale at 15 % on prompt payment will be allowed. From the following particulars available from the branch prepare the branch trading and profit and loss account for the year ended 31st March 1992 in the books of head office, so as to show the actual profit or loss of the branch for the year 1991-92:

	(₹000)
Stock 1-4-1991 (invoice price)	12,000
Goods received form head office (invoice price)	1,32,000
Debtors on 1-4-1991	10,000
Sales (cash)	46,000
Sales (credit)	1,00,000
Cash received from debtors	85,635
Discount allowed to debtors	13,365
Expenses at the branch	6,000
Remittance to the head office	1,20,000
Debtors on 31-3-1992	11,000
Cash in hand on 31-3-1992	5,635
Stock on 31-3-1992 (invoice price)	15,000

It was reported that a part of stock at the branch was lost by fire during the year whose value is to be ascertained and provision should be made for discount to be allowed to debtors as on 31-3-1992 on the basis of the year₹s trend of prompt payment.

QUESTION 14 (MAY 1997) (RETAIL BRANCH)

Rahul Limited operates a number of retail outlets to which goods are invoiced at wholesale price, which is cost plus 25 %. These outlets sells the goods at the retail price, which is wholesale price plus 20 %.

Following is the information regarding one of the outlets for the year ended 31.3.97:

	₹
Stock at the outlet 1.4.96	30,000
Goods invoiced to outlet during the year	3,24,000
Gross profit made by the outlet	60,000
Goods lost by fire	?
Expenses of the outlet for the year	20,000
Stock at the outlet 31.3.97	36,000

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.97:

(a) Outlet stock account

(b) Outlet profit and loss account

QUESTION 15 (ACCOUNTING FOR LOSSES)

The Empire store Limited invoice goods to their various branches at cost and the branches sell on credit as well as for cash. For the following details relating to the Bombay branch, prepare the necessary accounts in the Head Office books:-

Debtors 1st January 1992	26,200
Debtors 31st December 1992	31,100
Cash balance 1st January 1992	300
Stock, 1st January 1992	15,000
Stock 31st December 1992	13,900
Goods received from Head office	50,800
Cash received from Head office	1,500
Goods returned to Head office	700
Cash sales	33,500
Credit sales	60,000
Allowances to customers	320
Returns from customers	580
Discount allowed to customers	2,400
Bad debts	600
Remittance to Head office	74,900
Rent and rates	1,800
Wages and salaries	6,000
General Trade charges	1,300
Normal loss of goods due to Wastage	1,200
Abnormal loss of goods due to pilferage	3000

QUESTION 16 (STOCK & DEBTORS METHOD)

During the year ended 31st December 2002, X & company of Madras sent to their branch at Bombay goods costing ₹1,00,000. They used to invoice to the branch at a price designed to show a gross profit of 33-1/3 per cent on invoice price.

Collections at the branch from debtors amounting to ₹26,390 were all sent to Head office. Branch transactions during the year were:-

Cash sales - ₹1,21,050

Credit sales- ₹27,600

Goods returned by customers- ₹300

Goods returned to Head office – ₹780 (invoice price).

Opening balances:

Stock 2,250

Debtors 1,320

Closing balances:

Stock 2,700

Debtors 2,230

Goods at the branch of ₹1260 (invoice price) were lost. Insurances Company paid ₹730 on the claim. Branch expenses, paid by Head office amount to ₹36,780.

Show the necessary ledger accounts as would appear in the Head office books recording the above the transactions relating to branch Profit and Loss account.

QUESTION 17 (ACCOUNTING FOR LOSSES)

Atlantic paper products send goods to Bhopal branch at cost plus 20%. You are given the following particulars:

Opening stock at branch at its cost	5,000
Goods sent to branch at invoice price	20,000
Loss in transit at invoice price	2,500
Theft at invoice price	1,000
Loss in weight (normal) at invoice price	500
Sales	25,500
Expenses	8,000
Closing stock at branch at cost to Branch	6,000
Claim received from the insurance company for loss in transit.	2,000

You are required to prepare in the head office books:

1. Branch stock account.
2. Branch adjustment account
3. Branch Profit and Loss account

QUESTION 18 (HOME WORK: LOSS 800)

On 1st January 1980 goods costing ₹132000 were invoiced by Madras Head office to its branch at Delhi and charged at selling price to produce a gross profit of 25 per cent on the selling price. At the end of the month the return from Delhi branch showed that the sales were ₹150000. Goods invoiced at ₹1200 to Delhi branch had been returned to Madras Head office. The closing stock at Delhi branch was ₹24000 at selling price. Record the above transactions in Branch stock account in the Head office books and close the said accounts on 31st January 1980.

QUESTION 19 (MAY 2006)

Concept & company with its Head office at Mumbai has a branch at Nagpur. Goods are invoiced to the branch at cost plus 33.33%. The following information is given in respect of the Branch for the year ended 31.3.2006:

	₹
Goods send to branch (invoice price)	4,80,000
Stock at branch on 1.4.2005 (invoice price)	24,000
Cash sales	1,80,000
Return of goods by customers to the branch	6,000
Branch expenses paid in cash	53,500
Branch Debtors balance on 1.4.2005	30,000
Discount allowed	1,000
Bad debts	1,500
Collection from Debtors	2,70,000
Branch Debtors cheques returned dishonored	5,000
Stock at branch on 31.3.2006(invoice price)	48,000
Branch Debtors balance on 31..03.2006	36,500

Prepare under the stock and Debtors system the following ledger accounts in the books of the head office:

(i) Nagpur branch stock account

(ii) Nagpur branch Debtors account

(iii) Nagpur branch adjustment account

Also compute shortage of stock at branch, if any?

SOLUTION:

Branch Stock Account

Particulars	Amount	Particulars	Amount
To Balance b/d	24,000	By Cash sales	1,80,000
To Goods sent to branch (cost)	3,60,000	By Branch Debtors	2,80,000
To Branch adjustment	1,20,000	(credit sales)	
(loading)		By Branch PL a/c	1,500
To Branch Debtors	6,000	By Branch adjust.	500
		(w.n#1)	
		By Balance c/d	48,000
	5,10,000		5,10,000

Branch Debtors Account

Particulars	Amount	Particulars	Amount
To Balance b/d	30,000	By Discounts	1,000
To Bank (dishonored cheque)	5,000	By B. stock	6,000
To Branch stock		(goods returned)	
(credit sales)	2,80,000	By Bad debts	1,500
(Balancing Figure)		By Bank (collection)	2,70,000
		By Balance c/d	36,500
	3,15,000		3,15,000

Branch Adjustment Account

Particulars	Amount	Particulars	Amount
To Branch Stock (Shortage)	5,00	By Stock reserve (opening)	6,000
To Stock Reserve (closing)	12,000	By Branch stock (loading on goods)	1,20,000
To Branch profit and loss account (Balancing Figure)	1,13,500		
	1,26,000		1,26,000

Working note:1

Calculation of shortage (invoice price)

Opening stock	24,000
Goods sent to branch	4,80,000
Goods from Debtors (returned)	6,000
Less: Cash sales	1,80,000
Credit sales	2,80,000
Closing stock	48,000
Shortage (balancing figure)	2,000
Cost of shortage(2,000*100/133.33)	1,500
Loading (2,000*33.33/133.33)	500

Notes:

(i) Shortage is calculated at invoice price. We have assumed that the shortage is an abnormal shortage so it should be divided into two break ups of cost and loading. Cost should be debited to branch profit and loss account and loading in adjustment account.

(ii) In the question, there is no requirement in relation to calculation of profit, so we have not prepared the profit and loss account.

QUESTION 20 (C A MAY 2010) (HOMEWORK)

Ram Limited of Chennai has a branch at Nagpur to which office, goods are invoiced at cost plus 25% . the branch makes sales 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 at Nagpur.

From the following details , relating to the year 2009, prepare the accounts in Head office Ledgr and ascertain branch

Profit. Branch does not maintain any books of accounts , but sends weekly returns to Head Office :

	₹
Goods received from Head Office at invoice price	1,20,000
Returns of head office at invoice price	2,400
Stock at Nagpur Branch on 1.1.2009	12,000
Sale during the year – cash	40,000
Credit	72,000
Debtors at Nagpur Branch	14,400
Cash received from Debtors	64,000
Discounts allowed to debtors	1,200
Bad debts during the year	800
Sales Returns at Nagpur Branch	1,600
Salaries and wages at Branch	12,000
Rent, Rates and taxes at Branch	3,600
Office Expenses at Nagpur Branch	1,200
Stock at Branch on 30.12.2009 at invoice price	24,000

SOLUTION :

Branch net profit 7120

QUESTION 21 (C A MAY 2007)(HOMEWORK)

Red and Co. of Mumbai started a branch at Bangalore on 1.4.2006 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. the branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in

H.O. following further details are given for the year ending on 31.3.2007 :

	₹
Cost of goods sent to branch	1,00,000
Goods received by branch till 31.3.2007 at invoice price	1,08,000
Credit sales for the year	1,16,000
Closing debtors on 31.3.2007	41,600
Bad Debts written off during the year	400
Cash remitted to H.O.	86,000
Closing cash on hadn at branch on 31.3.2007	4,000
Cash remitted by H.O. to branch during the year	6,000
Closing stock in hand at branch at invoice price	12,000
Expenses incurred at branch	24,000

Draw up the necessary Ledger accounts like branch Debtors Account, branch stock account , goods sent to branch account, branch cash Account, branch Expenses Account and branch Adjustments A/c for ascertaining gross profit and branch Profit and loss a/c for ascertaining branch profit.

SOLUTION :

Branch Stock Account

Particulars	Amount	Particulars	Amount
To Balance b/d	NIL	By Cash sales	34,000
To Goods sent to branch (IP)	1,20,000	(REFER CASH A/C)	
		By credit sale	1,16,000
To gross profit	54,000	(credit sales)	
		By Balance c/d	
		Transit	12,000
		Hand	12,000
	1,74,000		1,74,000

Branch Debtors Account

Particulars	Amount	Particulars	Amount
To credit sale	1,16,000	By bad debts	400
(credit sales)		By cash (bal.fig)	74000
		By Balance c/d	41600
	1,16,000		1,16,000

Branch cash Account

Particulars	Amount	Particulars	Amount
To branch debtors	74,000	By HO cash	86,000
To ho cash (received)	6,000	By Branch expenses	24,000
To branch sales (bal.fig)	34,000	By Balance c/d	4,000
	1,14,000		1,14,000

Branch Adjustment Account

Particulars	Amount	Particulars	Amount
To Stock Reserve	4,000	By GSTB	20,000
(closing)		(loading on goods)	
(24000X20/120)			
TO GP	70,000	BY GP	54,000
	74,000		74,000

Branch Expenses Account

Particulars	Amount	Particulars	Amount
To Branch cash	24,000	By branch P&L	24,400
To bad debts	400		
	24,400		24,400

Branch P&L Account

Particulars	Amount	Particulars	Amount
TO BRANCH EXPENSES	24,400	BY GP	70,000
TO NP	45,600		
	70,000		70,000

QUESTION 22 (C A NOV 2010) (RETAIL BRANCH)

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 1.4.2009	2,20,000
Goods sent during the year	11,00,000
Sale 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.

QUESTION 23 (HOMEWORK)

Fanna Cloth Mills opened a branch at Mumbai on is April, 2011. The goods were invoiced to the branch at selling price which was 125% of the cost to the head office.

The following are the particulars of the transactions relating to branch during the year ended 31sf March, 2012:

	₹	₹
Goods sent to branch at cost to head office		4212600
Sales		
Cash	1876050	
Credit	2661450	4537500
Cash collected from debtors		2355000
Discount allowed to debtors		23550
Returns from debtors		15000
Spoiled cloth in bales written off at invoice price		7500
Cheques sent to branch for:		
Rent	108000	
Salaries	270000	
Other Expenses	52500	430500

Prepare Branch Account based on invoice price under Debtors method for ascertaining profit for the year ended 31sf March, 2012.

SOLUTION :

Branch Account

	₹	₹		₹	₹
To Good sent to Branch account		5265750	By H.O.Cash (Remit-tances)		
To Bank-			Sale	1876050	
Rent	108000		Collection from debtors	2355000	4231050
Salaries	270000				
Other Expenses	52500	430500	Goods sent to branch		1053150
To Branch Stock Re-serve (7,35,750x25/125)		147150	Account (Loading) (52,65,750x25/125)		
To H.O. Profit and loss Account		444450			
- Transfer of profit			Balance c/d		
			Branch Stock	735750	
			Branch Debtors	267900	1003650
		6287850			6287850

Working Notes:

Memorandum Branch Stock Account

To Goods Sent to Branch			By Cash- Sale	1876050
Cost	4212600		By Credit Sales	2661450
Add: Loading @ 25%	1053150	5265750	By Abnormal Loss	7500
To Returns from Debtors		15000	-spoiled cloth	
			By Balance c\d	735750
			(Bal.fig.)	
		5280750		5280750

Memorandum Branch Debtors Account

	₹		₹
To Credit Sales	2661450	By Cash collected	2355000
		By Discount allowed	23550
		By Returns	15000
		By Balance c/d (Balancing figure)	2,67,900
	2661450		2661450

QUESTION 24 (DEBTORS METHOD)

LMN is having branch at Mumbai. Goods are invoiced to the branch at 25% profit on sale. B ranch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses, which are met by the Branch. From the following particulars, prepare branch account in the books of head office:

Particular	Amounts (₹)	Particular	Amounts (₹)
Stock as on 1st April, 2013 (Invoice price)	40000	Discount allowed to debtors	300
Sundry Debtors as on 1st April, 2013	25,000	Expenses paid by head office :	
Cash in hand as on 1st April, 2013	1,000	Salary	4,000
Office Furniture as on 1st April, 2013	4,000	Staff Welfare	750
Goods invoiced from head office (invoice price)	1,80,000	Telephone Expenses	1,200
Goods return to head office	6,000	Other Misc. Expenses paid by branch Stock as on 31st March, 2014	700
Goods return by debtors	1,250	(at invoice price)	35,000
cash received from Debtors	65,000	Depreciation to be provided on branch furniture	10% p. a.
Cash Sales	1,20,000		
Credit sales	70,000		

SOLUTION :

In the books of Head office -LMN

Mumbai Branch Account (At invoice price)

Particular		Amount (₹)	Particular		Amount (₹)
To Balance b/d :			By Stock Reserve (opening)		10,000
Stock		40,000	By Remittances		
Debtors		25,000	Cash Sales	1,20,000	
cash in hand		1,000	Cash from Debtors	65,000	1,85,000
Furniture		4,000	By Goods sent to Branch (loading)		45,000
To Goods send to branch		1,80,000	By Good returned by branch (Returns to HO)		6,000
To Goods returned by branch (loading)		1,500	By Balance c/d:		
			Stock		35,000
To Bank (Expenses paid by Head office)			Debtors		28,450
Salary	4000		Cash (₹ 1,000- ₹ 700)		300
Staff	750		Furniture (₹ 4,000- ₹ 400)		3,600
Telephone	1200	5950			
To Stock Reserve (closing)		8750			
To profit Transferred to General profit & Loss A/c		47,150			
		3,13,350			3,13,350

Working Note :

Debtors Account

Particular	Amount (₹)	Particular	Amount (₹)
To Balance b/d	25,000	By Cash A/c	65,000
To Sales A/c (Credit)	70,000	By Sales Return	1,250

		By Discount allowed	300
		By Balance c/d	28,450
	95,000		95,000

QUESTION 25

XYZ Company is having its₹ branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the branch manager. from the following particulars prepare branch account in the books of Head office.

	₹		₹
Stock on 1st April 2010 (invoice price)	30,000	Discount allowed to debtors	160
Sundry debtors on 1st April, 2010	18,000	Expenses paid by head office :	
Cash in hand as on 1st April, 2010	800	Rent	1800
		Salary	3200
Office furniture on 1st April, 2010	3,000	Stationary & Printing petty exp. paid by the branch	800 600
Goods invoiced from the head office (invoice price)	1,60,000	Depreciation to be	
Goods return by Branch	2000	Provided on branch	
		furniture at 10% p.a.	
Goods return by debtors	960		
Cash received from debtors	60,000		
Cash sales	1,00,000	Stock on 31st March	
Credit sales	60,000	2011 (at invoice price)	28,000

SOLUTION :

In the books of Head Office - XYZ Company

Kolkata branch Account (at invoice)

Particular	Amt. (₹)	Particular	Amt. (₹)
To Balance b/d		By Stock reserve (Opening)	6,000
Stock	30,000	By H O CASH (remittances)	
Debtors	18,000	(Daily= 1,00,000+ 60,000)	1,60,000
Petty cash	800	By Loading in GSTB	32,000
Furniture	3,000	By goods returned by	
To goods sent to branch	1,60,000	Branch (Return to H.O.)	2,000
To Goods returned branch (loading)	400	By Balance c/d	
To Bank (expenses paid by H.O.)		Stock	28,000
Rent 1800		Debtors	16,880
Salary 3200		Cash (800-600)	200
Stationery & Printing 800	5,800	Furniture (3,000-300)	2,700
To stock reserve (Closing)	5,600		
To Profit transferred to	24,180		
General Profit & Loss A/c			
	2,47,780		2,47,780

Working Note :

Debtors Account

	₹		₹
To Balance b/d	18,000	By cash account	60,000
To sales account (credit)	60,000	By Sales return account	960
		By Discount allowed account	160
		By balance c/d	16,880
	78,000		78,000

Note : It is assumed that goods returned by branch are at invoice price.

PART-2
INDEPENDENT BRANCHES

QUESTION 26

Ring Bell Limited Delhi has a branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December 1998.

Head Office Trial Balance

	₹	₹
Share capital (Authorised : 10,000 equity shares of ₹100 each)		
Issued: 8,000 equity shares		8,00,000
Profit and Loss account 1.1.98		25,310
Interim dividend paid--August 1998	30,000	
General reserve		1,00,000
fixed assets	5,30,000	
Stock	2,22,470	
Debtors and creditors	50,500	21,900
Profit for the year 1998		82,200
Cash balance	62,730	
Branch current account	1,33,710	
	10,29,410	10,29,410

Branch Trial Balance

	₹	₹
Fixed assets	95,000	
Profit for 1998		31,700
Stock	50,460	
Debtors and creditors	19,100	10,400
Cash balance	6,550	
Head office current account		1,29,010
	1,71,110	1,71,110

The difference between the balances of the current account in the two sets of books is accounted for as follows:

(a) Cash remitted by the branch on 31st December 1998 but received by the Head office on 1st January 1999—₹3,000

(b) Stock stolen in transit from Head office and charged to branch by the Head office but not credited to Head office in the branch books as the branch manager declined to admit any liability (not covered by insurance) – ₹1,700.

Give the branch current account in the Head office books after incorporating branch trial balance through journal. Also prepare the company₹s Balance Sheet as on 31st December 1998.

QUESTION 27

Ashwin, a trader commenced business on 1st January 1995 with a Head office and one branch. Purchases were made exclusively by the Head office where the goods were processed before sale. There was no loss or wastage.

Only processed goods received from head office were handled by the branch and these were charged to the branch at processed cost plus 10 per cent.

All sales whether by head office or the branch were at uniform gross profit of 25 per cent on their respective cost.

The following Trial Balance as on 31st December 1995 was extracted from the books.

Head office Branch

	Debit	Credit	Debit	Credit
	₹	₹	₹	₹
Capital		2,20,000		
Drawings	25,000			
Purchases	19,93,350			
Cost of processing	34,650			
Sales		14,20,000		6,40,000
Goods sent to branch/				
Received by branch		6,51,200	6,40,200	
Selling & General expenses	2,24,000		27,000	
Debtors/Creditors	2,30,000	5,83,350	92,000	2,400
Branch/H.O. current a/c	2,05,550			1,50,800

Balance at bank	1,62,000		34,000	
Total	28,74,550	28,74,550	7,93,200	7,93,200

Further details are:

(a) Goods charged by head office to branch in December 1995 at ₹11,000, were not received by the branch until January 1996. A remittance of ₹43,750 from the branch to head office in December 1996 is still in transit.

(b) Stock taking at branch disclosed shortage of ₹5,000 (at selling price).

(c) Cost of unprocessed goods at head office as on 31st December 1995 was ₹1,80,000.

You are required to prepare in columnar form Profit and Loss account and Balance Sheet of the head office, branch and the business as whole.

QUESTION 28 (NOV.2005)

M/s. Shah & Co. commenced business on 1.4.2004 with a Head office and one branch. Purchases were made exclusively by the Head office where the goods were processed before sale. There was no loss or wastage.

Only processed goods received from head office were handled by the branch and these were charged to the branch at processed cost plus 10 per cent.

All sales whether by head office or the branch were at uniform gross profit of 25 per cent on their respective cost.

The following Trial Balance as on 31.03.2005 was extracted from the books.

Head office Branch

	Debit	Credit	Debit	Credit
	₹	₹	₹	₹
Capital		3,10,000		
Drawings	55,000			
Purchases	19,69,500			
Cost of processing	50,500			
Sales		12,80,000		8,20,000
Goods sent to branch/				
Received by branch		9,24,000	8,80,000	
Selling & General expenses	50,000		6,200	
Administrative expenses	1,39,000		15,000	

Debtors/Creditors	3,09,600	6,01,400	1,13,600	10,800
Branch/H.O. current a/c	3,89,800			2,61,500
Balance at bank	1,52,000		77,500	
Total	31,15,400	31,15,400	10,92,300	10,92,300

Further details are:

(d) Goods charged by head office to branch in March, 2005 at ₹44,000, were not received by the branch until 2.4.2005.

(e) A remittance of ₹84,300 from the branch to head office was also similarly not received up to 31.3.2005.

(f) Stock taking at branch disclosed shortage of ₹20,000 (at selling price).

(g) Cost of unprocessed goods at head office as on 31.03.2005 was ₹1,00,000.

You are required to prepare in columnar form Profit and Loss account and Balance Sheet of the head office, branch and the business as whole.

QUESTION 29

KP Limited manufactures a range of goods which it sells to wholesale customers only from its head office. In addition the head office 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 head office) 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 include in the overhead costs shown in the trial balances.

From the information given below you are required to prepare for the year ended 31st December 1998 in columnar form:

(a) A Profit and Loss Account for (i) H.O. (ii) the branch (iii) the entire business.

(b) A Balance Sheet as on 31st December 1998 for the entire business.

Head Office Branch

	₹	₹	₹	₹
Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			

Stock on 1-1-98				
Raw material	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			
Inter-unit accounts	5,000		2,300	
Capital		50,000		2,000
Sundry creditors		13,000		
Provision for unrealized profit in stock		1,200		
Sales		2,00,000		
Goods sent to branch		46,000		65,200
Goods received from H.O.			44,500	
	3,10,200	3,10,200	67,200	67,200

Notes:

(a) On 28th December 1998 the branch remitted ₹1,500 to head office and this has not yet been recorded in the head office books. Also on the same date, the head office dispatched goods to the branch invoiced at ₹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.

(b) The stock of raw materials held at the head office on 31st December 1998 was valued at ₹2,300

(c) You are advised that:

(i) There were no stock losses incurred at the head office or at the branch.

(ii) It is the company ₹s practice to value finished goods stock at the head office at factory cost.

(iii) There were no opening or closing stock of work-in-progress.

(d) Branch employees are entitled to a bonus of ₹156 under a bilateral agreement.

QUESTION 30

AFFIX Limited 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 1997 the Branch Balance Sheet was as follows:

Liabilities	₹	Assets	₹
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 30-9-97 the following transactions took place at Delhi.

	₹		₹
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 ₹2,000)	6,400	Discount earned	1,200
General expenses	1,600	Cash paid to creditors	60,000
Fire insurance (paid for one year)	3,200	Building account (further payment)	4,000
Remittance to head office	38,400	Cash in hand	1,600
		Cash at bank	28,000

Set out the head office account in Delhi books and the Branch Balance Sheet as on 30-9-1997. Also give journal entries in the Delhi books.

QUESTION 31

The following trial balances as at 31st December 1997 have been extracted from the books of Major Limited and its branch at a stage where the only adjustments requiring to be made prior to the preparation of a Balance Sheet for the undertaking as a whole:

Head Office Branch

	Debit ₹	Credit ₹	Debit ₹	Credit ₹
Share capital		1,50,000		
Sundry fixed assets	75,125		18,901	
Sundry current assets	1,21,089		23,715	(Note 3)
Sundry current liabilities		34,567		9,721
Stock reserve, 1st Jan. 997				
(Note 2)		693		
Revenue account		43,210		10,250
Branch account	31,536			
Head office account				22,645
	2,28,470	2,28,470	42,616	42,616

Notes:

(1) Goods transferred from head office to the branch are invoiced at cost plus 10% and both revenue accounts have been prepared on the basis of the prices charged.

(2) Relating to the head office goods held by the branch on 1st January 1997.

(3) Includes goods received from head office at invoice price ₹4,565.

(4) Goods invoiced by head office to branch at ₹3,641 were in transit at 31st December 1997 as was also a remittance of ₹3,500 from the branch.

(5) At 31st December 1997 the following transactions were reflected in the head office books but unrecorded in the branch books:

(a) The purchase price of lorry, ₹2,500 which reached the branch on Dec. 25;

(b) A sum received on December 30,1997 from one of the branch debtors ₹750.

You are required:

(i) To record the foregoing in the appropriate ledger accounts in both set of books.

(ii) To prepare a Balance Sheet as on 31st December 1997 for the undertaking as a whole.

QUESTION 32 (MAY 1996)

Head office passes adjustment entry at the end of each month to adjust the position arising out of inter-branch transactions during the month. Form the following inter-branch transactions in January, 1996, make the entry in the books of Head office:

(a) Bombay branch

(i) Received Goods: ₹6000 from Calcutta Branch, ₹4000 from Patna Branch.

(ii) Sent Goods to: ₹10000 to Patna, ₹8000 to Calcutta.

(iii) Received B/R: ₹6000 from Patna

(iv) Sent Acceptance: ₹4000 to Calcutta, ₹2000 to Patna.

(b) Madras Branch (Apart from the above):

(i) Received goods: ₹10000 from Calcutta, ₹4000 from Bombay.

(ii) Cash sent: ₹2000 to Calcutta, ₹6000 to Bombay

(c) Calcutta Branch (apart from the above):

(i) Sent goods to Patna ₹6000

(ii) Paid B/P: ₹4000 to Patna, ₹4000 cash to Patna.

QUESTION 33 (MAY 2002)

On 31st March 2000 Kanpur branch submits the following trial balance to its head office at Lucknow:

Debit balances	(₹ in lacs)
Furniture and equipment	18
Depreciation on furniture	2
Salaries	25
Rent	10
Advertising	6
Telephone, Postage and Stationary	3
Sundry office expenses	1
Stock on 1.4.1999	60
Goods received from head office	288
Debtors	20
Cash at bank and in hand	8
Carriage inwards	7
	448

Credit balances

Outstanding expenses	3
Goods returned to head office	5
Sales	360
Head office	80
	448

Additional information:

Stock on 31st March 2000 was valued at ₹62 lacs on 29th March 2000 the head office dispatched goods costing ₹10 lacs to its branch. Branch did not receive these goods 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 ₹1,00,000 for centralized services for which the branch has no passed the entry.

You are required to:

(i) Pass journal entries in the books of the branch to make the necessary adjustments.

(ii) Prepare final accounts of the branch including balance sheet and

(iii) Pass journal entries in the books of the head office to incorporate the whole of the Branch Trial Balance.

QUESTION 34

A Madras Head office has an independent Branch at Ahmedabad. From the following particulars, close the books of the Ahmedabad Branch.

Ahmedabad Branch

Trial balance as at 31st December, 2002

Debit balances	Amount	Credit balances	Amount
Stock on 1st Jan 2002	8,200	Creditors	2,700
Purchases	12,800	Sales	34,950
Wages	6,550	Head office A/c	14,000
Manufacturing expenses	3,400	Discount	150
Rent	1,700	Purchase returns	300
Salaries	5,500		
Debtors	4,000		
General expenses	2,000		

Goods received from H.O	7,200		
Cash at bank	750		
	52,100		52,100

(a) Closing stock at branch ₹14,350

(b) The branch fixed assets maintained in H.O books were: machinery ₹25,000, furniture ₹1,000. Depreciation is to be charged at 10 per cent on machinery and 15 per cent on furniture.

(c) Rent due ₹150

(d) A remittance of ₹4000 made by the branch on 28th December, 2002 was received by the H.O on 4th January 2003.

SOLUTION :

Loss ₹400

QUESTION 35

A Calcutta H.O passes one entry at the end of each month to adjust the position arising out of inter branch transactions during the month, from the following inter-branch transaction in April 19—make the entries in the books of Calcutta Head office: (give details of working)

(a) **Delhi Branch:**

a. Received goods from Nagpur Branch ₹9000 and Ahmedabad Branch ₹6000.

b. Sent goods to Ahmedabad branch ₹15,000 and Nagpur Branch ₹12,000.

c. Received bills receivables from Ahmedabad Branch ₹9,000.

d. Sent Acceptances to Nagpur ₹6,000 and Ahmedabad 3,000.

(b) **Kanpur Branch:** (in addition to the above)

a. Received goods from Nagpur branch ₹15,000 and Delhi Branch ₹6,000.

b. Cash sent to Nagpur Branch ₹3,000 and Delhi Branch ₹6,000.

(c) **Nagpur Branch:** (in addition to the above)

a. Sent goods to Ahmedabad Branch ₹9,000.

b. Received bills receivable from Ahmedabad Branch ₹9,000.

c. Received cash from Ahmedabad Branch ₹5000.

QUESTION 36

A Bombay merchant opens a new branch in Delhi, which trades independently of the head office. The transactions of the branch for the year ended 31st March 1990 are as under:

	₹	₹
Goods supplied by Head office		2,00,000
Purchases from outsiders:		
Credit	1,55,500	
Cash	30,000	1,85,500
Sales:		
Credit	2,50,500	
Cash	46,000	2,96,500
Cash received from customers		3,04,500
Cash paid to creditors		1,42,500
Expenses paid by branch		89,500
Furniture purchased by branch on credit		35,000
Cash received from Head office initially		40,000
Remittance to Head office		1,10,000

Prepare the Branch Final Accounts and the Branch Account in Head office books on incorporation of the Brach trial balance in the Head office books after taking the following into consideration:

(a) The accounts of the branch fixed assets are maintained in the Head office books.

(b) Write off depreciation on furniture at 5 per cent per annum for full year.

(c) A remittance of ₹20,000 from the branch to head office is in transit.

(d) The branch values its closing stock at ₹1,20,000.

QUESTION 37

Anil and Sunil are partners of a business having head office in Delhi and Branch at Calcutta. Anil looks after the Delhi office and Sunil books after the Calcutta Branch. Anil is entitled to 40% of the profits made at Delhi while Sunil is entitled to 30% of the profits at Calcutta. The balance profits/losses are shared equally.

The following trial balances as on 31st December, 1981 are furnished to you.

	DELHI HEAD OFFICE		CALCUTTA BRANCH	
	Dr.	Cr.	Dr.	Cr.
Opening stock at cost	30,000	-	40,000	-
Purchases and returns	1,80,000	10,000	2,75,000	15,000
Goods sent to:				
Calcutta	-	50,000	-	-
Delhi	-	-	-	70,000
Goods received from:				
Calcutta	65,000	-	-	-
Delhi	-	-	48,000	-
Sales and returns	15,000	3,15,000	20,000	3,70,000
Expenses	28,000	-	39,000	-
Customer accounts	64,000	4,000	71,000	3,000
Suppliers accounts	2,000	32,000	1,000	51,000
Bank account	70,000	-	-	6,000
Fixed assets opening WDV				
Calcutta branch A/c	50,000	-	80,000	-
Delhi H.O. A/c	-	5,000	-	-
Capital and drawing :	-	-	17,000	-
Anil	30,000	83,000	4,000	35,000
Sunil	5,000	40,000	25,000	70,000
	5,39,000	5,39,000	6,20,000	6,20,000

You are informed that:

(a) On 30th December 1981 Delhi head office remitted ₹5000 by bank draft to Calcutta branch. The envelope was received by the branch on 2nd January 1982.

(b) Stock at cost on 31st December 1981, was worth:-

a. ₹46,000 at Delhi and

b. ₹54,000 at Calcutta

(c) Depreciation is to be provided at 10%.

(d) 10% of the cash expenses relating to the Head office are to be treated as overheads incurred on behalf of the branch.

(e) You are required to prepare the:-

i. Trading and Profit and Loss account both for the branch and H.O.

ii. Consolidated balance sheet of the firm as on 31st December 1981,

iii. Branch and head office accounts of the respective books.

SOLUTION :

Net profit:-branch =76,200, Head office=1,00,800. Balance Sheet total=4,37,000 branch and head office accounts balances in the respective books 7200

QUESTION 38

Unique products operates from a head office in Cuttack and a branch in Ranchi. The following trial balance have been extracted from the books of accounts as at 31st March 2000:

	HEAD OFFICE		RANCHI BRANCH	
	Dr.	**Cr.**	**Dr.**	**Cr.**
Capital		20,50,000		
Cash and bank	77,500		65,000	
Debtors and creditors	3,00,000	2,50,000	3,00,000	
Operating expenses	14,02,500		1,07,500	
Branch current account	8,75,000			
Head office account				6,00,000
Bad debt provisions		45,000		12,500
Provision for depreciation		7,00,000		1,50,000
Provision for unrealized profit		20,000		
Opening stock	40,000		1,00,000	
Fixed assets (at cost)	17,50,000		5,00,000	
Drawings	2,00,000			
Sales		42,50,000		21,85,000
Goods sent to branch at invoice price		19,00,000	18,75,000	
Purchases	45,70,000			
	92,15,000	92,15,000	29,47,500	29,47,500

Additional information:

(a) Sock at 31st March 2000 are valued at

1. head office ₹60,000
2. branch ₹75,000(invoice price)

(b) All goods are invoiced at cost plus 25%.

(c) Fixed assets are depreciated at 10% on costs.

(d) Provisions for bad debts are to be maintained at 5% on debtors.

(e) Goods in transit at invoice price from the head office to the branch at ₹25,000

(f) Cash in transit from the branch to the head office ₹2,50,000.

Prepare, in columnar form, the head office and the branch trading and Profit and Loss account for the year ended 31st March 2000 and a Balance Sheet for the business as a whole.

SOLUTION :

H.O= gross profit and net profits =16,00,000 and 52,500

Branch = Gross profit and net profits= 2,85,000 and 1,25,000

(Balance total is 22,77,500)

QUESTION 39 (NOV 2004)

Give journal entries in the books of Branch A to rectify or adjust the following:

(a) Head office expenses ₹3,500 allocated to the Branch, but not recorded in the branch books.

(b) Depreciation of branch assets, whose accounts are kept by the head office not provided for ₹1,500.

(c) Branch paid ₹2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the branch to salaries account.

(d) H.O collected ₹10,000 directly from a customer on behalf of the branch, but no intimation to this effect has been received by the branch

(e) A remittance of ₹15,000 sent by the branch has not yet been received by the head office.

(f) Branch A incurred advertisement expenses of ₹3,000 on behalf of Branch B.

SOLUTION:

JOURNAL ENTRIES

(i)	Expenses Account	Dr.	3500	
	To Head Office Account			3500
(ii)	Depreciation Account	Dr.	1500	
	To Head office Account			1500
(iii)	Head office Account	Dr.	2000	
	To Salaries Account			2000
(iv)	Head Office Account	Dr.	10000	
	To Branch Debtors Accounta			10000
(v)	------------------------NO ENTRY------------------------------			
(vi)	Head office Account	Dr.	3000	
	To Bank Account			300
	(being expenditure is paid on the direction of head office)			

QUESTION 40 (MAY 2003)

Show adjustment journal entries in the books of head office at end of April 2003 for incorporation of inter branch transactions assuming that only head office maintains different branch accounts in its books:

(A) Delhi branch

a. Received goods from Mumbai: ₹35,000 and 15,000 from Kolkata

b. Sent goods to Chennai ₹25,000 and Kolkata ₹20,000

c. Bills receivables received ₹20,000 from Chennai

d. Acceptances sent to Mumbai ₹25,000, Kolkata ₹10,000

(B) Mumbai Branch (apart from above)

a. Received goods from Kolkata ₹15,000, Delhi ₹20,000

b. Cash sent to Delhi RS.15,000 and Kolkata ₹7,000

(C) Chennai Branch (apart from above)

a. Received goods from Kolkata ₹30,000

b. Acceptances and cash sent to Kolkata ₹20,000 and ₹10,000 respectively

(D) Kolkata Branch (apart from above)

a. Sent to goods to Chennai ₹35,000

b. Paid cash to Chennai ₹15,000

c. Acceptances sent to Chennai ₹15,000

All working should form part of the answer.

QUESTION 41

The following is the Trial Balance of ICS branch as at 30th june 2002:

	Debit	Credit
H.O account	32,400	
Opening stock	60,000	
Purchases	1,78,000	
Goods received from H.O	90,000	
Sales		3,80,000
Goods supplied to H.O		60,000
Salaries	15,000	
Debtors	37,000	
Creditors		18,500
Rent	9,600	
Office expenses	4,700	
Cash in hand and at bank	17,800	
Furniture	14,000	
	4,58,500	4,58,500

Additional information:

(a) Stock on hand was valued at ₹27,000

(b) The branch account in the head office books on 30th June 2002 stood at ₹4600 debit

(c) On 28th June 2002, the Head office forwarded goods to the value of ₹25,000 to the branch where they were received on 3rd July 2002.

(d) A cash remittance of ₹12,000 by branch on 24th June was received by H.O on July 1.

Required:

(a) Journal entries necessary to incorporate the above trial balance

(b) The results of trading at branch

(c) ICS branch account in the books of H.O

SOLUTION : 1,09,700

QUESTION 42

The head office of Ganpati company and its branch keep their own books prepare own profit and loss account. The following are the balances appearing in the two sets of the books as on 31.3.2004 after ascertainment of profits and after making all adjustments except those referred to below:

Particulars	Head office		Branch office	
Capital	-	10,00,000	-	-
Fixed assets	3,60,000	-	1,60,000	-
Stock	3,42,000	-	1,07,400	-
Debtors and creditors	78,200	39,600	48,400	19,200
Cash	1,07,400	-	14,200	-
Profit and loss account	-	1,46,600	-	30,600
Branch account	2,98,600	-	-	-
Head office account	-	-	-	2,80,200
Total	11,86,200	11,86,200	3,30,000	3,30,000

Set out the Balance Sheet of the business as on 31.03.2004 and the journal entries necessary (in both sets of books) to record the adjustments dealing with the following:

1. On 31.3.2004 the branch had sent a cheque for ₹10,000 to the head office, not received by the head office nor credited to the branch till next month.
2. Goods valued at ₹4400 had been forwarded by the head office to the branch and invoiced on 30.3.2004 but were not received by the branch nor dealt with in their books till next month.
3. It was agreed that the branch should be charged with ₹3000 for administration services rendered by the head office during the year.
4. Stock stolen in transit from the head office to the branch and charged to the branch by the head office but not credited to the head office in the branch books as the manager declined to admit any liability , ₹4000 (not covered by the insurance)
5. Depreciation of branch assets of which accounts are maintained by head office not provided for ₹2500.
6. The balance profits shown by the branch is to be transferred to head office books.

SOLUTION:

Balance Sheet Of Ganpati Co. as at 31.03.2004

Liabilities	₹	₹	Assets	₹	₹
Capital	10,00,000		**Fixed assets:**		
Add: net profit:			Head office	3,60,000	
Head office	1,45,600		Branch	1,60,000	
Branch	25,100	11,70,700	**Less:**		5,17,500
			depreciation	(2,500)	
			Stock:		
Creditors:			Head office	3,42,000	
Head office	39,600		Branch	1,07,400	
Branch	19,200	58,800	In transit	4,400	4,53,800
			Debtors:		
			Head office	78,200	
			Branch	48,400	1,26,600
			Cash:		
			Head office	1,07,400	
			Branch	14,200	
			In transit	10,000	1,31,600
		12,29,500			12,29,500

Journal entries in the books of Head office

S.No.	Particulars		Dr	Cr
1.	Cash in transit A/c	Dr.	10,000	
	To Branch A/c			10,000
2.	Branch A/c	Dr.	3,000	
	To profit and loss a/c			3,000
3.	Profit and loss account	Dr.	4,000	
	To Branch A/c			4,000

4.	Branch A/c	Dr.	2,500	
	To fixed Assets account			2,500
5.	Branch profit and loss account	Dr.	25,100	
	To profit and loss account			25,100

HEAD OFFICE PROFIT AND LOSS ACCOUNT

Particulars	Amount	Particulars	Amount
To branch-stock stolen	4,000	By balance b/d	1,46,600
To profit -transferred	1,45,600	By branch- expenses	3,000
	1,49,600		1,49,600

Journal entries in the Books of Branch

S.No.	Particulars		Dr	Cr
1.	Goods in Transit A/c	Dr.	4,400	
	To Head office A/c			4,400
2.	Profit and loss account	Dr.	3,000	
	To Head office a/c			3,000
3.	Profit and loss account	Dr.	2,500	
	To head office A/c			2,500
5.	Profit and loss account	Dr.	25,100	
	To Head office Account			25,100
	(being profit transferred to head office account)			

BRANH OFFICE PROFIT AND LOSS ACCOUNT

Particulars	Amount	Particulars	Amount
To head office-expenses	3,000	By balance b/d	30,600
To head office-depreciation	2,500		
To profit-transferred to H.O	25,100		
	30,600		30,600

QUESTION 43 (CA NOV 2008)(2MARKS)

Goods worth ₹ 50,000 sent by head office but the branch has received till the closing date goods only ₹ 40,000. Give journal entry in the books of H.O. and branch for goods in transit.

SOLUTION :

Goods in Transit A/c Dr.	10,000	
To Head Office A/c		10,000

QUESTION 44 (CA INTER MAY 2007 2 MARKS)

Alpha & Co. Having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account .on 31.3.2007, it was found that the goods dispatched by head office for ₹ 2,00,000 was received by the branch only to the extent of ₹ 1,50,000. The balance goods are in transit. What is the accounting entry to be passed by the branch for recording the goods in transit, in its books?

SOLUTION :

Nagpur branch must include the inventory in its books as goods in transit.

The following journal entry must be made by the branch:

Goods in Transit A/c Dr.	50,000	
To Head Office A/c		50,000

QUESTION 45

Messrs Ramhand & Co., Hydera bad have a branch in Delhi. The Delhi Branch deals not only in the goods from Head Office but also buys some auxiliary goods and deals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the year and open them afresh on the basis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office.

The goods from the Head Office are in voiced at selling prices to give a profit of 20 per cent on the sale price. The goods sent from the branch to Head Office are at cost. From the following prepare Branch Trading and Profit & Loss Account and Branch Assets Account in the Head Office Books.

Trail Balance of the Delhi Branch as on 31-12-2012

Debit	₹	Credit	₹
Head office opening balance on 1-1-12	15000	Sales	100000
Goods from H.O	50000	Goods to H.O	3000

Purchase	20000	Head office current A/c	15000
Opening stock		Sundry Creditors	3000
(H.O. goods at invoice prices)	4000		
Opening stock of other goods	500		
Salaries	7000		
Rent	3000		
Office expenditure	2000		
Cash on Hand	500		
Cash at Bank	4000		
Sundry Debtors	15000		
	121000		121000

The Branch balances as on 1st January, 2012, were as under: Furniture 5,000 Sundry Debtors ₹ 9,500: Cash 1,000. Creditors 30,000: Stock (HO. goods at invoice price) 4,000; other goods 500. The closing stock at branch of the head office goods at invoice price is 3,000 and that of purchased goods at cost is 1,000. Depreciation is to be provided at 10 per cent on branch assets.

SOLUTION :

Delhi Branch Trading and Profit & Loss Account
for the year ended 31st Dec., 2012

	₹		₹
To opening Stock		By Sales	1,00,000
Head office Goods 3,200		By Goods from Branch	3,000
Other 500	3700	By Closing Stock:	
To Goods to Branch	40000	Head Office goods 2,400	
To Purchase	20000	Other 1,000	3,400
To Gross profit c/d	42700		
	1,06,400		1,06,400
To Salaries	7,000	By Gross profit b/d	42,700

To Rent	3000		
To office Expenses	2000		
To Dep. on furniture @ 10%	500		
To Net Profit	30,200		
	42,700		42700

Branch (Fixed) Assets Account (In Head office Books)

2012		₹	2012		₹
Jan.1	To Balance b/d	5000	Dec. 31	By Delhi Branch A/c (Depreciation)	500
				By Balance c/d	4,500
		5000			5000
2013 Jan.1	To Balance b/d	4500			

QUESTION 46 (2007 - NOV [4])

Beta Ltd. having office at Mumbai has a branch at Nagpur. The Head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz.., Cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st march, 2007:

	Head Office ₹	Branch ₹
Opening Stock (as on 1.4.2006)	2,25,000	-
Purchases	25,50,000	-
Goods sent to Brach	9,54,000	-
(Cost to H.O. plus 80%)		
Sales	27,81,000	9,50,000
Office expenses	90,000	8,500
Selling expenses	72,000	6,300
Staff Salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the Head Office and Branch for the year ended 31st March, 2007.

SOLUTION:

Trading & P&L A/c of the Branch

Particulars	₹	Particulars	₹
To Op Stock	-	By Sales	9,50,000
To Goods received from H.O.	9,54,000	By closing (W.N.-1)	99,000
To Gross Profit c/d	95,000		
	10,49,000		10,49,000
To Office exp.	8,500	By Gross Profit b/d	95,000
To Selling exp.	6,300		
To Staff salary	12,000		
To Net profit	68,200		
	95,000		95,000

Trading & P&L A/c the of H.O.

Particulars	₹	**Particulars**	₹
To Opening Stock	2,25,000	By Sales	27,81,000
To purchase	25,50,000	By goods sold to branch	9,54,000
To G.P. c/d	16,60,000	By closing (W.N.-2)	7,00,000
	44,35,000		44,35,000
To Office expenses	90,000	By Gross Profit b/d	16,60,000
To selling expenses	72,000		
To Staff Salary	65,000		
To Branch Stock Revenue (WN-1)	44,000		
To Net Profit	13,89,000		
	16,60,000		16,60,000

Working Notes:

1.	**Calculation of closing stock of branch:**	
		₹
	Goods received from head office [at invoice value]	9,54,000
	Less : Invoice value of goods sold [9,50,000 x 180/200]	8,55,000
2.	**Calculation of closing stock of head office:**	₹
	Opening stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold	
	[(27,81,000 + 9,54,000) x 100/ 180]	20,75,000
		7,00,000
3.	**Calculation of unrealised profit in branch stock :**	₹
	Branch stock	99,000
	Profit included	80% of cost
	Therefore , unrealised profit would be = ₹ 99,000 x 80/180	₹ 44, 000

QUESTION 47 (2014- MAY [6])

Pass necessary Journal entries in the books of an independent Branch of a company, wherever required, to rectify or adjust the following :

(i) Income of ₹ 2,800 allocated to the branch by Head office but not recorded in the branch books

(ii) Provision for doubtful debts, whose accounts are kept by the Head office, not provided earlier for ₹ 1,000.

(iii) Branch paid ₹ 3,000 as salary to a Head Office Manager , but the amount paid has been debited by the Branch to Salaries Account.

(iv) Branch incurred travelling expenses of ₹ 5,000 on behalf of Branches, but not recorded in the books of Branch.

(v) A remittance of ₹ 1,50,000 sent by the branch has not received by Head office on the date of reconciliation Accounts.

(vi) Head office allocated ₹ 75,000 to the branch as Head office expenses, which has not yet been recorded by the Branch.

(vii) Head office collected ₹ 30,000 directly from a branch Customer. The intimation of the fact has been received by the branch only now.

(viii) Goods dispatched by the Head Office amounting ₹ 10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

QUESTION 48 {2011- NOV}

Global Limited has a branch which closes its books of account every year on 31st March, This is an independent branch which maintains comprehensive books of account for recording their transactions.

You are required to show journal entries in the books of branch on 31st March, 2011 to rectify or adjust the following :

(i) Head Office allocates ₹ 1,35,000 to the branch as head office expenses, which have not yet been recorded by branch.

(ii) Deprecation of branch fixed assets, whose account are kept by head office in its books, not yet recorded in the branch books ₹ 1,15,000.

(iii) Branch paid ₹ 1,40,000 as salary to an official from head office on visit to branch and debited the amount to its Salaries Account.

(iv) Head office collected ₹ 1,30,000 directly from a branch customer on behalf of the branch, but no intimation was received earlier by the branch. Now the branch learns about it.

(v) It is learnt that a remittance of ₹ 1,50,000 sent by the branch has not been received by head office till date.

SOLUTION :

In the books of Branch

Journal Entries

S.No.	Particulars	Dr. (R)	Cr. (R)
(i)	Expenses A/c Dr. To Global Limited (H.O.) A/c (Being expenses allocated to branch by head office	1,35,000	1,35,000
(ii)	Deprecation a/c Dr. To Global Limited (H.O.) A/c (Being depreciation on fixed assets of branch , whose account are maintained by head office)	1,15,000	1,15,000

(iii)	Global Limited (H.O.) A/c Dr. To Salaries A/c (Being the rectification of salary paid, on behalf of the head office)	1,40,000	1,40,000
(iv)	Global Limited (H.O.) A/c Dr. To Debtors A/c (Being adjustment of direct collection from branch debtors, by head office)	1,30,000	1,30,000

QUESTION 49 {2012- NOV}

Give Journal Entries in the books of Head office to rectify or adjusted the following :

(i) Goods sent to branch ₹ 12,000 stolen during transit, branch manager refused to accept any liability.

(ii) Branch paid ₹ 15,000 as salary to the officer of head office on his visit to the branch.

(iii) On 28th March, 2012, The H.O. dispatched goods to the branch invoiced at ₹ 25,000 which was not received by branch till 31st March, 2012.

(iv) A remittance of ₹ 10,000 sent by the branch on 30th March, 2012, received by the head office on 1st April, 2012.

SOLUTION :

In the books head office

Journal entries

	Particulars	Dr. Amount ₹	Cr. Amount
(i)	Loss of goods due to theft during transit Dr. To Branch Account (Being goods lost on account of theft during transit.	12,000	12,000
(ii)	Salaries account Dr. To Branch account (Being salary paid by the branch for H.O. employee)	15,000	15,000

(iii)	No entry in the books of head office for goods sent to branch not received by branch till 31st March, 2012.		
(iv)	Cash in transit account Dr. To branch account (being remittance by branch not received by 31st March, 2012)	10,000	10,000

PART-3
FOREIGN BRANCHES (AS 11)

QUESTION 50

The New York branch of Fine Textiles Limited, Delhi sent the following Trial Balances as on 31st December 19X9.

	$	$
Fixed assets	1,20,000	
Stock 1st January 19X9	56,000	
Goods from head office	3,20,000	
Sales		4,20,000
Expenses	25,000	
Debtors and Creditors	24,000	17,000
Cash at bank	6,000	
Head office account		1,14,000
	5,51,000	5,51,000

In the head office books the branch account stood as shown below:

New York Branch Account

	Debit		Credit
	₹		₹
To Balance b/d	10,05,000	By Cash	26,08,000
To Goods sent to branch	24,63,000	By Balance c/d	8,60,000
	34,68,000		34,68,000

Goods are invoiced to the branch at cost plus 10% and branch has instruction to sell at invoice price plus 25%. Fixed assets were acquired on 1st January 19X1 when $ 100 = ₹380. Rates of exchange were:

1st January 19X9	$ 100 = ₹760
31st December 19X9	$ 100 = ₹770
Average	$ 100 = ₹750

Fixed assets have to be depreciated by 10% and the branch manager is entitled to commission of 5% on the profit of the branch (on invoice price basis).

You are required to convert the branch Trial Balance into rupees and prepare the Branch Trading and Profit and Loss account and the Branch Account.

QUESTION 51

The New York branch of Delhi Export House sent the following Trial Balance as on 31-12-19X3.

	$ Debit	$ Credit
Fixed assets	17,500	
Loan (taken to purchase fixed assets)		13,000
Depreciation	2,500	
Stock 1-1-X3	8,200	
Goods from Head office	58,800	
Sales		1,05,200
Salaries and wages	15,200	
Interest	2,880	
Cash at bank	1,700	
Debtors	21,200	
Head Office account		9,780
	1,27,980	1,27,980

Fixed assets were purchased on 1-1-X1 when $1 = ₹25.50, life was estimated to be 10 years. To finance the fixed asset a loan amounting to $ 22,000 was taken @ 18% interest per annum. Annual loan instalment of 3,000 and interest were payable in every December.

Exchange Rates:

Average of 19X1	$1 = ₹25.70	
31-12-19X1		$1 = ₹26.10
Average of 19X2	$1 = ₹26.20	
31-12-X2		$1 = ₹26.40
Average of 19X3	$1 = ₹36.50	
31-12-X3		$1 = ₹42.20

In the Head office books London Branch account appeared as follows:

New York Branch Account

	$	₹		$	₹
To Balance b/d	7,000	1,84,800	By Bank	56,020	20,44,730
To Goods	58,800	21,46,200	By Balance	9,780	4,12,716
To P & L a/c		1,26,446			
Exchange gain					
	65,800	24,57,446		65,800	24,57,446

Closing Stock : $ 2,400

You are required to show:

(1) Branch Fixed A/c, (2) Branch Loan A/c, (3) Branch Trial Balance in Rupee Terms, (4) Branch Profit and Loss A/c (5) Adjustment Entries to incorporate branch balances in the head office loans.

QUESTION 52 (NOV 1999)

An Indian company has a branch at Washington. Its trial balance as on 30th September 1998 is as follows:

	Dr.	Cr.
	US $	US $
Plant and machinery	1,20,000	—
Furniture and fixtures	8,000	—
Stock, October 1,1997	56,000	—
Purchases	2,40,000	—
Sales	—	4,16,000
Goods from Indian co. (H.O.)	80,000	—
Wages	2,000	—
Carriage inward	1,000	—
Salaries	6,000	—
Rent, rates and taxes	2,000	—
Insurance	1,000	—

Trade expenses	1,000	—
Head Office a/c	—	1,14,000
Trade debtors	24,000	—
Trade creditors	—	17,000
Cash at bank	5,000	—
Cash in hand	1,000	—
US $	5,47,000	5,47,000

The following information is given:

(i) Wages outstanding-- $ 1000

(ii) Depreciation Plant and Machinery and furniture and fixtures @ 10 % p.a.

(iii) The head office sent goods to branch for ₹39,40,000.

(iv) The head office shows an amount of ₹43,00,000 due from branch.

(v) Stock on 30th September 1998 -- $ 52,000.

(vi) There were no in transit items either at the start or at the end of the year.

(vii) On September 1, 1996, when the fixed assets were purchased the rate of exchange was ₹38 to one $.

On October 1,1997 the rate was RS.39 to one $.

On September 30,1998 the rate was ₹41 to one $.

Average rate during the year was ₹40 to one $.

You are asked to prepare:

(a) Trial Balance incorporating adjustments given under 1 to 4 above, converting dollars into rupees;

(b) Trading and profit and loss account for the year ended 30th September 1998 and balance sheet as on that date depicting the profitability and net position of the branch as would appear in India for the purpose of purpose of incorporating in the main balance sheet.

QUESTION 53 (MAY 1999)

Carlin & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trial balance as on 31.3.99 and the additional information given thereafter:

	Dr.	Cr.
	(Rupees in thousand)	
Stock on 1.4.1998	300	—
Purchases and sales	800	1,200
Sundry debtors and creditors	400	300
Bill of exchange	120	240
Wages and salaries	560	—
Rent, rates and taxes	360	—
Sundry charges	160	—
Computers	240	—
Bank balance	420	—
New York office A/c	—	1,620
₹	3,360	3,360

Additional information:

(a) Computers were acquired from a remittance of US $ 6000 received from New York head office and paid to the suppliers. Depreciate computers at 60 % for the year.

(b) Unsold stock of Mumbai branch was worth ₹4,20,000, on 31.3.1999.

(c) The rates of exchange may be taken as follows:

(i) On 1.4.1998 @ ₹40 per US $

(ii) On 31.3.1999 @ ₹42 per US $

(iii) Average exchange rate for the year @ ₹41 per US $

(iv) Conversion in $ shall be made up to two decimal accuracy.

You are required to prepare in US dollars the revenue statement for the year

-ended 31.3.1999 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.1999 in New York books and there were no items pending reconciliation.

QUESTION 54 (C A NOV 2009)

DM Ltd. Delhi has a branch in London. London branch is an integral foreign operation of DM Ltd at the end of the year 31st March, 2009, the branch furnishes the following trial balance in U.K. Pound :

Fixed assets (Acquired on 1st April, 2005)	24,000	
Stock as on 1st April, 2008	11,200	
Goods from head office	64,000	
Expenses	4,800	
Debtors	4,800	
Creditors		3,200
Cash at bank	1,200	
Head Office Account		22,800
Purchase	12,000	
Sale		96,000
	1,22,000	**1,22,000**

In head office books, the branch account stood as shown below :

London branch A/c

Dr.			**Cr.**
Particular	**Amount** ₹	**Particular**	**Amount** ₹
To Balance b/d	20,10,000	By bank a/c	52,16,000
To Goods sent to branch	49,26,000	By bank c/d	17,20,000
	69,36,000		69,36,000

The following further information are given:

(a) Fixed assets are to be depreciated @ 10% p.a. straight line basis.

(b) On 31st March , 2008:

Expenses outstanding	£400
Prepared expenses	£200
Closing stock	£ 8,000

(C) Rate of Exchange :

1st April, 2005	-	₹ 70 to £1
1st April, 2008	-	₹ 76 to £1
31st April, 2009		
AVERAGE RATE	-	₹ 77 to £1
	-	RS.75 to £1

You are required to prepare:

(1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees.

(2) Trading and profit and Loss A/c for the year ended 31st march, 2009 and the Balance sheet as on that date of Londaon branch as would appear in the books of Delhi head office of DM Ltd.

SOLUTION:

Gross profit 11,38,800 Net profit 6,08,200 B/S TOTAL 26,05,400

QUESTION 55 (C A MAY 2008)

The Washington branch of XYZ Ltd., Mumbai sent the following trial balance as on 31st December , 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 HO	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

	₹		₹
To Balance b/d	810,000	By cash	28,76,000
To goods sent to branch	29,26,000	By Balances c/d	8,60,000
	37,36,000		**37,36,000**

Goods are sent to the branch at cost plus 10% and the branch sell goods at invoice price plus 25% Machinery were acquired on 31st January, 2002.

When $ 1.00 = ₹ 40 .

Rate of Exchange were

1st January 2007	$ 1.00 = ₹ 46
31st December 2007	$ 41.00 – ₹ 48
Average	$ 1.00 = ₹ 47

Machinery is depreciated @ 10% and the branch manager is entailed to a commission of 5% on the profit of the branch after charging such commission.

You are required to:

(i) Prepare the branch trading & Profit & Loss a/c in Dollars

(ii) Convert the trial balance of the 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) **Trading and Profit & Loss A/c (In Dollars)**

Particular	₹	**Particular**	₹
To Opening Stock	11,200	By Sales	84,000
To Good from H.O.	64,000	By Closing Stock	8,000
To Goods Profit c/d	16,800		
	92,000		**92,000**
To Expenses	5,000	By Gross Profit b/d	16,800
To Depreciation	24000		
To Manager's Commission (WN1)	448		
To Net Profit c/d	8,952		
	16,800		**16,800**

(ii) (a) **Converted Trial Balance**

Particular	Rate per Re.	(Dr. (₹)	Cr (₹)
Machinery	40	9,60,000	
Stock Jan. 1,2007	46	5,15,200	
Good from H.O.	-	29,26,000	
Sales	47	-	39,48,000
Expenses	47	2,35,000	-
Debtors & Creditors	48	2,30,400	163,200
H.O. A/c	-	-	8,60,000
Cash at Bank	-	57600	-
Difference of Exchange	-	47000	-
	-	**49,71,200**	49,71,200
Closing Stock $ 8,000 (WN 2)	48		3,64,000

(b) **Trading and Profit & Loss Account**

Particular	₹	Particular	₹
To Opening Stock	5,15,200	By sales	39,48,000
To Goods from H.O.	29,26,000	By Closing Stock	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	8,90,000
To Depreciation @ 10% on R.s 9,60,000	96,000		
To Exchange differenc-es	47,000		
To Manger₹s Commis-sion (WN1)	21,504		
TO Net Profit c/d	4,91,296		
	8,90,800		8,90,800

Working Notes

(i) Manager₹s Commission = 5/105 of [16,800 – (5,000 + 2.400)] = $ 448 (approx)

Manager₹s Commission in ₹ $448 x 48 = 21,504

(ii) Calculation of closing stock

Opening stock	11,200
Add: Goods from H.O.	64,000
Less: Cost of Goods Sold (at invoice price) [100/125 x 84,000]	(67,200)
Closing Stock	8,000

QUESTION 56 (2010- MAY [1])

On 31st March, 2010, the following Ledger balances have been extracted from the books of Washington branch office :

Ledger A/c	**$**
Building	180
Stock as on 1.4.2009	26
Cash and bank balances	57
Purchases	96
Sales	110
Commission receipts	28
Debtors	46
Creditors	65

You are required to convert above ledger balances into Indian Rupees .

Use the following rates of exchanges:

Opening Rate $ = 46

Closing Rate $ = 50

Average rate $ = 48

For Fixed Assets $ = 42

SOLUTION :

Conversion of ledger balances (in Dollars) into Rupees

Particulars	$	Rate per $	Amount in ₹
Building	180	42	7560
Stock as on 01.04.2009	26	46	1196
Cash and bank balances	57	50	2850
Purchases	96	48	4608
Sales	110	48	5280
Commission receipts	28	48	1344
Debtors	46	50	2300
Creditors	65	50	3250

QUESTION 57 {2013- MAY [6]}

ABCD Ltd . Delhi has a branch in New York, USA, which is an integral foreign operation of the company. At the end on 31st March, 2013, the following ledger balances have been extracted from the books of the Delhi office and the New York Branch.

Particulars	Delhi (₹ thousands)		New York $ thousand	
	Debit	Credit	Debit	Credit
Share capital		1250		
Reserves and Surplus		940		
Land	475			
Building (cost)	1,000			
Buildings Depreciation Reserve		200		
Plant & Machinery (cost)	2,000		100	
Plant & Machinery Depreciation Reserve		500		20
Trade receivables/ payables	500	270	60	20
Stock (01-04-2012)	250		25	
Branch stock Reserve		65		

Cash & Bank Balances	125		4	
Purchases/ Sales	275	600	25	125
Goods sent to branch		1,500	30	
Managing Director₹s salary	50			
Wages & Salaries	100		18	
Rent			6	
Office Expenses	25	12		
Commission receipts		275		100
Branch /H.O. current A/c	800	-	-	15
Total	**5,600**	**5,600**	**280**	**280**

The following information is also available:

(1) Stock as at 31-01-2013

Delhi - ₹ 2,00,000

New york - $ 10 (all stock received from Delhi)

(2) Head office always sent goods to the branch at cost plus 25%

(3) Provision is to be made for doubtful debts at 5%

(4) depreciation is to be provided on Building at 10% and on Building at 10% and on plant and Machinery at 20% on written down values.

You are required.

(a) To convert the Branch Trial balance into rupees, using the following rates of exchange:

Opening Rate	1$ = ₹ 50
Closing rate	1$ = ₹ 55
Average rate	1$ = ₹ 52
For fixed assets	1$ = ₹ 45

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March , 2013, showing to the extent possible, Head office result and branch results separately.

ABCD Ltd.

New York Branch Trial Balance

(As on 31st March, 2013)

Particular	Dr.	Cr.	Conversion rate per $	Dr.	Cr.
Plant & Machinery (cost)	100		₹ 45	4,500	
Plant& Machinery Dep. Reserve		20	₹ 45		900
Trade receivable / payable	60	20	₹ 55	3,300	1,100
Stock (1.4.2012)	25		₹ 50	1,250	
Cash & Bank Balances	4		₹ 55	220	
Purchase /sales	25	125	₹ 52	1,300	6,500
Goods received from H.O.	30			1,500	
Wages & Salaries	18		₹ 52	936	
Rent	6		₹ 52	312	
Office expenses	12		₹ 52	624	
Commission Receipts		100	₹ 52		5,200
H.O. Current A/c		15			800
				13942	14,500
Exchange loss (bal. fig)				558	
				14500	14,500

(b) **Trading and Profit & Loss Account**

for the year ended 31st March, 2013

	H.O.	Branch	Total		H.O.	Branch	Total
To Opening stock	250	1250	1500	By Sales	6600	500	7,100.00
To Purchase	275	1300	1575	By Goods Sent to Branch	1500	-	1500
To Goods re-ceive from Head Office							
To wages & salaries	-	1500	1500	Closing stock	200	0.55	200.55

To Gross Profit c/d	100	936	1036				
	1675	1514.55	3189.55				
	2,300	6500.55	8800.55		2300	6,500.55	3800.55
To Rent	-	312	312	By Gross profit b/d	1675	1514.55	3189.55
To Office expenses	25	624	649	By Commission receipt	275	5200	5475
To Provision for doubtful debts @ 5%	25	165	190				
To Deprecation (W.N.1)	380	720	1100				
To Balance c/d	1520	4893.55	6413.55				
	1950		8664.55		1950	6714.55	8664.55
To Exchange loss			558	By Balance b/d			6413.55
To Managing director's Salary			50	By Branch stock Reserve (W.N.2)			64.89
To balances c/d			5870.44				
			6478.44				6478.44

Working Notes:

(1) **Calculation of Deprecation** **(in ₹000)**

Particular	**H.O.₹**	**Branch ₹**
Building Cost	1,000	
Less: Dep. Reserve	-200	

WDV	800	
Deprecation @ 10% (A)	80	
Plant & Machinery Cost	2,000	4500
Less: Dep. Reserve	(500)	(900)
WDV	1,500	3,600
Depreciation @ 20% (B)	300	720
Total Depreciation (A+B)	380	720

(2) **Calculation of Additional Branch Stock Reserve** **(₹ in ₹ 000)**

Particulars	(₹)
Closing stock of Branch	0.55
Reserve on closing stock (0.55 x 1/5)	0.11
Less: Branch stock reserve (as on 1.4.2012)	(65)
Reversal of stock Reserve	(64.89)

QUESTION 58

On 31st December, 2012 the following balances appeared in the books of Chennai Branch of an English firm having its HO office in New York:

	Amount in ₹	**Amount in ₹**
Stock on 1st Jan., 2012	2,34,000	
Purchases and Sales	1562500	2343750
Debtors and Creditors	765,000	510000
Bills Receivable and Payable	204,000	178500
Salaries and Wages	1,00,000	
Rent, Rates and Taxes	1,06,250	
Furniture	91,000	
Bank A/c	5,68,650	
New York Account	-	599150
	3631400	3631400

Stock on 31st December, 2012 was 6,37,500.

Branch account in New York books showed a debit balance of $13,400 on 31 December, 2012 and Furniture appeared in the Head Office books at $1,750.

The rate of exchange for on 31 December, 2011 was 52 and on 31st December, 2012 was 51. The average rate for the year was 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch.

SOLUTION :

In the books of English Firm (Head Office in New York)

Chennai Branch Profit and Loss Account

for the year ended 31st December, 2012

	$		$
To Opening stock	4500	By Sales	46875
To Purchases	31250	By Closing	12500
To Gross profit c/d	23625	(6,37,500/51)	
	59375		59375
To Salaries	2000	By gross profit	23625
To Rent, rates and taxes	2125		
To Exchange translation loss	2000		
To Net Profit c/d	17500		
	23625		23625

Balance Sheet of Chennai Branch

as on 31st December, 2012

Liabilities	$	$	Assets	$
Head Office A/c	13400		Furniture	1750
Add: Net Profit	17500	30900	Closing Stock	12500
Trade Creditors		10000	Trade Debtors	15000
Bills Payable		3500	Bills Receivable	4000
			Cash at bank	11150
		44400		44400

Working Note:

Calculation of Exchange Translation Loss

Chennai Branch Trial Balance (converted in $)

as on 31st December, 2012

	Dr.	**Cr.**	**Conversion**	**Dr.**	**Cr.**
	₹	₹	**Rate**	**($)**	**($)**
Stock on lst Jan., 2012	234000		52	4500	
Purchases & Sales	1562500	2343750	50	31250	46875
Debtors & creditors	765000	510000	51	15000	10000
Bills Receivable and Bills Payable	204000	178500	51	4000	3500
Salaries and wages	100000		50	2000	
Rent, Rates and Taxes	106250		50	2125	
Furniture	91000			1750	
Bank A/c	568650		51	11150	
New York Account		599150			13400
Exchange translation loss (bat. fig.)				2000	
	3631400	3631400		73775	73775

PAST EXAMINATION QUESTIONS

QUESTION 59

M/s. ABC & Co. has head office at New York (U.S.A.) and branch in Bangalore (India). Bangalore branch is an integral foreign operation of ABC & Co.

Bangalore branch furnishes you with its trial balance as on 31st March, 2015 and the additional information given thereafter:

	Dr.	Cr.
	(Rupees in thousands)	
Stock on 1st April, 2014	300	
Purchases and Sales	800	1,200
Sundry Debtors & Creditors	400	300
Bills of Exchange	120	240
Wages & Salaries	560	-
Rent, Rates & Taxes	360	-
Sundry Charges	160	-
Computers	240	-
Bank Balance	420	-
New York Office A/c.	-	1,620
	3,360	3,360

Additional Information:

(a) Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.

(b) Unsold stock of Bangalore branch was worth ₹ 4,20,000 on 31st March, 2015.

(c) The rates of exchange may be taken as follows:

- On 01.04.2014 @ ₹ 55 per US $
- On 31.03.2015 @ ₹ 60 per US $
- Average exchange rate for the year @ ₹ 58 per US $
- Conversion in $ shall be made up to two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2015 and the balance sheet as on that date of Bangalore branch as would appear in the books of New York head office of ABC & Co. You are informed that Bangalore branch account showed a debit balance of US $ 29845.35 on 31.3.2015 in New York books and there were no items pending reconciliation.

SOLUTION :

M/s. ABC & Co.

Bangalore Branch Trial Balance

in (US $) as on 31st March, 2015

	Conversion rate per	Dr. US $	Cr. US $
	US $ (₹)	₹	₹
Stock on 1.4.14	55	5,454.55	-
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	-
Rent, rates and taxes	58	6,206.90	-
Sundry Charges	58	2,758.62	-
Computers	-	6,000.00	-
Bank Balance	60	7,000.00	-
New York office A/c.	-	-	29,845.35
		59,535.01	59,535.01

Trading and Profit & Loss Account

for the year ended 31st March, 2015

	US $		**US $**
To Opening Stock	5,454.55	By Sales	20,689.66
To Purchases	13,793.10	By Closing Stock	7,000.00
To Wages and Salaries	9,655.17	(₹4,20,000/60)	
		By Gross Loss c/d	1,213.16
	28,902.82		**28,902.82**
To Gross Loss b/d	1,213.16	By Net Loss	13,778.68

To Rent, rates and taxes	6,206.90		
To Sundry Charges	2,758.62		
To Depreciation on computers (US $ 6,000x0.6)	3,600.00		
	13,778.68		13,778.68

Balance Sheet of Bangalore
Branch as on 31st March, 2015

Liabilities		US $	Assets	US $	US $
New York Office A/c.	29,845.35		Computers	6,000.00	
Less:			Less: Dep.	(3,600,00)	2,400.00
Net Loss	(13,778.68)	16,066.67	Closing Stock		7,000.00
Sundry Creditors		5,000.00	Sundry Debtors		6,666.67
Bills Payable			Bills receivable		2,000.00
		4,000.00			
			Bank Balance		7,000.00
		25,066.67			25,066.67

QUESTION 60

Raju Industries, Kolkata has a branch in Delhi 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 branch has to remit ash received to the Head Office Bank Account.

From the following details, relating to calendar year 2014, prepare the accounts in the Head Office Ledger ascertain the Branch Profit, Branch does not maintain any books of account, but sends weekly returns to Head Office.

Particulars	Amount in ₹
Goods received from Head Office at Invoice Price	6,00,000

Returns to Head Office at Invoice Price	12,000
Stock at Delhi as on 1st Jan. 2014	60,000
Sales during the year – Cash	1,80,000
- Credit	3,80,000
Sundry Debtors at Delhi as on 1st Jan. 2014	72,000
Discount allowed to debtors	8,000
Bad Debts in the year	6,000
Sales returns at Delhi Branch	6,000
Rent, Rates, Taxes at Branch	16,000
Salaries, Wages, Bonus at Branch	62,000
Office Expenses	6,000
Stock at Branch on 31st December, 2014	1,20,000

SOLUTION :

Delhi Branch Stock Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Goods sent to branch A/c. (Returns)	12,000
To Goods sent to branch A/c.	6,00,000	By Bank A/c. (Cash Sales)	1,80,000
To Branch Debtors A/c. (Returns)	6,000	By Branch debtors A/c. (Credit sales)	3,80,000
To Branch adjustment A/c. (Surplus over invoice price)	26,000	By Balance c/d	1,20,000
	6,92,000		6,92,000

Delhi Branch Adjustment Account

Particulars	₹	Particulars	₹
To Stock reserve – 20% of ₹1,20,000 (Closing Stock)	24,000	By Delhi Branch stock A/c.	26,000

To Branch profit & loss A/c.	1,31,600	By Stock reserve – 20% of ₹60,000 (Opening Stock)	12,000
		By Goods sent to branch A/c. – 20% of ₹ 5,88,000	1,17,600
	1,55,600		1,55,600

Branch Expenses Account

Particulars	₹	Particulars	₹
To Bank A/c. (Rent, rates & taxes)	16,000	By Branch profit and loss A/c. (Transfer)	84,000
To Bank A/c.(Salaries & Wages)	62,000		
To Bank A/c.(Office exp.)	6,000		
	84,000		84,000

Branch Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	72,000	By Bank A/c.	4,32,000
To Branch stock A/c.	3,80,000	By Branch profit and loss A/c. (Bad debts and discount)	14,000
		By Branch stock A/c. (Sales returns)	6,000
	4,52,000		4,52,000

Goods sent to Branch Account

Particulars	₹	Particulars	₹
To Branch Stock A/c.	12,000	By Branch Stock A/c.	6,00,000
To Branch Adjustment A/c.	1,17,600		
To Purchases A/c.	4,70,400		
	6,00,000		6,00,000

Branch Profit & Loss Account

Particulars	₹	Particulars	₹
To Branch expenses A/c.	84,000	By Branch adjustment A/c.	1,31,600
To Branch debtors A/c. (Discount)	8,000		

* In the absence of information about closing balance of Branch debtors A/c. and cash received from debtors closing balance of debtors is assumed as nil and balancing figure is considered as cash received from debtors

To Branch debtors A/c. (Bad Debts)	6,000		
To Net Profit (transferred to Profit & Loss A/c)	33,600		
	1,31,600		1,31,600

QUESTION 61 (CA INTER NOV 2019)(5 MARKS)

Karan Enterprises having its Head Office in Mangalore, Karnataka has a branch in Greenville, USA. Following is the trial balance of Branch as at 31 -3-2019:

Particulars	Amount ($) Dr.	Amount ($) Cr.
Fixed assets	8,000	
Opening inventory	800	
Cash	700	
Goods received from Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account		4,300
	28,350	28,350

(i) Fixed assets were purchased on 1st April, 2015.

(ii) Depreciation at 10% p.a. is to be charged on fixed assets on straight line method.

(iii) Closing inventory at branch is \$ 700 as on 31-3-2019.

(iv) Goods received from Head Office (HO) were recorded at ₹ 1,85,500 in HO books.

(v) Remittances to HO were recorded at ₹ 1,62,000 in HO books.

(vi) HO account is recorded in HO books at ₹ 2,84,500.

(vii) Exchange rates of US Dollar at different dates can be taken as :

1-4-2015 ₹ 63

1-4-2018 ₹ 65 and

31-3-2019 ₹ 67

Prepare the trial balance after been converted into Indian rupees in accordance with AS-11.

SOLUTION :

Trial Balance of Foreign Branch (converted into Indian Rupees) as on March 31, 2019

Particulars	\$ (Dr.)	\$ (Cr.)	Conversion Basis	Rate	₹ (Dr.)	₹ (Cr.)
Fixed Assets	8,000		Transaction Date Rate	63	5,04,000	
Opening Inventory	800		Opening Rate	65	52,000	
Goods Received from HO	2,800		Actuals		1,85,500	
Sales		24,050	Average Rate	66		15,87,300
Purchases	11,800		Average Rate	66	7,78,800	
Expenses	1,800		Average Rate	66	1,18,800	
Cash	700		Closing Rate	67	46,900	
Remittance to HO	2,450		Actuals		1,62,000	
HO Account		4,300	Actuals			2,84,500
Exchange Rate Difference			Balancing Figure		23,800	
	28,350	28,350			18,71,800	18,71,800
Closing Stock	700		Closing Rate	67	46,900	
Depreciation	800		Fixed Asset Rate	63	50,400	

QUESTION 62 (CA INTER NOV 2020)(10 MARKS)

Vijay & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts, but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (₹)
Goods received from Head office at Invoice Price	8,40,000
Goods returned to Head office at Invoice Price	60,000
Cash sales for the year 2019-20	1,85,000
Credit Sales for the year 2019-20	6,25,000
Stock at Branch as on 01-04-2019 at Invoice price	72,000
Sundry Debtors at Patna branch as on 01-04-2019	96,000
Cash received from Debtors	4,38,000
Discount allowed to Debtors	7,500
Goods returned by customer at Patna Branch	14,000
Bad debts written off	5,500
Amount recovered from Bad debts previously written off as Bad	1,000
Rent, Rates & taxes at Branch	24,000
Salaries & wages at Branch	72,000
Office Expenses (at Branch)	9,200
Stock at Branch as on 31-03-2020 at cost price	1,25,000

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit.

SOLUTION :

Branch Stock Account

			₹				₹	₹	₹
1.4.19	To	Balance b/d (opening stock)	72,000	31.3.20	By	Sales:			
						Cash		1,85,000	
						Credit	6,25,000		
31.3.20	To	Goods Sent to Branch A/c	8,40,000			Less: Return	(14,000)	6,11,000	7,96,000
	To	Branch P&L	94,000		By	Goods sent to branch - returns			60,000
					By	Balance c/d (closing stock)			1,50,000
			10,06,000						10,06,000
1.4.20	To	Balance b/d	1,50,000						

Branch Debtors Account

			₹				₹
1.4.19	To	Balance b/d	96,000	31.3.20	By	Cash	4,38,000
31.3.20	To	Sales	6,25,000		By	Returns	14,000
					By	Discounts	7,500
					By	Bad debts	5,500
					By	Balance c/d	2,56,000
			7,21,000				7,21,000
1.4.20	To	Balance b/d	2,56,000				

Branch Expenses Account

			₹				₹
31.3.20	To	Salaries & Wages	72,000	31.3.20	By	Branch P&L A/c.	1,18,200
	To	Rent, Rates & Taxes	24,000				
	To	Office Expenses	9,200				
	To	Discounts	7,500				
	To	Bad Debts	5,500				
			1,18,200				1,18,200

Branch Profit & Loss Account for year ended 31.3.20

			₹				₹
31.3.20	To	Branch Expenses A/c	1,18,200	31.3.20	By	Branch stock	94,000
	To	Net Profit transferred to General P & L A/c	93,800		By	Branch Stock Adjustment account	1,17,000
					By	Bad debts recovered	1,000
			2,12,000				2,12,000

Branch Stock Adjustment Account for year ended 31.3.20

			₹				₹
31.3.20	To	Goods sent to Branch (60,000x1/6) - Returns	10,000	31.3.20	By	Balance b/d (72,000x1/6)	12,000
	To	Branch P & L A/c	1,17,000		By	Goods sent to branch (8,40,000x1/6)	1,40,000
	To	Balance c/d (1,50,000x1/6)	25,000				
			1,52,000				1,52,000

QUESTION 63 (CA INTER JAN 21)(5MARKS)

Give Journal Entries in the books of Branch to rectify or adjust the following:

(1) Branch paid ₹ 5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.

(2) Asset Purchased by branch for ₹ 25,000, but the Asset account was retained in H.O Books.

(3) A remittance of ₹8,000 sent by the branch has not been received by H.O.

(4) H.O collected ₹ 25,000 directly from the customer of Branch but fails to give the intimation to branch.

(5) Remittance of funds by H.O to branch ₹5,000 not entered in branch books.

SOLUTION :

Journal Entries in Books of Branch A

	Particulars		Dr. Amount ₹	Cr. Amount ₹
(i)	Head office account	Dr.	5,000	
	To Salaries account			5,000
	(Being the rectification of salary paid on behalf of H.O.)			
(ii)	Head office account	Dr.	25,000	
	To Bank / Liability A/c			25,000
	(Being Asset purchased by branch but Asset account retained at head office books)			
(iii)	No Entry in Branch Books			
(iv)	Head office account	Dr.	25,000	
	To Debtors account			25,000
	(Being the amount of branch debtors collected by H.O.)			
(v)	Bank A/c	Dr.	5,000	
	To Head Office			5,000
	(Remittance of Funds by H.O. to Branch)			

QUESTION 64 (CA INTER JULY 21)(10 MARKS)

Manohar of Mohali has a branch at Noida to which the goods are supplied from Mohali but the cost thereof is not recorded in the Head Office books. On 31st March, 2020 the Branch Balance Sheet was as follows:

Liabilities	₹	**Assets**	₹
Creditors Balance	62,000	Debtors Balance	2,24,000
Head Office	1,88,000	Building Extension A/c	
		Closed by transfer to H.O. A/c	-
		Cash at Bank	26,000
	2,50,000		2,50,000

During the six months ending on 30-09-2020, the following transactions took place at Noida:

	₹		₹
Sales	2,78,000	Manager's salary	16,400
Purchases	64,500	Collections from debtors	2,57,000
Wages Paid	24,000	Discounts allowed	16,000
Salaries (inclusive of advance of ₹ 5,000)	15,600	Discount earned	4,600
General Expenses	7,800	Cash paid to creditors	88,500
Fire Insurance (Paid for one year)	11,200	Building Account (further payment)	14,000
Remittance to H.O.	52,900	Cash in Hand	5,600
		Cash at Bank	47,000

Set out the Head Office Account in Noida Books and the Branch Balance Sheet as on 30.09.2020. Also give journal entries in the Noida books.

SOLUTION :

Journal Entries in the Books of Noida Branch

Particulars		Debit (₹)	Credit (₹)
Salary Advance A/c	Dr.	5,000	
To Salaries A/c			5,000
(Being the amount paid as advance adjusted by debit to Salary Advance A/c)			
Prepaid Insurance A/c (11,200 X 6/12)	Dr.	5,600	
To Fire Insurance A/c			5,600
(Being the six months premium transferred to the Prepaid Insurance A/c)			

Head Office Account

2020	Particulars	Amount (₹)	2020	Particulars	Amount (₹)
Sept 30	To Cash Remittance	52,900	April 1	By Balance b/d	1,88,000
	To Sundries* (Revenue)	1,44,900		By Sundries* (Revenue)	2,82,600
	To Building A/c	14,000			
	To Balance c/d	2,58,800			
	Total	4,70,600		Total	4,70,600

* Instead of using Sundries (Revenue) A/c, the concerned revenue accounts can be posted in the ledger.

Balance Sheet of Noida Branch

As at 30th Sept 2020

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	33,400	Debtors	2,29,000
Head Office A/c	2,58,800	Salary Advance	5,000
Building Extension A/c transferred to HO		Prepaid Insurance	5,600
		Cash in Hand	5,600
		Cash at Bank	47,000
Total	2,92,200	Total	2,92,200

Working Notes

Cash and Bank Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	26,000	By Wages	24,000
To Collection from debtors	2,57,000	By Salaries	15,600
		By Insurance	11,200
		By General Expenses	7,800
		By HO A/c	52,900
		By Manager's Salary	16,400
		By Creditors	88,500
		By Building A/c.	14,000
		By Balance c/d	
		- Cash in Hand	5,600
		- Cash at bank	47,000
Total	2,83,00	Total	2,83,000

Debtors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	2,24,000	By Cash Collection	2,57,000
To Sales A/c	2,78,000	By Discount (Allowed)	16,000
		By Balance c/d	2,29,000
Total	5,02,000	Total	5,02,000

Creditors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Cash A/c	88,500	By Balance b/d	62,000
To Discount (Earned)	4,600	By Purchases	64,500
To Balance c/d	33,400		
Total	1,26,500	Total	1,26,500

Note: Since the date of payment of fire insurance has not been mentioned in the question, it is assumed that it was paid on 01 April 2020. Alternative answer considering otherwise also possible.

QUESTION 65

Beta, having head office at Mumbai has a branch at Nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 20X1:

	Head Office (₹)	Branch (₹)
Opening stock	2,25,000	
Purchases	25,50,000	
Goods sent to branch (Cost to H.O. plus 80%)	9,54,000	
Sales	27,81,000	9,50,000
Office expenses	90,000	8,500

Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 20X1.

SOLUTION :

Trading and Profit and Loss A/c For the year ended 31st March 20X1

	Head office ₹	Branch ₹		Head office ₹	Branch ₹
To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000
To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	_
To Goods received from head office	-	9,54,000	By Closing stock (W.N.1 & 2)	7,00,000	99,000
To Gross profit c/d	16,60,000	95,000			
	44,35,000	10,49,000		44,35,000	10,49,000
To Office expenses	90,000	8,500	By Gross profit b/d	16,60,000	95,000
To Selling expenses	72,000	6,300			
To Staff salaries	65,000	12,000			
To Branch Stock Reserve (W.N.3)	44,000	_			
To Net Profit	13,89,000	68,200			
	16,60,000	95,000		16,60,000	95,000

Working Notes:

(1)	Calculation of closing stock of head office:	₹
	Opening Stock of head office	2,25,000
	Goods purchased by head office	25,50,000
		27,75,000
	Less: Cost of goods sold [37,35,000 x 100/180]	(20,75,000)
		7,00,000
(2)	Calculation of closing stock of branch:	₹
	Goods received from head office [At invoice value]	9,54,000
	Less: Invoice value of goods sold [9,50,000 x 180/200]	(8,55,000)
		99,000
(3)	Calculation of unrealized profit in branch stock:	
	Branch stock ₹ 99,000	
	Profit included 80% of cost	
	Hence, unrealized profit would be = ₹ 99,000 x 80/180	₹ 44,000

QUESTION 66 (CA INTER DEC. 2021 10 MARKS)

Delta Ltd. has a branch at Kanpur. Goods are invoiced from head office to Branch at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office.

Prepare necessary Ledger accounts in the books of Delta Ltd. under Stock and Debtors system to show profit earned at the branch for the year ending 31 st March, 2021.

Following information related to Branch is given:

Stock on 1st April, 2020 (Invoice price)	31,200	Goods returned by Debtors	3,000
Debtors on 1st April, 2020	17,400	Surplus in stock (Invoice price)	600
Goods invoiced at cost	72,000	Expenses at Branch	13,400
Sales at Branch: Cash sales	20,000	Discount allowed to Debtors	700
Credit sales	68,200	Debtors on 31st March, 2021	14,300

SOLUTION :

Books of Delta Ltd.

Kanpur Branch Stock Account

	₹		₹
To Balance b/d – Opening Stock	31,200	By Bank A/c – Cash Sales	20,000
To Branch Debtors A/c – Sales Return	3,000	By Branch Debtors A/c - Credit Sales	68,200
To Goods sent to Branch A/c (72,000 +50% of 72,000)	1,08,000	By Balance c/d - Closing stock	54,600
To Surplus in stock	600		
	1,42,800		1,42,800

Kanpur Branch Stock Adjustment Account

	₹		₹
To Branch Profit and Loss Account	28,400	By Balance b/d (1/3 of ₹ 31,200)	10,400
To Balance c/d (1/3 of 54,600)	18,200	By Goods sent to Branch A/c (1/3 of ₹ 1,08,000)	36,000
		By Surplus in stock	200
	46,600		46,600

Goods Sent to Branch Account

	₹		₹
To Kanpur Branch Stock Adjustment A/c	36,000	By Kanpur Branch Stock A/c	1,08,000
To Purchases A/c	72,000		
	1,08,000		1,08,000

Branch Debtors Account

	₹		₹
To Balance b/d	17,400	By Bank (Bal fig.)	67,600
To Branch Stock A/c	68,200	By Branch Expenses A/c (Discount allowed)	700
		By Branch Stock - Sales Returns	3,000
		By Balance c/d	14,300
	85,600		85,600

Branch Expenses Account

	₹		₹
To Bank A/c (expenses)	13,400	By Branch Profit & Loss A/c (Transfer)	14,100
To Branch Debtors A/c (Discount allowed)*	700		
	14,100		14,100

Branch Profit & Loss Account for the year ending 31st March 2021

	₹		₹
To Branch Expenses A/c	14,100	By Branch Adjustment A/c	28,400
To Net Profit	14,700	By surplus in stock (Cost)	400
	28,800		28,800

Note: * Discount allowed to debtors may be shown in Branch Profit and Loss account directly instead of transferring it through Branch Expenses account.

QUESTION 67 (CA INTER MAY 2022 10 MARKS)

Walkaway Footwears has its head office at Nagpur and Branch at Patna. It invoiced goods to its branch at 20% less than the list price which is cost plus 100%, with instruction that cash sales were to be made at invoice price and credit sales at catalogue price (i.e. list price).

The following information was available at the branch for the year ended 31st March,2022.

(Figures in ₹)

Stock on 1st April,2021 (invoice price)	12,000
Debtors on 1st April, 2021	10,000
Goods received from head office (invoice price)	1,32,000
Sales:	
Cash 46,000	
Credit 1,00,000	1,46,000
Cash received. from debtors	85,000
Expenses at branch	17,500
Debtors on 31st March, 2022	25,000
Stock on 31st March, 2022 (invoice price)	17,600
Remittances to head office	1,20,000

You are required to prepare Branch Stock Account, Branch Adjustment Account, Branch Profit & Loss Account and Branch Debtors Account for the year ended 31st March, 2022.

SOLUTION :

In the books of walkaway footwears

Patna Branch Stock Account

	Particulars		Amount (₹)		Particulars		Amount (₹)
1.1.21	To	Balance b/d Goods sent to	12,000	31.12.21	By	Bank A/c (Cash sales)	46,000
31.12.21	To	branch A/c	1,32,000		By	Branch debtors A/c (credit sales)	1,00,000

	To	Branch adjustment A/c (Surplus over invoice price)	20,000	31.12.21	By	Shortage in stock A/c	400
					By	Balance c/d	17,600
			1,64,000				1,64,000

Patna Branch Adjustment Account

		Particulars	Amount (₹)			Particulars	Amount (₹)
31.12.21	To	Stock reserve - ₹ 17,600 x 60/160 (closing stock)	6,600	31.12.21	By	Stock reserve – ₹ 12,000 x 60/160 (Opening stock)	4,500
	To	Shortage (400x 60/160)	150		By	Goods sent to branch A/c (₹ 1,32,000 x 60/160)	49,500
	To	Branch profit & loss A/c (Gross profit)	67,250				
					By	Branchstock A/c	20,000
			74,000				74,000

Branch Profit & Loss Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
To	Branch expenses A/c	17,500	By	Branch adjustment A/c (Gross Profit)	67,250
To	Shortage in stock A/c	250			
To	Net profit (transferred to Profit & Loss A/c)	49,500			
		67,250			67,250

Branch Debtors Account

	Particulars	Amount (₹)		Particulars	Amount (₹)
1.1.21	To Balance b/d	10,000		By Bank A/c	85,000
31.12.21	To Branch stock A/c	1,00,000	31.12.21	By Balance c/d (bal. fig.)	25,000
		1,10,000			1,10,000

QUESTION 68 (CA INTER NOV 2022 10 MARKS)

Modern Stores of Delhi operates a branch at Nagpur. The Head office affects all purchases and the branch is charged at cost plus 60%. All the cash received by Nagpur Branch is remitted to Delhi. The Branch expenses are met by the Branch out of an Imprest Account which is reimbursed by the Delhi Head Office every month. The Branch maintains a Sales Ledger and certain essential subsidiary records, but otherwise all branch transactions are recorded at Delhi.

The following branch transactions took place during the year ended 31st March, 2022:

	₹
Goods received from Delhi at Selling Price	1,50,000
Cash Sales	69,000
Goods returned to Delhi at Selling Price	3,000
Credit Sales (Net of returns)	63,000
Authorized Reduction in Selling Price of Goods Sold	1,500
Cash Received from Debtors	48,000
Debtors written off as irrecoverable	2,000
Cash Discount allowed to Debtors	1,500

On 1st April, 2021 the Stock in trade at the Branch at Selling Price amounted to ₹ 60,000 and the Debtors were ₹ 40,000.

- A consignment of goods sent to the Branch on 27th March,2022 with a Selling Price of ₹ 1,800 was not received until 5th April,2022 and had not been accounted for in stock.
- The Closing Stock at Selling Price was ₹ 72,900.
- The expenses relating to the Branch for the year ended 31 st March,2022 amounted to ₹ 18,000.

You are required to prepare the Branch Stock Account, Branch Debtors Account, Branch Adjustment Account and Branch Profit and Loss Account maintained at Delhi under Stock and Debtors method. Any stock unaccounted for is to be regarded as normal wastage.

SOLUTION :

Books of Modern Store Delhi

Nagpur Branch Stock A/c

Particulars	₹	Particulars	₹
To Opening stock	60,000	By Bank A/c (Cash Sales)	69,000
To Goods sent to branch A/c	1,50,000	By Branch Debtors A/c (Credit sales)	63,000
To Goods sent to branch A/c	1,800	By Goods sent to branch A/c (Return)	3,000
		By Branch adjustment A/c (Reduction in selling price)	1,500
		By Branch adjustment A/c (Normal Loss)	600
		By Closing stock (including stock in transit of ₹ 1,800)	74,700
	2,11,800		2,11,800

Branch Debtors A/c

Particulars	₹	Particulars	₹
To Bal. b/d	40,000	By Cash/Bank A/c	48,000
To Branch Stock (Sales)	63,000	By Branch P&L A/c (Bad debts)	2,000
		By Branch P & L A/c (Discount)	1,500
		By Bal. c/d	51,500
	103,000		103,000

Branch Adjustment A/c

Particulars	₹	**Particulars**	₹
To Branch Stock Account (Reduction in selling price)	1,500	By Stock reserve A/c (60,000 X 60/160)	22,500
To Branch Stock Account (Normal loss*)	600	By Goods sent to branch A/c (Loading) (1,51,800 X 60/160)	56,925
To Goods sent to branch A/c (loading on returns) (3,000 X 60/160)	1,125		
To Branch P&L A/c	48,187		
To Stock reserve A/c (74,700 X 60/160)	28,013**		
	79,425		79,425

Note: * Alternatively, the loading of ₹ 225 on normal loss may be charged to Branch Adjustment A/c and cost ₹375 thereof may be charged to Branch P&L A/c.

** rounded off. Alternatively may be rounded off as ₹ 28,012.

Branch P&L A/c

Particulars	₹	**Particulars**	₹
To Branch expenses A/c	18,000	By Branch Adjustment A/c	48,187
To Bad debts A/c	2,000		
To Discount A/c	1,500		
To Net Profit	26,687		
	48,187		48,187

QUESTION 69 (CA INTER MAY 2023 5 MARKS)

Artis Limited has a branch at Seattle USA. Its Trial Balance as on 31st December, 2022 is as follows:

	Dr.in US $	Cr.in US $
Stock as on 01.01.2022	22,000	-
Purchases	1,00,000	-
Sales	-	1,30,500
Goods from H.O.	30,000	-
Salaries	4,000	-
Head Office A/c.	-	27,000
Sundry Debtors	2,200	-
Sundry Creditors	-	1,500
Cash at Bank & Head	800	-
Total	1,59,000	1,59,000

The following information is given:

(i) Salaries outstanding are $ 500.

(ii) The Head Office sent goods to Branch for ₹ 24,00,000.

(iii) The Head Office shows an amount of ₹ 21,90,000 due from Branch.

The exchange rates were as below:

- On 1st January 2022- ₹ 79 to 1$
- On 31st December 2022- ₹ 83 to 1 $
- Average rate during the year was ₹ 79.50 to 1 $

You are required to prepare the Seattle Branch Trial Balance incorporating adjustments given above. converting dollars into rupees.

SOLUTION :

Seattle Branch Trial balance (in ₹)

Particulars	Rate as per ₹	Debit ₹	Credit ₹
Stock (01-01-2022)	79.00	17,38,000	
Purchases	79.50	79,50,000	
Sales	79.50		1,03,74,750

Goods from HO	Given	24,00,000	
Salaries ($ 4,000 + $ 500 = $ 4,500 x ₹ 79.50)[1]	79.50	3,57,750	
Head Office A/c	Given		21,90,000
Sundry Debtors	83.00	1,82,600	
Sundry Creditors	83.00		1,24,500
Cash at Bank & Hand	83.00	66,400	
Salaries Outstanding ($ 500 x ₹ 83)	83.00		41,500
Exchange gain		36,000	
Total		1,27,30,750	1,27,30,750

NOTES

BUY BACK OF SHARES

CONCEPT 1: RULES UNDER COMPANIES ACT 2013 (SECTION 68)

The Companies Act, 2013 under Section 68(1) permits companies to buy back their own shares and other specified securities out of:

(i) its free reserves; or

(ii) The securities premium account; or

(iii) The proceeds of the issue of any shares or other specified securities

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

The other important provision relating to the buyback are:

(1) Section 68(2) further states that no company shall purchase its own shares or other specified securities unless—

(a) The buy-back is authorized by its articles;

(b) A special resolution has been passed in general meeting of the company authorizing the buy-back;

However, the above provision do not apply where the buy back is ten percent or less of the paid up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) The buy-back is equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company:

(d) The ratio of the debt owed by the company (both secured and unsecured) after such buy - back is not mo1e than twice the total of its paid up capital and its free reserves:

Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.

(e) All the shares or other specified securities for buy-back are fully paid-up;

(f) The buy-back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

(g) The buy-back in respect of shares or other specified securities other than those specified in clause (F) is in accordance with the guidelines as may be prescribed. Provided that no offer of buy back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy back if any. This means that there cannot be more than one buy back in one year.

(2) Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors where the buy back is up to 10% of the paid up equity capital + free reserves.

(3) The buy-back may be-

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) By purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(4) Where a company has passed a special resolution under clause (b) of Sub-section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any:

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(5) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy- back.

(6) Where a company completes a buy-back of it share or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(7) If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakh but which may extend to three lakh rupees and

every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but which may extend to three lakh rupees or with both.

(8) Section 69(1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

(9) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(10) Where a company buy-back its securities under this section, it shall maintain a register the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(11) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on anyrecognisedstockexchange. Some Important Terms

 (a) "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time;

 (b) "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

CONCEPT 2 : SOME BASIC QUESTIONS

QUESTION 1

ON 31st March, 2001 following was the balance sheet of new Era Ltd.:

Liabilities	₹ In lacs	Assets	₹ In lacs
Equity share capital (fully paid up shares of ₹10 each)	2,400	Machinery	3600
		Furniture	452
Securities premium	350	Investments	148
General reserve	930	Stock	1200
Profit and loss account	340	Debtors	520
12% debentures	1500	Cash at bank	740
sundry creditors	750		
sundry provisions	390		
	6660		6660

On 1st April 2001, the company announced the buy back of 25% of its equity shares at the rate of ₹15 per share. For the purpose, it sold all of its investments for ₹ 150 lacs and issued 2 lacs 14% preference shares of ₹ 100 each at par. The entire amount being payable with application.

The issue was fully subscribed. The company achieved the target of the buy back. Later the company issued one fully paid equity share of ₹ 10 by way of bonus share for every four equity shares held by the equity shareholders.

Show journal entries for all the transaction including cash transactions.

QUESTION 2

Following is the balance sheet of XYZ Ltd. as on 31.3.2000

Liabilities	Amount	Assets	Amount
Equity share capital (40,000 shares of 10 each)	4,00,000	Fixed assets	15,00,000
General reserve	12,00,000	Stock	50,000
Share premium	80,000	Debtors	80,000
12% debentures	1,60,000	Bank	2,80,000

Sundry Creditors	70,000		
	19,10,000		19,10,000

The company decided to buy back 10,000 equity shares through tender method. Shares were purchased @25 per share. Company made a public issue of 3000 preference shares of ₹ 10 each at par for the purpose. Expenses on buy back of shares amounted to ₹8000.

QUESTION 3

The balance sheet of Gunshot Ltd. As on 31.3.2008: is given:

(₹ In '000)

Liabilities	Amount	Assets	Amount
Share capital :		Fixed Assets	2,700
Equity share of ₹ 10 each	800	Non-trade investments	300
Share premium	100	Stock	600
General Reserve	780	Sundry Debtors	360
Profit and Loss A/c	120	Cash and bank	160
10% Debenture	2,000		
Creditors	320		
	4120		4,120

Gunshort Ltd. buy back 16,000 shares at ₹ 20 per share. For this purpose, the Company sold its all Non-trade investments for ₹ 3,20,000 Give journal Entries what full narrations effecting the buy back.

QUESTION 4 (HOME WORK)

M. Ltd. furnishes the following summarised balance Sheet as at 31st March, 20X1:

	₹ in'000	₹ in '000
Equity & Liabilities		
Share Capital:		
Authorised Capital:		5,000
Issued and Subscribed Capital		
3,00,000 Equity shares of ₹ 10 each fully paid up	3,000	

20,000 9% Preference Shares of 100 each	2,000	5,000
Reserve and Surplus:		
Capital reserve	10	
Revenue reserve	4,000	
Securities premium	500	
Profit and Loss account	1,800	6,310
Non-current liabilities -10% Debentures		400
Current liabilities and provisions		40
		11,750
Assets		
Fixed Assets: Cost	3,000	
Less: Provision for depreciation	250	2,750
Non-current investment at cost		5,000
Current assets, loans and advances (including		
Cash and bank balances)		4,000
		11,750

The company passed a resolution to buy back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 25 lakhs.

You are required to pass necessary journal entries.

SOLUTION

Journal Entries in the books of M Ltd.

		Dr.	Cr.
		₹ in 000	₹ in'000
1.	Bank A/c Dr.	2,500	
	Profit and Loss A/c Dr.	500	
	To Investment A/c		3,000
	(Being investment sold for the purpose of buy-back of Equity Shares)		
2.	Equity share capital A/c Dr.	600	
	Premium payable on buy-back Dr.	300	
	To Equity shares buy-back A/c		900
	(Being the amount due on buy-back of equity shares)		
3.	Equity shares buy-back A/c Dr.	900	
	To Bank A/c		900
	(Being payment made for buy-back of equity shares)		
4.	Securities premium A/c Dr.	300	
	To Premium payable on buy-back		300
	(Being Premium payable on buy-back charged form Securities Premium)		
5.	Revenue reserve A/c Dr.	600	
	To Capital Redemption Reserve A/c		600
	(Being Creation of capital redemption reserve to the extent of the equity shares bought back)		

QUESTION 5

Anu Ltd. (a non-listed company) furnishes you with the following summarised balance sheet as at 31st March, 20X1:

		(₹ in crores)
Sources of Funds		
Share Capital:		
Authorised		100
Issued:		
12% Redeemable preference shares of ₹ 100 each fully paid	75	
Equity shares of ₹ 10 each fully paid	25	100
Reserves and surplus:		
Capital reserve	15	
Securities premium	25	
Revenue reserves	260	300
		400
Application of Funds		
Fixed assets: cost	100	
Less: Provision for depreciation	(100)	Nil
Non-current investment at cost (Market value ₹ 400 Cr.)		100
Current assets	340	
Less: Current liabilities (Trade payables)	(40)	300
		400

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

(i) Pass Journal entries to record the above.

(ii) Prepare balance sheet as at. 1.4.20X1.

QUESTION 6

Dee Limited (a non-listed company) furnishes the following summarised balance Sheet as at 31st March, 20X1:

	₹'000	₹'000
Liabilities		
Share capital:		
Authorised capital		30,00
Issued and subscribed capital		
2,50,000 Equity shares of ₹ 10 each fully paid up	25,00	
2,000, 10% Preference shares of ₹ 100 each	2,00	
(Issued two months back for the purpose of buy back)		27,00
Reserves and surplus:		
Capital reserve	10,00	
Revenue reserve	30,00	
Securities premium	22,00	
Profit and loss account	35,00	97,00
Current liabilities and provisions		14,00
		1,38,00
Assets		
Fixed assets		93,00
Investments		30,00
Current assets, loans and advances (including cash and bank balance)		15,00
		1,38,00

The company passed a resolution to buy back 20% of its equity capital @ ₹ 50 per share. For this purpose, it sold all of its investment for ₹ 22,00,000.

You are required to pass necessary journal entries and prepare the Balance Sheet.

SOLUTION

In the books of Dee Limited

Journal Entries

	Particulars		Dr.	Cr.
				(₹ in '000)
(i)	Bank Account	Dr.	22,00	
	Profit and Loss Account	Dr.	8,00	
	To Investment Account			30,00
	(Being the investments sold at for the purpose of buy back)			
(ii)	Equity Share capital account	Dr.	5,00	
	Premium payable on buy back Account	Dr.	20,00	
	To Equity shares buy back Account			25,00
	(Being the amount due on buy back)			
(iii)	Securities Premium Account	Dr.	20,00	
	To Premium payable on buy back Account			20,00
	(Being the premium payable on buy back adjusted against securities premium account)			
(iv)	Revenue reserve Account	Dr.	3,00	
	To Capital redemption Reserve Account			3,00
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)			
(v)	Equity shares buy –back Account	Dr.	25,00	
	To Bank Account			25,00
	(Being the payment made on buy back)			

Balance Sheet of Dee Limited as on 1st April, 20X1

(After buy back of shares)

Particulars	Note No	(₹ in '000)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	22,00
(b) Reserves and Surplus	2	69,00
(2) Current Liabilities		14,00
Total		10,500
II. Assets		
(1) Non-current assets		
(a) PPE		93,00
(2) Current assets (15,00-3,00)		12,00
Total		10,500

Notes to Accounts

			(₹ in '000)	(₹ in '000)
1	**Share Capital**			
	Authorised Capital:			30,00
	Issues and subscribed capital:			
	2,00,000 Equity shares of ₹ 10 each fully paid up		20,00	
	2,000 10% Preference shares of ₹ 100 each fully paid up		2,00	22,00
2	**Reserves and Surplus**			
	Capital reserve		10,00	
	Capital redemption reserve		3,00	
	Securities Premium	22,00		
	Less: Premium payable on buy back of shares	20,00	2,00	
	Revenue reserve	30,00		
	Less: Transfer to Capital redemption reserve	3,00	27,00	
	Profit and loss A/c	35,00		
	Less: Loss on investment	8,00	27,00	69,00

QUESTION 7

Extra Ltd. (a non – listed company) furnishes you with the following summarised Balance Sheet as on 31st March, 20X1:

(₹ in lakhs)

Liabilities	Amount	Assets	Amount
Equity shares of ₹ 10 each fully paid	100	Fixed assets less depreciation	50
9% Redeemable preference		Investments at cost	120
Shares of ₹ 100 each fully paid	20	Current assets	142
Capital reserves	8		
Revenue reserves	50		
Securities premium	60		
10%Debentures	4		
Current liabilities	70		
	312		312

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share.

The payment for the above was made out of huge bank balances, which appeared as a part of the current assets.

(iii) Included in its investments were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.

(iv) The company had 1,00,000 equity stock option outstanding on the above mentioned date, to the employees at ₹ 20 when the market price was ₹ 30 (This was included under current liabilities). On 1.04.20X1 employees exercised their options for 50,000 shares.

Pass the journal entries to record the above.

Prepare Balance Sheet as at. 01.04.20X1.

QUESTION 8

M Ltd. furnishes the following summarised Balance Sheet as at 31st March, 2013:

	₹ In '000	₹ in '000
Equity & Liabilities		
Share Capital		5,000
Authorised Capital:		
Issued and Subscribed Capital		
3,00,000 Equity shares of ₹ 10 each fully paid up	3,000	
20,000 9% preference Shares of 100 each	2,000	5,000
(issued two months back for the purpose of buy back)		
Reserve and Surplus:		
Capital reserve	10	
Revenue reserve	4,000	
Securities premium	500	
Profit and Loss account	1,800	6,310
Non-current liabilities -10% Debentures		400
Current liabilities and provisions		40
Assets		11,750
Fixed Assets: Cost	3,000	
Less: Provision for depreciation	250	2,750
Non-current investments at cost		5,000
Current assets, loans and advances (including		4,000
Cash and bank balances)		--------------
		11,750

(1) The company passed a resolution to buy back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ lakhs.

(2) The Company redeemed the preference shares at a premium of 10% on 1st April , 2013.

(3) Included in its investments were 'Investments in own debentures' costing ₹ 3 lakhs (face value ₹ 3.30 lakhs). These debentures were cancelled on 1st April, 2013.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2013.

QUESTION 9

KG Limited furnishes the following summarised Balance Sheet as at 31st March, 20X1:

Liabilities	(₹ in lakhs)	Assets	(₹ in lakhs)
Equity share capital	1,200	Machinery	1,800
(fully paid up shares of ₹ 10 each)		Furniture	226
Securities premium	175	Investment	74
General reserve	265	Inventory	600
Capital redemption reserve	200	Trade receivables	260
Profit & loss A/c	170	Cash at bank	740
12% Debentures	750		
Trade payables	745		
Other current liabilities	195		
	3,700		3,700

On 1st April, 20X1, the company announced the buyback of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 75 lakhs.

On 5th April, 20X1, the company achieved the target of buy back. On 31th April, 20X1 the company issued one fully paid up equity share of ₹ 10 by of bonus for every four equity shares held by the equity shareholders.

You are required to:

(1) Pass necessary journal entries for the above transactions.

(2) Prepare Balance Sheet of KG Limited after bonus issue of the shares.

SOLUTION :

In the books of KG Limited

Journal Entries

Date 20X1	Particulars	Dr. (₹ lakhs)	Cr. (₹ lakhs)
April 1	Bank A/c Dr.	75	
	To Investment A/c		74
	To Profit on sale of investment		1
	(Being investment sold on profit)		

April 5	Equity share capital A/c Dr. Securities premium A/c Dr. To Equity shares buy back A/c (Being the amount due to equity shareholders on buy back)	300 150	 450
	Equity shares buy back A/c Dr. To Bank A/c (Being the payment made on account of buy back of 30 Lakh Equity Shares)	450	 450
April 5	General reserve A/c Dr. Profit and Loss A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)	265 35	 300
April 30	Capital redemption reserved A/c Dr. To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	225	 225
	Bonus shares A/c Dr. To Equity share capital A/c (Being issue of one bonus equity share for every four equity shares held)	225	 225

Balance Sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount (₹ in Lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,125
(b) Reserves and Surplus	2	436
(2) Non-Current Liabilities		
(a) Long –term borrowings -12% Debentures		750
(3) Current Liabilities		
(a) Trade payables		745
(b) Other current liabilities		195
Total		3,251
II. Assets		
(1) Non-current assets		
(a) PPE		
(i) PPE	3	2,026
(2) Current assets		
(a) Current investments		
(b) Inventory		600
(c) Trade receivables		260
(d) Cash and cash equivalents (W.N.2)		365
Total		3,251

Note to Accounts

			₹
1.	**Share Capital** Equity share capital (Fully paid up shares of ₹ 10 each)		1125

2.	**Reserves and Surplus**			
	General Reserve	265		
	Less: Transfer to CRR	(265)	-	
	Capital Redemption Reserve	200		
	Add: Transfer due to buy-back of shares from P/L	35		
	Transfer due to buy-back of shares from Gen/res	265		
	Less: Utilisation for issue of bonus shares	(225)	275	
	Securities Premium	175		
	Less: Adjustment for premium paid on buy back	(150)	25	
	Profit & Loss A/c	170		
	Add: Profit on sale of investment	1		
	Less: Transfer to CRR	(35)	136	436
3.	PPE			
	Machinery		1800	
	Furniture		226	2026

Working Notes:

1. Amount of bonus shares = 25% of (1,200-300) lakhs = ₹ 225 lakhs
2. Cash at bank after issue of bonus shares

	₹ in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: payment for buy back of shares	(450)
	365

Note: In the given solution, in is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

CONCEPT 3 :PROPORTIONATE CANCELLATION

QUESTION 10

Number of shares to be bought back by company A 2,00,000

Share price of company A ₹ 38 per share

Quotes received from shareholders are tabulated as under:

Buy back price range	Shares offered for buy back by A	Shares offered for buy back by B	Shares offered for buy back by C	Shares offered for buy back byD	Total shares for buy back
₹40	20,000	40,000	20,000	50,000	1,30,000
₹42	35,000	55,000	30,000	70,000	1,90,000
₹44	50,000	55,000	60,000	85,000	2,50,000
₹46	80,000	1,00,000	1,00,000	1,20,000	4,00,000

QUESTION 11

Current market price of shares of ABC Ltd. ₹40

No of shares announced to be bought back by company 2,00,000

Buy back price announced by the company ₹50

No number of shares offered for buy back at the buy back price 8,00,000

CONCEPT 4 :MASTER PROBLEMS ON BUY BACK

QUESTION 12

Following is the Balance Sheet of M/s competent Limited as on 31st march, 2012:

Liabilities	Rs	Assets	Rs
Equity Shares of Rs 10 each		Fixed Assets	46,50,000
Fully paid	12,50,000	Current Assets	30,00,000
Revenue	15,00,000		
Securities Premium	2,50,000		
Profit. & Loss Account	1,25,000		
Secured Loans :			
12% Debentures _	18,75,000		
Unsecured Loans	10,00,000		
Current Liabilities_	16,50,000		
Total	**76,50,000**		**76,50,000**

The company wants, to buy back 25,000 equity shares of Rs 10 each, on 1st April, 2012, at Rs 20 per share. Buy back of shares is duly authorized by its articles and necessary resolution passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as a part of current assets.

Comments with your calculation, whether buy back of shares by company is within the provisions of the companies act, 2013. Pass necessary journal entries towards buy back of shares and prepare balance sheet after buy back of shares.

QUESTION 13

(STUDY MATERIAL)

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.2011:

	Particulars	(in crores)	
(1)	Equity Share Capital (Shares of 10 each fully paid)	-	330
(2)	Receives and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-

	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
(3)	Loan Funds		1,800

The shareholders of Perrotte Ltd., on the Recommendation of their Board of Directors have approved on 12.09.2011 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 Development Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either Rs 1,200 crores or ₹1,500 crores.

Assuming that the entire buy back is completed by 09.12.2011, show the accounting entries in the company's books in each situation.

TEST YOUR KNOWLEDGE PROBLEMS

QUESTION 14

The following summarised Balance Sheet pee Limited (a non-listed company) furnishes as at 31st March, 2017:

	₹	₹
Equity & Liabilities		
Share capital		
Authorised capital		
2,50,000 Equity shares of ₹ 10 each fully paid up	25,00,000	
5,000, 10% Preference shares of ₹ 100 each	5,00,000	30,00,000
Issued and subscribed capital:		
2,40,000 Equity shares of ₹ 10 each fully paid up	24,00,000	
3,000, 10% Preference shares of ₹100 each	3,00,000	27,00,000
(Issued two months back for the purpose of buy back)		
Reserves and surplus:		
Capital reserve	10,00,000	
Revenue reserve	25,00,000	
Securities Premium	27,00,000	
Profit and loss account	35,00,000	97,00,000
Current Liabilities		16,00,000
Trade payables	13,00,000	1,40,00,000
Other current Liabilities	3,00,000	
Assets		
Tangible assets		
Building	25,00,000	
Machinery	31,00,000	
Furniture	20,00,000	
Non-current Investments		76,00,000
		30,00,000

Current assets		
Inventory	12,00,000	
Trade receivables	7,00,000	
Cash and bank balance	15,00,000	34,00,000
		1,40,00,000

On 1st April, 2017, the company passed a resolution to buy back 20% of its equity capital @ ₹ 60 per share. For this purpose, it sold all of its investment for ₹ 25,00,000

The company achieved its target of buy-back. You are required to:

(a) Pass necessary journal entries and

(b) Prepare the Balance Sheet of the company after buy back of Shares.

SOLUTION

Journal Entries in the books of pee Limited

	Particulars		Dr.	Dr.
(i)	Bank Account	Dr.	25,00,000	
	Profit and Loss Account	Dr.	5,00,000	
	To Investment Account			30,00,000
	(Being the investments sold at loss for the purpose of buyback)			
(ii)	Equity Share Capital account	Dr.	4,80,000	
	Premium payable on buy back Account	Dr.	24,00,000	
	To Equity shares buy back Account			28,80,000
	(Being the amount due on buy back)			
(iii)	Securities Premium Account	Dr.	24,00,000	
	To Premium payable on buy back Account			24,00,000
	(Being the Premium payable on buy back adjusted against securities Premium account)			

(iv)	Revenue Reserve Account Dr. To Capital Redemption Reserve Account (Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account (4,80,000-3,00,000)	1,80,000	 1,80,000
(v)	Equity shares buy-back Account Dr. To Bank Account (Being the payment made on buy back)	28,80,000	 28,80,000

Balance Sheet of Pee Limited as on 1st April, 2017

(After buy back of shares)

Particulars	Note No	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	22,20,000
(b) Reserves and Surplus	2	68,00,000
(2) Current Liabilities		16,00,000
Total		1,06,20,000
II. Assets		
(i) Non-Current assets		
(a) PPE		76,00,000
(2) Current assets		30,20,000
Total		1,06,20,000

Note to Accounts

			₹
1	**Share Capital**		
	Authorised capital		30,00,000
	Issued and subscribed capital:		
	1,92,000 Equity shares of ₹ 10 each fully paid up	1,92,0000	
	3,000 10% preference shares of ₹ 100 each fully paid up	3,00,000	22,20,000
	Reconciliation of shares capital		
	Opening no. of shares	2,40,000	
	Buy-back of shares during the year	48,000	1,92,000
	During the year the company has buy back of 48,000 shares		
2	**Reserves and Surplus**		
	Capital reserve	10,00,000	
	Capital redemption reserve	1,80,000	
	Securities Premium 27,00,000		
	Less: Premium payable on buy back of shares 24,00,000	3,00,000	
	Revenue reserve 25,00,000		
	Less: Transfer to Capital redemption reserve 1,80,000	23,20,000	
	Profit and loss A/c 35,00,000		
	Less: Loss on investment 5,00,000	30,00,000	68,00,000

QUESTION 15

Following is the summarised Balance Sheet of Complicated Ltd. As on 31st March, 2016:

Liabilities	Amount(₹)
Equity shares of ₹ 10 each, fully paid up	12,50,000
Bonus shares of ₹ 10 each, fully paid up	1,00,000
Share option outstanding Account	4,00,000
Revenue Reserve	15,00,000
Securities Premium	2,50,000
Profit & Loss Account	1,25,000
Capital Reserve	2,00,000
Unpaid dividends	1,00,000
12% Debentures (Secured)	18,75,000
Advance from related parties (Unsecured)	10,00,000
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000
	86,50,000
Fixed Assets	46,50,000
Current Assets	40,00,000
	86,50,000

The Company wants to buy back 25,000 equity shares of ₹ 10 each, on 1st April, 2016 at ₹ 20 per share. Buy back of shares is duly authorised by its Articles and necessary resolution has been passed by the Company towards this. The buy back of shares by the Company is also within the provisions of the Companies Act, 2013. The payment for buy back of shares will be made by the Company out of sufficient bank balance available shown as part of Current Assets.

You are required to give the necessary journal entries towards buy back of shares and prepare the Balance sheet after buy back of shares.

SOLUTION

As per the information given in the question, buy- back of 25,000 shares @ ₹ 20,as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

		Debit(₹)	Debit (₹)
(a)	Equity Shares buy-back account Dr. To Bank account (Being buy back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)	5,00,000	 5,00,000
(b)	Equity share capital account Dr. Securities premium account Dr. To Equity shares buy-back account (Being cancellation of shares bought back)	2,50,000 2,50,000	 5,00,000
(c)	Revenue reserve account Dr. To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)	2,50,000	 2,50,000

Balance Sheet of Complicated Led.

As on 1st April, 2016

Particulars	Note No	Amount ₹
EQUITY AND LIABILATIES		
1 Shareholders' funds		
(a) Share capital	1	11,00,000
(b) Reserves and Surplus	2	22,25,000
2 Non-current liabilities		
(a) Long-term borrowings	3	28,75,000
3 Current liabilities		
(a) Other current liabilities	4	19,50,000
Total		81,50,000

ASSETS		
1 Non-current assets		
(a) PPE		46,50,000
2 Current assets (40,00,000 -5,00,000)		35,00,000
Total		81,50,000

Note to Accounts

			₹	₹
1.	Share Capital			
	Equity share capital			
	1,10,000 Equity shares of ₹ 10 each			11,00,000
2.	Reserves and Surplus			
	Profit and Loss A/c		1,25,000	
	Revenue reserves	15,00,000		
	Less: Transfer to CRR	(2,50,000)	12,50,000	
	Securities premium	2,50,000		
	Less: Utilization for share buy-back	(2,50,000)	NIL	
	Share Option Outstanding Account		4,00,000	
	Capital reserve		2,00,000	
	Capital Redemption Reserve		2,50,000	22,25,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		10,00,000	28,75,000
4.	Other Current Liabilities			
	Current maturities of long term borrowings		16,50,000	
	Unpaid dividend		1,00,000	
	Application money received for allotment due for refund		2,00,000	19,50,000

QUESTION 16

Alpha Limited furnishes the following summarised Balance Sheet as at 31st March, 2017:

Liabilities	(₹ In lakhs)	Assets	(₹ In lakhs)
Equity share capital	2,400	Machinery	3,600
(fully paid up shares of ₹ 10 each)		Furniture	450
		Investment	148
Securities premium	350	Inventory	1,200
General reserve	530	Trade receivables	500
Capital redemption reserve	400	Cash at bank	1,500
Profit & loss A/c	340		
12% Debentures	1,500		
Trade payables	1,400		
Other current liabilities	400		
	7,398		7,398

On 1st April, 2017, the company announced the buy back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 150 lakhs.

On 5th April, 2017, the company achieved the target of buy back.

You are required to:

(1) Pass necessary journal entries for the buy- back.

(2) Prepare Balance sheet of Alpha Limited after buy-back of the shares.

(Hint; The Given amount of CRR in balance sheet is related with earlier buy back. It is not related with current buy back)

SOLUTION

In the books of Alpha Limited

Journal Entries

(₹ in lakhs)

Date 2017	Particulars		Dr.	Cr.
April 1	Bank A/c	Dr.	150	
	To Investment A/c			148
	To Profit on sale of investment			2
	(Being investment sold on profit)			

April 5	Equity share capital A/c	Dr.	600	
	Securities premium A/c	Dr.	300	
	To Equity share buy back A/c			900
	(Being the amount due to equity shareholders on buy back)			
	Equity shares buy back A/c	Dr.		
April 5	General reserve A/c	Dr.	530	
	Profit and Loss A/c	Dr.	70	
	To Capital redemption reserve A/c			600
	(Being amount equal to nominal value of bought back shares form free reserves transferred to capital redemption reserve account as per the law)			

Balance Sheet (After buy back)

Particulars	Note No	Amount (₹ In lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,800
(b) Reserves And Surplus	2	1,322
(2) Non-Current Liabilities		
(a) Long-term borrowings-12% Debentures		1,500
(3) Current Liabilities		
(a) trade payables		1,400
(b) Other current liabilities		478
Total		6,500

II. Assets		
(1) Non-current assets		
(a) PPE		
(i) Tangible assets	3	4,050
(2) Current assets		
(a) Current investments		
(b) Inventory		1,200
(c) Trade receivables		5,00
(d) Cash and cash equivalents (W.N)		750
Total		6,500

Note to Account

				₹
1.	**Share Capital**			
	Equity share capital (Fully paid up shares of ₹ 10 each)			1800
2.	**Reserves and Surplus**			
	General Reserve	530		
	Less: Transfer to CRR	(530)	-	
	Capital Redemption Reserve	400		
	Add: Transfer due to buy-back of shares form P/L	70		
	Transfer due to buy-back of shares from Gen.res	530	1,000	
	Securities premium	350		
	Less: adjustment for premium paid on buy back	(300)	50	
	Profit & Loss A/c	340		
	Add: profit on sale of investment	2		
	Less: Transfer to CRR	(70)	272	1,322
3.	**PPE**			
	Machinery		3,600	
	Furniture		450	4,050

Working Note:

Cash at back after buy-back

	₹ In lakhs
Cash balance as on 1st April, 2017	1,500
Add: Sale of investments	150
	1,650
Less: Payment for buy back of shares	(900)
	750

QUESTION 17

The following was the balance sheet of Mukta Ltd. as on 31st March, 2016

Equity & liability	₹ (in lakhs)	Assets	₹ (in lakhs)
Authorised Capital:		Fixed Assets	1,12,000
Equity shares of ₹ 10 each	80,000	Investments	24,000
Issued Capital		Cash at Bank	13,200
Equity Shares of ₹ 10 each fully paid up	64,000	Trade Receivables	66,000
10% Redeemable preference Shares of 10 each, Fully paid Up	20,000		
Reserves & Surplus:			
Capital Redemption Reserve	8,000		
Securities Premium	6,400		
General Reserve	48,000		
Profit & Loss Account	2,400		
9% Debentures	40,000		
Trade payables	26,400		
	2,15,200		2,15,200

On 1st April, 2016 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 25% of its Equity Shares at ₹ 20 per Share. In order to make Cash available, the Company sold all the Investments for ₹ 25,200 Lakhs and raised a Bank Loan amounting to ₹ 16,000 lakh on the Security of the Company's Plant.

Give the necessary Journal Entries considering that the buy back is authorised by the articles of company and necessary resolution is passed by the company for this. The amount of Securities Premium will be utilised to the maximum extent s allowed by law.

SOLUTION

Journal entries

In the books of Mukta Ltd.

		Dr.	Cr.
			₹ In lakhs
1	Bank A/c Dr. To Investments A/c To Profit and Loss A/c (Being Investments sold and, profit being credited to profit and Loss Account)	25,200	 24,000 1,200
2	10% Redeemable Preference Share Capital A/c Dr. Premium payable on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (Being amount payable on redemption of Preference shares, at a Premium of 10%)	20,000 2,000	 22,000
3	Securities Premium A/c Dr. To Premium payable on Redemption of Preference Shares A/c (Being Securities Premium utilised to provide Premium on Redemption of Preference Shares)	2,000	 2,000
4	Equity Share Capital A/c Dr. Premium payable on Buyback A/c Dr. To Equity Share buy back A/c (Being the amount due on buy-back)	16,000 16,000	 32,000

5	Securities Premium A/c (6,400 – 2,000) Dr. General Reserve A/c (balancing figure) Dr. To Premium payable on Bay back A/c (Being Premium on buy back provided first out of Securities Premium and the balance out of General Reserves.)	4,400 11,600	 16,000
6	Bank A/c Dr. To Bank Loan A/c (Being Loan taken from Bank to finance Buy back	16,000	 16,000
7	Preference Shareholders A/c Dr. Equity Shares buy back A/c Dr. To Bank A/c (Being payment made to preference Shareholders and Equity Shareholders)	22,000 32,000	 54,000
8	General Reserve Account Dr. To Capital Redemption Reserve Account (Being amount transferred to Capital Redemption Reserve Account to the extent of face value of Preference shares redeemed and equity Shares bought back) (20,000 + 16,000)	36,000	 36,000

QUESTION 18

Umest Ltd. resolves to buy 4 Lakhs of its fully paid equity shares of ₹ 10 each at ₹ 22. Per share. For the purpose, it issued 1 lakh11% preference Shares of ₹ 10 each at par, the entire amount payable with application. The company uses ₹ 16 lakhs of its balance in Securities Premium Account apart From its adequate balance in General Reserve to Fulfill the legal requirements regarding buy- back. Give necessary journal entries to record the above transactions.

SOLUTION

Journal Entries

		₹	₹
1.	Bank A/c Dr. To 11% Preference share application & allotment A/c (Being receipt of application money on preference shares)	10,00,000	 10,00,000
2.	11% Preference share application & allotment A/c Dr. To 11% Preference Share Capital A/c (Being allotment of 1 lakh preference Share	10,00,000	 10,00,000
3.	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being creation of capital redemption reserve for buy back of shares)	30,00,000	 30,00,000
4.	Equity share capital A/c Dr. Securities premium A/c Dr. General reserve A/c Dr. To Equity shareholders/Equity Shares buy back A/c (Amount payable to equity shareholder on buy back)	40,00,000 16,00,000 32,00,000	 88,00,000
5.	Equity shareholders/ Equity Shares buy back A/c Dr. To Bank A/c (Being payment made for buy back of shares)	88,00,000	 88,00,000

Working Notes:

1. Calculation of amount used form General Reserve Account

	₹
Amount paid for buy back of shares (4,00,000 shares x ₹ 22)	88,00,000
Less: Proceeds from issue of Preference Shares	(10,00,000)
(1,00,000 shares x ₹ 10)	
Less: Utilisation of Securities Premium Account	(16,00,000)
Balance used from General Reserve Account	62,00,000

2. Amount to be transferred to Capital Redemption Reserve account

	₹
Nominal value of shares bought back	40,00,000
(4,00,000 shares x ₹ 10)	
Less: Nominal value of Preference Shares issued for such buy	(10,00,000)
Back (1,00,000 shares x ₹ 10)	
Amount transferred to Capital Redemption Reserve Account	30,00,000

Note: It is assumed that buy- back of 4,00,000 equity shares is within the prescribed 25% limit of total equity shares.

QUESTION 19

M. Ltd. furnishes the following summarised Balance Sheet as at 31st March, 2015:

	₹ in '000	₹ in '000
Equity & Liabilities		
Share Capital		
Authorised Capital:		10,000
Issued and Subscribed Capital:		
6,00,000 Equity shares of ₹ 10 each fully up	6,000	
40,000 9% Preference Shares of 100 each	4,000	10,000

Reserve and Surplus:		
Capital reserve	20	
Revenue reserve	8,000	
Securities Premium	1,000	
Profit and Loss account	3,600	12,620
Non-current liabilities -10% Debentures		500
Current liabilities and provisions		380
		23,500
Assets		
Fixed Assets: Cost	6,000	
Less: Provision for depreciation	500	5,500
Non-current investments as cost		10,000
Current assets, loans and advances (including Cash and bank balance)		8,000
		23,500

The company passed a resolution to buy back 10% of its equity @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 60 lakhs for ₹ 50 lakhs. The company also redeemed all preference shares at par on 1st April, 2015.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04. 2015.

SOLUTION

Journal Entries in the books of M Ltd.

		Dr.	Cr.
		₹ in '000	₹ in'000
1	Bank A/c Dr.	5,000	
	Profit and Loss A/c Dr.	1,000	
	To Investment A/c		6,000
	(Being investment sold for the purpose of buy-back of Equity Shares)		

2	Preference Share capital A/c Dr. To Preference shareholders A/c (Being redemption of preference share capita at par)		4,000	 4,000
3	Preference shareholders A/c Dr. To Bank A/c (Being payment made to preference shareholders)		4,000	 4,000
4	Revenue Reserve A/c Dr. To Capital redemption reserve A/c (Being creation of capital redemption reserve to the extent of nominal value of preference shares redeemed and amount of equity bought back i.e. 4,000 + 600		4,600	 4,600
5	Equity share capital A/c Dr. Securities Premium A/c (Premium payable on buy- back Dr. To Equity shares buy-back A/c (Being the amount due on buy-back of equity shares)		600 300	 900
6	Equity shares buy-back A/c Dr. To Bank A/c (Being payment made for buy-back of equity shares)		900	 900

Balance sheet of the M Ltd. as on 1st April, 2015

	Note No.	₹ In'000
Equity and Liabilities		
1 Shareholders funds		
Share Capital	1	5,400
Reserves and Surplus	2	11,320

2 Non-current liabilities		
Long term borrowings	3	500
3 Current liabilities		380
Total		17,600
Assets		
1 Non-current assets		
(a) PPE		5,500
(b) Non-current investments		4,000
2 Current assets	4	8,100
Total	5	17,600

Note to Accounts

			₹ in'000	₹ in'000
1.	Share Capital			
	Authorised share capital:			10,000
	Issued ,Subscribed and fully paid up share capital:			
	5,40,000 Equity shares of ₹ 10 each, fully paid up			5,400
	(60,000 equity shares had been bought back and cancelled during the year)			
2.	Reserves and Surplus			
	Capital Reserves		20	
	Securities premium	1,000		
	Less: premium on buy-back of equity shares	(300)	700	
	Revenue Reserve	8,000		
	Less: Transfer to Capital Redemption Reserve	(4,600)	3,400	
	Capital Redemption reserve		4,600	
	Surplus (Profit & Loss Account)	3,600		
	Less: Loss on sale of investment	1,000	2,600	11,320

3.	Long term borrowing			
	10% Debentures			
4.	Non-current investments			
	Balance			500
	Add: Cash received on sale of investment			10,000
	Less: Payment made to equity shareholders for buy back of shares			
	Payment made to preference shareholders			
5.	Current assets			
	Balance		8,000	
	Add: Cash received on sale of investment		5,000	
	Less: Payment made to equity shareholders for buy back of shares		(900)	
	Payment made to preference shareholders		(4,000)	
				8,100

EXTRA QUESTIONS

QUESTION 20 (CA INTER MAY 2019 10 MARKS)

Following is the summarized Balance Sheet of Super Ltd. as on 31st March, 2018.

Liabilities	In ₹
Share Capital	
Equity Shares of ₹ 10 each fully paid up	17,00,000
Reserves & Surplus	
Revenue Reserve	**23,50,000**
Securities Premium	2,50,000
Profit & Loss Account	2,00,000
Infrastructure Development Reserve	1,50,000
Secured Loan	
9% Debentures	22,50,000
Unsecured Loan	8,50,000
Current Maturities of Long term borrowings	15,50,000
	93,00,000
Assets	
Fixed Assets	
Tangible Assets	58,50,000
Current Assets	
Current Assets	34,50,000
	93,00,000

Super Limited wants to buy back 35,000 equity shares of ₹ 10 each fully paid up on 1st April, 2018 at ₹ 30 per share.

Buy Back of shares is fully authorised by its articles and necessary resolutions have been passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as part of the Current Assets.

Comment with calculations, whether the Buy Back of shares by the company is within the provisions of the Companies Act, 2013.

SOLUTION:

(a) Determination of maximum no. of shares that can be bought back as per the Companies Act, 2013

1. **Shares Outstanding Test**

Particulars	**(Shares)**
Number of shares outstanding	1,70,000
25% of the shares outstanding	42,500

2. **Resources Test:** Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	17,00,000
Free reserves (₹) (23,50,000 + 2,50,000 + 2,00,000)	28,00,000
Shareholders' funds (₹)	45,00,000
25% of Shareholders fund (₹)	11,25,000
Buy back price per share	₹ 30
Number of shares that can be bought back (shares)	37,500
Actual Number of shares proposed for buy back	35,000

3. **Debt Equity Ratio Test:** Loans cannot be in excess of twice the Equity Shareholder's Funds post Buy Back

	Particulars	₹
(a)	Loan funds (₹) (22,50,000+8,50,000+15,50,000)	46,50,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	23,25,000
(c)	Present equity/shareholders fund (₹)	45,00,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (45,00,000 – 5,43,750)	39,56,250*
(e)	Maximum permitted buy back of Equity (₹) [(d) – (b)]	16,31,250
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	54,375 shares
(g)	Actual Buy Back Proposed	35,000 Shares

Summary statement determining the maximum Number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	42,500
Resources Test	37,500
Debt Equity Ratio Test	54,375
Maximum number of shares that can be bought back [least of the above]	37,500

Company qualifies all tests for buy-back of shares and it can buy back maximum 37,500 shares on 1st April, 2018.

However, company wants to buy-back only 35,000 equity shares @ ₹ 30. Therefore, buy-back of 35,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

QUESTION 21 (CA INTER NOV 2019 15 MARKS)

X Ltd. furnishes the following summarized Balance Sheet as at 31 -03-2018.

Liabilities	(in ₹)	(in ₹)
Share Capital		
Equity Share Capital of ₹ 20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹ 100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	20,00,000	
Dividend Equalization Fund	5,50,000	43,50,000

Non-Current Liabilities		
12% Debenture		12,50,000
Current Liabilities and Provisions		5,50,000
Total		**1,21,50,000**
Assets	**(in ₹)**	**(in ₹)**
Fixed Assets		
Tangible Assets		1,00,75,000
Current Assets		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	15,75,000	20,75,000
Total		**1,21,50,000**

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

(1) Buy back 25% of the paid up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹ 30 per share.

(2) To finance the buy-back of shares, company:

  (a) Issues 3000, 14% debentures of ₹ 100 each at a premium of 20%.

  (b) Issues 2500, 10% preference shares of ₹ 100 each.

(3) Sell investment worth ₹ 1,00,000 for ₹ 1,50,000.

(4) Maintain a balance of ₹ 2,00,000 in Revenue Reserve.

(5) Later the company issue three fully paid up equity share of ₹ 20 each by way of bonus share for every 15 equity share held by the equity shareholders.

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. ₹	Cr. ₹
1.	Bank A/c Dr.	3,60,000	
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
	(Being 14 % debentures issued to finance buy back)		
2.	Bank A/c Dr.	2,50,000	
	To 10% preference share capital A/c		2,50,000
	(Being 10% preference share issued to finance buy back)		
3.	Bank A/c Dr.	1,50,000	
	To Investment A/c		1,00,000
	To Profit on sale of investment		50,000
	(Being investment sold on profit)		
4.	Equity share capital A/c (62,500 x ₹20) Dr.	12,50,000	
	Securities premium A/c (62,500 x ₹16) Dr.	10,00,000	
	To Equity shares buy back A/c (62,500 x ₹36)		22,50,000
	(Being the amount due to equity shareholders on buy back)		
5.	Equity shares buy back A/c Dr.	22,50,000	
	To Bank A/c		22,50,000
	(Being the payment made on account of buy back of 62,500 Equity Shares as per the Companies Act)		

6.	Revenue reserve	Dr.	3,00,000	
	Securities premium	Dr.	2,60,000	
	Profit and Loss A/c	Dr.	4,40,000	
	To Capital redemption reserve A/c*			10,00,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)			
	[12,50,000 less 2,50,000]			
7.	Capital redemption reserve A/c	Dr.	7,50,000	
	To Bonus shares A/c (W.N.1)			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 ₹ 10,00,000 (after deducting only pref. share capital) has been credited to CRR while solving the question.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	57,50,000
(b) Reserves and Surplus	2	27,10,000
(2) Non-Current Liabilities	3	
(a) Long-term borrowings		15,50,000
(3) Current Liabilities		
(a) Trade payables		-
(b) current liabilities & Provisions		5,50,000
Total		**1,05,60,000**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment		1,00,75,000
(2) Current assets		
(a) Investments		2,00,000
(b) Inventory		2,00,000
(c) Cash and cash equivalents (W.N. 2)		85,000
Total		**1,05,60,000**

Notes to Accounts

				₹
1.	**Share Capital**			
	Equity share capital (Fully paid up shares of ₹ 20 each)			
	(2,50,000-62,500+37,500 shares)		45,00,000	
	10% preference shares @ ₹ 100 each			
	(10,00,000 + 2,50,000)		12,50,000	57,50,000
2.	Reserves and Surplus			
	Capital Reserve		1,00,000	
	Revenue reserve		2,00,000	
	Securities premium	12,00,000		
	Add: Premium on debenture	60,000		
	Less: Adjustment for premium paid on buy back			
	(10,00,000)			
	Less: Transfer to CRR	(2,60,000)	Nil	
	Capital Redemption Reserve			
	Transfer due to buy-back of shares from P&L			
		10,00,000		
	Less: Utilisation for issue of			
	bonus shares	(7,50,000)	2,50,000	
	Profit & Loss A/c	20,00,000		
	Add: Profit on sale of investment	50,000		
	Less: Transfer to CRR	(4,40,000)	16,10,000	
	Dividend equalization reserve	(5,50,000)	5,50,000	27,10,000
	Long-term borrowings - 12% Debentures	12,50,000		
	- 14% Debentures	3,00,000		15,50,000

WORKING NOTES

1. Amount of bonus shares = [(2,50,000 -25%)3/15] x 20 = 37,500 x 20=7,50,000
2. Cash at bank after issue of bonus shares

	₹
Cash balance as on 30.3.2018	15,75,000
Add: Issue of debenture	3,60,000
Add: issue of preference shares	2,50,000
Add: Sale of investments	1,50,000
	23,35,000
Less: Payment for buy back of shares	(22,50,000)
	85,000

QUESTION 22 (CA INTER JAN 2021 5 MARKS)

The Directors of Umang limited passed a resolution of buy back 5,00,000 of its fully paid equity share of 10 each at 15 each per share. This buy back is in compliance with the provisions of the companies Act 2013.

For this purpose, the company

(i) Sold its investments of 30,00,000 for 25,00,000

(ii) Issued 20,000, 12% preference shares of 100 each at par, the entire amount being payable with application.

(iii) Used 15,00,000 of its Securities Premium Account apart from its adequate balance in General Reserve to fulfil the legal requirement regarding buy back.

(iv) The company has necessary cash balance for the payment to shareholders.

You are required to pass necessary journal entries (including narration) regarding buy back of shares in the books of Umang limited.

QUESTION 23 (CA INTER JULY 2021 15 MARKS)

A company provides the following 2 possible Capital Structures as on 31st March, 2021:

Particulars	Situation 1 (₹)	Situation 2 (₹)
Equity Share Capital (Shares of ₹ 10 each, fully paid up)	30,00,000	30,00,000
Reserves & Surplus:		
General Reserve	12,00,000	12,00,000
Securities Premium	6,00,000	6,00,000
Profit & Loss	2,10,000	2,10,000
Statutory Reserve	4,20,000	4,20,000
Loan Funds	25,00,000	1,20,00,000

The company is planning to offer buy back of Equity Share at a price of ₹ 30 per equity share.

You are required to calculate maximum permissible number of equity shares that can be bought back in both the situations as per Companies Act, 2013 and are also required to pass necessary Journal Entries in the situation where the buyback is possible.

SOLUTION :

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	When loan fund is	
	₹ 25,00,000	**₹ 1,20,00,000**
Shares Outstanding Test (W.N.1)	75,000	75,000
Resources Test (W.N.2)	41,750	41,750
Debt Equity Ratio Test (W.N.3)	94,000	Nil
Maximum number of shares that can be bought back [least of the above]	41,750	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 25,00,000)

₹

	Particulars		Debit	Credit
(a)	Equity shares buy-back account	Dr.	12,52,500	
	To Bank account			12,52,500
	(Being payment for buy-back of 41,750 equity shares of ₹ 10 each @ ₹ 30 per share)			

(b)	Equity share capital account	Dr.	4,17,500	
	Premium Payable on buy-back account	Dr.	8,35,000	
	To Equity shares buy-back account			12,52,500
	(Being cancellation of shares bought back)			
	Securities Premium account General Reserve / Profit & Loss A/c	Dr. Dr.	6,00,000 2,35,000	
	To Premium Payable on buy-back account			8,35,000
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)			
(c)	General Reserve*	Dr.	4,17,500	
	To Capital redemption reserve account			4,17,500
	(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)			

*Profit and Loss account balance amounting ₹ 2,10,000 may also be used and General Reserve may be debited for the balance amount.

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in crores)
Number of shares outstanding	3,00,000
25% of the shares outstanding	75,000

2. Resources Test

Particulars	
Paid up capital (₹)	30,00,000
Free reserves (₹) (12,00,000+6,00,000+2,10,000)	20,10,000
Shareholders' funds (₹)	50,10,000
25% of Shareholders fund (₹)	₹ 12,52,500
Buy-back price per share	₹ 30
Number of shares that can be bought back	41,750 shares

3. **Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back**

	Particulars	When loan fund is	
(a)	Loan funds (₹)	₹ 25,00,000	₹ 1,20,00,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	12,50,000	60,00,000
(c)	Present equity shareholders fund (₹)	50,10,000	50,10,000

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

$$= (50{,}10{,}000 - x) - 12{,}50{,}000 = y$$

$$= 37{,}60{,}000 - x = y \quad (1)$$

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

$y/30 \times 10 = x$ or

$3x = y \quad (2)$

by solving the above two equations we get

$$x = ₹\ 9{,}40{,}000 \text{ and}$$

$$y = ₹\ 28{,}20{,}000$$

In situation 2, first equation will be negative. Buy back not possible in this situation.

QUESTION 24 (CA INTER DEC. 2021 10 MARKS)

Mohan Ltd. furnishes the following summarised Balance Sheet on 31st March 2021.

(₹ in Lakhs)

	Amount
Equity and Liabilities:	
Shareholders' fund	
Share Capital	
Equity Shares of ₹ 10 each fully paid up	780
6% Redeemable Preference shares of ₹ 50 each fully Paid up	240

Reserves and Surplus	
Capital Reserves	58
General Reserve	625
Securities Premium	52
Profit & Loss	148
Revaluation Reserve	34
Infrastructure Development Reserve	16
Non-current liabilities	
7% Debentures	268
Unsecured Loans	36
Current Liabilities	395
	2652
Assets:	
Non-current Assets	
Plant and Equipment less depreciation	725
Investment at cost	720
Current Assets	1207
	2652

Other Information:

(1) The company redeemed preference shares at a premium of 10% on 1st April,2021.

(2) It also offered to buy back the maximum permissible number of equity shares of ₹ 10 each at ₹ 30 per share on 2nd April 2021.

(3) The payment for the above was made out of available bank balance, which appeared as a part of the current assets.

(4) The company had investment in own debentures costing ₹ 60 lakhs (face value ₹ 75 lakhs). These debentures were cancelled on 2nd April 2021.

(5) On 4th April 2021 company issued one fully paid-up equity share of ₹ 10 each by way of bonus for every five equity shares held by the shareholders.

You are required to:

(a) Calculate maximum possible number of equity shares that can be bought back as per the Companies Act, 2013 and

(b) Record the Journal Entries for the above-mentioned information.

SOLUTION :

(i) Statement determining the maximum number of shares to be bought back

Number of shares (in lakhs)

Particulars	**When loan fund is ₹ 304 lakhs**
Shares Outstanding Test (W.N.1)	19.5
Resources Test (W.N.2)	11.175
Debt Equity Ratio Test (W.N.3)	29.725
Maximum number of shares that can be bought back [least of the above]	11.175

Thus, the company can buy 11,17,500 Equity shares at ₹ 30 each.

Working Notes:

1. Shares Outstanding Test

Particulars	**(Shares in lakh)**
Number of shares outstanding	78
25% of the shares outstanding	19.5

2. Resources Test

Particulars	
Paid up capital (₹ in lakh)	780
Free reserves (₹ in lakh) (625+52+148-24-240*)	561
Shareholders' funds (₹ in lakh)	1341
25% of Shareholders fund (₹ in lakh)	335.25
Buy-back price per share	30
Number of shares that can be bought back	11.175
*Amount transferred to CRR is excluded from free reserves. Premium on redemption also reduced.	

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	**₹ In lakh**
(a)	Loan funds (₹)	304
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹) (a/2)	152

(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1043.75 (1341-297.25)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	891.75
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	29.725
	As per the provisions of the Companies Act, 2013, company	Qualifies

Alternatively, when current liabilities are considered as part of loan funds, in that case Debt Equity Ratio Test will be done as follows:

	Particulars	₹ in lakh
(a)	Loan funds (₹)	699
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	349.5
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1093.125 (1341-247.875)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	743.625
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	24.7875
	As per the provisions of the Companies Act, 2013, company	Qualifies

4. **Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method**

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR) - Minimum Equity to be maintained = Maximum Permitted Buy-Back

$$= (1341 - x) - 152 = y$$

$$= 1189 - x = y \quad (1)$$

Equation 2: Maximum Permitted Buy-Back x Nominal Value Per Share/Offer Price Per Share

$$y/30 \times 10 = x \text{ or } 3x = y \quad (2)$$

by solving the above two equations we get

x = ₹ 297.25 and y = ₹ 891.75

Alternatively, when current liabilities are considered as part of loan funds, in that case

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

$= (1341 - x) - 349.5 = y$

$= 991.5 - x = y$ (1)

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

$y/30 \times 10 = x$ or $3x = y$ (2)

by solving the above two equations we get $x = 247.875$ and $y = 743.625$

(ii) Journal Entries for Buy Back **(₹ in lakhs)**

Date	Particulars		Debit	Credit
2021 1st April	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c	Dr.	24	
	To Preference shareholders A/c			264
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	264	
	To Bank A/c			264
	(Being payment made to shareholders)			
	General Reserve or P&L A/c*	Dr.	24	
	To Premium on redemption of preference shares A/c			24
	(Being premium on redemption of preference shares adjusted through securities premium)			
2nd April	Equity shares buy-back A/c	Dr.	335.25	
	To Bank A/c			335.25
	(Being 11.175 lakhs equity shares of ₹ 10 each bought back @ ₹ 30 per share)			
	Equity share capital A/c	Dr.	111.75	
	Securities Premium A/c	Dr.	52	
	General Reserve or P&L A/c	Dr.	171.50	

	To Equity Shares buy-back A/c			335.25
	(Being cancellation of shares bought back)			
	General reserve A/c	Dr.	351.75	
	To Capital redemption reserve A/c			351.75
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law ie. 240 + 111.75 lakhs)			
2nd April	7% Debentures A/c	Dr.	75	
	To Investment (own debentures) A/c			60
	To Profit on cancellation of own debentures A/c			15
	(Being cancellation of own debentures costing ₹ 60 lakhs, face value being ₹ 75 lakhs and the balance being profit on cancellation of debentures)			
4th April	Capital Redemption Reserve	Dr.	133.65	
	To Bonus Shares A/c			133.65
	(Being issue of one bonus equity share for every five equity shares held)			
	Bonus shares A/c Dr.		133.65	
	To Equity share capital A/c			133.65
	(Being bonus shares issued)			

Working Note: Bonus Share to be issued =66.825 (78 - 11.175) lakh shares divided by 5 = 13.365 lakh shares.

Note: *Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and complies with the Accounting Standards prescribed for them. Alternative entry considering otherwise is also possible by utilizing securities premium amount.

QUESTION 25 (CA INTER MAY 2022 10 MARKS)

Quick Ltd. has the following capital structure as on 31st March,2021:

		₹ in Crores	
(1)	**Share Capital:**		462
	(Equity Shares of ₹ 10 each, fully paid)		
(2)	**Reserves and Surplus:**		
	General Reserve	336	
	Securities Premium Account	126	
	Profit and Loss Account	126	
	Statutory Reserve	180	
	Capital Redemption Reserve	87	
	Plant Revaluation Reserve	33	888
(3)	**Loan Funds:**		
	Secured	2,200	
	Unsecured	320	2,520

On the recommendations of the Board of Directors, on 16th September, 2021, the shareholders of the company have approved a proposal to buy-back of equity shares. The prevailing market value of the company's share is ₹ 20 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 50% over market value. The company had sufficient balance in its bank account for the buy-back of shares.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,680 Crores or ₹ 2,100 Crores.

Assuming that the entire buy-back is completed by 31st December,2021, Pass the necessary accounting entries (narrations not required) in the books of the company in each situation.

SOLUTION :

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	When loan fund is		
	₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
Shares Outstanding Test (W.N.1)	11.55	11.55	11.55
Resources Test (W.N.2)	8.75	8.75	8.75

Debt Equity Ratio Test (W.N.3)	Nil	5.25	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	5.25	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 1,680 crores)

₹ in crores

	Particulars		Debit	Credit
(a)	Equity share buy-back account	Dr.	157.5	
	To Bank account			157.5
(b)	Equity share capital account (5.25 x ₹ 10)	Dr.	52.5	
	Securities premium account (5.25 x ₹ 20)	Dr.	105	
	To Equity share buy-back account			157.5
(c)	General reserve account	Dr.	52.5	
	To Capital redemption reserve account			52.5

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in crores)
Number of shares outstanding	46.2
25% of the shares outstanding	11.55

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	462
Free reserves (₹ in crores) (336+126+126)	588
Shareholders' funds (₹ in crores)	1,050
25% of Shareholders fund (₹ in crores)	₹ 262.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	8.75 crores shares

3. Debt Equity Ratio Test

	Particulars	When loan fund is		
		₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
(a)	Loan funds (₹ in crores)	2,520	1,680	2,100
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹ in crores)	1,260	840	1,050
(c)	Present equity shareholders fund ₹ in crores)	1,050	1,050	1,050
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	N.A.	997.5 (1,050-52.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	Nil	157.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @30 per share (shares in crores) (See Note 2)	Nil	5.25 (by simultaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.
2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back.

   Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

   Then

   Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buy-back of equity

   $(1,050 - x) - 840 = y$

   Since $210 - x = y$

   Equation 2 :

   $$= \left(\frac{\text{Maximum buy-back}}{\text{Other price for buy-back}} \times \text{Nomnal Value} \right)$$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10\right) = x$$

Or $3x = y$ (2)

by solving the above two equations we get

x = ₹ 52.5 crores

y = ₹ 157.5 crores

3. Statutory reserves, capital redemption reserve and plant revaluation reserves are not free reserves.
4. For calculation of debt -equity ratio both secured and unsecured loans have been considered.

QUESTION 26 (CA INTER NOV 2022 5 MARKS)

PG Limited furnishes the following Balance Sheet as at 31st March,2022:

	Particulars	Notes	₹ (in Lakhs)
1.	**Equity and Liabilities**		
	Shareholders' funds		
	Share Capital	1	12,000
	Reserves and Surplus	2	8,100
2	**Current liabilities**		
	(a) Trade Payables		7,450
	(b) Other Current Liabilities		1,950
	Total		29,500
	Assets		
1	**Non-current assets**		
	Property, Plant and Equipment		12,760
	Non-current Investments		740
2.	**Current assets**		
	Inventories		6,000
	Trade receivables		2,600
	Cash and cash equivalents		7,400
	Total		29,500

Notes to accounts:

	Particulars	₹ (in Lakhs)
1.	Share Capital	
	Authorized, issued and subscribed capital	
	Equity share capital (fully paid up shares of ₹ 10 each)	12,000
2.	Reserves and Surplus	
	Securities premium	1,750
	General reserve	2,650
	Capital redemption reserve	2,000
	Profit and Loss account	1,700
	Total	8,100

On 1stApril, 2022, the company announced the buy-back of 25% of its Equity Shares @ ₹ 15 per share. For this purpose, it sold all of is investments for ₹ 750 lakhs.

On 5thApril, 2022, the company achieved the target of buy-back You are required to pass necessary journal entries for the above transactions.

SOLUTION :

In the books of PG Limited

Journal Entries

Date	Particulars		Dr.	Cr.
2022			(₹ in lakhs)	
April 1	Bank A/c	Dr.	750	
	To Investment A/c			740
	To P& L A/c (Profit on sale of investment)			10
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	3,000	
	Premium payable on buy-back A/c	Dr.	1,500	
	To Equity shares buy-back A/c			4,500
	(Being the amount due to equity shareholders on buy- back)			
	Securities Premium A/c	Dr.	1,500	
	To Premium payable on buy-back A/c			1,500
	(Being the amount of premium charged from securities premium account)			

	Equity shares buy-back A/c Dr.	4,500	
	To Bank A/c		4,500
	(Being the payment made on account of buy-back of 30 Lakh Equity Shares)		
April 5	Profit and Loss A/c Dr.	1,700	
	General reserve A/c Dr.	1,300	
	To Capital redemption reserve A/c		3,000
	(Being amount equal to nominal value of buy-back shares from free reserves transferred to capital redemption reserve account as per the law)		

Note:

1. In the last entry given in the solution, it is possible to adjust transfer to Capital Redemption Reserve Account from different combinations of amounts from Securities Premium, General Reserve and Profit and Loss Account to the extent available.
2. Calculation of amount of Buy Back of Share: ₹12,000/10 X 25% X ₹ 15 = ₹ 4,500 Lakhs

QUESTION 27 (CA INTER MAY 2023)

VIJ Ltd. has the following capital structure as on 31st March, 2022:

Particular		**(₹ In laksh)**
Equity share capital (Shares of ₹ 10 each, fully paid)		990
Reserve and Surplus:		
General Reserve	720	
Securities Premium Account	270	
Profit & Loss Account	270	
Infrastructure development Reserve	540	1800
Loan Funds		5400

On the recommendation of the Board of Directors, the shareholders of the company have approved on 2nd September 2022 a proposal to buy- back the maximum permissible number of equity shares, considering the sufficient funds available at the disposal of the company.

The current market value of the company's shares is ₹ 25 per share and in order to induce the existing shareholders offer their shares for buy- back, it was decided to offer a price of 20% over market value.

You are also informed that the Infrastructure Development Reserve is created to satisfy income tax requirements.

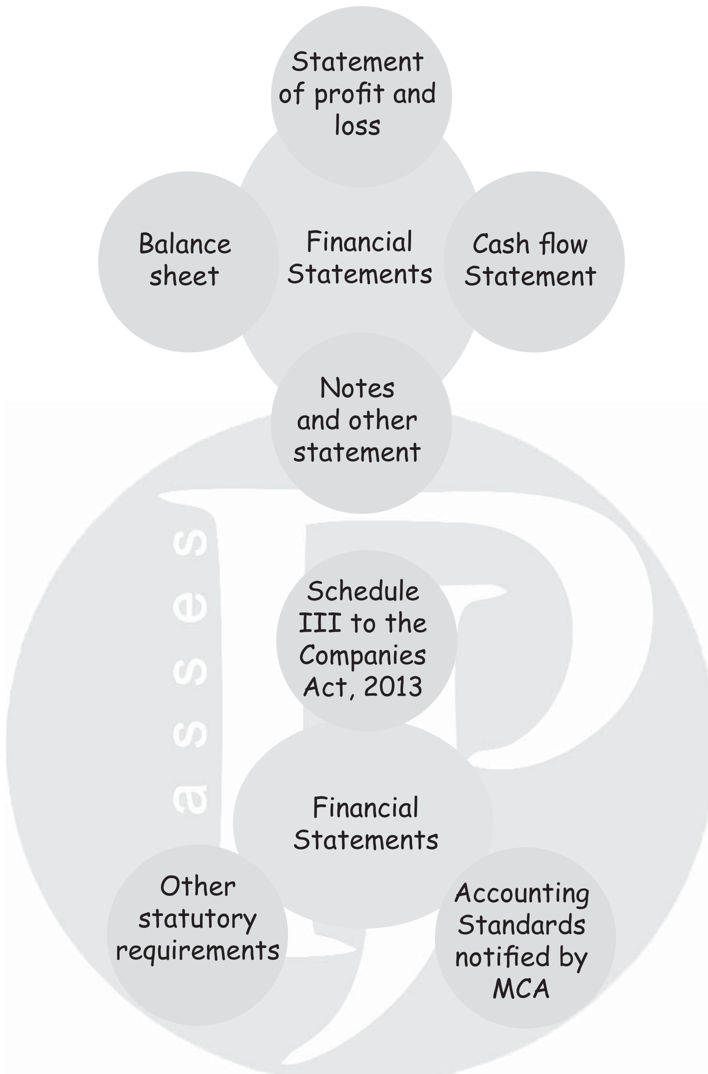
You are required to compute the maximum permissible number of equity shares that can be brought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 3600 lakh or ₹ 4500 lakh.

The entire buy-back is completed by 09/12/2022, show the accounting entries with full narrations in the company's books in each situation.

NOTES

COMPANY FINAL ACCOUNTS

OVERVIEW



MEANING OF COMPANY

As per Section 2 (20) of the Companies Act, 2013, "Company" means a company incorporated under the Companies Act, 2013 or under any previous company law (e.g., the Companies Act, 1956). Different types of companies have been defined (under various sub-sections of the Companies Act, 2013) as follows:

2(21) "**company limited by guarantee**" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being would up;

2(22) "**Company limited by shares**" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them;

2(42) "**Foreign company**" means any company or body corporate incorporated outside India which-

(a) has a place of business in India whether by itself or through an agent physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

2(45) " **Government company**" means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government of Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company;

2(62) "**One Person Company**" means a company which has only one person as a member;

2(68) "**Private company**" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,-

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred;

Provided that where two or more person hold one or more shares in a company jointly, they should, for the purposes of this sub-clause, be treated as a single member;

Provided further that-

(A) person who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, should not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company;

2(71) "**Public Company**" means a company which -

(a) is not a private company;

(b) has a minimum paid-up share capital as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, should be deemed to be public company for the purposes of this Act even where such subsidiary company continue to be a private company in its articles;

2(85) "**Small company**" means a company, other than a public company,

(i) paid-up share capital of which does not exceed ₹50 lakhs or such higher amount as may be prescribed which should not be more than ₹ 5 crores; or

(ii) turnover which as per its last profit and loss account does not exceed ₹ 2 crores; or such higher amount as may be prescribed which should not be more than ₹ 20 crores:

Provided that nothing in this clause should apply to: (A) a holding company or a subsidiary company (B) a company registered under section 8

(C) a company or body corporate governed by any special Act

2(92) "**Unlimited company**", in relation to one or more other companies, means a company of which such companies are subsidiary companies;

2(46) "**Holding company**", in relation to one or more other companies, means a company of which such companies are subsidiary companies;

2(87) "**Subsidiary company**", or "**subsidiary**", in relation to any other company (that is to say the holding company), means a company in which the holding company-

(i) control the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies;

Provided that such class or classes of holding companies as may be prescribed should not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation - For the purposes of this clause,-

(a) a company should be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors should be deemed to be controlled by another company if that other company by exercise of some power exercisable by its at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes anybody corporate ;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries;

MAINTENANCE OF BOOKS OF ACCOUNT

As per Section 128 of the Companies Act, 2013, Every company should prepare and keep at its registered office books of account and other relevant books and papers and financial statement of every financial year which give a true and fair view of the state of the affairs of the company, including that of tis branch office or offices, if any, and explain the transactions effected both a the registered office and its branches and such books should be kept on accrual basis and according to the double entry system of accounting:

Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Maintenance at Place other than Registered Office

It is a duty of the company to inform the Registrar of Companies within seven days of the decision in case the Board of Directors decides to maintain books at the place other than the registered office.

In Case of Branch Office

Where a company has a branch office in India or outside India, it should be deemed to have complied with the provisions of the Act, if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns periodically are sent by the branch office to the company at its registered office or such other place as the Board of Directors has decided.

Section 128 (3) further lays down that the books of account and other books and papers maintained by the company within India should be open for inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information should be maintained and produced for inspection by any director subject to such conditions as may be prescribed. Section 128 (5) further states that the books of account of every company relating to a period of not less than

8 financial years immediately preceding a financial years, or where the company had been in existence for a period less than 8 years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account should be kept in good order.

STATUTORY BOOKS

The following statutory books are required to be maintained by a company under different sections of the Companies Act, 2013:

- Register of Investments of the company held in its own name (Section 187)
- Register of Charges (Section 85)
- Register of Members (Section 88)
- Register of Debenture- holders and other Security holders (Section 88)
- Minute Books (Section 118)
- Register of Contracts, or arrangements in which directors are interested (Section 189)
- Register of directors and key managerial personnels and their shareholding (Section 170
- Register of Loans and Investments by Company (Section 186)
- In addition, a company usually maintains a number of statistical books to keep a record

of its transactions which have resulted either in the payment of money to it or constitute the basis on which certain payment have been made by it.

- Registers and documents relating to the issue of shares are:

  (i) Share Application and Allotment Book

  (ii) Share Call Book

  (iii) Certificate Book

  (iv) Register of Members

  (v) Share Transfer Book

  (vi) Dividend Register.

ANNUAL RETURN

In accordance with Section 92 of the Companies Act, 2013, every company should prepare an annual return in the form prescribed by the Companies Act,

2013 signed by a director and the company secretary, or where there is no

company secretary, by a company secretary in practice:

Provided that in relation to One Person Company and small company, the annual return should be signed by the company secretary, or where there is no company secretary, by the director of the company.

The annual return should be filed with the Register within 60 days from the day on which each of the annual general meeting (AGM) is held or where no AGM is held in any year, within 60 days from the date on which AGM should have been held along with a statement showing the reason why AGM was not held.

FINAL ACCOUNTS

Under Section 129 of the companies Act, 2013, at the annual general meeting of a company, the Board of Directors of the company should lay financial statements before the company:

Financial Statements as per Section 2(40) of the Companies Act, 2013, inter-alia include

(i) a balance sheet as at the end of the financial year:

(ii) a profit and loss account, or in the case of a company carrying on any activity Not for profit, an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year;

(iv) a statement of changes in equity, if applicable; and

(v) any explanatory note annexed to, or forming part of, any document referred to in (i) to (iv) above:

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Requisites of Financial Statements

It should give a true and fair view of the state of affairs of the company as at the end of the financial year.

Provisions Applicable

(1) Specific Act is Applicable

For instance, any

(a) insurance company

(b) banking company or

(c) any company engaged in generation or supply of electricity[1]* or

(d) any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company

(2) In case of all other companies

Balance Sheet as per Form set out in Part I of Schedule III and Statement of

Profit and Loss as per Part II of Schedule III

Points to be kept in mind while prepare final accounts:

- Requirements of schedule III to the Companies Act;
  - Other statutory requirements;
  - Accounting Standards notified by Ministry of Corporate Affairs (MCA) (AS 1 to AS 29 [1]*);
- Statements and Guidance Notes issued by the Institute Chartered

Accountants of India (ICAI); which are necessary for understanding the accounting treatment/ valuation/ disclosure suggested by the ICAI.

COMPLIANCE WITH ACCOUNTING STANDARDS

As per section 133 of the Companies Act, it is mandatory to comply with accounting standards notified by the Central Government from time to time.

Schedule II of the Companies Act, 2013

As per section 129 of the Companies Act, 2013, Financial statements should give a true and fair view of the state of affairs of the company or companies and comply with the accounting standards notified under section 133 and should be in the form or forms as may be provided for different class or classes of companies in Schedule III under the Act. Schedule III to the Companies Act, 2013 has been given as Annexure at the end of this chapter.

EXAMPLE 1

In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of ₹ 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non- disclosure a violation of the Schedule III to the Companies Act? Comment.

SOLUTION

Schedule III has come into force for the Balance Sheet and Profit and Loss Account prepared for the financial year commencing on or after 1st April, 20X1. As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 20X2 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. Schedule III does not require a company to disclose the source from which bonus shares have been issued. Therefore, non-disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

* The Electricity Act, 2000 does not specify any format for presentation of Financial Statements. Therefore, Schedule III of the Companies Act, 2013 is followed by Electricity Companies in preparation of their financial statements.

EXAMPLE 2

The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III.

SOLUTION

Schedule II to the companies Act does not require that the amounts of WIP at the beginning and at the end of the accounting period to be disclosed in the statement of profit and loss. Only changes in inventories of WIP need to be disclosed in the statement of profit and loss. Non-disclosure of such change in the statement of profit and loss by the company may not amount to violation of Schedule III if the differences between opening and closing WIP are not material.

EXAMPLE 3

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 20X1:

	Amount ₹ in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

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

SOLUTION

Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) should be shown as a negative figure under the head 'Surplus'. Similarly, the balance of

'Reserves and Surplus', after adjusting negative balance of surplus, should be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balances of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 250 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

EXAMPLE 4

Sumedha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalments is due on 30.09.20X1 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III.

1* AS 6 and AS 8 have been withdrawn

SOLUTION

As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria;

(i) It is expected to be settled in the company's normal operating cycle;

(ii) It is held primarily for the purpose of being traded;

(iii) It is due to be settled within twelve months after the reporting date;

or

(iv) the company does not have an unconditional right to defter settlement of the liability for at least twelve months after the reporting date.

In the given case, instalments due on 30.09.20X1 and 31.03.20X2 will be shown under the head „other current liabilities' as per criteria (c).

Therefore, in the balance sheet as on 31.3.20X1, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowing's and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'Other Current Liabilities' as current maturities of loan from bank.

Note: Students may note that the questions based on preparation of statement of Profit and Loss and Balance Sheet and explanatory notes as per Schedule III have been given in this Unit. However, questions requiring preparation of cash Flow statements have been separately given in the next unit of this chapter.

MANAGERIAL REMUNERATION

QUESTION 1

The following is the Draft Profit & Loss A/c of Mudra Ltd., the year ended 31st March, 20X1:

		₹			₹
To	Administrative, Selling and distribution expenses	8,22,542	By	Balance b/d	5,72,350
To	Directors fees	1,34,780	By	Balance from Trading A/c	40,25,365
To	Interest on debentures	31,240	By	Subsidies received from Govt.	2,73,925
To	Managerial	2,85,350			
To	Depreciation on fixed assets	5,22,543			
To	Provision for Taxation	12,42,500			
To	General Reserve	4,00,000			
To	Investment Revaluation Reserve	12,500			
To	Balance c/d	14,20,185			
		48,71,640			48,71,640

Depreciation on fixed assets as per Schedule II of the Companies Act, 2013 was ₹ 5,75,345. You are required to calculate the maximum limits of the managerial remuneration as per Companies Act, 2013.

SOLUTION:

Calculation of net profit u/s 198 of the Companies Act, 2013

	₹	₹
Balance from Trading A/c		40,25,365
Add: Subsidies received from Government		2,73,925
		42,99,290
Less; Administrative, selling and distribution expenses	8,22,542	
Director's fees	1,34,780	
Interest on debentures	31,240	
Depreciation on fixed assets as per Schedule II	5,75,345	(15,63,907)
Profit u/s 198		27,35,383

Maximum Managerial remuneration under Companies Act, 2013 = 11% of ₹ 27,35,383 = ₹ 3,00,892

QUESTION 2

The following extract of Balance Sheet of X Ltd. was obtained:

Balance Sheet (Extract) as on 31st March, 20X1

Liabilities	₹
Authorised capital:	
20,000, 14% preference shares of ₹ 100	20,00,000
2,00,000 Equity shares of ₹ 100 each	2,00,00,000
	2,20,00,000
Issued and subscribed capital :	
15,000, 14% preference shares of ₹ 100 each fully paid	15,00,000
1,20,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	96,00,000
Share suspense account	20,00,000
Reserves and surplus:	
Capital reserves (₹ 1,50,000 is revaluation reserve)	1,95,000

Securities premium	50,000
Secured loans:	
15% Debentures	65,00,000
Unsecured loans:	
Public deposits	3,70,000
Cash credit loan from SBI (Short term)	4,65,000
Current Liabilities:	
Trade Payables	3,45,000
Assets:	
Investment in shares, debentures, etc.	75,00,000
Profit and Loss account (Dr. balance)	15,25,000

Share suspense account represents application money received on shares, the allotment of which is not yet made.

You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if X Ltd. is an investment company?

SOLUTION

Computation of effective capital:

	Where X Ltd. is a non- investment company	Where X ltd. is an investment company
	₹	₹
Paid-up share capital -		
15,000, 14% Preference shares	15,00,000	15,00,000
1,20,000 Equity shares	96,00,000	96,00,000
Capital reserves (1,95,000-1,50,000)	45,000	45,000
Securities premium	50,000	50,000
15% Debentures	65,00,000	65,00,000
Public Deposits	3,70,000	3,70,000
(A)	1,80,65,000	1,80,65,000
Investments	75,00,000	-
Profit and Loss account (Dr. balance)	15,25,000	15,25,000

(B)	90,25,000	15,25,000
Effective capital (A-B)	90,40,000	1,65,40,000

QUESTION 3

Kumar Ltd., a non-investment company has been incurring losses for the past few years. The company provides the following information for the current year:

	(₹ in lakhs)
Paid up equity share capital	120
Paid up Preference share capital	20
Reserves (including Revaluation reserve ₹ 10 lakhs)	150
Securities premium	40
Long term loans	40
Deposits repayable after one year	20
Application money pending allotment	720
Accumulated losses not written off	20
Investments	180

Kumar Ltd. has only one whole-time director, Mr. X. You are required to calculate the amount of maximum remuneration that can be paid to him as per provisions of Part II of Schedule XIII, if no special resolution is passed at the general meeting of the company in respect of payment of remuneration for a period not exceeding three years.

SOLUTION

Calculation of effective capital and maximum amount of monthly remuneration

	(₹ in lakhs)
Paid up equity share capital	120
Paid up Preference share capital	20
Reserve excluding Revaluation reserve (150-10)	140
Securities premium	40
Long term loans	40
Deposits repayable after one year	380
	(20)

Less: Accumulated losses not written of Investments	(180)
Effective capital for the purpose of managerial remuneration	180

Since Kumar Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of effective capital of the company, therefore maximum remuneration payable to the Managing Director should be @ 60,00,000 per annum.

Note: Revaluation reserve and application money pending allotments are not included while computing effective capital of Kumar Ltd.

QUESTION 4

The manager of M/s Slow and Steady Limited is entitled to get a salary of ₹2,500 per month plus 1 per cent commission on the net profit of the company after such salary and commission. The following is the Profit and Loss account of the company for the year ended 30th June 1998:

Particulars	₹	Particulars	₹
To Salaries, wages and bonus	1,92,500	By Gross profit b/d	9,00,000
To General expenses	74,000	By Subsidy from Govt.	60,000
To Depreciation	82,000	By Profit on sale of assets (cost price ₹2,50,000 and written- down value ₹1,80,000)	1,00,000
To Expenditure on scientific research (cost of an apparatus)	14,000		
To Manager's salary	30,000		
To Commission to manager (on account)	6,000		
To Provisions for bad and doubtful debts	17,500		
To Provision for income tax	2,40,000		
To Proposed dividend	1,00,000		
To net profit	3,04,000		
	10,60,000		**10,60,000**

Depreciation as schedule ii of companies act 2013 amounts to ₹81,000. Calculate the remuneration payable to the manager.

QUESTION 5

From the following profit and loss account for the year ended 31.3.2002 of XY Ltd., calculate commission payable to the managing director and other directors @ 5% and 1% of the net profit respectively:

Particulars	₹	Particulars	₹
To administrative expenses	4,00,000	By Gross profit b/d	12,00,000
To interest on loans	50,000	By Profit on sale of investments	15,000
To managing directors remun.	15,000	By dividend on shares	9,000
To depreciation	55,000	By transfer fees	1,000
To directors fees	4,000		
To capital redemption reserve	40,000		
To provision for taxation	2,50,000		
To development rebate reserve	15,000		
To net profit	3,96,000		
	12,25,000		12,25,000

Depreciation as per Schedule II is ₹45,000.

QUESTION 6

Pagadiwala Containers Limited having three whole-time director on its Board, the others being part-time directors, earned profits during the year ended 31st March 1997 to the tune of ₹2,50,000 after taking into consideration the following:

Depreciation on fixed assets

(Depreciation admissible as per the Companies Act ₹32,800)	₹ 47,800
Provisions for income-tax	₹ 1,22,500
Capital expenditure included in General expenses charged to	
Profit and Loss account	₹ 12,500

Calculate the maximum remuneration payable to the whole time directors and the part-time directors assuming that the remuneration payable to the whole-time directors is to be calculated on net profits remaining after payment of commission to part-time directors and that the commission to part-time directors is to be calculated on net-profits remaining after payment of remuneration to whole-time directors.

QUESTION 7

(a) From the following particulars of Ganga Limited, you are required to calculate the managerial remuneration in the following situation:

(b) There is only one whole time director.

(c) There are two whole time directors.

(d) There are two whole time directors a part time director and a manager.

	₹
Net profit before provision for income tax and managerial Remuneration, but after depreciation and provision for repairs	8,70,410
Depreciation provided for in the books	3,10,000
Provision for repairs of machinery during the year	25,000
Depreciation allowable under Schedule XIV	2,60,000
Actual expenditure incurred on repairs during the year	15,000

DIVISIBLE PROFIT

One of the important functions of company accounting is to determine the amount of profits which is available for distribution to the shareholders as dividend. This is necessary since the amount for profits disclosed by the Profit & Loss Account, in every case, is not available for distribution. The availability of profits for distribution depends on a number of factors, e.g., their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.

Meaning of Dividend

(a) A dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights attaching thereto.

(b) Such a distribution may or may not entail a release of assets; it would be where a distribution involves payment of cash.

(c) But when profits are capitalised and the amount distributed is applied towards payment of bonus shares, issued free to the shareholders, no part of the assets of the company can be said to have been released since, in such a case, profits are only capitalised, thereby increasing the paid up capital of the company. The company does not give up any asset.

As per Section 2 (35) of the Companies Act, 2013, term "Dividend" includes interim dividend also.

Under Section 123 (1) of the Companies Act, 2013, no dividend should be declared or paid by a company for any financial year except -

(a) Out of the profits of the company for that financial year arrived at after providing for depreciation in accordance with the provisions of section 123 (2), or

(b) Out of the profits for any previous financial years arrived at after providing for depreciation in accordance with the provisions of that sub section and remaining undistributed; or

(c) Out of both the above;

(d) Out of the moneys provided by the Central Government or any State Government for the payment of dividend by the Company in pursuance of any guarantee given by the that government

Provided that no dividend should be declared or paid by a company from its reserves other than free reserves.

Declaration of a dividend presupposes that there is a trading profit or a surplus available for distribution, arrived at after providing for depreciation on assets, not only for the year in which the profits were earned but also for any arrears of depreciation of the past years, calculated in the manner prescribed by sub- section (2) of Section 123.

Sub-section (3) of Section 124 further states that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared : Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

Dividends cannot be declared except out of profits.

Capital cannot be returned to the shareholders by way of dividend.

Dividend can be declared and paid by a company only out of the profits or free reserves (other than moneys provided by Central or State Govt.) as the payment of dividend from any other source will amount to payment of dividend from capital units.

<u>Provisions for Depreciation</u>

Section 123 (2) provides that depreciation must be to the extent specified in Schedule II to the Companies Act, 2013. Further, when the assets are sold, discarded, demolished or destroyed in any financial year, the excess of the written down value over its sale proceeds as scrap, if any should be written off in the same financial year.

Declaration and Payment of Dividend

For the purpose of second proviso to sub-section (1) of section 123, a company may declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserves, in the event of inadequacy or absence of profits in any year, subject to the fulfillment of the following conditions as per Companies (Declaration and Payment of Dividend) Rules, 2014:

(1) The rate of dividend declared should not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: provided that this sub-rule should not apply to a company, which has not declared any dividend in each of the three preceding financial year.

(2) The total amount to be drawn from such accumulated profits should not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(3) The amount so drawn should first be utilized to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(4) 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.

(5) No company should declared dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

Transfer to Reserves

I The Board of Directors are free and can appropriate a part of the profits to the credit of a reserve or reserves as per section 123 (1) of the Companies Act, 2013.

II Appropriation of a part of profit is sometimes made under law.

(A) For example, under the Bank Regulation Act, a fixed percentage of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed.

(B) Transfer of a part of profit to a reserve is also necessary where the company has undertaken, at the time of raising of loan, that before any part of its profits is distributed, a specified percentage of the profit every year should be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount should remain invested in a specified manner.

III Apart from appropriations aforementioned, it may also be necessary to provide for losses and arrears of depreciation and to exclude capital profit, as mentioned earlier, to arrive at the amount of divisible profit.

Declaration of Dividend

As per Section 123 of the Companies Act, 2013, Board of Directors of a company may declare dividend including interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared:

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate

higher than the average dividends declared by the company during the immediately preceding there financial years.

The amount of the dividend, including interim dividend, should be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

No dividend should be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and should not be payable except in cash: Provided that nothing in Section 123 should be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company:

Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

Dividend on preference shares

(a) Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.

(b) But such a right can be exercised subject to there being profits and the Directors recommending payment of the dividend.

Dividend on partly paid shares:

- A company may if so authorised its Article, pay a dividend in proportion to the amount paid on each share (Section 51 of the Companies Act, 2013).

Calls in Advance

Calls paid in advance do not rank for payment of dividend.

Payment of Dividend

As per Section 124 of the Companies Act, 2013:

(1) Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company should, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.

(2) The company should, within a period of ninety days of making any transfer of an amount under this section to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

(3) If any default is made in transferring the total amount or any part thereof to the Unpaid Dividend Account of the company, it should pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12% per annum and the interest accruing on such amount should ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(4) Any person claiming to be entitled to any money transferred to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

(5) Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer should be transferred by the company along with interest accrued, if any, thereon to the Fund "Investor Education and Protection Fund" established section 125 and the company should send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority should issue a receipt to the company as evidence of such transfer.

(6) All shares in respect of which unpaid or unclaimed dividend has been transferred to "Investor Education and Protection Fund" should also be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Provided that any claimant of shares transferred above should be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

(7) If a company fail to comply with any of the requirements of this section, the company will be punishable with fine which will not be less than five lakh rupees but which may

extend to twenty-five lakh rupees and every office of the company who is in default will be punishable with fine which will not be less than one lakh rupees but which may extend to five lakh rupees.

QUESTION 8

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	₹
17,500 9% Preference shares of ₹ 100 each, fully paid up	17,50,000
8,00,000 Equity shares of ₹ 10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	25,00,000
Capital Reserves as on 1.4.20X1	3,00,000
Revaluation Reserves as on 1.4.20X1	3,50,000
Net Profit for the year ended 31st March, 20X2	3,00,000

Average rate of dividend during the last five year has been 12%

SOLUTION

Amount that can be drawn from reserves for 10% dividend

10% dividend on ₹ 80,00,000		₹ 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilized from reserves		6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves ie. ₹ 12,25,000 [10% of (80,00,000 +17,50,000 + 25,00,000)]

Condition III

The balance of reserves after drawl ₹ 18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15% of its paid up capital ie. ₹ 14,62,500 (15% of ₹ 97,50,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated reserves. (as per Declaration and Payment of Dividend Rules, 2014.)

QUESTION 9

Rajianand Carpets Limited started its business in 1992 and closed its accounting on 31st December. The position in different years is given below:

Year	Depreciation charge ₹	Net profit or net loss ₹	Dividend declared ₹
1992	15,000	10,000 (loss)	
1993	18,000	26,000	10,000
1994	20,000	30,000 (loss)	
1995	30,000	35,000	10,000
1996	28,000	10,000 (loss)	
1997	32,000	18,000	

The company wants to know the amount of divisible profit in its hand as at 31st December 1997 in order to determine the rate of dividend that can be declared.

QUESTION 10

Due to inadequacy of profit during the year the company proposes to declare dividend out of general reserve. From the following particulars you are to ascertain the amount that can be drawn applying the Companies (Declaration of Dividend out of Reserve) Rules,1975:

	₹
5,000, 8% preference shares of ₹100 each fully paid	5,00,000
2,00,000 equity shares of ₹10 each fully paid	20,00,000
General reserve	6,00,000
Capital reserve on revaluation of assets	1,00,000
Share premium	1,00,000
Profit and Loss account (credit balance)	18,000
Net profit for the year	1,02,000

Average rate of dividend during the last five years; 15%

PRACTICAL PROBLEMS ON FINANCIAL STATEMENTS

QUESTION 11

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures in ₹ '000)

	Debit		Credit
Land at cost	220	Equity Capital (Shares of ₹ 10 each)	300
Plant & Machinery at cost	770	10% Debentures	200
Trade Receivables	96	General Reserve	130
Inventories (31.3.X2)	86	Profit & Loss A/c	72
Bank	20	Securities Premium	40
Adjusted Purchases	320	Sales	700
Factory Expenses	60	Trade Payables	52
Administration Expenses	30	Provision for Depreciation	172
Selling Expenses	30	Suspense Account	4
Debenture Interest	20		
Interim Dividend Paid	18		
	1670		1670

Additional Information:

(i) The authorised share capital of the company is 40,000 shares of ₹ 10 each.

(ii) The company on the advice of independent valuer wish to revalue the land at ₹ 3,60,000.

(iii) Declared final dividend @ 10%

(iv) Suspense account of ₹ 4,000 represent cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost. You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

QUESTION 12

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemical Ltd.
Trial Balance as at 31st March, 20X1

Particulars	₹	Particulars	₹
Inventory	6,80,000	Equity Shares	
Furniture	2,00,000	Capital (Shares of ₹ 10 each)	25,00,000
Discount	40,000	11% Debentures	5,00,000
Loan to Directors	80,000	Bank loans	6,45,000
Advertisement	20,000	Trade payables	2,81,000
Bad debts	35,000	Sales	42,68,000
Commission	1,20,000	Rent received	46,000
Purchases	23,19,000	Transfer fees	10,000
Plant and Machinery	8,60,000	Profit & Loss account	1,39,000
Rentals	25,000	Depreciation provisions :	
Current account	45,000	Machinery	1,46,000
Cash	8,000		
Interest on bank loans	1,16,000		
Preliminary expenses	10,000		
Fixtures	3,00,000		
Wages	9,00,000		
Consumables	84,000		
Freehold land	15,46,000		
Tools & Equipment's	2,45,000		
Goodwill	2,65,000		
Trade receivables	4,40,000		
Dealer aids	21,000		
Transit insurance	30,000		
Trade expenses	37,000		
Distribution freight	54,000		
Debenture interest	55,000		
	85,35,000		85,35,000

Additional information: Closing Inventory on 31-3-20X1: ₹ 8,23,000.

QUESTION 13

You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 20X2:

Authorised Capital divided into 5,000 6% Preference Shares of ₹ 100 each and 10,000₹

	Dr.	Cr.
	₹	₹
Authorised Capital divided into 5,000 6%		
Preference Shares of ₹ 100 each and ₹ 10,000		
Equity Shares of ₹ 100 each		15,00,000
Subscribed Capital		
5,000 6% Preference Shares of ₹ 100 each		5,00,000
Equity Capital		8,05,000
Purchases - Wines, Cigarettes, Cigars, etc.	45,800	
- Foodstuffs	36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	
Sale - Wines, Cigarettes, Cigars, etc.		68,400
- Food		57,600
Coal and Firewood	3,290	
Carriage and Coolidge	810	
Sundry Expenses	5,840	
Advertising	8,360	
Repairs	4,250	
Rent of Rooms		48,000
Billiard		5,700
Miscellaneous Receipts		2,800
Discount received		3,300
Transfer fees		700

Freehold Land and Building	8,50,000	
Furniture and Fittings	86,300	
Inventory on hand, 1st April, 20X1		
Wines, Cigarettes. Cigars, etc.	12,800	
Foodstuffs	5,260	
Cash in hand	2,200	
Cash with bankers	76,380	
Preliminary and formation expenses	8,000	
2,000 Debentures of ₹ 100 each (6%)		2,00,000
Profit and Loss Account		41,500
Trade payables		42,000
Trade receivables	19,260	
Investments	2,72,300	
Goodwill at cost	5,00,000	
General Reserve		2,00,000
	19,75,000	19,75,000
Wages and Salaries Outstanding	1,280	
Inventory on 31st March, 20X2		
Wines, Cigarettes and Cigars, etc.	22,500	
Foodstuffs	16,400	

Depreciation: Furniture and Fittings @ 5% p.a.: Land and Building @ 2% p.a.

The Equity capital on 1st April, 20X1 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid. The Directors declare a dividend of 8% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

QUESTION 14

From the following particulars furnished by Pioneer Ltd. prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary-

	Debit ₹	Creit ₹
Equity Capital (Face value of ₹ 100)		10,00,000
Calls in Arrears	1,000	
Land	2,00,000	
Building	3,50,000	
Plant and Machinery	5,25,000	
Furniture	50,000	
General Reserve		2,10,000
Loan from State Financial Corporation		1,50,000
Inventory :		
Finished Goods 2,00,000		
Raw Materials 50,000	2,50,000	
Provision for Taxation		68,000
Trade receivables	2,00,000	
Advances	42,700	
Dividend Payable		60,000
Profit and Loss Account		86,700
Cash Balance	30,000	
Cash at Bank	2,47,000	
Loan (Unsecured)		1,21,000
Trade payables (For Goods and Expenses)		2,00,000
	18,95,700	**18,95,700**

The following additional information is also provided:

(1) 2,000 equity shares were issued for consideration other than cash.

(2) Trade receivables of ₹ 52,000 are due for more than six months.

(3) The cost of assets:

Building	₹ 4,00,000
Plant and Machinery	₹ 7,00,000
Furniture	₹ 62,500

(4) The balance of ₹ 1,50,000 in the loan account with State Finance Corporation is inclusive of ₹ 7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.

(5) Balance at Bank includes ₹ 2,000 with Perfect Bank Ltd. which is not a Scheduled bank.

(6) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

PROBLEMS & SOLUTIONS FOR SELF PRACTICE

QUESTION 15

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

(i) Share application money received in excess of issued share capital.

(ii) Share option outstanding account.

(iii) Unpaid matured debenture and interest accrued thereon.

(iv) Uncalled liability on shares and other partly paid investments.

(v) Calls unpaid.

(vi) Intangible Assets under development.

(vii) Money received against share warrant.

SOLUTION :

(i) Current Liabilities/ Other Current Liabilities

(ii) Shareholder's Fund/ Reserve & Surplus

(iii) Current liabilities/ Other Current Liabilities

(iv) Contingent Liabilities and Commitments

(v) Shareholder's Fund/ Share Capital

(vi) Fixed Assets

(vii) Shareholder's Fund/ Money received against share warrants

QUESTION 16

The following extract of Balance Sheet of Star Ltd. (Non-investment) company was obtained:

Balance Sheet (Extract) as on 31st March, 20X1

Liabilities	₹
Authorised capital :	
60,000 14% preference shares of ₹ 100	60,00,000
6,00,000 Equity shares of ₹ 100 each	6,00,00,000
	6,60,00,000
Issued and subscribed capital :	
45,000, 14% preference shares of ₹ 100 each fully paid	45,00,000

3,60,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	2,88,00,000
Share suspense account	60,00,000
Reserves and surplus:	
Capital reserves (₹ 4,50,000 is revaluation reserve)	5,85,000
Securities premium	1,50,000
Secured loans:	
15% Debentures	1,95,00,000
Unsecured loans:	
Public deposits	11,10,000
Cash credit loan from SBI (short term)	3,95,000
Current Liabilities:	
Trade Payables	10,35,000
Assets:	
Investment in shares, debentures, etc.	2,25,00,000
Profit and Loss account (Dr. balance)	45,75,000

Share suspense account represents application money received on shares, the allotment of which is not yet made.

You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if Star Ltd. is an investment company?

SOLUTION :

Computation of effective capital:

	Where Stare Ltd. is a non-investment company ₹	Where Star Ltd. is an investments company ₹
Paid-up share capital -		
45,000, 145 Preference shares	45,00,000	45,00,000
3,60,000 Equity shares	2,88,00,000	2,88,00,000
Capital reserves (5,85,000 - 4,50,000)]	1,35,000	1,35,000
Securities premium	1,50,000	1,50,000
15% Debentures	1,95,00,000	1,95,00,000
Public Deposits	11,10,000	11,10,000
(A)	5,41,95,000	5,41,95,000
Investments	2,25,00,000	-
Profit and Loss account (Dr. balance)	45,75,000	45,75,000
(B)	2,70,75,000	45,75,000
Effective capital (A-B)	2,71,20,000	4,96,20,000

QUESTION 17

On 31st March, 20X1 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 20X1:

Credit Balances:

	₹
Equity shares capital, fully paid shares of ₹ 10 each	70,00,000
General Reserve	15,49,100
Loan from State Finance Corporation	10,50,000
(Secured by hypothecation of Plant & Machinery Repayable within one year ₹ 2,00,000)	
Loans: Unsecured (Long term)	8,47,000
Sundry Creditors for goods & expenses	14,00,000

(Payable within 6 months)	
Profit & Loss Account	7,00,000
Provision for Taxation	8,16,900
	1,33,63,000

Debit Balances:

	₹
Calls in arrear	7,000
Lands	14,00,000
Buildings	20,50,000
Plant and Machinery	36,75,000
Furniture & Fixture	3,50,000
Inventories: Finished goods	14,00,000
Raw Materials	3,50,000
Trade Receivables	14,00,000
Advances: Short -term	2,98,900
Cash in had	2,10,000
Balances with banks	17,29,000
Preliminary Expenses	93,100
Patents & Trademarks	4,00,000
	1,33,63,000

The following additional information is also provided in respect of the above balances:

(i) 4,20,000 fully paid equity shares were allotted as consideration for land & buildings.

(ii) Cost of Building ₹ 28,00,000

(iii) Cost of Plant & Machinery ₹ 49,00,000

Cost of Furniture & Fixture ₹ 4,37,500

(iv) Trade receivables for ₹ 3,80,000 are due for more than 6 months.

(v) The amount of Balances with Bank includes ₹ 18,000 with a bank which is not a scheduled Bank and the deposit of ₹ 5 lakhs are for a period of 9 months.

(vi) Unsecured loan includes ₹ 2,00,000 from a bank and ₹ 1,00,000 from related parties.

You are not required to give previous year figures. You are required to prepare the Balance Sheet of the Company as on 31st March, 20X1 as required under Schedule III of the Companies Act, 2013.

SOLUTION :

Bose and Sen Ltd.
Balance Sheet as on 31st March, 20X1

	Particulars	Notes	Figures at the end of current reporting period (₹)
Equity and Liabilities			
1	**Shareholder's funds**		
a	Share capital	1	69,93,000
b	Reserves and Surplus	2	21,56,000
2	**Non-current liabilities**		
a	Long-term borrowings	3	16,97,000
3	**Current liabilities**		
a	Trade Payables		14,00,000
b	Other current liabilities	4	2,00,000
c	Short-term provisions	5	8,16,900
	Total		1,32,62,900
Assets			
1	**Non-current assets**		
a	Fixed assets		
	Tangible assets	6	74,75,000
	Intangible assets (Patents & Trade Marks)		4,00,000
2	**Current assets**		
a	Inventories	7	17,50,000
b	Trade receivables	8	14,00,000
c	Cash and bank balances	9	19,39,000
d	Short-term loans and advances		2,98,900
	Total		1,32,62,900

Notes to accounts

1	**Share Capital**		₹
	Equity share capital		
	Issued, subscribed and called up 7,00,000 Equity Shares of ₹ 10 each	70,00,000	
	(Out of the above 4,20,000 Shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(7,000)	69,93,000
		Total	**69,93,000**
2	**Reserves and Surplus**		
	General Reserve		15,49,100
	Surplus (Profit & Loss A/c)	7,00,000	
	Less: Preliminary expenses	(93,100)*	6,06,900
		Total	21,56,000
	* Preliminary expenses have been written off in line with Accounting Standards.		
3	**Long-term borrowings**		
	Secured		
	Term Loan		
	Loan from State Finance Corporation		8,50,000
	(₹ 10,50,000 - ₹ 2,00,000)		
	(Secured by hypothecation of Plant and Machinery		
	Unsecured		
	Bank Loan	2,00,000	
	Loan from related parties	1,00,000	
	Others	5,47,000	8,47,000
		Total	16,97,000
4	**Other current liabilities**		
	Current maturities of long-term debt- loan Instalment repayable within one year		2,00,000

5	**Short-term provisions**		
	Provisions for taxation		8,16,900
6	**Tangible assets**		
	Land		14,00,000
	Buildings	28,00,000	
	Less: Depreciation	(7,50,000)	20,50,000
		(b.f.)	
	Plant & Machinery	49,00,000	
	Less: Depreciation	(12,25,000 (b.f)	36,75,000
	Furniture & Fittings	4,37,500	
	Less: Depreciation	(87,500) (b.f.)	3,50,000
		Total	74,75,000
7	**Inventories**		
	Raw Material		3,50,000
	Finished goods		14,00,000
			17,50,000
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		3,80,000
	Other Debts		10,20,000
		Total	14,00,000
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank with Scheduled Banks	12,11,000	
	With others	18,000	12,29,000
	Cash in hand		2,10,000
	Other bank balances		
	Bank deposits for period of 9 months 5,00,000		5,00,000
		Total	19,39,000

QUESTION 18 (CA INTER DEC. 2021 5 MARKS)

X Ltd. a non investment company has been incurring losses for the past few years. The company provides the following information for the current year:

	₹ in lakhs
Paid up equity share capital	90
Paid up preference share capital	10
Reserves (including revaluation reserve ₹ 5 lakhs)	75
Securities premium	30
Long term loans	20
Deposit repayable after one year	10
Application money pending allotment	360
Accumulated losses not written off	40
Investment	90

X Ltd. has only one whole time director, Mr. Y. You are required to calculate the amount of maximum remuneration that can be paid to him if no special resolution is passed at the general meeting of the company in respect of payment of remuneration for a period not exceeding three years.

SOLUTION :

Calculation of effective capital and maximum amount of managerial remuneration

	(₹ In lakhs)
Paid up equity share capital	90
Paid up Preference share capital	10
Reserve excluding Revaluation reserve (75 – 5)	70
Securities premium	30
Long term loans	20
Deposits repayable after one year	10
	230
Less: Accumulated losses not written off	(40)
Investments	(90)
Effective capital for the purpose of managerial remuneration	100

Since X Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of effective capital of the company as the effective capital is less than 5 crores. Therefore, maximum remuneration payable to the Managing Director should be @ ₹ 60,00,000 per annum.

Note: Revaluation reserve, and application money pending allotment are not included while computing effective capital of Kumar Ltd.

QUESTION 19

Ring Ltd. was registered with a nominal capital of ₹ 10,00,000 divided into shares of ₹ 100 each. The following Trial Balance is extracted from the books on 31st March, 20X2:

Particulars	₹	Particulars	₹
Buildings	5,80,000	Sale	10,40,000
Machinery	2,00,000	Outstanding Expenses	4,000
Closing Stock	1,80,000	Provision for Doubtful	6,000
Loose Tools	46,000	Debts (1-4-20X1)	
Purchases (Adjusted)	4,20,000	Equity Share Capital	4,00,000
Salaries	1,20,000	General Reserve	80,000
Director's Fees	20,000	Profit and Loss A/c	50,000
Rent	52,000	(1-4-20X1)	
Depreciation	40,000	Creditors	1,84,000
Bed Debts	12,000	Provision for depreciation:	
Investment	2,40,000	On Building 1,00,000	
Interest accrued on investment	4,000	On Machinery 1,10,000	2,10,000
Debenture Interest	56,000	14% Debentures	4,00,000
Advances Tax	1,20,000	Interest on Debentures	28,000
Sundry expenses	36,000	accrued but not due	
Debtors	2,50,000	Interest on Investments	24,000
Bank	60,000	Unclaimed dividend	10,000
	24,36,000		24,36,000

You are required to prepare statement of Profit and Loss for the year ending 31st March, 20X2 and Balance sheet as at that date after taking into consideration the following information :

(a) Closing stock is more than opening stock by ₹ 1,60,000;

(b) Provide to doubtful debts @ 4% on Debtors

(c) Make a provision for income tax @ 30%.

(d) Depreciation expense included depreciation of ₹ 16,000 on Building and that of ₹ 24,000 on Machinery.

(e) The directors declared a dividend @ 25% and transfer to General Reserve @ 10%

(f) Bills Discounted but not yet matured ₹ 20,000.

QUESTION 20

Provisional Balance Sheet of P Ltd. as at 31st March, 2014 was as under:

Liabilities	₹	₹	Asset	₹
Share Capital			Fixed Assets (at cost less depreciation)	7,00,000
50,000 equity shares of ₹ 10 each, ₹ 7 per share called up	3,50,000			
Less: Calles in arrears on 10,000 Shares @ ₹ 2 per share	(20,000)		Cash & bank balances	2,00,000
	3,30,000		Other Current assets	6,00,000
Add: Calls in advance on 40,000 shares @ ₹ 3 per share	1,20,000	4,50,000		
20,000 10% Redeemable preference shares of ₹ 10 each, fully paid up		2,00,000		
Reserves & Surplus :				
General Reserve		3,00,000		
Profit & Loss Account		2,70,000		
Trade Payables		2,80,000		
		15,00,000		15,00,000

Calls in arrear are outstanding for 6 months. Calls in advance were also received 6 months back. Interest @ 10% p.a. on calls in advance and 12% p.a. on calls in arrear are allowed/ charged.

The Board of Directors have recommended that:

(i) Dividend for the year 2013-14 be declared @ 20% on equity shares.

(ii) Money on calls in advance be refunded. Calls in Arrear with interest received.

(iii) The preference shares, which are redeemable at a premium of 10% any time after 31st March, 2014 may be redeemed by issue of 10% Debentures of ₹ 100 in cash.

Show Journal Entries to give effect to the above proposals including payment and receipt of cash and redraft the Statement of Profit and Loss and Balance Sheet of P Ltd.

LATEST EXAMINATION PROBLEMS

QUESTION 21 (CA INTER NOV 2019) (10 MARKS)

From the following particulars furnished by the Prashant Ltd., prepare the Balance Sheet as at 31st March, 2019 as required by Schedule III of the Companies Act, 2013 :

Particulars	Debit (₹)	Credit (₹)
Equity share capital (face value of ₹ 10 each)		15,00,000
Calls-in-arrears	5,000	
Land	5,50,000	
Building	4,85,000	
Plant & machinery	5,60,000	
General reserve		2,70,000
Loan from State Financial Corporation		2,10,000
Inventories	3,15,000	
Provision for taxation		72,000
Trade receivables	2,95,000	
Short-term loans & advances	58,500	
Profit & loss account		1,06,800
Cash in hand	37,300	
Cash at bank	2,85,000	
Unsecured loans		1,65,000
Trade payables		2,67,000
Total	25,90,800	25,90,800

The following additional information is also provided :

(1) 10,000 equity shares were issued for consideration other than cash.

(2) Trade receivables of ₹ 55,000 are due for more than six months.

(3) The cost of building and plant & machinery is ₹ 5,50,000 and ₹ 6,25,000 respectively.

(4) The loan from State Financial Corporation is secured by hypothecation of plant & machinery. The balance of ₹ 2,10,000 in this account is inclusive of ₹ 10,000 for interest accrued but not due.

(5) Balance at Bank included ₹ 15,000 with Aakash Bank Ltd., which is not a scheduled bank.

SOLUTION:

Prashant Ltd.
Balance Sheet as on 31st March, 2019

Particulars	Notes	₹
Equity and Liabilities		
1 **Shareholders' funds**		
a Share capital	1	14,95,000
b Reserves and Surplus	2	3,76,800
2 **Non-current liabilities**		
Long-term borrowings	3	3,65,000
3 **Current liabilities**		
a Trade Payables		2,67,000
b Other current liabilities	4	10,000
c Short-term provisions	5	72,000
Total		25,85,800
Assets		
1 **Non-current assets**		
Property, Plant and Equipment	6	15,95,000
2 **Current assets**		
a Inventories		3,15,000
b Trade receivables	7	2,95,000
c Cash and bank balances	8	3,22,300
d Short-term loans and advances		58,500
Total		25,85,800

Notes to accounts

		₹
1 Share Capital		
Issued & subscribed & fully paid up		
1,50,000 Equity Shares of ₹ 10 each		
(of the above 10,000 shares have been issued For		
Consideration other than cash)	15,00,000	
Less: Calls in arrears	(5000)	14,95,000
2 Reserves and Surplus		
General Reserve		2,70,000
Profit & Loss balance		1,06,800
	Total	3,76,800
3 Long-term borrowings		

QUESTION 22 (CA INTER NOV 2019)(5 MARKS)

The following extract of Balance Sheet of Prabhat Ltd. (Non investment Company) was obtained:

Balance Sheet (Extract) as on 31st March, 2019

Liabilities	₹
Issued and subscribed capital:	
30,000, 12% preference shares of ₹ 100 each (fully paid)	30,00,000
24,00,000 equity shares of ₹10 each, ₹ 8 paid up	1,92,00,000
Share suspense account	40,00,000
Reserves and Surplus:	
Securities premium	1,00,000
Capital reserves (₹ 3,00,000 is revaluation reserve)	3,90,000
Secured loans:	
12% debentures	1,30,00,000
Unsecured loans:	
Public deposits	7,40,000

Current liabilities:	
Trade payables	6,90,000
Cash credit from SBI (short term)	9,30,000
Assets	
Investments in shares, debentures etc.	1,50,00,000
Profit & loss account (Dr. balance)	30,50,000

Share suspense account represents application money received on shares, the allotment of which is not yet made.

You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if Prabhat Ltd. is an investment company?

SOLUTION :

Computation of effective capital

	Where Prabhat Ltd. Is a non-investment company ₹	**Where Prabhat Ltd. is an investment company** ₹
Paid-up share capital —		
30,000, 12% Preference shares	30,00,000	30,00,000
24,00,000 Equity shares of ₹ 8 paid up	1,92,00,000	1,92,00,000
Capital reserves (3,90,000 – 3,00,000)	90,000	90,000
Securities premium	1,00,000	1,00,000
12% Debentures	1,30,00,000	1,30,00,000
Public Deposits	7,40,000	7,40,000
(A)	36,130,000	36,130,000
Investments	1,50,00,000	—
Profit and Loss account (Dr. balance)	30,50,000	30,50,000
(B)	1,80,50,000	30,50,000
Effective capital (A–B)	1,80,80,000	3,30,80,000

QUESTION 23 (CA INTER NOV 2020)(5MARKS)

Following is the draft Profit & Loss Account of X Ltd. for the year ended 31st March, 2020:

	Amount (₹)		Amount (₹)
To Administrative Expenses	5,96,400	By Balance b/d	7,25,300
To Advertisement Expenses	1,10,500	By Balance from Trading A/c	42,53,650
To Sales Commission	1,05,550	By Subsidies received from Government	3,50,000
To Director's fees	1,48,900		
To Interest on Debentures	56,000		
To Managerial Remuneration	3,05,580		
To Depreciation on Fixed Assets	5,78,530		
To Provision for taxation	12,50,600		
To General Reserve	5,50,000		
To Investment Revaluation Reserve	25,800		
To Balance c/d	16,01,090		
	53,28,950		53,28,950

Depreciation on Fixed Assets as per Schedule II of the Companies Act, 2013 was ₹ 6,51,750. You are required to calculate the maximum limits of the managerial remuneration as per Companies Act, 2013.

SOLUTION:

Calculation of net profit of X Ltd. as per the Companies Act, 2013

	₹	₹
Balance from Trading A/c		42,53,650
Add: Subsidies received from Government		3,50,000
		46,03,650
Less: Administrative expenses	5,96,400	
Advertisement expenses	1,10,500	
Sales commission	1,05,550	
Director's fees	1,48,900	
Interest on debentures	56,000	
Depreciation on fixed assets as per Schedule II	6,51,750	(16,69,100)
Profit u/s 198		29,34,550

Maximum Managerial remuneration under Companies Act, 2013 = 11% of ₹ 29,34,550 = ₹ 3,22,800 (rounded off).

QUESTION 24 (CA INTER JAN 21)(5MARKS)

The following is the Draft Profit & Loss A/c of Brown Ltd. the year ended 31st March,2020:

	Amount (₹)		Amount (₹)
To Administrative expenses	4,99,200	By Balance b/d	6,27,550
To Advertisement	1,18,200	By Balance from	
To Commission on sales	95,225	Trading A/c	38,15,890
To Director's Fees	1,35,940	By Subsidies	
To Interest on debentures	28,460	received from Govt.	2,50,000
To Managerial remuneration	2,75,550	By Profit on sale of	20,000
To Depreciation on fixed assets	4,82,565	forfeited shares	
To Provision for Taxation	11,50,200		
To General Reserve	4,50,000		

To Investment Revaluation Reserve	52,800		
To Balance c/d	14,25,300		______
	47,13,440		47,13,440

Depreciation on fixed assets as per Schedule II of the Companies Act, 2013 was ₹ 5,15,675. You are required to calculate the maximum limit of managerial remuneration as per Companies Act, 2013.

SOLUTION:

Calculation of net profit u/s 198 of the Companies Act, 2013

	₹	₹
Balance from Trading A/c		38,15,890
Add: Subsidies received from Government		2,50,000
Less: Administrative, selling and distribution expenses	7,12,625	40,65,890
(4,99,200 + 1,18,200 + 95,225)		
Director's fees	1,35,940	
Interest on debentures	28,460	
Depreciation on fixed assets as per Schedule II	5,15,675	(13,92,700)
Profit u/s 198		26,73,190

Maximum Managerial remuneration under Companies Act, 2013= 11% of ₹ 26,73,190 = ₹ 2,94,051 (rounded off).

Note:

1. Investment Revaluation reserve not to be deducted for calculation of profit under section 198;
2. Profit on sale of forfeited shares not to added for calculation of profit under section 198.

*Alternative presentation of the above answer also possible by starting from Net profit as per Profit and Loss Account.

QUESTION 25 (CA INTER MAY 23 EXAM)(20MARKS)

The following is the Trial Balance of H Ltd., as on 31st March, 2021

	Dr.	Cr.
Equity Capital (Shares of ₹ 100 each)		8,05,000
5,000, 6% preference shares of ₹ 100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000
Profit & Loss A/c (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2020*)	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	1,30,29,000

Additional Information:

(i) The authorised share capital of the company is : ₹

5,000, 6% preference shares of ₹ 100 each 5,00,000

10,000, equity shares of ₹ 100 each 10,00,000

Issued equity capital as on 1st April 2020 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares of ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 2020. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid.

(ii) On 31st March 2021, the Directors declared a dividend of 5% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

(iii) The company on the advice of independent valuer wishes to revalue the land at ₹ 36,00,000.

(iv) Suspense account of ₹ 40,000 represents amount received for the sale of some of the machinery on 1-4-2020. The cost of the machinery was ₹ 1,00,000 and the accumulated depreciation thereon being ₹ 30,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Amortize 1/5th of Goodwill.

You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures & taxation.

SOLUTION:

H Ltd

Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in ₹
Equity and Liabilities		
I. Shareholders' Funds		
α. Share Capital	1	13,00,000
b. Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
α. Long Term Borrowings	3	4,00,000
III. Current Liabilities		
α. Trade Payables	4	10,40,000
β. Other Current Liabilities	5	70,000
Total		82,01,900
Assets		
I. Non-Current Assets		
α. Property, Plant and Equipment	6	40,61,000

b. Intangible Assets	7	10,00,000
II. Current Assets		
α. Inventories		9,50,000
β. Trade Receivables		19,60,000
χ. Cash and Cash equivalents		2,30,900
Total		82,01,900

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No	Amount in ₹
I. Revenue from operations		60,00,000
Total Revenue		60,00,000
II. Expenses		
Purchases (adjusted)		22,32,100
Finance Costs	8	36,000
Depreciation and Amortization	9	3,17,000
Other Expenses	10	32,30,000
Total Expenses		58,15,100
III. Profit/(Loss) for the period		1,84,900

Notes to Accounts

(Amount in ₹)

1	**Share Capital**		
	α. Authorized Capital		
	5,000, 6% Preference shares of ₹ 100/- each		5,00,000
	10,000 Equity Shares of ₹100/- each		10,00,000
			15,00,000
	β. Issued & Subscribed Capital		
	5,000, 6% Preference shares of ₹100/- each		5,00,000
	8,000, Equity shares of ₹100/- each		8,00,000

	Total		13,00,000
2	**Reserves & Surplus**		
	Capital Reserve (100 X (90-40))		5,000
	Revaluation Reserve (36,00,000-24,00,000)		12,00,000
	General Reserve		40,00,000
	Surplus	1,84,900	
	Add: Balance from previous year	72,000	
	Less: Dividends declared	(70,000)	
	Profit/(Loss) carried forward to Balance Sheet		1,86,900
	Total		53,91,900
3.	**Long-Term Borrowings**		
	Secured		
	9% Debentures		4,00,000
4.	**Trade Payables**		10,40,000
5	**Other Current Liabilities**		
	Dividend Payable		
	Preference Dividend		30,000
	Equity Dividend		40,000
	Total		70,000
6.	**Property, Plant and Equipment**		
	Land		
	Opening balance	24,00,000	
	Add : Revaluation Adjustment	12,00,000	
	Closing Balance		36,00,000
	Plant and Machinery		
	Opening Balance	7,70,000	
	Less : Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	

	Closing Balance		4,61,000
	Total		40,61,000
7.	**Intangible Assets**		
	Goodwill		12,50,000
	Less : Amortized (1/5th)		(2,50,000)
	Total		10,00,000
8.	**Finance Costs**		
	Debenture Interest		36,000
9.	**Depreciation and Amortization**		
	Plant and Machinery		67,000
	Goodwill		2,50,000
	Total		3,17,000
10.	Other Expenses		
	Factory Expenses		15,00,000
	Selling Expenses		14,00,000
	Administrative Expenses		3,00,000
	Loss on sale of Plant and Machinery		
	Bank Value		
	(1,00,000 - 30,000)	70,000	
	Less : Sale Value	(40,000)	30,000
			32,30,000

Note

1. The inventories (31.3.20) amounting ₹ 9,50,000 (given in the trial balance of the question) should have been as closing inventory i.e. as on 31.3.21. In the above solution, this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on 31.3.21 and in that case, the balance sheet will not tally without using suspense account amounting ₹ 9,50,000.
2. The financial statements given in the above answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the question.

However, practically dividends are declared in the annual general meetings which take place after the reporting date.

QUESTION 26 (CA INTER MAY 2022 5 MARKS)

The following information is provided by Exe Limited for 31st March,2022:

Particulars	₹
Net Profit before Income Tax and Managerial Remuneration, but after	
Depreciation and Provision for Repairs	9,40,000
Depreciation provided in the Books	4,05,000
Provision for repairs for Machinery during the year	35,000
Depreciation Allowable under Schedule II	3,40,000
Actual Expenditure incurred on Repairs during the year	25,000
Provision for Income Tax	1,50,000

You are required to calculate the Managerial Remuneration for Exe Limited as on 31st March, 2022 in the following situations:

(i) There is only one Whole Time Director.

(ii) There are two Whole Time Directors.

(iii) There are two Whole Time Directors, a part time Director and a Manager.

SOLUTION :

Calculation of net profit u/s 198 of the Companies Act, 2013

	₹	₹
Net profit before income tax and managerial remuneration but after depreciation and provision for repairs		9,40,000
Add: Depreciation provided	4,05,000	
Provision for repairs	35,000	4,40,000
		13,80,000
Less: Repairs	25,000	
Depreciation as per schedule III	3,40,000	3,65,000
Profit u/s 198		10,15,000

Maximum Managerial remuneration under Companies Act, 2013

(i) When there is only one Whole time director: The remuneration payable to any one managing director; or whole-time director or manager should not exceed 5% of the net profits of the company. Therefore Managerial remuneration will be ₹ 50,750 i.e 5% of ₹10,15,000.

(ii) When there are two Whole time directors: if there are more than one such director, remuneration should not exceed 10% of the net profits to all such directors and manager taken together. Therefore Managerial remuneration will be ₹1,01,500 i.e 10% of ₹10,15,000.

(iii) When there are two whole time directors, a part time director and a manager, then 11% of the net profits of the company. Therefore Managerial remuneration will be ₹ 1,11,650 i.e 11% of ₹10,15,000.

QUESTION 27 (CA INTER NOV 2022 20 MARKS)

The following is the Trial Balance of Anmol Limited as on 31st March, 2022

Debit Balance	Amount (₹)	Credit Balances	Amount (₹)
Purchases	82,95,000	Sales	1,25,87,000
Wages and Salaries	12,72,000	Commission	72,500
Rent	2,20,000	Equity Share Capital	10,00,000
Rates and Taxes	50,000	General Reserve	10,00,000
Selling & Distribution Expenses	4,36,000	Surplus (P&L A/c) 01.04.2021	8,75,000
Directors Fees	32,000	Securities Premium	2,50,000
Bad Debts	38,500	Term Loan from Public Sector Bank	1,02,00,000
Interest on Term Loan	8,05,000	Trade Payables	55,08,875
Land	24,00,000	Provision for Depreciation:	
Factory Building	36,80,000	On Plant & Machinery	9,37,500
Plant and Machinery	62,50,000	On Furniture and Fittings	82,500
Furniture and Fittings	8,25,000	On Factory Building	1,84,000
Trade Receivables	64,75,000	Provision for Doubtful Debts	25,000
Advance Income Tax Paid	37,500	Bills Payable	1,25,000
Stock (1st April,2021)	9,25,000		
Bank Balances	9,75,000		

Cash on Hand	1,31,875		
Total	3,28,47,875		3,28,78,875

Following information is provided:

(1) The Authorized Share Capital of the Company is 2,00,000 Equity Shares of ₹ 10 each. The Company has issued 1,00,000 Equity Shares of ₹ 10 each.

(2) Rent of ₹ 20,000 and Wages of ₹ 1,56,500 are outstanding as on 31st March, 2022.

(3) Provide Depreciation @ 10% per annum on Plant and Machinery, 10% on Furniture and Fittings and 5% on Factory Building on written down value basis.

(4) Closing Stock as on 31st March, 2022 is ₹ 11,37,500.

(5) Make a provision for Doubtful Debt @ 5% on Debtors.

(6) Make a provision of 25% for Corporate Income Tax.

(7) Transfer ₹ 1,00,000 to General Reserve.

(8) Term Loan from Public Sector Bank is secured against Hypothecation of Plant and Machinery. Installment of Term Loan falling due within one year is ₹ 17,00,000.

(9) Trade Receivables of ₹ 85,600 are outstanding for more than six months.

(10) The Board declared a dividend @10% on Paid up Share Capital on 5 th April, 2022.

You are required to prepare Balance Sheet as on 31st March 2022 and Statement of Profit and Loss with Note to Accounts for the year ending 31st March, 2022 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures.

SOLUTION :

Balance Sheet of Anmol Ltd. as at 31st March, 2022

Particulars	**Note No**	₹
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	10,00,000
b Reserves and Surplus	2	24,76,462
2 Non-current liabilities		
a Long-term borrowings	3	85,00,000
3 Current liabilities		
a Short term borrowings (Installment of term loan falling due in one year)		17,00,000

			Notes	Amount
	b	Trade Payables	4	56,33,875
	c	Other current liabilities	5	1,76,500
	d	Short term provisions (provision for tax)		1,16,988
		Total		1,96,03,825
ASSETS				
1	**Non-current assets**			
	a	PPE	6	1,11,70,700
2	**Current assets**			
	a	Inventories		11,37,500
	b	Trade receivables	7	61,51,250
	c	Cash and bank balances	8	11,06,875
	d	Short term loans & advances (Advance tax paid)		37,500
				1,96,03,825

Statement of Profit and Loss of Anmol Ltd.

for the year ended 31st March, 2022

	Particulars	**Notes**	**Amount**
I.	Revenue from operations		1,25,87,000
II.	Other income (Commission income)		72,500
III.	Total Income (I + II)		1,26,59,500
IV.	Expenses:		
	Purchases of Inventory-in-Trade		82,95,000
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	9	(2,12,500)
	Employee benefits expense	10	14,28,500
	Finance costs (interest on term loan)		8,05,000
	Depreciation		7,80,300
	Other operating expenses	11	10,95,250
	Total expenses		1,21,91,550
V.	Profit (Loss) for the period (III - IV)		4,67,950

VI.	(-) Tax (25%)		(1,16,988)
VII.	PAT		3,50,962

Notes to accounts

			₹
1	Share Capital		
	Equity share capital		
	Authorized		
	2,00,000 equity shares of ₹ 10 each		20,00,000
	Issued & subscribed		
	1,00,000 equity shares of ₹ 10 each		10,00,000
2	Reserves and Surplus		
	General Reserve	10,00,000	
	Add: current year transfer	1,00,000	11,00,000
	Profit & Loss balance		
	Opening balance: Surplus P & L A/c	8,75,500	
	Profit for the year	3,50,962	
	Less: Appropriations:		
	Transfer to General reserve	(1,00,000)	11,26,462
	Securities premium		2,50,000
			24,76,462
3	Long-term borrowings		
	Term loan from public sector bank (Secured by hypothecation)		1,02,00,000
	Less: Installment of Term loan falling due within one year		(17,00,000)
	Total		85,00,000
4	Trade payables		
	Trade payables	55,08,875	

	Bills payable	1,25,000	56,33,875
5	Other current liabilities		
	Rent outstanding	20,000	
	Wages and Salaries Outstanding	1,56,500	1,76,500
6	PPE (Note 2)		
	Land		24,00,000
	Factory Buildings		33,21,200
	Plant & Machinery		47,81,250
	Furniture & Fittings		6,68,250
	Total		1,11,70,700
7	Trade receivables		
	Debtors Outstanding for period exceeding 6 months	85,600	
	Other debts	63,89,400	
	Less: Provision for doubtful debt	(3,23,750)	61,51,250
8	Cash and bank balances		
	Cash and cash equivalents		
	Bank balance	9,75,000	
	Cash on hand	1,31,875	11,06,875
9	Changes in Inventories		
	Opening Inventory	9,25,000	
	Less: Closing Inventory	(11,37,500)	
	Change		(2,12,500)
10	Employee benefit expense		
	Wages and Salaries	12,72,000	
	Add: Wages and Salaries Outstanding	1,56,500	14,28,500
11	Other operating expenses		
	Rent	2,20,000	
	Add: outstanding	20,000	2,40,000

	Rates and Taxes		50,000
	Selling & Distribution expenses		4,36,000
	Bad debts		38,500
	Provision for Doubtful Debts (3,23,750-25,000)		2,98,750
	Director's fee		32,000
	Total		10,95,250

Note:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2022. Such dividends will be disclosed in notes only.

2. **Calculation of depreciation:**

	Book value	Accumulated depreciation	WDV	Current year Depreciation	Current year WDV
Land	24,00,000	-	24,00,000	-	24,00,000
Factory building	36,80,000	1,84,000	34,96,000	1,74,800	33,21,200
Plant & Machinery	62,50,000	9,37,500	53,12,500	5,31,250	47,81,250
Furniture & Fittings	8,25,000	82,500	7,42,500	74,250	6,68,250
Total				7,80,300	1,11,70,700

QUESTION 28 (CA INTER NOV 2022 5 MARKS)

The following information is provided by Sarovar Limited, a Non-Investment company, incurring losses from past 2 years:

Particulars	Amount in (₹)
Share Capital (Issued & Subscribed)	1,05,73,000
Capital Reserve	90,000
Securities Premium	67,000
Public Deposits	14,50,000
Trade Payables	1,98,000

Investment in other Co's Shares	50,00,000
Profit & Loss (Dr.)	10,25,000

Sarovar Limited has a one Whole time Director, Mr. Shyam.

You are required to calculate the effective capital and the maximum remuneration that can be paid to Mr. Shyam, if, no special resolution is passed at the General Meeting of the company for the payment of remuneration for a period not exceeding three years.

SOLUTION :

Calculation of effective capital and maximum amount of monthly remuneration

	(₹)
Paid up share capital	1,05,73,000
Capital reserves	90,000
Securities premium	67,000
Public Deposits	14,50,000
(A)	1,21,80,000
Less: Investments	50,00,000
Accumulated losses not written off (P & L A/c Dr. balance)	10,25,000
(B)	(60,25,000)
Effective capital for the purpose of managerial remuneration (A-B)	61,55,000

Since Sarovar Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of effective capital of the company. The effective capital of the company is less than 5 crores, therefore maximum remuneration payable to the Managing Director should be @ ₹ 60,00,000 per annum.

INTERNAL RECONSTRUCTION

CONCEPT 1: PROBLEMS ON CONVERSION IN FACE VALUE OF EQUITY SHARES

QUESTION 1

The following is the Balance Sheet of Rocky Limited as at 31st March 2018:

In lacs

Liabilities:-	
Fully paid equity shares of ₹10 each	500
Capital reserve	6
12% debentures	400
Debenture interest outstanding	48
Trade creditors	165
Director's Remuneration outstanding	10
Other outstanding expenses	11
Provisions	33
	1,173
Assets:	
Goodwill	15
Land and building	184
Plant and machinery	286
Furniture and fixtures	41
Stock	142
Debtors	80
Cash and bank	27
Discount on issue of debentures	8
Profit and loss account	390
	1,173

The following scheme of internal reconstruction was framed, approved by the court, all the concerned parties and implemented:

(a) All the equity shares converted into the same number of fully paid shares of ₹2.50 each.

(b) Directors agree to forego their outstanding remuneration.

(c) The debenture holders also agree to forego outstanding interest in return of their 12% debentures being converted into 13% debentures.

(d) The existing shareholders agree to subscribe for cash, fully paid equity shares of ₹2.50 each for ₹125 lacs.

(e) Trade creditors are given the option of either to accept fully paid equity shares of ₹2.50 each for the amount due to them or to accept 80% of the amount due in cash. Creditors for ₹65lacs accept equity shares whereas those for ₹100lacs accept ₹80lacs in cash in full settlement.

(f) The assets are revalued as under: (In Lacs)

a. Land and building	230
b. Plant and machinery	220
c. Stock	120
d. Debtors	76

Pass the journal entries for all the above-mentioned transactions and draft the company's Balance Sheet immediately after the reconstruction

QUESTION 2

Green Limited had decided to reconstruct the Balance Sheet since it had accumulated huge losses. The following is the Balance Sheet of the company on 31.3.2018 before reconstruction:

Balance Sheet of Green Limited as at 31.3.2018

Liabilities		Assets	
50,000 equity shares of ₹50 each	25,00,000	Goodwill	20,00,000
		Building	10,00,000
1,00,000 equity shares of ₹50 each., ₹40 paid up	40,00,000	Plant	10,00,000
		Computers	25,00,000
12% first Debentures	5,00,000	Investment	nil
12% second Debentures	10,00,000	Current assets	nil
Sundry creditors	5,00,000	Profit and Loss account	20,00,000
	85,00,000		85,00,000

The following is the interest of Mr. X and Mr. Y in Green Limited:

	Mr. X (₹)	Mr. Y (₹)
12% first Debentures	3,00,000	2,00,000
12% second Debentures	7,00,000	3,00,000
Sundry creditors	2,00,000	1,00,000
	12,00,000	6,00,000
Fully paid up ₹50 shares	3,00,000	2,00,000
Partly paid up shares	5,00,000	5,00,000

The following scheme of reconstruction is approved by all parties interested and also by the court:-

(a) Uncalled capital is to be called up in full and such shares and the other fully paid up shares be converted into equity shares of ₹20 each.

(b) Mr. X is to cancel ₹7,00,000 of his total debt (other than share amount) and to pay ₹2 lakh to the company and to receive new 14% first debentures for the balance amount.

(c) Mr. Y is to cancel ₹3,00,000 of his total debt (other than equity shares) and to accept new 14% first debentures for the balance.

(d) The amount thus rendered available by the scheme shall be utilized in writing off of goodwill, Profit and Loss account and the balance to write off the value of computers.

You are required to draw the journal entries to record the same and also show the Balance Sheet of the reconstructed company

QUESTION 3

The paid up capital of Toy Limited amounted to ₹2,50,000 consisting of 25,000 equity shares of ₹10 each.

Due to losses incurred by the company continuously, the directors of the company prepared a scheme for reconstruction, which was duly approved by the court. The terms of reconstruction were as under:

(a) In lieu of their present holdings; the shareholders are to receive:

i. Fully paid equity shares equal to 2/5th of their holding.

ii. 5% preference shares fully paid up to the extent of 20% of the above new equity shares.

iii. 3,000 6% second debentures of ₹10 each.

(b) An issue of 2,500 5% first debentures of ₹10 each was made and fully subscribed in cash.

(c) The assets were reduced as follows:

i. Goodwill from ₹1,50,000 to ₹75,000

ii. Machinery from ₹50,000 to ₹37,500

iii. Leasehold premises from ₹75,000 to ₹62,500.

Show the journal entries to give effect to the above scheme of reconstruction.

QUESTION 4

The Balance Sheet of BCR Limited as on 31.03.2018 appears as below:

Liabilities	₹
Share capital:	
1,50,000 equity shares of ₹10 each fully paid	15,00,000
5,000 11% preference shares of ₹100 each fully paid	5,00,000
Secured loans:	
11% Debentures	5,00,000
Interest accrued and due on Debentures	1,10,000
Bank overdrafts	6,30,000
Unsecured loans	5,00,000
Interest accrued and due	1,50,000
Current liabilities	5,00,000
	43,90,000
Assets:	
Fixed assets at cost	20,00,000
Less depreciation reserves	15,00,000
	5,00,000
Stocks and stores	6,00,000
Receivables	14,50,000
Other current assets	2,00,000
Miscellaneous expenditure: Profit and Loss account	16,40,000
Total	43,90,000

A scheme of reconstruction has been agreed amongst the shareholders and the creditors with the following salient features:

(a) Interest due on unsecured loans is waived.

(b) 50% of the interest due on the Debentures is waived.

(c) The 11% preference shares holders rights are to be reduced to 50% and converted into 15% Debentures of ₹100 each.

(d) Current liabilities would be reduced by ₹50,000 on account of provisions no longer required.

(e) The banks agree to the arrangement and to increase the case credit/over draft limits by ₹1,00,000 upon the shareholders agreeing to bring in a like amount by way of new equity.

(f) Besides additional subscription as above, the equity shareholders agree to convert the existing equity share into new 10-rupee shares of total value ₹5,00,000.

(g) The debit balance in the Profit and Loss account is to be wiped out. ₹2,60,000 provided for doubtful debts and the value of the fixed assets increased by ₹4,00,000.

Redraft the Balance Sheet of the company based on the above scheme of reconstruction.

QUESTION 5

Paradise Limited which had experienced trading difficulties, decided to reorganize its finances. On March 31,2018 a final Trial balance extracted from the books of the company showed the following position:

	Dr (₹)	Cr (₹)
Share capital, Authorised and issued:		
1,500 6% Cumulative preference shares of ₹100 each		1,50,000
2,000 equity shares of ₹100 each		2,00,000
Capital reserve		36,000
Profit and Loss account	1,10,375	
Preliminary expenses	7,250	
Goodwill at cost	50,000	
Trade creditors		42,500
Debtors	30,200	
Bank overdraft		51,000
Leasehold property at cost	80,000	

Leasehold property, Provision for depreciation		30,000
Plant and machinery at cost	2,10,000	
Plant and machinery, Provision for depreciation		57,500
Stock in trade	79,175	
	5,67,000	5,67,000

The approval of the court was obtained for the following scheme for reduction of capital:

(a) The preference shares to be reduced to ₹75 per share.

(b) The equity shares to be reduced to ₹12.50 per share.

(c) One ₹12.50 equity shares to be issued for each ₹100 of gross preference dividend arrears, the preference dividend had not been paid for three years.

(d) The balance of capital reserve account to be utilized.

(e) Plant and machinery to be written down to ₹75,000.

(f) The Profit and Loss account balance and all intangible assets to be written off.

At the same time as the resolution to reduce capital was passed, another resolution was approved restoring the total authorized capital to ₹3,50,000 consisting of 1,500 6% Cumulative preference shares of ₹75 each and the balance in equity shares of ₹12.50 each. As soon as the above resolutions had been passed 5,000 equity shares were issued at par, for cash, payable in full upon application. The same were fully subscribed and paid. You are required:

(i) To show the journal entries necessary to record the above transactions in the company's books and

(ii) To prepare the Balance Sheet of the company after completion of the scheme.

QUESTION 6

The Balance Sheet of A & Company Limited as on 31.12.2018 is as follows:

Assets	₹	₹
Fixed assets:		
Freehold property	4,25,000	
Plant	50,000	
Patent	37,500	

Goodwill	1,30,000	6,42,500
Traded investments (at cost)		55,000
Current assets:		
Debtors	4,85,000	
Stock	4,25,000	
Deferred advertising	1,00,000	10,10,000
Profit and Loss account		4,35,000
Total		21,42,500
Liabilities:		
Share capital:		
4000 6% cumulative preference shares of ₹100 each	4,00,000	
75,000 Equity shares of ₹10 each	7,50,000	11,50,000
6% Debentures (secured on freehold property)	3,75,000	
Accrued interest	22,500	3,97,500
Current liabilities:		
Bank overdraft	1,95,000	
Creditors	3,00,000	
Directors' loans	1,00,000	5,95,000
Total		21,42,500

The court approved a scheme of re-organisation to take effect on 1.1.2018 whereby:

(i) The preference shares to be written down to ₹75 each and equity shares to ₹2 each.

(ii) Of the preference share dividends which are in arrears for four years, three fourths to be waived and equity shares of ₹2 each to be allotted for the remaining quarter.

(iii) Accrued interest on Debentures to be paid in cash.

(iv) Debenture-holders agreed to take over freehold property, book value ₹1,00,000 at a valuation of ₹1,20,000 in part repayment of their holdings and to provide additional cash of ₹1,30,000 secured by a floating charge on company's assets at an interest rate of 8% per annum.

(v) Patents, Goodwill and Deferred advertising to be written off.

(vi) Stock to be written off by ₹65,000.

(vii) Amount of ₹68,500 to be provided for bad debts.

(viii) Remaining freehold property to be re-valued at ₹3,87,500.

(ix) Trade investments be sold for ₹1,40,000.

(x) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹2 each and as to 5% in cash and balance 5% being waived.

(xi) There were capital commitments totaling ₹2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(xii) Ignore taxation and cost of the scheme.

You are requested to show journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the scheme.

QUESTION 7

Liabilities	Amount	Assets	Amount
Equity shares of ₹10 each		Goodwill	3,00,000
10% preference shares of ₹10 each	10,00,000	Land	4,00,000
		Building at cost	3,75,000
12% debentures	4,00,000	Machinery at cost	2,20,000
Interest payable on deb.	3,00,000	Investment	2,25,000
Loan from directors	36,000	Stock	3,60,000
Provision for depreciation:	1,00,000	Debtors	2,00,000
Building	75,000	Cash	5,000
Machinery	80,000	Advertisement suspense account	25,000
Bank overdraft	1,50,000	Profit and Loss account	2,90,000
Sundry creditors	2,59,000		
	24,00,000		24,00,000

The authorized share capital of the company is 2,50,000 equity shares of ₹10 each and 50,000 10% preference shares of ₹10 each.

It was decided during a meeting of the shareholders and directors of the company to carry out a scheme of internal reconstruction as follows:

I. Each equity share is to be re designated as a share of ₹2.50. The equity shareholders are to accept a reduction in the nominal value of their share from ₹10 to ₹2.50 and subscribe for a new issue on the basis of 1for 2 at a price of ₹4 per share.

II. The existing preference shares are to be exchanged for a new issue of 30,000 15% preference shares of ₹10 each and 40,000 equity shares of ₹2.50 each.

III. The debenture holders are to accept 10,000 equity shares of ₹2.50 each in lieu of interest payable. The interest rate is to be increased to 14%. A further ₹1,00,000 of 14% debentures of ₹100 each is to be issued and taken up by the existing holders at ₹90.

IV. ₹40,000 of director's loan is to be cancelled. The balance amount is to be settled by issue of 10,000 equity shares of ₹2.50 each.

V. The investments are to be sold at current market price of ₹3,00,000.

VI. The bank overdraft is to be repaid.

VII. A sum of ₹1,59,000 is to be paid to the creditors immediately and the balance is to be paid at quarterly intervals.

VIII. All intangible and fictitious assets are to be eliminated.

IX. The following assets are to be adjusted to fair values: debtors ₹1,80,000, stock ₹3,20,000, machinery ₹1,00,000: building ₹2,50,000 and land ₹3,20,000.

X. It is estimated that under new arrangements net profit before interest and tax will be ₹2,50,000 per annum. There will be no tax liability of the company for the next five years.

You are required to:

(a) Show the journal entries to effect the reconstruction scheme.

(b) Prepare the Balance Sheet of the company immediately after reconstruction and

(c) Show how the anticipated profits will be distributed under new arrangements.

SOLUTION : HINT :

RECONSTRUCTION ACCOUNT

Particulars	Amount	Particulars	Amount
To goodwill	3,00,000	By equity share capital	7,50,000
To Advertisement suspense	25,000	By interest o/s	11,000
To profit/loss	2,90,000	By director loan	40,000
To discount	10,000	By bank (investment)	75,000
To stock	40,000	By securities premium	1,10,000
To debtors	20,000		
To machinery	40,000		
To building	50,000		
To land	80,000		
To capital Reserve(bal.fig)	**1,31,000**		
	9,86,000		**9,86,000**

B/S TOTAL =14,56,000

QUESTION 8

The balance sheet of Y Ltd. as on 31 March 2018 was as follows:

Liabilities	Amount	Assets	Amount
5,00,000 Equity shares of ₹10 each fully paid	50,00,000	Goodwill	10,00,000
		Patent	5,00,000
9% 20,000 Preference shares of ₹100 each fully paid	20,00,000	Land and building	30,00,000
		Plant and machinery	10,00,000
10% First debentures	6,00,000	Furniture and fixtures	2,00,000
10% Second debentures	10,00,000	Computers	3,00,000
Debentures interest outstanding	1,60,000	Trade investment	5,00,000
Trade creditors	5,00,000	Debtors	5,00,000
Director's loan	1,00,000	Stock	10,00,000
Bank O/D	1,00,000	Discount on issue of debentures	1,00,000
Outstanding liabilities	40,000	Profit and loss a/c (loss)	15,00,000
Provision for tax	1,00,000		
	96,00,000		96,00,000

Note: Preference dividend is in arrears for last three years.

A hold 10% first debentures for ₹4,00,000 and 10% second debentures for ₹6,00,000. He is also creditors for ₹1,00,000. B holds 10% first debentures for ₹2,00,000 and 10% second debentures for ₹4,00,000 and is also creditors for ₹50,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

1) All the Equity shares be converted into fully paid Equity shares of ₹5 each.
2) The Preference shares be reduced to ₹50 each and the Preference shareholders agree to forego their arrears of Preference dividends in consideration of which 9% Preference shares are to be converted into 10% Preference shares.
3) Mr. A is to cancel ₹6,00,000 of his total debt including interest on debentures and to pay ₹1 lakh to the company and to receive new 12% debentures for the balance amount.
4) Mr. B is to cancel ₹3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.
5) Trade creditors (other than A and B) agreed to forego 50% of their claim.
6) Directors to accept settlement of their loans as to 60% thereof by allotment of Equity shares and balance being waived.
7) There were capital commitments totaling ₹3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.
8) The directors refund ₹1,10,000 of the fees previously received by them.
9) Reconstruction expenses paid ₹10,000
10) The taxation liability of the company is settled at ₹80,000 and the same is paid immediately.
11) The assets are revalued as under:

	₹
Land and building	28,00,000
Plant and machinery	4,00,000
Stock	7,00,000
Debtors	3,00,000
Computers	1,80,000
Furniture and fixtures	1,00,000
Trade investment	4,00,000

Pass journal entries for all the above mentioned transactions including amounts to be written off of goodwill, patents, loss in profit and loss account and discount on issue of debentures. Prepare bank account and working of allocation of interest on debentures between A and B.

QUESTION 9

following is the Balance Sheet of ABC Ltd. as at 31st March, 2018:

Liabilities	₹	Assets	₹
Share Capital :		Plant and Machinery	9,00,000
2,00,000 Equity Shares of ₹ 10 each fully paid up	20,00,000	Furniture and Fixtures	2,50,000
6,000 8% preference shares of ₹ 100 each	6,00,000	Patents and Copyrights investment (at cost)	70,000
9% Debentures	12,00,000	(Market value ₹ 55,000)	68,000
Bank overdraft	1,50,000	Stock	14,00,000
Sundry Creditors	5,92,000	Sundry Debtors	14,39,000
		Cash and Bank Balance	10,000
		Profit and loss	4,05,000
	45,42,000		45,42,000

The following scheme of reconstruction was finalized:

- Preference shareholders would give up 30% of their Capital in exchange for allotment of 11% Debentures to them.
- Debenture holders having charge on Plant and machinery would accept Plant and machinery in full settlement of their dues.
- Stock equal to ₹ 5,00,000 in book value will be taken over by Sundry Creditors in full settlement of their dues.
- Investment value to be reduced to market price.
- The Company would issue 11% Debentures for ₹ 3,00,000 and augment its working capital requirement after settlement of bank overdraft.

Pass necessary Journal Entries in the books of the company. Prepare Capital reduction account and Balance Sheet of the company after internal reconstruction.

QUESTION 10

The Balance Sheet of R. Ltd. at 31 march, 2018 was as follows:

	₹		₹
Share capital Authorized	14,00,000	Intangibles	68,000
Issued : 64,000 8% cumulative preference shares of ₹ 10 each, fully paid	6,40,000	Freehold premises at cost	1,40,000
64,000 Equity share of ₹ 10 each, ₹ 7.5 paid	4,80,000	Plant and equipment at cost less depreciation	2,40,000
Loans from directors	60,000	Q Ltd. at cost	3,24,000
Sundry creditors	4,40,000	Stocks	2,48,000
Bank overdraft	2,08,000	Debtors	3,20,000
		Deferred Revenue expenditure	48,000
		Profit and Loss account	4,40,000
	18,28,000		18,28,000

Note: the arrear of Preference dividends amount to ₹ 51,200.

A scheme of reconstruction was duly approved with effect from 1 April, 2018 under the conditions state below:

(a) The unpaid amount on the Equity shares would be called up.

(b) The preference shareholders would forego their arrear dividends. In addition, they would accept a reduction of ₹ 2.5 per share. The dividend rate would be enhanced to 10%.

(c) The Equity shareholders would accept a reduction of ₹ 7.5 per share.

(d) R Ltd. holds 21,600 shares in Q Ltd. This represents 15% of the share capital of that company .Q Ltd. Is not a quoted company, The average net profit (after tax) of the company is ₹ 2,50,000. The shares would be valued based on 12% capitalization rate.

(e) A bad debt provision at 2% would be created.

(f) The –other assets would be valued as under:

	₹
Intangibles	48,000
Plant	1,40,000
Freehold premises	3,80,000
Stock	2,50,000

The Profit and Loss account debit balance and the balance standing to the debit of the deferred revenue Expenditure account would be eliminated.

(h) The directors would have to take equity shares at the new face value of ₹ 2.5 per share in settlement of their loan.

(i) The Equity shareholders, including the directors, who would receive equity shares in settlement of their loans, would take up two new equity shares for every one held.

(j) The Preference shareholders would take up one new preference share for every four held.

(k) The authorized Share capital would be restated to RS. 14,00,000.

(l) The new face values of the shares-preference and equity will be maintained at their reduced levels.

You are required to prepare:

(i) Necessary journal entries to effect the above ; and

(ii) The Balance Sheet of the company after reconstruction.

QUESTION 11

Following is the Balance Sheet of Weak Ltd. as on 31.03.2018:

Liabilities	Amount	Assets	Amount
Equity shares of 100 each	1,00,00,000	Fixed assets	1,25,00,000
12% Preference shares of ₹100 each	50,00,000	Investments (market value ₹9,50,000)	10,00,000
10% Debentures of 100 each	40,00,000	Current assets	1,00,00,000
Creditors	50,00,000	Profit and Loss Account	4,00,000
Taxation provision	1,00,000	Preliminary expenses	2,00,000
	2,41,00,000		2,41,00,000

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to ₹40 each paid up.

(ii) All Preference shares are reduced to ₹60 each paid up

(iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹100 each and exchange the same for fresh debentures of ₹70 each for every debentures held by them.

(iv) One of the creditors of the company to whom the company owes ₹20,00,000 decides to forego 40% of his claim. He is allotted 30,000 equity shares of ₹40 each in full satisfaction of his claim.

(v) The taxation liability of the company is settled at ₹1,50,000.

(vi) Fixed assets are to be written down by 30%.

(vii) Current assets are to be revalued at ₹45,00,000.

(viii) Investments are to be brought at market value.

(ix) It is decided to write off the fictitious assets.

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

SOLUTION :

Journal entries

	Debit ₹	Credit ₹
Equity share capital Dr. Preference share capital Dr. To Capital reduction a/c (being equity capital is reduced to ₹40 per share and Preference share capital to ₹60 per share)	60,00,000 20,00,000	 80,00,000
10% debentures account Dr. To 12% debentures To Capital reduction account (being interest rate of debentures is changed and 30% amount is reduced by converting the debentures into 70 each)	40,00,000	 28,00,000 12,00,000
Creditors account Dr. To capital reduction account To equity share capital (40% amt. of creditors is reduced and for remaining 60% equity shares are issued)	20,00,000	 8,00,000 12,00,000

Provision for taxation Dr. Capital reduction a/c Dr. To Bank account (being tax liability is settled at ₹ 150000)	1,00,000 50,000	 1,50,000
Capital reduction account Dr. To fixed assets To current assets To investments (being assets are revalued as per given information)	93,00,000	 37,50,000 55,00,000 50,000
Capital reduction account Dr. To Profit and Loss Account To preliminary expenses (being fictitious assets are written off)	6,00,000	 4,00,000 2,00,000
Capital reduction account Dr. To Capital Reserve (unutilized amount in reduction account is transferred)	50,000	 50,000

CAPITAL REDUCTION ACCOUNT

Particulars	Amount	Particulars	Amount
To cash (additional tax)	50,000	By equity share capital	60,00,000
To fixed assets	37,50,000	By Preference capital	20,00,000
To current assets	55,00,000	By debentures	12,00,000
To investments	50,000	By creditors	8,00,000
To Profit and loss Account	4,00,000		
To preliminary expenses	2,00,000		
To capital reserve **(bal.fig)**	50,000		
	1,00,00,000		**1,00,00,000**

CONCEPT 2: PROBLEMS ON CONVERSION IN PAID UP VALUE OF EQUITY SHARES

QUESTION 12

XY Limited
Balance Sheet as at 31st March 2018

Liabilities	Amount	Assets	Amount
2,00,000 equity shares of ₹10 each, ₹5 paid	10,00,000	Fixed assets	11,40,000
6,000 8% preference shares of ₹100 each	6,00,000	Patents and copyrights	80,000
9% Debentures	6,00,000	Investment at cost (Market value ₹55,000)	65,000
Interest accrued on Debentures	1,08,000	Stock	4,00,000
Bank overdraft	1,50,000	Debtors	4,39,000
Interest accrued on bank overdraft	15,000	Bank	10,000
Creditors	69,000	Profit and Loss account	4,08,000
	25,42,000		25,42,000

Preference dividend is in arrear for one year.

(a) Preference shares holders to give up their claims, inclusive of dividends, to the extent of 30% and desire to be paid off.

(b) Debenture- holders agree to give up their claims to interest in consideration of their interest being enhanced to 12%.

(c) Bank agrees to give up 50% of its interest outstanding in consideration of its being paid off at once.

(d) Creditors would like to grant a discount of 5% if they are paid immediately.

(e) Balance of Profit and Loss account. Patents and copyrights and debtors of ₹30,000 to be written off.

(f) Fixed assets to be written down by ₹34,000.

(g) Investments are to reflect their market value.

(h) To the extent not specifically stated, equity shareholders suffer on reduction of their rights. Cost of reconstruction is ₹.3,350.

Draft journal entries in the books of the company assuming that the scheme has been put through fully with the equity shareholders bringing in necessary cash to pay off the parties and to leave a working capital of ₹30,000, and prepare the Balance Sheet after reconstruction.

QUESTION 13

The directors of Hardluck Limited decided to recommend to the shareholders certain steps to put the affairs of the company back on the rails. On 30th June 2018 the Balance Sheet of the company was as under:

Liabilities	₹	Assets		₹
Share capital:		Fixed assets:		
Authorized: 1,00,000 equity shares of ₹1 each	1,00,000	Goodwill at cost		22,600
Issued and paid up:		Freehold property at cost	50,000	
85,000 equity shares of ₹1 each fully paid	85,000	Less depreciation	8,500	41,500
Reserves and surplus:		Plant and machinery at cost	1,19,000	
Share premium	15,000	Less depreciation	59,000	60,000
Current liabilities:		Investments:		
Trade creditors	64,500	Shares—at cost in associated companies	30,000	
Bank overdraft	56,500	Other quoted investments at cost	16,000	46,000
Loan from bank	60,000	Current assets:		
		Stock	23,000	
		Debtors	19,600	42,600
		Profit and Loss account		68,300
	2,81,000			2,81,000

The scheme of reconstruction as approved by the competent authorities was as under:

(a) The issued ordinary shares were reduced to 5 paise each paid up; the unpaid value of the share was subsequently called by the company and paid by all the shareholders.

(b) The balance of un-issued capital was allotted to the bank in part discharge of the loan; the balance due was paid in cash.

(c) The authorized capital of the company is to be increased by another 50,000 shares and these are to be issued to the existing shareholders as rights issue. The amount due from the shareholders was realized.

(d) Trade creditors to give up 25% of their claims and the balance due to them to be converted into 12% secured Debentures of ₹100 each.

(e) Interest of ₹6,500 on overdraft to be waived by the bank and the balance overdraft to be paid off.

(f) All amounts available including share premium to be utilized to write off losses, goodwill and the value of shares in associated companies.

Show the journal entries to record the above and also draw the Balance Sheet of the company after the scheme is fully implemented. All workings should form part of your answer.

CONCEPT 3: PROBLEMS ON SHARE SURRENDER

QUESTION 14

Liabilities	Amount	Assets	Amount
8,000 equity shares of ₹100 each fully paid	8,00,000	Land, Building and Machinery	14,00,000
8% debentures	14,00,000	Stock	1,00,000
Accrued interest on Debentures	70,000	Sundry debtors	40,000
Sundry creditors	4,50,000	Investments	15,000
Income tax liability	10,000	Cash at bank	1,03,000
		Cash in hand	2,000
		Profit and Loss account	10,70,000
	27,30,000		27,30,000

The fixed assets are heavily overvalued. A scheme of reorganization was prepared and passed. The salient points of the scheme are the following:

(a) Each share shall be sub divided into ten fully paid equity shares of ₹10 each.

(b) After such sub division, each shareholder shall surrender to the company 90% of his holding, for the purpose of reissue to debenture holders and creditors so far as required and otherwise for cancellation.

(c) Of those surrendered 50,000 equity shares of ₹10 each, shall be converted into 8% preference shares of ₹10 each fully paid for debenture holders.

(d) The debenture holders total claim shall be reduced to ₹5,00,000. This will be satisfied by the issue of 50,000 preference shares of ₹10 each fully paid.

(e) The claim of sundry creditors shall be reduced by 80% and the balance shall be satisfied by allotting them equity shares of ₹10 each fully paid from the shares surrendered.

(f) Shares surrendered and not reissued shall be cancelled.

Assuming that the scheme is duly approved by all parties interested and by the court, draft necessary journal entries and Balance Sheet of the company after the scheme has been carried into effect.

QUESTION 15

The Balance Sheet of Revise Limited as at 31st March, 2018 was as follows:

Liabilities	Amount	Assets	Amount
Authorized and subscribed capital:		Fixed assets:	
10,000 equity shares of ₹100 each fully paid	10,00,000	Machinery	1,00,000
Unsecured loan:		Current assets:	
12% debentures	2,00,000	Stock	3,20,000
Accrued interest	24,000	Debtors	2,70,000
Current liabilities:		Bank	30,000
Creditors	72,000	Profit and Loss account	6,00,000
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:

(a) Each share be sub-divided into ten fully paid equity shares of ₹10 each.

(b) After sub-division, each shareholder shall surrender to the company 50 per cent of his holding, for the purpose of re-issue to debenture-holders and creditors as necessary.

(c) Out of shares surrendered, 10,000 shares of ₹10 each shall be converted into 12% preference shares of ₹10 each fully paid up.

(d) The claims of the debenture holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹1,00,000 which are converted out of shares surrendered.

(e) Creditors claim shall be reduced to 50 per cent, to be settled by the issue of equity shares of ₹10 each out of shares surrendered.

(f) Balance of profit and loss account to be written off.

(g) 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

CONCEPT 4: PROBLEMS ON FORMATION OF SCHEME

QUESTION 16

Liabilities	Amount	Assets	Amount
10,000, 10% cumulative preference shares of ₹10 each fully paid up	1,00,000	Goodwill	25,000
20,000 equity shares of ₹10 each fully paid up	2,00,000	Freehold property at cost	90,000
Creditors	75,000	Plant and machinery at cost less depreciation	85,000
Bank overdraft	15,000	Investments (market value 86,000)	80,500
General reserve	70,000	Stock	35,000
		Debtors	40,000
		Cash at bank	500
		Profit and Loss account	1,04,000
	4,60,000		4,60,000

Prepare a capital reduction scheme and redraft the Balance Sheet after incorporating your proposals for submission to board to directors. The cumulative preference dividend are in arrears for two years.

CONCEPT 5: ALTERATION OF SHARE CAPITAL

QUESTION 17

On 31-12-20X1, B Ltd. had 20,000, ₹ 10 Equity Shares as authorised capital and the shares were all issued on which ₹ 8 was paid up. In June, 20X2 the company in general meeting decided to sub-divide each share into shares of ₹ 5 with ₹ 4 paid up. In June, 20X3 the company in general meeting resolved to consolidate 20 shares of ₹ 5, ₹ 4 per share paid up into one share of ₹ 100 each, ₹ 80 paid up.

Pass entries. And show how share capital will appear in notes to Balance Sheet as on 31- 12-20X1, 31-12-20X2 and 31-12-20X3.

QUESTION 18

C Ltd. had ₹ 5,00,000 authorised capital on 31-12-20X1 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully up. In June 220X2 the Company decided to convert the issued shares into stock. But in June, 20X3 the Company re-converted the stock into shares of ₹ 10 each, fully paid up.

Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

MASTER PROBLEM

QUESTION 19

Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June, 20X1:

Liabilities	₹	Assets	₹
6,000 shares of ₹ 60,each,₹ 30 paid up		Property, Machinery and plant etc. (Cost ₹ 3,90,000)	
First debentures	3,00,000	Estimated at	1,50,000
Second debentures	6,00,000	Cash in hand of the receiver	2,70,000
Unsecured Trade payables	4,50,000	Charged under debentures	4,20,000
		Uncalled capital	1,80,000
			6,00,000
		Deficiency	7,50,000
	13,50,000		13,50,000

A holds the first debentures for ₹ 3,00,000 and second debentures for ₹ 3,00,000. He is also on unsecured creditor for ₹ 90,000. B holds second debentures for ₹ 3,00,000 and is an unsecured trade payables for ₹ 60,000.

The following scheme of reconstruction is proposed:

1. A is to cancel ₹ 2,10,000 of the total debt owing to him, to bring ₹ 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.
2. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.
3. In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of ₹ 7.50 each, fully paid against their claim for each share of ₹60. The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the Scheme. The nominal share capital is to be increased accordingly.
4. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus making the shares of ₹ 7.50 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

SELF PRACTICE QUESTIONS

QUESTION 20

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 reconstructions.

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital			
50,000 Share of ₹ 50 each fully paid up	25,00,000	Good will	22,00,000
1,00,000 shares of ₹ 50 each ₹ 40 paid up	40,00,000	Land & Building	42,70,000
Capital Reserve	5,00,000	Machinery	8,50,000
8% Debentures of ₹ 100 each	4,00,000	Computer	5,20,000
12% Debentures of ₹ 100 each	6,00,000	Stock	3,20,000
Trade Creditors	12,40,000	Trade Debtors	10,90,000
Outstanding Expenses	10,60,000	Cash at Bank	2,68,000
		Profit & Loss Account	7,82,000
Total	1,03,00,000	Total	1,03,00,000

Following the interest of Mr. Shiv and Mr. Ganesh in M/s Platinum Limited.

	Mr. Shiv		Mr. Ganesh
8% Debentures	3,00,000		1,00,000
12% Debentures	4,00,000		2,00,000
Total	**7,00,000**	**Total**	**3,00,000**

The following scheme of internal reconstruction was framed and implemented, as approved by the Court and concerned parties.

(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹ 40 each.

(2) The existing shares holders agree to subscribe in cash, fully paid up equity shares of ₹ 40 each for ₹ 12,50,000.

(3) Trade Creditors are given option of either to accept fully paid equity shares of ₹ 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade creditors for ₹ 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.

(4) Mr. Shiv agrees to cancel debenture amounting to ₹ 2,00,000 out of total debentures due to him and agree to accept 15% debentures for the balance amount due. He also agree to subscribe further 15% Debenture in cash amounting to ₹ 1,00,000.

(5) Mr. Ganesh agrees to cancel debentures amounting to ₹ 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

(6) Land & Building to be revalued at ₹ 51,84,000, Machinery at ₹ 7,20,000, Computers at ₹ 4,00,000, Stock at ₹ 3,50,000 and Trade Debtors at 10% less to as they are appearing in Balance Sheet as above.

(7) Outstanding Expenses are fully paid in cash.

(8) Goodwill and Profit & Loss A/c will be written off and balance, if any of Capital Reduction A/c will be adjusted against capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstructions.

SOLUTION :

Journal entries	Debit ₹	Credit ₹
Equity share final call Dr.	10,00,000	
To Equity share capital		10,00,000
(being final call is made on 1,00,000 shares @10)		
Bank account Dr.	10,00,000	
To Equity share final call		10,00,000
(being amount of share final call is received from shareholders)		
Equity Share capital account Dr. (50)	75,00,000	
To Reconstruction account(10)		15,00,000
To equity share capital (40)		60,00,000
(being equity shares of ₹50 are converted into ₹40 per share)		

Bank account Dr. To Equity Share capital (being new equity shares are issued to existing shareholders)	12,50,000	 12,50,000
Creditors account Dr. To Equity share capital To Cash(70%) To Reconstruction account(30%) (being creditors are settled in cash and shares)	12,40,000	 7,50,000 3,43,000 1,47,000
8% Debentures account Dr 12% Debentures account Dr. To Mr. Shiv (being amount due to shiv)	3,00,000 4,00,000	 7,00,000
Mr. Shiv account Dr. Bank account Dr. To 15% Debentures To Reconstruction (being amount is settled which was payable to Mr.shiv))	7,00,000 1,00,000	 6,00,000 2,00,000
8% Debentures account Dr 12% Debentures account Dr. To Mr. Ganesh (being amount due to Ganesh)	1,00,000 2,00,000	 3,00,000
Mr. Ganesh account Dr. To 15% Debentures To Reconstruction (being amount is settled which was payable to Mr. Ganesh)	3,00,000	 2,50,000 50,000

Land & Building account Dr.	9,14,000	
Stock account Dr.	30,000	
To Reconstruction account		9,44,000
(being assets are revalued upward as per given market values)		
Reconstruction account Dr.	3,59,000	
To Machinery		1,30,000
To computers		1,20,000
To debtors		1,09,000
(being assets revalued downward as per given market values)		
Outstanding expenses account Dr.	10,60,000	
To bank		10,60,000
(being expenses are paid in cash)		
Reconstruction account Dr.	29,82,000	
To profit & loss account		7,82,000
To Goodwill		22,00,000
(being losses are written off as per requirement)		
Capital reserve account Dr.	5,00,000	
To Reconstruction account		5,00,000
(being capital reserve is adjusted against reconstruction) **(REFER RECONSTRUCTION ACCOUNT)**		

RECONSTRUCTION ACCOUNT

Particulars	**Amount**	**Particulars**	**Amount**
To machinery	1,30,000	By Equity share capital	15,00,000
To computers	1,20,000	By creditors	1,47,000
To debtors	1,09,000	By shiv	2,00,000
To profit and loss	7,82,000	By Ganesh	50,000
To goodwill	22,00,000	By land and building	9,14,000
		By stock	30,000
		By capital reserve (balancing figure)	**5,00,000**
	33,41,000		**33,41,000**

Balance Sheet Total = 88,50,000 (Home Work)

(Hint: Journal entries related with shiv & ganesh can be shown on net basis without making any amount due to them as we did in class)

QUESTION 21 (16MARKS)

The Balance Sheet of M/s Cube Limited as on 31-03-2013 is given below :

Particular	Note No.	Amount (₹ in laksh)
Equity & Liabilities Shareholder's Funds		
Share Capital	1	700
Reserves & Purples	2	(261)
Non- Current Liabilities		
Long term Borrowing	3	350
Current Liabilities		
Trade Payables	4	51
Other Liabilities	5	12
Total		852
Assets		
Non-Current Assets		
Fixed Assets		
Tangible Assets	6	375
Current Assets		
Current Investments	7	100
Inventories	8	150
Trade Receivables	9	225
Cash & Cash Equivalents	10	2
Total		852

Note		Amount (₹ in lakh)
1.	Share Capital Authorised	
	100 lakh Equity Shares of ₹ 10 each	1,000
	4 laksh, 8% Preference Share of ₹ 100 each	400
		1,400
	Issued, Subscribed and paid-up	
	50 laksh Equity Share of ₹ 10 each, fully paid up	500
	2 lakh 8% Preference Share of ₹ 100 each, fully paid up	200
		700
2.	Reserves & Surplus	
	Debit balance of profit & Loss A/c	(261)
3.	Long Term Borrowing	
	6% Debentures (Secured by Freehold Property	200
	Director's Loan	150
		350
4	Trade Payable	
	Sundry Creditors for Goods	51
5.	Other Current Liabilities	
	Interest Accrued and Due on 6% Debentures	12
6.	Tangible Assets	
	Freehold Property	275
	Plant & Machinery	100
		375
7.	Current Investment	
	Investment in Equity Instruments	100
8.	Inventories	
	Finished Goods	150
9.	Trade Receivable	
	Sundry Debtors for Goods	225
10.	Cash and cash Equivalents	
	Balance with Bank	2

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹ 80 each and Equity Shares to ₹ 2 each.

(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3 rd and for balance 1/3 rd, Equity Shares of ₹ 2 each to be alloted.

(3) Debenture Holder agreed to take one Freehold Property at its book value of ₹ 150 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.

(4) Interest accrued and due on Debentures to be paid in cash.

(5) Remaining Freehold Property to be valued at ₹ 200 lakh.

(6) All investments sold out for ₹ 125 lakh.

(7) 70% of Director's loan to be waived and for the balance, Equity Share of ₹ 2 each to be allowed.

(8) 40% of Sundry Debtors and 80% of Inventories to be written off.

(9) Company's contractual commitments amounting to ₹ 300 lakh have been settled by paying 5% penalty of contract value.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction.

(b) Prepare Reconstruction Account and

(c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet immediately after the implementation of scheme of internal reconstruction.

SOLUTION :

IN THE BOOKS OF CUBE LTD.

Journal entries	**Debit** ₹	**Credit** ₹
8% Preference share capital(₹100) Dr.	200	
To 8% Preference share capital(₹80)		160
To Reconstruction account		40
(being preference share capital is converted from ₹100 each in to ₹80 each)		

Equity Share Capital a/c (₹10) Dr. To Equity Share Capital (₹2) To Reconstruction account (being equity shares capital is converted from ₹10 each into ₹2 each)	500	 100 400
Reconstruction account Dr. To equity share capital (being payment of preference dividend in equity shares is considered as an additional liability)	16	 16
6% Debentures account Dr. To freehold property account (being payment of debentures is made)	150	 150
Outstanding interest account Dr. To bank (being interest is paid)	12	 12
Freehold property account Dr. To Reconstruction account (being balance freehold property is revalued)	75	 75
Bank account Dr. To investment account To profit on sale of investment (being investments are sold at profit)	125	 100 25

Profit on sale of investment account Dr. To Reconstruction account (being profit on sale of investment is transferred to reconstruction account)	25	 25
Director' loan account Dr. To Reconstruction account (70%) To Equity share capital (30%) (being outstanding balance in director' loan account is settled)	150	 105 45
Reconstruction account Dr. To Debtors (225*40%) To stock (150*80%) (being assets are revalued at market price)	210	 90 120
Reconstruction account Dr. To bank (being penalty on cancellation on contracts is paid)	15	 15
Reconstruction account Dr. To profit and loss account (being debit balance in profit and loss account is written off)	261	 261
Reconstruction account Dr. To capital reserve (being excess surplus in reconstruction account is transferred to capital reserve account)	143	 143

RECONSTRUCTION ACCOUNT

Particulars	Amount	Particulars	Amount
To equity share capital (dividends)	16	By equity share capital	400
		By Preference capital	40
To debtors	90	By freehold property	75
To stock	120	By profit on sale of invest.	25
To bank(penalty)	15	By director' loan	105
To profit and loss a/c	261		
To capital reserve **(bal.fig)**	143		
	645		**645**

NOTES TO BALANCE SHEET:

SHARE CAPITAL:

Authorized capital:

100 Lakh equity shares of 2 each 200 lakhs

4 Lakh preference shares of 80 each 320 lakhs

Issued,subscribed and paid up capital:

Equity share capital (2each) 161 lakhs

(500 -400+16+45)

Preference share capital (80 each) 160lakhs

(200lakhs-40lakhs)

PPE:

Freehold property (275 lakhs -150 lakhs +75 lakhs) 200 lakhs

Plant and machinery 100 lakhs

QUESTION 22 (ALTERATION IN SHARE CAPITAL)

Pass journal entries for the following transactions :

(i) Conversion of 2 Lakh fully paid equity shares of ₹ 10 each into stock of ₹ 1,00,000 and balance has 12% fully convertible Debenture.

(ii) Consolidation of 40 Lakh fully paid equity shares of ₹ 2.50 each into 10 lakh fully paid equity share of 10 each.

(iii) Sub-division of 10 lakh fully paid 11% preference shares of ₹ 50 each into 50 lakh fully paid 11% preference shares of ₹ 10 each.

(iv) conversion of 12% preference shares of ₹ 5,00,000 into 14% preference shares ₹ 3,00,000 and remaining balance as 12% Non-cumulative preference shares.

SOLUTION :

No.	JOURNAL ENTRIES	AMOUNT	AMOUNT
1.	Equity share capital Dr.(10)	20,00,000	
	To Equity Stock		1,00,000
	To 12% Debentures		19,00,000
	(being equity share capital is converted in to Stock and debentures)		
2.	Equity share capital Dr.(2.5)	1,00,00,000	
	To Equity share capital (10)		1,00,00,000
	(being 40 lacs equity shares of 2.5 each are converted into 10lacs of 10 each)		
3.	11% P.S.C Dr. (50)	5,00,00,000	
	To 11% P.S.C (10)		5,00,00,000
	(being 10lac preference shares of 50 are sub divided into 50 lac shares of 10 each)		
4.	12% P.S.C Dr.	5,00,000	
	To 14% P.S.C		3,00,000
	To 12% P.S.C		2,00,000
	(being preference shares are converted)		

QUESTION 23 (16MARKS)

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

Liabilities	Amount	Assets	Amount
Share Capital:		Land & Building	75,00,000
Equity Shares of ₹ 50 each fully paid up	60,00,000	Plant & Machinery	22,00,000
		Trade Investment	16,50,000
9%preference shares of ₹ 10 each fully paid up	40,00,000	Inventories	9,50,000
		Trade Receivable	18,00,000
7% debentures (secured by plant & machinery)	23,00,000	Cash and bank	
8% debentures	17,00,000	Balances	3,60,000
trade payable	6,00,000	Profit & Loss	2,15,000
provision for tax	75,000	Account	
	------------		--------------
	1,46,75000		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 ₹ 50 each as under:

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

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

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

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

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

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

(5) Other trade creditors of ₹ 5,00,000 are given option of either to accept fully paid 9% preference shares of 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 ₹ 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 ₹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 50 each and agreed to accept 10% debenture of 80 ah for every two 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 hooks of M/s Clean Ltd. as per Schedule Ill to the Companies Act., 2013.

SOLUTION :

IN THE BOOKS OF CLEAN LTD.

Journal entries	Debit ₹	Credit ₹
Equity Share Capital a/c (50) Dr.	60,00,000	
To Equity Share Capital (10)		40,00,000
To 9% Preference share capital (8)		10,00,000
To 10% Debentures (80)		2,80,000
To Reconstruction account		7,20,000
(being existing equity shares capital is converted in to new equity shares, preference shares and debentures otherwise cancelled)		
9% Preference share capital(10) Dr.	40,00,000	
To 9% Preference share capital(8)		32,00,000
To Reconstruction account(2)		8,00,000
(being preference share capital is converted from 10 each in to 8 each)		

Bank account Dr. To Equity share capital (10) (being new issue of equity shares made to preference shareholders) $\frac{(10,00,000 + 32,00,000)}{8}$ =(5,25,000/5)x2x10	21,00,000	 21,00,000
Provision for taxation account Dr. To Bank To Reconstruction account (being Tax liability settled)	75,000	 66,000 9,000
Creditors account Dr. To Reconstruction account (30%) To Equity share capital (70%) (being creditors of 1,00,000 settled)	1,00,000	 30,000 70,000
Creditors account Dr. To 9% Preference share capital To cash (150000x80%) To Reconstruction account(150000x20%) (being balance in creditors account settled)	5,00,000	 3,50,000 1,20,000 30,000
Reconstruction account Dr. To bank (being penalty on cancellation on contracts is paid)	26,000	 26,000

7%Debentures account Dr. To Plant & machinery account To Reconstruction account (being outstanding balance in debenture account is settled by transfer of plant & machinery)	23,00,000	 22,00,000 1,00,000
8% Debentures account Dr. To 10% Debentures To Reconstruction account (being 8% debentures converted into 10% debentures) (17,00,000/50) = $\frac{34000}{2}$ x 1 x 80	17,00,000	 13,60,000 3,40,000
Reconstruction account Dr. To Debtors (18,00,000x1/4) To stock (9,50,000x1/5) (being assets are revalued at market price)	6,40,000	 4,50,000 1,90,000
Reconstruction account Dr. To Land & building (75,00,000x5%) (being building revalued)	3,75,000	 3,75,000
Reconstruction account Dr. To profit and loss account (being debit balance in profit and loss account is written off)	2,15,000	 2,15,000
Reconstruction account Dr. To capital reserve (being excess surplus in reconstruction account is transferred to capital reserve account)	7,73,000	 7,73,000

RECONSTRUCTION ACCOUNT

Particulars	Amount	Particulars	Amount
To Bank (penalty)	26,000	By equity share capital	7,20,000
To debtors	4,50,000	By Preference capital	8,00,000
To stock	1,90,000	By provision for tax	9,000
To Land & building	3,75,000	By creditors	60,000
To profit and loss a/c	2,15,000	(30,000+30,000)	
To capital reserve **(bal.fig)**	7,73,000	By 7%Debentures	1,00,000
		By 8% Debentures	3,40,000
	20,29,000		**20,29,000**

BALANCE SHEET OF CLEAN LTD.(& reduced) as on 31.3.2015

	AMOUNT	AMOUNT
Shareholders fund:		
Equity share capital	61,70,000	
(60L-60L+40L+21L+.7L)		
9% Preference share capital	45,50,000	
(40L-8L+10L+3.5L)		
Capital Reserve	7,73,000	1,14,93,000
Noncurrent liabilities:		
8% Debentures (17L-3.4L)	13,60,000	
9% Debentures	2,80,000	16,40,000
Current liabilities:	--	--
		1,31,33,000

Non current Assets:		
Land & building	71,25,000	
Trade investments	16,50,000	87,75,000
Current assets:		
Stock	7,60,000	
Debtors	13,50,000	
Cash and bank balances	22,48,000	43,58,000
		1,31,33,000

QUESTION 24

Following is the Balance Sheet of XYZ Ltd. as on 31st March, 2010.

Liabilities	₹	Assets	₹
8000 – 7 1/2 % Preference Shares @ ₹100 each Fully Paid	8,00,000	Plant and Machinery	8,50,000
		Furniture & Fittings	1,60,000
		Patents and Copy right	60,000
1,80,000 Equity Shares @₹10 each fully paid	18,00,000	Goodwill	35,000
		Investments (at cost)	65,000
11% Debentures	10,00,000	Sundry Debtors	12,00,000
Bank overdraft	1,65,000	Stock	13,00,000
Loan from Director	15,000	Cash in Hand	12,000
Trade creditors	6,20,000	Profit & Loss a/c.	7,18,000
	44,00,000		44,00,000

Due to heavy losses and overvaluation of Assets, the following scheme of reconstruction was finalized:

(i) Preference shareholder will surrender their 20% shares and they have been allotted 9% (new) preference shares for remaining amount.

(ii) Debenture holders having charge on plant and machinery would accept plant and machinery in full settlement.

(iii) Trade creditors accepted to take over the stock upto the value of ₹6,20,000.

(iv) Equity shareholders are to accept reduction of rs.4 per share.

(v) Investment is to be valued at market price i.e. ₹ 60,000.

(vi) Sundry Debtors and remaining stock is to be valued a 90% of their book value.

(vii) **Directors have to forgo their loan in full.**

(viii) **Patents and Copy Right and Goodwill have no more value.**

Pass necessary Journal entries in the books of XYZ Ltd. assuming that all the legal formalities have been completed. Prepare Capital reduction account and Balance Sheet of the company after reduction.

SOLUTION :

In the books of XYZ Ltd.

Journal Entries

	Particulars	L.F.	₹	₹
(i)	$7\frac{1}{2}$% Preference Share Capital A/c. Dr.		8,00,000	
	To 9% Preference Share CapitalA/c.			6,40,000
	To Capital Reduction A/c.			1,60,000
	(Being surrender of 20% shares by 7.5% Preference shareholders and issuance of 9% preference shares for remaining balance as per the scheme of reconstruction)			
(ii)	11% Debentures A/c. Dr.		10,00,000	
	To Debenture holders A/c.			10,00,000
	(Being 11% debentures transferred to debenture holders account)			
(iii)	Debenture holders A/c. Dr.		10,00,000	
	To Plant & Machinery A/c.			8,50,000
	To Capital Reduction A/c.			1,50,000
	(Being plant and machinery given to debenture holders in full settlement as per the scheme of reconstruction)			

(iv)	Trade Creditors A/c. Dr. To (Inventories) A/c. (Being stock given to trade creditors against heir dues as per the scheme of reconstruction)		6,20,000	 6,20,000
(v)	Equity Share Capital A/c (₹10) Dr. To Equity Share Capital A/c. (₹6) To Capital Reduction A/c. (Being reduction of ₹ 4 per equity share as per the scheme of reconstruction).		18,00,000	 10,80,000 7,20,000
(vi)	Capital Reduction A/c. Dr. To Trade Receivable A/c. To Investment A/c. To Inventories A/c. To Patents and copyright To Goodwill To Profit and Loss A/c. (Being writing off losses and reduction in the values of assets as per the scheme of reconstruction).		10,06,000	1,20,000 5,000 68,000 60,000 35,000 7,18,000
(vii)	Director's Loan A/c. Dr. To Capital Reduction A/c. (Being loan forgo by directors as per the scheme of reconstruction)		15,000	 15,000
(viii)	Capital Reduction A/c. Dr. To Capital Reserve A/c. (Being balance of capital reduction account transferred to capital reserve account)		39,000	 39,000

Capital Reduction Account

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Provision for doubtful debts	1,20,000	By $7\frac{1}{2}$% Preference share Capital A/c.	1,60,000
To Investment A/c.	5,000		
To Inventory A/c.	68,000	By 11% Debentures A/c.	1,50,000
To Patents & Copyright A/c.	60,000	By Equity Share Capital	7,20,000
To Goodwill A/c.	35,000	By Director's Loan A/c.	15,000
To Profit and Loss A/c.	7,18,000		
To Capital Reserve A/c.	39,000		
	10,45,000		10,45,000

Balance Sheet of M/s. XYZ Ltd.(and reduced)

Particulars	Notes No.	₹ in 000
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	17,20
(b) Reserve and Surplus	2	39
(2) Current Liabilities		
(a) Other current liabilities	3	165
Total		1,924
II. Assets		
(1) Non-current assets		
(a) Fixed Assets	4	160
(b) Non-current investment		60
(2) Current assets		
(a) Inventory-stock		612
(b) Trade Receivable	5	10,80
(c) Cash and Cash equivalents		12
Total		1,924

Notes to Accounts:

	Particulars		₹ in '000
1.	**Share Capital**		
	Equity Shares		
	1,80,000 Equity share @ ₹6 each 9% Pref. Share	10,80	
	6,400, 9% Pref. share @ ₹100 each	6,40	1,720
2.	**Reserve & Surplus**		
	Capital reserve		39
3.	**Current Liabilities**		
	Bank overdraft		1,65
4.	**PPE**		
	Furniture & Fixture		1,60
5.	**Trade Receivable**		
	Sundry Debtors	12,00	
	Less: Prov. for doubtful debts	(1,20)	10,80

QUESTION 25

The Balance Sheet of X Ltd. as at 31st March, 2014 was as follows:-

X Limited
Balance Sheet as at 31.03.2014

	Particulars	Amount (₹)
1.	Equity and Liabilities	
	1. Shareholder's Funds	
	Share Capital	
	(a) 40000 equity shares of ₹100 each fully paid	40,00,000
	(b) 20000, 10% preference shares of ₹ 100 each fully paid	20,00,000
	Reserve & Surplus	
	(a) Securities Premium Account	1,50,000
	(b) Profit & Loss Account	(23,00,000)
	Non Current Liabilities	

2.	Long Term Borrowings		4,00,000
	7% Debentures of ₹ 100 each		
	Current Liabilities		
3.	Other Current Liabilities		
	(a) Creditors		10,00,000
	(b) Loan from Director		2,00,000
	Total Liabilities		54,50,000
	Assets		
II.	1. Non Current Assets		
	Fixed Assets		
	(a) Land & Building	20,00,000	
	(b) Plant & Machinery	12,00,000	32,00,000
	Intangible Assets		
	Goodwill		4,00,000
	2. Current Assets		
	(a) Debtors	12,00,000	
	(b) Stock	5,00,000	
	(c) Cash at Bank	1,50,000	18,50,000
	Total Assets		54,50,000

No Dividend on Preference Shares has been paid for last 5 years.

The following scheme of reorganization was duly approved by the Court:

(i) Each equity share to be reduced to ₹25.

(ii) Each existing "Preference Share to be reduced to ₹ 75 and then exchanged for one new 13% Preference Share of ₹ 50 each and one Equity share of ₹25 each.

(iii) Preference Shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity shares of ₹25.

(iv) The Debenture Holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of ₹ 50 each issued at par. One-fourth (in value) of the Debenture Holders accepted Preference Shares for their claims. The rest were paid in cash.

(v) Contingent Liability of ₹ 2,00,000 is payable which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the Company.

(vi) Goodwill does not have any value in the present. Decrease the value of Plant & Machinery, Stock and Debtors by ₹ 3,00,000; ₹ 1,00,000 and ₹2,00,000 respectively. Increase the value of Land & Building to ₹ 25,00,000.

(vii) 50,000 new Equity Shares of ₹ 25 each are to be issued at par payable in full on application. The issue was underwritten for a commission of4%. Shares were fully taken up.

(viii) Total expenses incurred by the Company in connection with the Scheme excluding Underwriting Commission amounted to ₹ 20,000.

Pass necessary Journal entries to record the above transactions.

SOLUTION :

In the books of X Ltd.

Journal Entries

	Particulars	L.F.	Amount ₹	Amount ₹
(i)	Equity Share Capital (₹ 100) A/c. Dr.		40,00,000	
	To Equity Share Capital (₹25) A/c.			10,00,000
	To Capital Reduction A/c.			30,00,000
	(Being Equity Shares of ₹ 100 each reduced to ₹ 25 each and balance transferred to Capital Reduction A/c.)			
(ii)	10% Preference Share Capital (₹100) A/c		20,00,000	
	To 10% Preference Share Capital (₹75)			15,00,000
	To Capital Reduction A/c.			5,00,000
	(Being Preference Shares of ₹100 each reduced to ₹75 each and balance transferred to Capital Reduction A/c.)			

(iii)	10% Preference Share Capital (₹75) A/c. To 13% Preference Share Capital (₹50) A/c. To Equity Share Capital a/c. (Being one new 13% Preference Share of ₹50 each and one Equity Share of ₹25 each issued against 10% Preference Share of ₹75 each)		15,00,000	 10,00,000 5,00,000
(iv)	Capital Reduction A/c. Dr. To Preference Share Dividend Payable A/c. (Being arrear of Preference Share Dividend payable for one year)		2,00,000	 2,00,000
(v)	Preference Share Dividend Payable A/c. Dr. To Equity Share Capital A/c. (₹ 25) (Being Equity Shares of ₹ 25 each issued for arrears of Preference Share Dividend)		2,00,000	 2,00,000
(vi)	7% Debenture A/c. Dr. To Debenture Holders A/c. (Being balance of 7% Debentures transferred to Debenture Holders A/c.)		4,00,000	 4,00,000
(vii)	Debenture Holder A/c. Dr. To 13% Preference Share Capital A/c. To Bank A/c. To Capital Reduction A/c. (Being 25% of Debenture Holders opted to take 13% Preference Shares at par and remaining took 90% cash payment for their claims)		4,00,000	 1,00,000 2,70,000 30,000

(viii)	Loan from Director Dr. To Provision for Contingent Liability A/c. (Being contingent liability of ₹ 2,00,000 is payable and adjusted against loan from Director A/c.)		2,00,000	2,00,000
(ix)	Bank A/c. Dr. To Equity Share Application & Allotment A/c. (Being application money received on 50,000 Equity Shares @ ₹25 each)		12,50,000	12,50,000
(x)	Equity Share Application & Allotment A/c. To Equity Share Capital A/c. (Being application money transferred to Capital A/c. on allotment)		12,50,000	12,50,000
(xi)	Underwriting Commission A/c. Dr. To Bank A/c. (Being underwriting commission paid)		50,000	50,000
(xii)	Land & Building A/c. Dr. To Capital Reduction A/c. (Being value of Land & Building appreciated)		5,00,000	5,00,000
(xiii)	Expenses on Reconstruction A/c. Dr. To Bank A/c. (Being payment of expenses on reconstruction)		20,000	20,000

(xiv)	Capital Reduction A/c Dr.		38,30,000	
	To Goodwill A/c.			4,00,000
	To Plant & Machinery A/c.			3,00,000
	To Stock A/c.			1,00,000
	To Debtors A/c.			2,00,000
	To Profit & Loss A/c.			23,00,000
	To Expenses on Reconstruction A/c.			20,000
	To Underwriting Commission A/c.			50,000
	To Capital Reserve A/c.			4,60,000
	(Being various losses written off and balance of Capital Reduction A/c. transferred to Capital Reserve A/c)			

QUESTION 26

The following is the Balance Sheet of Star Ltd. as on 31st March, 2015.

A	Equity & Liabilities		₹
1.	**Shareholders' Fund**		
	(a) **Share Capital**		
	9,000 7% Preference Shares of ₹100 each fully paid		9,,00,000
	10,000 Equity shares of ₹100 each fully paid		10,00,000
	(b) **Reserve & Surplus**		
	Profit and Loss Account		(2,00,000)
2.	**Non-current liabilities:**		
	"A" 6% Debentures (Secured on Bombay Works)		3,00,000
	"B" 6% Debentures (Secured on Chennai Works)		3,50,000

3.	**Current Liabilities and Provisions:**		
	(a) Workmen's Compensation Fund:		
	Bombay Works		10,000
	Chennai Works		5,000
	(b) Trade Payables		1,25,000
	Total		**24,90,000**
B.	**Assets**		
1.	**Non Current Assets**		
	Tangible Assets:		
	Bombay Works		9,50,000
	Chennai Works		7,75,000
2.	**Investment:**		
	Investments for Workman's Compensation Fund		15,,000
3.	**Current Assets:**		
	(a) Inventories		4,50,000
	(b) Trade Receivables		2,50,000
	(c) Cash at Bank		50,000
	Total		**24,90,000**

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were as follows:

(i) Paid up value of 7% Preference Share to be reduced to ₹80, but the rate of dividend being raised to 9%.

(ii) Paid up value of Equity Shares to be reduced to ₹10

(iii) The directors of refund ₹ 50,000 of the fees previously received by them.

(iv) Debenture holders forego their interest of ₹26,000 which is included among the Sundry Creditors.

(v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.

(vi) "B" 6% debenture holders agreed to take over the Chennai works at rs.4,25,000 and to accept an allotment of 1,500 equity shares of ₹10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai Works), they allotted 9,000 equity shares of ₹10 each fully paid at par to Star Ltd.

(vii) The Chennai Workmen's compensation fund disclosed that there were actual liabilities of ₹1,000 only. As a consequence, the investments of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.

(viii) Stock was to be written off by ₹1,90,000 and a provision for doubtful debts is to be made to the extent of ₹20,000.

(ix) Chennai works completely written off.

(x) Any balance of the Capital reduction Account is to be applied as two thirds to write off the value of Bombay Works and one-third to Capital Reserve.

Pass necessary Journal Entries in the books of Star Ltd., after the scheme has been carried into effect.

SOLUTION :

In the Books of Star Ltd.

Journal Entries

	Particulars	L.F.	Amount ₹	Amount ₹
(i)	7% Preference share capital A/c (₹100)		9,00,000	
	To 9% Preference shae capital A/c(₹80)			7,20,000
	To Capital reduction A/c.			1,80,000
	(Being preference shares reduced to ₹80and also rate of dividend raised from 7% to 9%).			
(ii)	Equity share capital A/c. (₹100 each) Dr.		10,00,000	
	To Equity share capital A/c. (₹10 each)			1,00,000
	To Capital reduction A/c.			9,00,000
	(Being reduction of nominal value of one share of ₹100 each to ₹ 10 each)			

(iii)	Bank A/c. Dr. To Capital reduction A/c. (Being directors refunded the fee amount)		50,000	 50,000
(iv)	Trade payables A/c. (Interest on Dr. debentures) To Capital reduction A/c. (Being interest forgone by the debenture holders)		26,000	 26,000
(v)	No entry required.			
(vi) a	'B' 6% Debentures A/c. Dr. To Debentures holders A/c. (Being amount due to Debentures holders)		3,50,000	 3,50,000
b.	Debentures holders A/c. Dr. To Chennai Works A/c. To Equity Share Capital A/c. (Being Chennai works taken over and equity shares issued to 'B' 6% Debenture holders).		4,40,000	 4,25,000 15,000
c.	Equity Share of Zia Ltd. A/c. To Debentures holders A/c. (Being 9000 equiy shares of Zia Ltd. issued by Debentures holders)		90,000	 90,000
(vii) a.	Chennai Works – Workmen Compensation Fund Dr. To Capital Reduction A/c. (Being difference due to reduced amount of actual liability transferred to capital reduction account).		4,000	 4,000

b.	Bank A/c. Dr. To Investment for Workmen Compensation Fund To Capital reduction A/c. (Being Investment for Workmen Compensation Fund sold @ 10% profit)		15,400	 14,000 1,400
c.	Trade Payables A/c. Dr. To Bank A/c. (Being part payment made to trade payables)		15,400	 15,400
(viii)	Capital reduction A/c. To Provision for Doubtful Debts A/c. To Inventory A/c. (Being assets revalued)		2,10,000	 20,000 1,90,000
(ix)	Capital reduction A/c. Dr. To Profit & Loss A/c. To Tangible Assets – Chennai works (Being assets revalued and losses written off)		5,50,000	 2,00,000 3,50,000
(x)	Capital reduction A/c. Dr. To Tangible Assets – Bombay Works To Capital reserve A/c. (Being assets revalued and remaining amount transferred to capital reserve account)		4,01,400	 2,67,600 1,33,800

QUESTION 27 (CA INTER NOV 2019:15 MARKS)

Following is the summarized Balance Sheet of Fortunate Ltd. as on 31st March, 2019.

Particulars	Amount (₹)
Liabilities	
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	7,50,000
(b) 18,750 Equity shares of ₹ 50 each	9,37,500
Profit and Loss Account	(5,63,750)
Loan	7,16,250
Trade Payables	2,58,750
Other Liabilities	43,750
Total	21,42,500
Assets	
Building at cost less depreciation	5,00,000
Plant at cost less depreciation	3,35,000
Trademarks and goodwill at cost	3,97,500
Inventory	5,00,000
Trade Receivables	4,10,000
Total	21,42,500

(**Note:** Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and not earnings profits. A scheme of reconstruction has been approved by both the classes of shareholders. The summarized scheme of reconstruction is as follows:

(i) The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 5 by cancellation of ₹ 45.00 per share. They have also agreed to subscribe for three new equity shares of ₹ 5.00 each for each equity share held.

(ii) The preference shareholders have agreed to forego the arrears of dividends and to accept for each ₹ 50 preference share, 4 new 6% preference shares of ₹ 10 each, plus 3 new equity shares of ₹ 5.00 each, all credited as fully paid.

(iii) Lenders to the company for ₹ 1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of ₹ 10 each and 7,500 new equity shares of ₹ 5.00 each.

(iv) The directors have agreed to subscribe in cash for 25,000 new equity shares of ₹ 5.00 each in addition to any shares to be subscribed by them under (i) above.

(v) Of the cash received by the issue of new shares, ₹ 2,50,000 is to be used to reduce the loan due by the company.

(vi) The equity share capital cancelled is to be applied:

(a) To write off the debit balance in the Profit and Loss A/c, and

(b) To write off ₹ 43,750 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital, as reduced, is to be increased to ₹ 8,12,500 for preference share capital and ₹ 9,37,500 for equity share capital.

You are required to pass journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction.

SOLUTION :

In the books of Fortunate Ltd.

Journal Entries

	Particulars		**Debit (₹)**	**Credit (₹)**
1.	Equity share capital A/c (₹ 50)	Dr.	9,37,500	
	To Equity share capital A/c (₹ 5)			93,750
	To Capital reduction A/c*			8,43,750
	(Being equity capital reduced to nominal value of ₹ 5 each)			
2.	Bank A/c	Dr.	2,81,250	
	To Equity share capital			2,81,250
	(Being 3 right shares against each share was issued and subscribed)			

3.	8% Preference share capital A/c (₹ 50)	Dr.	7,50,000	
	Capital reduction A/c	Dr.	75,000	
	To 6% Preference share capital (₹ 10)			6,00,000
	To equity share capital (₹ 50)			2,25,000
	(Being 8% preference shares of ₹ 50 each converted to 6% preference shares of ₹ 10 each and also given to them 3 equity shares for every share held)			
4.	Loan A/c	Dr.	1,87,500	
	To 6% Preference share capital A/c (15,000 x ₹ 10)			1,50,000
	To Equity share capital A/c (7,500 x ₹5)			37,500
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c (25,000 x ₹5)	Dr.	1,25,000	
	To Equity share application A/c			1,25,000
	(Being shares subscribed by the directors)			
6.	Equity share application A/c	Dr.	1,25,000	
	To Equity share capital A/c			1,25,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,50,000	
	To Bank A/c			2,50,000
	(Being loan repaid)			
8.	Capital reduction A/c	Dr.	7,68,750	
	To Profit and loss A/c			5,63,750

	To Plant A/c		43,750
	To Trademarks and Goodwill A/c (Bal. fig.)		1,61,250
	(Being losses and assets written off to the extent required)		

Balance sheet of Fortunate Ltd. (and reduced)
as on 31.3.2019

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	15,12,500
2		Non-current liabilities		
	a	Long-term borrowings		2,78,750
		(7,16,250 – 1,87,500 – 2,50,000)		
3		Current liabilities		
	a	Trade Payables		2,58,750
	b	Other current liabilities		43,750
		Total		20,93,750
		Assets		
1		Non-current assets		
	a	Property, Plant and Equipment	2	7,91,250
	b	Intangible assets	3	2,36,250
2		Current assets		
	A	Inventories		5,00,000
	B	Trade receivables		4,10,000
	C	Cash and cash equivalents	4	1,56,250
		Total		20,93,750

Notes to accounts:

			₹
1	**Share Capital**		
	Authorized capital:		
	81,250 Preference shares of ₹ 10 each	8,12,500	
	1,87,500 Equity shares of ₹ 5 each	9,37,500	17,50,000
	Issued, subscribed and paid up:		
	1,52,500 equity shares of ₹ 5 each	7,62,500	
	75,000, 6% Preference shares of ₹ 10 each	7,50,000	15,12,500
2	**Property, Plant and Equipment**		
	Building at cost less depreciation	5,00,000	
	Plant at cost less depreciation	2,91,250	7,91,250
3	**Intangible assets**		
	Trademarks and goodwill		2,36,250
4	**Cash and cash equivalents**		
	Bank (2,81,250+1,25,000-2,50,000)		1,56,250

Note: *In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used.

QUESTION 28 (NOV 2018:10 MARKS)

The summarized Balance Sheet of SK Ltd. as on 31st March, 2018 is given below.

(₹in '000)

	Amount
Liabilities	
Equity Shares of ₹ 10 each	35,000
8%, Cumulative Preference Shares of ₹ 100 each	17,500
6% Debentures of ₹ 100 each	14,000
Sundry Creditors	17,500
Provision for taxation	350
Total	84,350
Assets	
Fixed Assets	43,750
Investments (Market value ₹ 3325 thousand)	3,500
Current Assets (Including Bank Balance)	35,000
Profit and Loss Account	2,100
Total	84,350

The following Scheme of Internal Reconstruction is approved and put into effect on 31st March, 2018.

(i) Investments are to be brought to their market value.

(ii) The Taxation Liability is settled at ₹ 5,25,000 out of current Assets.

(iii) The balance of Profit and Loss Account to be written off.

(iv) All the existing equity shares are reduced to ₹ 4 each.

(v) All preference shares are reduced to ₹ 60 each.

(vi) The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange them for fresh debentures of ₹ 80 each. Each old debenture is exchanged for one new debenture.

(vii) Balance of Current Assets left after settlement of taxation liability are revalued at ₹1,57,50,000.

(viii) Fixed Assets are written down to 80%.

(ix) One of the creditors of the Company for ₹ 70,00,000 gives up 50% of his claim. He is allotted 8,75,000 equity shares of ₹ 4 each in full and final settlement of his claim.

Pass journal entries for the above transactions.

SOLUTION:

Journal Entries in the books of SK Ltd.

		₹ '000	₹ '000
(i)	Equity share capital (₹ 10) A/c Dr.	35,000	
	To Equity Share Capital (₹ 4) A/c		14,000
	To Capital Reduction A/c		21,000
	(Being conversion of equity sharecapital of ₹ 10 each into ₹ 4 each as per reconstruction scheme)		
(ii)	8% Cumulative Preference Share capital (₹ 100) A/c Dr.	17,500	
	To 8% Cumulative Preference Share Capital (₹ 60) A/c		10,500
	To Capital Reduction A/c		7,000
	(Being conversion of 6% cumulative preference shares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		
(iii)	6% Debentures (₹ 100) A/c Dr.	14,000	
	To 9% Debentures (₹ 80) A/c		11,200
	To Capital Reduction A/c		2,800
	(Being 9% debentures of ₹ 80 each issued to existing 6% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Sundry Creditors A/c Dr.	7,000	
	To Equity Share Capital (₹ 4) A/c		3,500
	To Capital Reduction A/c		3,500
	(Being a creditor of ₹ 70,00,000 agreed to surrender his claim by 50% and was allotted 8,75,000 equity shares of ₹ 4 each in full settlement of his dues as per reconstruction scheme)		

(v)	Provision for Taxation A/c Dr.	350	
	Capital Reduction A/c Dr.	175	
	To Liability for Taxation A/c		525
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)		
(vi)	Liability for Taxation A/c Dr.	525	
	To Current Assets (Bank A/c)		525
	(Being the payment of tax liability)		
(vii)	Capital Reduction A/c Dr.	34,125	
	To P & L A/c		2,100
	To Fixed Assets A/c		8,750
	To Current Assets A/c		18,725
	To Investments A/c		175
	To Capital Reserve A/c (Bal. fig.)		4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)		

Working Note:

Capital Reduction Account

To Liability for taxation A/c	175	By Equity share capital	21,000
To P & L A/c	2,100	By 8% Cumulative preferences	7,000
To Fixed Assets	8,750	Share capital	
To Current assets	18,725	By 6% Debentures	2,800
To Investment	175	By Sundry creditors	3,500
To Capital Reserve (Bal. fig.)	4,375		
	34,300		**34,300**

QUESTION 29 (CA INTER JULY 2021 5 MARKS)

Sapra Limited has laid down the following terms upon the sanction of the reconstruction scheme by the court.

(i) The shareholders to receive in lieu of their present holding at 7,50,000 shares of ₹ 10 each, the following:

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

(ii) Goodwill which stood at ₹ 2,70,000 is to be completely written off.

(iii) Plant & Machinery to be reduced by ₹ 1,00,000, Furniture to be reduced by ₹ 88,000 and Building to be appreciated by ₹ 1,50,000.

(iv) Investment of ₹ 6,00,000 to be brought down to its existing market price of ₹ 1,80,000.

(v) Write off Profit & Loss Account debit balance of ₹ 2,25,000.

In case of any shortfall, the balance of General Reserve of ₹ 42,000 can be utilized to write off the losses under reconstruction scheme.

You are required to show the necessary Journal Entries in the books of Sapra Limited of the above reconstruction scheme considering that balance in General Reserve is utilized to write off the losses.

SOLUTION :

Journal Entries

		₹	₹
Equity Share Capital (old) A/c	Dr.	75,00,000	
To Equity Share Capital (₹ 10) A/c			45,00,000
To 6% Preference Share Capital (₹ 10) A/c			18,00,000
To 7% Debentures A/c			2,50,000
To Capital Reduction A/c			9,50,000
(Being new equity shares, 6% Preference Shares, 7% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
Building A/c	Dr.	1,50,000	
Capital Reduction A/c	Dr.	9,53,000	
To Goodwill Account			2,70,000

To Plant and Machinery Account			1,00,000
To Furniture Account			88,000
To Investment A/c			4,20,000
To Profit & Loss A/c			2,25,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery, furniture, investment and Profit & Loss as per the scheme)			
General reserve A/c	Dr.	3,000	
To Capital Reduction A/c			3,000
(Being general reserve utilized to write off the balance in Capital reduction A/c)			

Note: In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used in the above journal entries.

QUESTION 30 (CA INTER NOV 2022 20 MARKS)

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 : Rate of return :	(6/100) x ₹ 6,00,000 8% on Preference Shares	= ₹ 36,000
Dividend :	(8/100) x X =	₹ 36,000
	X = (36,000/8) x 100 =	₹ 4,50,000

New Preference Share Capital	=	₹ 4,50,000
Old Preference Share Capital	=	₹ 6,00,000
(6,00,000 – 4,50,000)	=	₹ 1,50,000 Amount taken to Capital Reduction A/c.

2. Since the company expects to earn a profit of ₹ 90,000 p.a. consecutively for three years and it shall be used to write-off debit balance of P & L account, hence ₹ 2,70,000 being loss shall be shown in the Balance Sheet under Reserve & Surplus head and ₹

30,000 shall be written-off from Capital Reduction A/c.

3. Calculation of Amount written off on Land & Building and Plant & Machinery

Land & Building	= (85/100) x 5,40,000	= ₹ 4,59,000
Plant & Machinery Reduced by:	= (80/100) x 4,80,000	= ₹ 3,84,000
Land & Building	= (5,40,000 - 4,59,000)	= ₹ 81,000
Plant & Machinery	= (4,80,000 - 3,84,000)	= ₹ 96,000

QUESTION 31 (CA INTER MAY 2023)

X Ltd. had ₹ 1,00,000 equity share capital divided into 1,000 shares of ₹ 100 each out of which ₹ 80 per share was called up and paid up. It has 1,500 cumulative preference shares of ₹ 100 each fully paid up. Intangible assets include Goodwill of ₹ 80,000 and patents of ₹ 27,800. Preference dividends are in arrears of ₹ 33,000.

You are required to show the entries (Ignore dates) under each of the following conditions:

(i) If X Ltd. resolves to subdivide the equity shares into 10,000 equity shares of ₹ 10 each of which ₹ 8 per share is called up and paid up.

(ii) If X Ltd. resolves to convert its 1,000 equity shares of ₹ 100 each (assume fully-paid) into ₹ 1,00,000 worth of stock.

(iii) The preference shares are to be converted into 11% unsecured debentures of ₹ 100 each (Including arrears of dividends).

(iv) Patents and Goodwill to be written -off.