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Intermediate
Course: Paper 1

ADVANCED ACCOUNTING

(New Scheme of Education and Training)

Part 1

By

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Dedicated

To My Parents

Late Sh. SATPAL SHARMA

Smt. JANKI DEVI

Syllabus

PAPER 1: ADVANCED ACCOUNTING

(One paper – Three hours – 100 Marks)

Objective:

To acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities.

Contents:

1. Process of formulation of Accounting Standards including Indian Accounting Standards (IFRS converged standards) and IFRSs; Convergence vs Adoption; Objective and Concepts of carve outs.
2. Framework for Preparation and Presentation of Financial Statements (as per Accounting Standards).
3. (i) Applicability of Accounting Standards to various entities

   (ii) Application of Accounting Standards:

   AS 1: Disclosure of Accounting Policies

   AS 2: Valuation of Inventories

   AS 3: Cash Flow Statements

   AS 4: Contingencies and Events Occurring After the Balance Sheet Date

   AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

   AS 7: Construction Contracts

   AS 9: Revenue Recognition

   AS 10: Property, Plant and Equipment

   AS 11: The Effects of Changes in Foreign Exchange Rates

   AS 12: Accounting for Government Grants

   AS 13: Accounting for Investments

   AS14: Accounting for Amalgamations (excluding inter- company holdings)

   AS 15: Employee Benefits

   AS 16: Borrowing Costs

   AS 17: Segment Reporting

   AS 18: Related Party Disclosures

   AS 19: Leases

AS 20: Earnings Per Share

AS21: Consolidated Financial Statements of single subsidiaries (excluding problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries).

AS 22: Accounting for Taxes on Income

AS 23: Accounting for Investment in Associates in Consolidated Financial Statements

AS 24: Discontinuing Operations

AS 25: Interim Financial Reporting

AS 26: Intangible Assets

AS 27: Financial Reporting of Interests in Joint Ventures

AS 28: Impairment of Assets

AS 29: Provisions, Contingent Liabilities and Contingent Assets

4. Company Accounts
   (i) Schedule III to the Companies Act, 2013 (Division I)
   (ii) Preparation of financial statements – Statement of Profit and Loss, Balance Sheet and Cash Flow Statement
   (iii) Buy back of securities
   (iv) Accounting for reconstruction of companies.
5. Accounting for Branches including foreign branches.

Note: If either new Accounting Standards (AS), Announcements and Limited Revisions to AS are issued or the earlier ones are withdrawn or new AS, Announcements and Limited Revisions to AS are issued in place of existing AS, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

Contents

Chapter 1	Introduction to Accounting Standards	1.1
	QUESTION BANK	1.3
	MCQs	1.5
Chapter 2	Framework for Preparation and Presentation of Financial Statements	2.1
	QUESTION BANK	2.5
	MCQs	2.18
Chapter 3	Applicability of Accounting Standards	3.1
	QUESTION BANK	3.3
	MCQs	3.4
Chapter 4	AS 1: Disclosure of Accounting Policies	4.1
	QUESTION BANK	4.4
	MCQs	4.11
Chapter 5	AS 2 (Revised): Valuation of Inventory	5.1
	QUESTION BANK	5.5
	MCQs	5.20
Chapter 6	AS 3: Cash Flow Statement	6.1
	QUESTION BANK	6.7
	MCQs	6.17
Chapter 7	Cash Flow Statements	7.1
	QUESTION BANK	7.32
	Cash Flow Statement - Additional Questions	7.59
Chapter 8	Accounting Standard 7 Construction Contracts	8.1
	QUESTION BANK	8.9
	MCQs	8.20
Chapter 9	Accounting Standard 9 Revenue Recognition	9.1
	QUESTION BANK	9.6
	MCQs	9.17

Chapter 10	AS 10: Property, Plant and Equipment	10.1
	QUESTION BANK	10.13
	MCQs	10.28
Chapter 11	AS 11: The Effects of Changes in Foreign Exchange Rates	11.1
	QUESTION BANK	11.7
	MCQs	11.17
Chapter 12	AS 12: Accounting for Government Grants	12.1
	QUESTION BANK	12.9
	MCQs	12.19
Chapter 13	AS 16: Borrowing Costs	13.1
	QUESTION BANK	13.7
	MCQs	13.22
Chapter 14	Accounting Standard 17 Segment Reporting	14.1
	QUESTION BANK	14.9
	MCQs	14.12
Chapter 15	Accounting Standard 20 Earnings Per Share	15.1
	QUESTION BANK	15.10
	MCQs	15.23
Chapter 16	Accounting Standard 24 Discontinuing Operations	16.1
	QUESTION BANK	16.3
	MCQs	16.7
Chapter 17	Preparation of Financial Statements	17.1
	QUESTION BANK	17.31
	MCQs	17.68

CHAPTER 1

Introduction to Accounting Standards

Question 1

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

(*Source: Question 6, Study Material*)

Answer

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

Following are the objectives of Accounting Standards:

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

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

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

The main advantage of setting accounting standards are as follows:

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

(b) Accounting Standards prevent any misleading accounting treatment.

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

Question 2

Briefly explain the process of issuance of Indian Accounting Standards.

(*Source: Question 7, Study Material*)

Answer

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

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

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

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

Question 3

Explain the significance of emergence of IFRS as Global Standards.

(*Source: Question 8, Study Material*)

Answer

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

Question 4

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

(*Source: Question 9, Study Material*)

Answer

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

QUESTION BANK

Question 5

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

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

Answer

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

The following are the benefits of Accounting Standards:

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

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

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

Question 6

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

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

Answer

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

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Question 7

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

(*RTP, November 2021*)

Answer

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

Historical cost	This is the Acquisition price. According to this, assets are recorded at an amount of cash and cash equivalent paid or the fair value of the assets at time of acquisition.
Current Cost	Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

Realisable (Settlement) Value	For assets, amount currently realizable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount expected to be paid on settlement of liability in the normal course of business.
Present Value	Assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

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

MCQ

Question - 1: Phase I of Ind AS was applicable to:

Answer:

1. *All listed companies in India or outside India*
2. *Companies with turnover INR 500 crores or more*
3. *Companies with net worth INR 500 crores or more.*
4. *Companies with turnover INR 250 crores or more*

Question - 2: IASB stands for

Answer:

1. *International Accounting Standards Bureau*
2. *International Advisory Standards Board*
3. *International Accounting Standard Board.*
4. *International Accounting System Board*

Question - 3: Which committee is responsible for approval of accounting standards and their modification for the purpose of applicability to companies?

Answer:

1. *National Advisory Committee on Accounting Standards*
2. *Central Government Advisory Committee*
3. *Advisory Committee for approval of Accounting Standards*
4. *None of the above.*

Question - 4: Accounting Standards cover the aspect of

Answer:

1. *Recognition of events and transactions in the financial transactions.*
2. *Measurement of events and transactions in the financial transactions.*
3. *Presentation and disclosure of events and transactions in the financial transactions.*
4. *All of the above.*

Question - 5: IFRS stands for

Answer:

1. *International Financial Reporting System*
2. *International Finance Reporting Standard*
3. *International Financial Reporting Standard.*
4. *International Financial Reserve Standard*

Question - 6: Additional guidance given in Ind AS over and above what is given in IFRS are called

Answer:

1. *Carve-outs.*
2. *Carve-ins.*
3. *Carve clarifications.*
4. *Clarifications*

Question - 7: Accounting Standards for non-corporate entities in India are issued by

Answer:

1. *Central Govt.*
2. *State Govt.*
3. *Institute of Chartered Accountants of India.*
4. *MCA*

Question - 8: Accounting Standards

Answer:

1. *Harmonise accounting policies and eliminate the non-comparability offinancial statements.*
2. *Improve the reliability of financial statements.*
3. *Both (a) and (b).*
4. *manipulate the data for the management.*

Question - 9: It is essential to standardize the accounting principles and policies in order toensure

Answer:

1. *Transparency.*
2. *Consistency.*
3. *Comparability .*
4. *All the above.*

Question - 10: Which committee is responsible for approval of accounting standards andtheir modification for the purpose of applicability to companies?

Answer:

1. *NFRA.*
2. *MCA.*
3. *Central Government Advisory Committee.*
4. *IASB*

Question - 11: Global Standards facilitate

Answer:

1. *Cross border flow of money.*
2. *Comparability of financial statements.*
3. *Uniformity and Transparency of financial statements.*
4. *All the three.*

Answer

Q1	**3**	**Q2**	**4**	**Q3**	**1**	**Q4**	**4**	**Q5**	**3**	**Q6**	**2**
Q7	**3**	**Q8**	**3**	**Q9**	**4**	**Q10**	**2**	**Q11**	**4**		

CHAPTER 2

Framework for Preparation and Presentation of Financial Statements

Question 1

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

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

Additional information:

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

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

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

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

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

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

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

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

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

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

(*Source: Illustration 1, Study Material*)

Answer:

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

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

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

Balance Sheet as at 31st March, 20X2

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

Question 2

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

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

Opening equity at closing current costs = ₹ 15,000

Closing equity at closing current costs = ₹ 12,000

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

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

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

(*Source: Illustration 2, Study Material*)

Answer:

Financial Capital Maintenance at historical costs

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

Financial Capital Maintenance at current purchasing power

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

Physical Capital Maintenance

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

Question 3

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

(*Source: Question 6, Study Material*)

Answer

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

Question 4

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

(*Source: Question 7, Study Material*)

Answer

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

Question 5

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

(*Source: Question 8, Study Material*)

Answer

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

Question 6

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

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

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

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

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

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

(*Source: Question 9, Study Material*)

Answer

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

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

Question 7

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

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

Additional Information:

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

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

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

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

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

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

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

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

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

(*Source: Question 10, Study Material*)

Answer

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

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

QUESTION BANK

Question 8

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

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

Additional Information is as follows:

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realizable value of fixed assets on 31.03.2018 was ₹ 3,215,000.
(2) Purchases and Sales in 2017-18 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.
(3) The cost and net realizable value of stock on 31.03.2018 were ₹ 2,00,000 and 2,50,000 respectively.
(4) Expenses for the year amounted to ₹ 78,000.
(5) Deferred Expenses are amortized equally over 5 years.
(6) Sundry Debtors on 31.03.2018 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successfully re-installation of certain product supplied to the customer.
(7) Closing Sundry Creditors are ₹ 75,000, likely to be settled at 10% discount.
(8) Cash balance as on 31.03.2018 is ₹ 4,22,000.
(9) There is an early repayment penalty for the loan of ₹ 25,000.

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

(1) Profit & Loss Account for the year 201718.
(2) Balance Sheet as on 31st March, 2018.

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

Answer

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

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

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

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

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

Question 9

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

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

Additional Information is as follows:

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realizable value of fixed assets on 31.03.2021 was ₹ 3,25,000.
(2) Purchases and Sales in 2020-21 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.
(3) The cost and net realizable value of stock on 31.03.2021 were ₹ 2,00,000 and ₹ 2,50,000 respectively.
(4) Expenses for the year amounted to ₹ 78,000 which includes interest on 10% loan amount for the year.
(5) Deferred Expenses are amortized equally over 5 years.
(6) Trade receivables on 31.03.2021 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successful re-installation of certain product supplied to the customer;
(7) Closing trade payables are ₹ 75,000, likely to be settled at 10% discount.
(8) Cash balance as on 31.03.2021 is ₹ 4,22,000.
(9) There is an early repayment penalty for the loan of ₹ 25,000.

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

(1) Profit & Loss Account for the year 2020-21.
(2) Balance Sheet as on 31st March, 2021.

(RTP May, 2022)

Answer

Books of Cloth Trader

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

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

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

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

Question 10

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

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

Answer

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

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

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

Question 11

Briefly explain the elements of financial statements,

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

Answer

Elements of Financial Statements

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

Question 12

With regard to financial statements name any four.

(1) Users
(2) Qualitative characteristics
(3) Elements

(*RTP May 2019*)

Answer

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

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

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

Question 13

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

(*RTP November 2018*)

Answer

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

A brief explanation of each measurement basis is as follows:

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

Question 14

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

(*RTP November 2018*)

Answer

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

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

Question 15

Explain main elements of Financial Statements.

(*RTP May 2018*)

Answer

Elements of Financial Statements

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

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

Question 16

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

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

Answer

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

A brief explanation of each measurement basis is as follows:

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

Question 17

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

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

Answer

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

A brief explanation of each measurement basis is as follows:

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

Question 18

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

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

Answer

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

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

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

Question 19

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

(*RTP November 2019*)

Answer

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

Question 20

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

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

Answer:

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

A brief explanation of each measurement basis is as follows:

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

Question 21

With regard to financial statements name any four.

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

(*RTP, November 2020*)

Answer

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

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

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

Question 22

What are the issues, with which Accounting Standards deal?

(*RTP, November 2020*)

Answer

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

Question 23

Explain how financial capital is maintained at historical cost?

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

Answer

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

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

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

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

Question 24

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

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

Answer

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

A brief explanation of each measurement basis is as follows:

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

Question 25

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

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

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

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

Answer

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

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

Question 26

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

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

Answer

Physical Capital Maintenance at Current Cost

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

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

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

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

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

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

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

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

Question 27

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

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

Answer

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

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(ii) Elements of Financial Statements:

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

(b)

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

Question 28

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

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

Answer

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

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

Question 29

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

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

Additional Information:

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

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

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

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

(v) Deferred expenditure is normally amortised equally over 5 years starting from the Financial year 2018-19 i.e. ₹6,000 per year.
(vi) Debtors on 31st March, 2020 is ₹ 65,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 10,000 debtors depends on successful re-installation of certain products supplied to the customer.
(vii) Closing Trade payable ₹ 48,000, which is likely to be settled at 5% discount.
(viii) There is a prepayment penalty of ₹ 4,000 for Bank loan outstanding.
(ix) Cash & Bank balances as on 31st March, 2020 is ₹ 1,65,200.

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

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

Answer

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

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

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

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

Question 30

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

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

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

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

Answer

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

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

Question 31

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

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

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

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

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

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

(MTP April, 2022) (5 Marks)

Answer

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

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

Question 32

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

Answer

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

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

A brief explanation of each measurement basis is as follows:

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

Question 33

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

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

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

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

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

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

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

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

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

Answer

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

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

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

Question 34

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

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

RTP May, 2023)

Answer

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

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

Journal entry

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

Question 35

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

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

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

(i) Historical Cost

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

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

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

Question 36

Framework for Preparation and Presentation of Financial Statements

Shiva started a business on 1st April 2022 with ₹ 15,00,000 represented by 80,000 units of ₹ 25 each. During the financial year ending on 31st March, 2023, he sold the entire stock for ₹ 35 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Shiva in the year 2022-23 if Financial Capital is maintained at historical cost.

(*Ad. Accounting May, 2024*)

Answer

Particulars	Financial Capital Maintenance at Historical Cost (₹)
Closing equity (₹ 35 x 80,000 units)	28,00,000 represented by cash
Opening equity	80,000 units x ₹ 25 = 20,00,000
Permissible drawings to keep Capital intact	8,00,000 (28,00,000 – 20,00,000)

Question 37

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

(*MTP Advanced Accounting April, 2024*) (*4 Marks*)

Answer

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

Question 38

Opening Balance Sheet of Mr. Amit is showing the aggregate value of assets, liabilities and equity ₹ 16 lakh, ₹ 6 lakh and ₹ 10 lakh respectively. During accounting period, Mr. Amit has the following transactions:

(1) Earned 10% dividend on 4,000 equity shares held of ₹ 100 each

(2) Paid ₹ 1,00,000 to creditors for settlement of ₹ 1,40,000

(3) Rent of the premises is outstanding ₹ 20,000

(4) Mr. A withdrew ₹ 18,000 for his personal use.

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

(*MTP Advanced Accounting April, 2024*) (*4 Marks*)

Answer

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

Transactions	Assets ₹ lakh	–	Liabilities ₹ lakh	=	Equity ₹ lakh
Opening	16.00	–	6.00	=	10.00
(1) Dividend earned	16.40	–	6.00	=	10.80
(2) Settlement of Creditors	15.40	-	4.60	=	10.80
(3) Rent Outstanding	15.40	–	4.80	=	10.60
(4) Drawings	15.22	–	4.80	=	10.42

Question 39

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein? (*MTP Advanced Accounting March, 2024*) (*4 Marks*)

Answer

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

Qualitative Characteristics of Financial Statements

• Understandability	• Information presented in financial statements should be readily understandable by the users with reasonable knowledge of business and economic activities.
• Relevance	• Financial statements should contain relevant information only. Information, which is likely to influence the economic decisions of the users is called relevant.
• Reliability	• Information must be reliable; that is to say, they must be free from material error and bias.
• Comparability	• Financial statements should provide both inter-firm and intra-firm comparison.

Question 40

What are the issues, with which Accounting Standards deal?

(*MTP Advanced Accounting March, 2024*) (*4 Marks*)

Answer

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

MCQs

Question - 1: Liabilities are recorded at the undiscounted amount of cash expected to be paid on settlement of liability in the normal course of business under:

Answer:

1. *Present value.*
2. *Realizable value.*
3. *Current cost.*
4. *Fair value.*

Question - 2. Which of the following are underlying assumptions of financial statements?

Answer:

1. *Relevance and reliability.*
2. *Financial capital maintenance and physical capital maintenance.*
3. *Accrual basis and going concern.*
4. *Prudence and conservatism.*

Question - 3: Framework for preparation and presentation of financial statements suggests that the financial statements should observe

Answer:

1. *Understandability*
2. *Relevance*
3. *Reliability.*
4. *All the three.*

Question - 4: Which of the assumption is not considered as fundamental accounting assumption?

Answer:

1. *Going Concern*
2. *Accrual*
3. *Reliability.*
4. *Comparability.*

Question - 5: A machine was acquired in exchange of an old machine and ₹20,000 paid in cash. The carrying amount of old machine was ₹2,00,000 whereas its fair value was ₹1,50,000 on the date of exchange. The historical cost of the new machine will be taken as

Answer:

1. *₹2,00,000*
2. *₹1,70,000*
3. *₹2,20,000*
4. *₹1,80,000.*

Question - 6: An item that meets the definition of an element of financial statements should be recognised in the financial statements if:

Answer:

1. *It is probable that any future economic benefit associated with the item will flow to the enterprise*
2. *Item has a cost or value that can be measured with reliability*
3. *Both 1 and 2*
4. *It is probable that no future economic benefit associated with the item will flow to the enterprise.*

Question - 7: The 'going concern' concept assumes that

Answer:

1. *The business can continue in operational existence for the foreseeable future.*
2 *The business cannot continue in operational existence for the foreseeable future.*
3. *The business is continuing to be profitable.*
4. *The business cannot continue if it is not able to earn profits.*

Question - 8: Two principal qualitative characteristics of financial statements are

Answer:

1. *Understandability and materiality*
2. *Relevance and reliability*
3. *Relevance and materiality*
4. *Comparability and materiality.*

Question - 9: All of the following are components of financial statements except

Answer:

1. *Balance sheet*
2. *Statement of Profit and loss*
3. *Human responsibility report*
4. *Social responsibility report.*

Question - 10: An accounting policy can be changed if the change is required

Answer:

1. *By statute or accounting standard*
2. *For more appropriate presentation of financial statements*
3. *Both (a) and (b)*
4. *By statute as well as accounting standards.*

Question - 11: Value of equity may change due to

Answer:

1. *Contribution from or Distribution to equity participants*
2. *Income earned*
3. *expenses incurred*
4. *All the three.*

Question - 12: Which of the following are underlying assumptions of financial statements?

Answer:

1. *Relevance and reliability.*
2. *Financial capital maintenance and physical capital maintenance.*
3. *Accrual basis and going concern.*
4. *Prudence and conservatism*

Question - 13: An item that meets the definition of an element of financial statements should be recognised in the financial statements if:

Answer:

1. *It is probable that any future economic benefit associated with the item will flow to the enterprise*
2. *Item has a cost or value that can be measured with reliability*
3. *Both 1 and 2*
4. *It is probable that no future economic benefit associated with the item will flow to the enterprise*

Question - 14: It is essential to standardize the accounting principles and policies in order to ensure

Answer:

1. *Transparency*
2. *Consistency*
3. *Comparability*
4. *All of the three.*

Answer

Q1	***2***	***Q2***	***3***	***Q3***	***4***	***Q4***	***3***	***Q5***	***2***	***Q6***	***3***
Q7	***1***	***Q8***	***2***	***Q9***	***3***	***Q10***	***3***	***Q11***	***4***	***Q12***	***3***
Q13	***3***	***Q14***	***4***								

CHAPTER 3

Applicability of Accounting Standards

Question 1

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

(*Source: Example 1, Study Material*)

Answer

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

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

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

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

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

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

Question 2

What are the issues, with which Accounting Standards deal?

(*Source: Question 6, Study Material*)

Answer

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

Question 3

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

(*Source: Question 7, Study Material*)

Answer

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

Question 4

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

(*Source: Question 8, Study Material*)

Answer

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

Question 5

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

(*Source: Question 9, Study Material*)

Answer

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

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

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

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

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

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

Question 6

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

(*Source: Question 10, Study Material*)

Answer

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

QUESTION BANK

Question 7

Applicability of Accounting Standards

Based upon criteria for rating of non-corporate entity, categorize the following as Level I, Level II and Level III Level IV entities for the purpose of compliance of Accounting Standards in India.

(a) Rama Textiles whose turnover (excluding other income) exceeds ten crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(b) Star Industries is having borrowings (including public deposits) in excess of rupees two crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(c) Newman Industries is having borrowings (including public deposits) less than rupees fifty lakh at any time during the immediately preceding accounting year.

(d) SS Finance is a financial institution carrying its business in India since last 10 years.

(e) DD Finance, holding company of SS Finance. (Entity mentioned at Point (v) above)

(f) Reliable Co-op Bank, a co-operative bank, carrying banking operations since last 15 years.

(*Ad. Accounting May, 2024*)

Answer

(a) Level III Entity – Rama textiles, whose turnover (excluding other income) exceeds rupees ten crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(b) Level III Entity – Star industries is having borrowings (including public deposits) in excess of rupees two crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(c) Level IV Entity– Newman Industries is having borrowings (including public deposits) less than rupees fifty lakhs at any time during the immediately preceding accounting year.

(d) Level I Entity – SS is a financial institutions carrying its business in India since last 10 years.

(e) Level I Entity – DD finance, Holding company of SS finance (Entity mentioned in point (d) above).

Level I Entity – Reliable co-operative banks carrying on banking business since last 15 years.

MCQs

Question - 1: All non-corporate entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crores but does not exceed rupees ten crores at any time during the immediately preceding accounting year.

Answer:

1. *Level II entities.*
2. *Level IV entities.*
3. *Level III entities.*
4. *Level I entities.*

Question - 2: Small and Medium Sized Company (SMC) means, a company-

Answer:

1. *which may be a bank, financial institution or an insurance company.*
2. *whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;*
3. *whose turnover (excluding other income) does not exceed rupees fifty crores in the immediately preceding accounting year;*
4. *whose turnover (excluding other income) does not exceed rupees five hundred crores in the immediately preceding accounting year.*

Question - 3: All non-corporate entities engaged in commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees 250 crores in the immediately preceding accounting year, are classified as

Answer:

1. *Level II entities.*
2. *Level I entities.*
3. *Level III entities.*
4. *Level IV entities.*

Question - 4: Non-corporate entities which are not Level I entities whose turnover (excluding other income) exceeds rupees _____ but does not exceed rupees two-fifty crores in the immediately preceding accounting year are classified as Level II entities.

Answer:

1. *five crores.*
2. *two crores.*
3. *fifty crores.*
4. *ten crores.*

Question - 5: One of the eligibility criteria for classification of non-corporate entities as Level II is that all commercial, industrial and business activities , whose turnover (excluding other income) exceeds

Answer:

1. *₹50 crore but does not exceed ₹250 crore in the immediately preceding accounting year*
2. *₹40 lakhs but does not exceed ₹50 crore in the immediately preceding accounting year*
3. *₹50 crore but does not exceed ₹200 crore in the immediately preceding accounting year*
4. *₹10 crores but does not exceed ₹50 crore in the immediately preceding accounting year.*

Question - 6: Which of the following accounting standards is not applicable to Level II and Level III non-corporate entities in their entirety?

Answer:

1. *AS 17 Segment Reporting*
2. *AS 28 Impairment of Assets*
3. *AS 19 Leases*
4. *AS 29, Provisions, Contingent Liabilities and Contingent Assets*

Question - 7: The following Accounting Standard is not applicable to Non-corporate Entities falling in Level II in its entirety

Answer:

1. *AS 10.*
2. *AS 17.*
3. *AS 2.*
4. *AS 13.*

Question - 8: Non-corporate entities which are not Level I entities whose turnover (excluding other income) exceeds rupees but does not exceed rupees two-fifty crores in the immediately preceding accounting year are classified as Level II entities.

Answer:

1. *five crores.*
2. *two crores.*
3. *fifty crores.*
4. *ten crores.*

Question - 9: The following Accounting Standard is not applicable to Non-corporate Entities falling in Level II in its entirety

Answer:

1. *AS 10.*
2. *AS 17.*
3. *AS 2.*
4. *AS 13.*

Question - 10: All non-corporate entities engaged in commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees 250 crores in the immediately preceding accounting year, are classified as

Answer:

1. *Level II entities.*
2. *Level I entities.*
3. *Level III entities.*
4. *Level IV entities.*

Question - 11: All non-corporate entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crores but does not exceed rupees ten crores at any time during the immediately preceding accounting year.

Answer:

1. *Level II entities.*
2. *Level IV entities.*
3. *Level III entities.*
4. *Level I entities.*

Question - 12: "Small and Medium Sized Company" (SMC) means, a company-

Answer:

1. *which may be a bank, financial institution or an insurance company.*
2. *whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;*
3. *whose turnover (excluding other income) does not exceed rupees fifty crores in the immediately preceding accounting year;*
4. *whose turnover (excluding other income) does not exceed rupees five hundred crores in the immediately preceding accounting year.*

Question - 13: All non-corporate entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crores but does not exceed rupees ten crores at any time during the immediately preceding accounting year.

Answer:

1. *Level II entities.*
2. *Level IV entities.*
3. *Level III entities.*
4. *Level I entities.*

Question - 14: Non-corporate entities which are not Level I entities whose turnover (excluding other income) exceeds rupees but does not exceed rupees two-fifty crores in the immediately preceding accounting year are classified as Level II entities.

Answer:

1. *five crores.*
2. *two crores.*
3. *fifty crores.*
4. *ten crores*

Answer

Q1	***3***	***Q2***	***2***	***Q3***	***2***	***Q4***	***3***	***Q5***	***1***	***Q6***	***1***	***Q7***	***2***
Q8	***3***	***Q9***	***2***	***Q10***	***2***	***Q11***	***3***	***Q12***	***2***	***Q13***	***3***	***Q14***	***3***

CHAPTER 4

AS 1: Disclosure of Accounting Policies

Question 1

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

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

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

(*Source: Illustration 1, Study Material*)

Answer

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

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

Question 2

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

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

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

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

(*Source: Illustration 2, Study Material*)

Answer

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

Notes on Accounts:

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

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

Question 3

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

(*Source: Illustration 3, Study Material*)

Answer

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

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

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

Question 4

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

(*Source: Question 4, Study Material*)

Answer

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

Question 5

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

(*Source: Question 5, Study Material*)

Answer

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

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

Question 6

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

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

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

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

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

(*Source: Question 6, Study Material*)

Answer

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

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

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

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

Question 7

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

(*Source: Question 7, Study Material*)

Answer

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

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

QUESTION BANK

Question 8

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

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

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

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

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

Answer

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

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

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

Question 9

What are fundamental accounting assumptions?

(*RTP May 2019*)

Answer

Fundamental Accounting Assumptions:

Accrual, Going Concern and Consistency

Question 10

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

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

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

Answer:

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

Notes on Accounts:

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

Question 11

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

actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.

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

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

Answer:

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

Notes on Accounts:

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

Question 12

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

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

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

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

Answer

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

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

Question 13

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

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

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

Answer

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

Notes on Accounts:

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

Question 14

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

(*RTP, November 2020*)

Answer

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

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

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

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

Question 15

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

Answer

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

Notes on Accounts:

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

Question 16

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

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

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

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

(*RTP May 2020*)

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

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

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

Answer

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

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

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

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

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

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

Question 17

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

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

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

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

(*5 Marks*)

Answer

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

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

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

Question 18

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

(*Old Study Material*)

Answer

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

Question 19

When can a company change its accounting policy? Explain.

(*Old Study Material*)

Answer

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

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

(ii) for compliance with an Accounting Standard or

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

Question 20

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

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

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

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

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

(*Old Study Material*)

Answer

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

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

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

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

Question 21

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

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

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

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

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

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

(*5 Marks*)

Answer

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

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

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

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

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

Question 22

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

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

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

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

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

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

[*MTP October, 2019, 5 marks*]

Answer

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

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

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

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

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

Question 23

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

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

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

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should not form part of the financial statements.

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

(v) There is a single list of accounting policies which are applicable to all circumstances.

(5 Marks) (MTP, May 2020)

Answer

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

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

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

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

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

Question 24

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

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

Answer

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

“The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present

year i.e. 2019-20, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000 (1,75,000 – 1,59,000)."

Question 25

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

Total value of stock ₹ 133.75 lakhs

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

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

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

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

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

Answer

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

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

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

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

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

Question 26

Discuss Disclosure requirements in following cases as per AS 1.

(*i*) *Accountant of A Ltd. charges a probable loss of losing a suit in books of accounts and also disclosed the same fact in financial statements. The probability of losing the suit is 25%.*

(*ii*) *Accountant of A Ltd. capitalized all the revenue expenses of repair and maintenance during the year to Plant & Machinery and is also disclosing the same as company policy in financial statements.*

(*iii*) *A Ltd. has followed accrual basis 'of accounting since incorporation. The chief accountant also disclosed this fact in financial statements.*

(*iv*) *A Ltd. was providing for after sales expenses @ 2% of sales for covering expenses during the warranty period. Now A Ltd. observes that actual after sales expenses were much less as compared to provision because of better technology used in manufacturing of the products. Now, the Board of A Ltd. decides to account for these expenses as and when they occur. Sales during the period are ₹ 50 crores.*

(*4 Marks*) (*November, 2023*) (*Accounts*)

MCQs

Question - 1: Two major considerations that govern the selection of accounting policy

Answer:

1. *Substance over form and Consistency*
2. *Prudence and Materiality*
3. *Prudence and Reliability*
4. *Reliability and Consistency*

Question - 2: Fundamental accounting assumption is

Answer:

1. *Materiality*
2. *Business entity*
3. *Going concern*
4. *Dual aspect*

Question - 3: AS-1 recognizes_____ Fundamental Accounting Assumptions

Answer:

1. *three.*
2. *four.*
3. *five.*
4. *none of the three.*

Question - 4: Which of the following is NOT a major consideration in selection and application of accounting policies?

Answer:

1. *Prudence*
2. *Comparability*
3. *Materiality*
4. *Substance over form*

Question – 5: Adoption of different accounting policies by different companies operating in the same industry affects which of the qualitative characteristics the most?

Answer:

1. *Comparability*
2. *Relevance*
3. *Faithful representation*
4. *Reliability*

Question - 6: Which of the following statement would not be correct in relation to disclosures to be made in the financial statements after making any change in an accounting policy?

Answer:

1. *Any change in an accounting policy which has a material effect should be disclosed.*
2. *The amount by which any item in the financial statements is affected by such change should be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.*
3. *If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.*
4. *If a change is made in an accounting policy which has material effect on the financial statements for the current period and is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed only in the later periods i.e. year(s) next to the year in which the change is adopted.*

Question - 7: Fundamental Accounting Assumption is compulsory for which of the following:

Answer:

1. *All Companies*
2. *All Commercial organisations*
3. *only private sector organisations*
4. *All entities (All profit and Not for profit organisations)*

Question - 8: All significant Accounting Policies are disclosed

Answer:

1. *In Auditors Report*
2. *In notes to Accounts of the financial statements*
3. *Board of Directors Report*
4. *Audit Committee Report*

Answer

Q1	***2***	***Q2***	***3***	***Q3***	***1***	***Q4***	***2***
Q5	***1***	***Q6***	***4***	***Q7***	***4***	***Q8***	***2***

CHAPTER 5

AS 2 (Revised): Valuation of Inventory

Question 1

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

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

What will be the value of closing stock?

(*Source: Illustration 1, Study Material*)

Answer

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

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

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

Question 2

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

(*Source: Illustration 2, Study Material*)

Answer

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

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

Question 3

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

(*Source: Illustration 3, Study Material*)

Answer

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

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

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

Question 4

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

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

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

(*Source: Illustration 4, Study Material*)

Answer

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

Cost per kg. of finished goods:

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

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

Question 5

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

(*Source: Question 5, Study Material*)

Answer

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

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

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

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

(d) selling and distribution costs.

Question 6

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-20X2 the Company used 12,000 MT of raw material costing ₹150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the

context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss, if any.

(*Source: Question 6, Study Material*)

Answer

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

Amount of Abnormal Loss:

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

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

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

Question 7

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

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

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

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

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

(*Source: Question 7, Study Material*)

Answer

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

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.20X1:

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

Question 8

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

(*Source: Question 8, Study Material*)

Answer

Valuation of unfinished unit

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

QUESTION BANK

Question 9

State whether the following statements are 'True' or 'False'. Also give reason for your answer.
As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price.

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

Answer

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

Question 10

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

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

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

Answer

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

Amount of Abnormal Loss:

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

(ii) Abnormal Loss in quantity (950 - 800) 150 MT
Abnormal Loss ₹ 30,000
[150 units @ ₹ 200 (₹ 30,40,000/15,200)]
Amount of ₹ 30,000 (Abnormal loss) will be charged to the Profit and Loss statement.

Question 11

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

(*RTP May 2019*)

Answer:

Valuation of unfinished unit

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

Question 12

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

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

Chemical Y	
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

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

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

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

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

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

(*RTP November 2018*)

Answer

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

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

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

Value of Closing Stock

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

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

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

Value of Closing Stock

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

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

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

Question 13

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

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

(*RTP May 2018*)

Answer

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

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

Question 14

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

(RTP May, 2022)

Answer

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

Question 15

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

Details of Purchases:

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

Details of issue of Inventory:

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

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

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

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

Answer:

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

= ₹ 107.75 x 20 units = ₹ 2,155

Value of inventory as per Weighted Average basis

Total units purchased and total cost:

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

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

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

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

Question 16

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

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

Answer:

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

Amount of Normal Loss and Abnormal Loss:

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

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

Question 17

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

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

Additional Information:

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

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

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

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

Answer:

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

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

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

Value of Closing Stock:

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

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

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

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

Question 18

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

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

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

Answer:

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

Amount of Normal Loss and Abnormal Loss:

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

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

Question 19

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

Details of Purchases:

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

Details of issue of Inventory:

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

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

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

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

Answer:

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

= ₹ 107.75 x 20 units = ₹ 2,155

Value of inventory as per Weighted Average basis

Total units purchased and total cost:

01.03.2017 ₹ 108 x 20 units = ₹ 2160

08.3.2017 ₹ 107 x 15 units = ₹ 1605

17.03.2017 ₹ 109 x 30 units = ₹ 3270

25.03.2017 ₹ 107 x 15 units = ₹ 1605

Total 80 units = ₹ 8640

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

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

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

Question 20

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

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

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

Answer:

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

Amount of Normal Loss and Abnormal Loss:

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

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

Question 21

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

(*RTP November 2019*)

Answer

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

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

Question 22

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

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

Additional Information:

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

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

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

[*RTP, November 2020*]

Answer

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

Value of Closing Stock:

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

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

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

Question 23

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

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

(5 Marks) (MTP, May 2020)

Answer

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

Amount of Normal Loss and Abnormal Loss:

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

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

Question 24

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

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

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

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

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

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

(*5 marks*)

Answer

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

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.2019:

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

Question 25

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

(*RTP May 2022*)

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

(*5 Marks*)

Answer

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

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

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

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

(d) selling and distribution costs.

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

Question 26

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

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

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

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

(*5 Marks*)

Question 27

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

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

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

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

Question 28

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

Details of cost for these products are:

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

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

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

Answer

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

Product – A

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

Product – B

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

Question 29

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

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

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

[*RTP May 2020*]

Answer

Calculation of cost for closing inventory

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

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

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

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

Question 30

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

(*Old Study Material*)

Answer

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

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

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

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

Question 31

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

(*Old Study Material*)

Answer

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

Amount of Abnormal Loss:

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

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

Question 32

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

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

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

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

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

(*Old Study Material*)

Answer

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

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.20X1:

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

Question 33

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

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

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

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

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

[*MTP October, 2019, 5 marks*]

Answer

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

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.2019:

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

Question 34

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

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

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

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

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

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

Answer

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

Hence the valuation will be done as under:

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

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

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

Valuation of Total Inventory as on 31.03.2019:

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

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

Question 35

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

(MTP April, 2022) (5 Marks)

Answer

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

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

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

Question 36

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

Raw Material P

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

Finished goods Q

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

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

Calculate the value of closing stock, when

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

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

(MTP, October 2021) (5 Marks)

Answer

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

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

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

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

Value of Closing Stock:

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

Working Note:

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

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

Question 37

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

(*RTP, November 2021*)

Answer

Valuation of unfinished unit

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

Question 38

Following information of Sarah Limited is given:

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

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

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

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

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

Answer

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

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

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

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

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

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

Question 39

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

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

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

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

(*RTP November, 2022*)

Answer

Valuation of closing stock

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

Working Notes:

1. Adjustment for Coats

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

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

Question 40

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

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

(ii) Allocation of material cost.

(*RTP May, 2023*)

Answer

Calculation of Normal cost per Kg.

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

Allocation of material cost

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

Note: Abnormal losses are recognized as separate expense.

Question 41

In the following cases, find the value of closing stock as per AS 2:

(*i*) *Sonu is a retailer dealing in toys. During the year, he purchased items worth for ₹ 1,47,000 and made a total sale ₹ 1,54,000. The average percentage of gross margin is 10% on cost. Opening stock of toys at cost was ₹ 20,000.*

(*ii*) *On 21st March, 2023, Mohan purchased 250 chairs at ₹ 300 each. The selling price of the chair is ₹ 400 each. Owing to a manufacturing defect, net realisable value of the whole lot of chair was determined at 70% of their normal selling price. No chairs were sold during the year.*

(*4 Marks*) (*November, 2023*) (*Accounts*)

Question 42

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

(ii) X Limited purchased goods at the cost of ₹ 40 lakhs in October, 2022. Till March, 2023, 75% of the stocks were sold. The company wants to disclose closing stock at ₹ 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct value of closing stock to be disclosed as at 31.3. 2023.

(4 Marks) (MTP October, 2023) (Accounts)

Answer

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

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

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

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

(d) selling and distribution costs.

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

Question 43

Wooden Plywood Limited has a normal wastage of 5% in the production process. During the year 2023-24, the Company used 16,000 MT of Raw material costing ₹ 190 per MT. At the end of the year, 950 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to :

(1) Calculate the amount of abnormal loss.

(2) Explain the treatment of normal loss and abnormal loss in the context of AS-2.

(*MTP Advanced Accounting April, 2024*) (*5 Marks*)

Answer

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

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

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

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

Question 44

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

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

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

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

(*Question Paper May, 2024) (7 Marks*)

MCQs

Question - 1: The cost of inventories of items that are not ordinarily inter-changeable and goods or services produced and segregated for specific projects should be assigned by

Answer:

1. *Specific identification of their individual costs.*
2. *FIFO.*
3. *Weighted average cost formula*
4. *(b) or (c)*

Question - 2: In determining the cost of inventories in accordance with AS 2, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred. An example of such cost is

Answer:

1. *Fixed production overheads.*
2. *Freight inwards.*
3. *Selling and distribution costs.*
4. *Costs of designing products for specific customers.*

Question - 3: Which item of inventory is under the scope of AS 2 (Revised)?

Answer:

1. *WIP arising under construction contracts*
2. *Raw materials*
3. *Shares*
4. *Debentures held as stock in trade.*

Question - 4: Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be

Answer:

1. *sold at or above cost.*
2. *sold above cost.*
3. *sold less than cost.*
4. *sold at market value(where market value is more than cost).*

Question - 5: All of the following costs are excluded while computing value of inventories except?

Answer:

1. *Selling and Distribution costs*
2. *Allocated fixed production overheads based on normal capacity.*
3. *Abnormal wastage*
4. *Storage costs (which is necessary part of the production process)*

Question - 6: Identify the statement(s) which is/are incorrect.

Answer:

1. *Storage costs which is a necessary part of the production process is included in inventory valuation.*
2. *Administration overheads are never included in inventory valuation.*
3. *Full amount of variable production overheads incurred are included in inventory valuation.*
4. *Administration overheads are always included in inventory valuation.*

Question - 7: Identify the statement(s) which is/are incorrect.

Answer:

1. *Storage costs which is a necessary part of the production process is included in inventory valuation.*
2. *Administration overheads are never included in inventory valuation.*
3. *Full amount of variable production overheads incurred are included in*
4. *Administration overheads are always included in inventory valuation.*

Question - 8: Which of the method is not recommended by AS 2?

Answer:

1. *FIFO*
2. *LIFO*
3. *Weighted average*
4. *Specific identification method*

Answer

Q1	***1***	***Q2***	***3***	***Q3***	***2***	***Q4***	***1***
Q5	***2***	***Q6***	***2***	***Q7***	***2***	***Q8***	***2***

CHAPTER 6

AS 3: Cash Flow Statement

Question 1

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

(a) Purchase of Machinery.
(b) Proceeds from issuance of equity share capital
(c) Cash Sales.
(d) Proceeds from long-term borrowings.
(e) Cheques collected from Trade receivables.
(f) Cash receipts from Trade receivables.
(g) Trading Commission received.
(h) Purchase of investment.
(i) Redemption of Preference Shares.
(j) Cash Purchases.
(k) Proceeds from sale of investment
(l) Purchase of goodwill.
(m) Cash paid to suppliers.
(n) Interim Dividend paid on equity shares.
(o) Wages and salaries paid.
(p) Proceed from sale of patents.
(q) Interest received on debentures held as investment.
(r) Interest paid on Long-term borrowings.
(s) Office and Administration Expenses paid
(t) Manufacturing Overheads paid.
(u) Dividend received on shares held as investments.
(v) Rent Received on property held as investment.
(w) Selling and distribution expense paid.
(x) Income tax paid
(y) Dividend paid on Preference shares.
(z) Underwritings Commission paid.
(aa) Rent paid.
(bb) Brokerage paid on purchase of investments.
(cc) Bank Overdraft
(dd) Cash Credit
(ee) Short-term Deposits

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

(gg) Refund of Income Tax received.

(*Source: Illustration 1, Study Material*)

Answer

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

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

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

(d) Cash Equivalent: ff.

Question 2

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

(*Source: Illustration 2, Study Material*)

Answer

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

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

Question 3

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

(i) Interest paid by financial enterprise

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

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

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

(v) Bad debts written off

(*Source: Illustration 3, Study Material*)

Answer

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

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

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

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

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

(v) Bad debts written off

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

Question 4

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

Cash Flow (Abstract)

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

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

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

(*Source: Illustration 4, Study Material*)

Answer

Cash Flow Statement for the year ended 31.3.20X1

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

Question 5

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

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

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

(*Source: Illustration 4, Study Material*)

Answer

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

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

Note:

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

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

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

Question 6

What are the main features of the Cash Flow Statement?

(*Source: Question 6, Study Material*)

Answer

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

Question 7

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

(*Source: Question 7, Study Material*)

Answer

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

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

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

Question 8

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

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

(*Source: Question 8, Study Material*)

Answer

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

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

Question 9

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

(i) Loans and Advances given to the following and interest earned on them:
  (1) to suppliers
  (2) to employees
  (3) to its subsidiaries companies
(ii) Investment made in subsidiary Smart Ltd. and dividend received
(iii) Dividend paid for the year

Discuss in the context of AS 3 Cash Flow Statement.

(*Source: Question 9, Study Material*)

Answer

Treatment as per AS 3 'Cash Flow Statement'

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

Cash flows from financing activities

Question 10

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

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

(*Source: Question 10, Study Material*)

Answer

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

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

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

Question 11

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

(*Source: Question 11, Study Material*)

Answer

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

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

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

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

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

QUESTION BANK

Question 12

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

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

(*RTP May 2020*)

Answer

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

Question 13

What are the main features of the Cash Flow Statement?

(*Old Study Material*)

Answer

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

Question 14

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

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

(*Old Study Material*)

Answer

Treatment as per AS 3 'Cash Flow Statement'

(i) Loans and advances given and interest earned
  (1) to suppliers Cash flows from operating activities
  (2) to employees Cash flows from operating activities
  (3) to its subsidiary companies Cash flows from investing activities
(ii) Investment made in subsidiary company and dividend received
  Cash flows from investing activities
(iii) Dividend paid for the year
  Cash flows from financing activities
(iv) TDS on interest income earned on investments made
  No cash inflow/cash outflow
(v) TDS on interest earned on advance given to suppliers
  No cash inflow/cash outflow

Question 15

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

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

(*Old Study Material*)

Answer

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

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

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

Question 16

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

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

Notes to Accounts

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

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

Additional Information:

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

(*RTP May, 2023*)

Answer

Fox Ltd.

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

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

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

Working Note:

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

Question 17

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

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

Notes to accounts

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

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

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

Further Information is available:

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

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

(*RTP November, 2022*)

Answer

Max Ltd.

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

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

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

Working Notes:

1. Calculation of Income taxes paid

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

2. Calculation of Fixed assets acquisitions

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

Question 18

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

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

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

Additional Information:

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

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

(iii) Depreciation provided during the year –
- Furniture and Fixtures ₹5,000
- Vehicles ₹2,200

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

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

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

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

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

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

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

Question 19

Answer the following Questions:

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2023.

Particulars	*Amount (₹)*
Machinery acquired by issue of shares at face value	*2,00,000*
Claim received for loss of machinery in earthquake	*55,000*
Unsecured loans given to associates	*5,00,000*
Interest on loan received from associate company	*70,000*
Pre-acquisition dividend received on investment made	*52,600*
Debenture interest paid	*1,45,200*
Term loan repaid	*4,50,000*
Interest received on investment (*TDS of ₹ 8,200 was deducted on the above interest*)	*73,800*
Book value of plant & machinery sold (*loss incurred ₹ 9,600*)	*90,000*

(*5 Marks*) (*MTP October, 2023*) (*Accounts*)

Answer

Cash Flow Statement from Investing Activities of Subham Creative Limited for year ended 31-03-2023

Cash generated from investing activities	₹	₹
Interest on loan received	70,000	
Pre-acquisition dividend received on investment made	52,600	
Unsecured loans given to subsidiaries	(5,00,000)	
Interest received on investments (gross value)	82,000	
TDS deducted on interest	(8,200)	

Cash generated from investing activities	***₹***	***₹***
Sale of Plant & Machinery ₹ (90,000 – 9,600)	80,400	
Cash used in investing activities (before extra-ordinary item)		(2,23,200)
Extraordinary claim received for loss of machinery		55,000
Net cash used in investing activities (after extra-ordinary item)		(1,68,200)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.

2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.

Question 20

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

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

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

(iii) Purchases for the year amounted to ₹440 crores out of which credit purchase was 80%.
Balance in creditors as on
1.4.2022 ₹168 crores
31.3.2023 ₹184 crores

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

(v) Employees of the enterprise were paid ₹40 crores in cash.

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

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

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

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

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

(xi) Dividends totalling ₹30 crores was also paid.

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

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

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

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

(10 Marks) (RTP November, 2023) (Accounting)

Answer

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

	(₹in crores)	***(₹in crores)***
Cash flow from operating activities		
Cash sales	524	
Cash collected from credit customers	268	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(502)	
Cash from operations	290	
Less: Income tax paid	(52)	
Net cash from operating activities		238
Cash flow from investing activities		
Net Payment for purchase of Machine (50 – 30)	(20)	
Proceeds from sale of investments	32	
Net cash from investing activities		12
Cash flow from financing activities		
Redemption of Preference shares	(64)	

	(₹ in crores)	*(₹ in crores)*
Proceeds from issue of Equity shares	48	
Debenture interest paid	(4)	
Dividend Paid	(30)	
Net cash used in financing activities		(50)
Net increase in cash and cash equivalents		200
Add: Cash and cash equivalents as on 1.04.2022		4
Cash and cash equivalents as on 31.3.2023		204

Working Note:

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

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

Question 21

AS 3 "Cash Flow Statements"

From the following particulars calculate cash flows from Operating activities:

Particulars	₹
Retained earning	17,000
Depreciation	4,000
Loss on Sale of Machinery	3,000
Provision for tax	7,000
Interim Dividend paid during the year	10,000
Dividend paid during the year	8,000
Premium payable on redeemable Preference Shares	2,000
Profit on sale of investment	10,000
Refund of tax	1,000

Additional Information:

	31.3.22 ₹	31.3.23 ₹
Trade Receivable	10,000	12,000
Trade Payable	7,000	15,000
Provision for Tax	4,000	7,000
Prepare Expenses	2,000	1,000
Outstanding Expenses	1,400	1,000

(*Ad. Accounting May, 2024*)

Answer

Calculation of Cash Flow from Operating Activities

Particulars	Amount ₹
Retained earnings	17,000
Add: Depreciation	4,000
Add: Loss on sale of Machinery	3,000
Add: Premium Payable on redeemable Preference Shares	2,000
Add: Dividend paid	8,000
Add: Interim dividend paid during the year	10,000
Add: provision for tax made during the current year	7,000
Less: Refund of tax	(1,000)
Less: Profit on Sale of Investment	(10,000)
Operating Profit before Working Capital Changes	40,000
Add: Decrease in Prepaid Expenses	1,000
Less: Increase in Trade receivable	(2,000)
Add: Increase in Trade Payable	8,000
Less: Decrease in Outstanding Expenses	(400)
Cash generated from (Net of refund) operation	46,600
Less: Income tax paid (4,000 – 1,000)	(3,000)
Net Cash flow operating activities	43,600

Question 22

The following information is provided for Aarambh Limited:

Particulars	31st March 2023 (₹)	31st March 2024 (₹)
Profit and Loss a/e	5,400 (Dr.)	37,800
Provision for Taxation	2,21,400	1,35,000
General Reserve	54,000	81,000
12% Debentures	1,18,800	2,91,600
Trade Payables	1,29,600	1,18,800
8% Current Investments	54,000	1,08,000
Property, plant and equipment (Gross)	3,99,600	3,99,600
Accumulated Depreciation	1,29,600	1,62,000
Trade Receivables (Gross)	81,000	2,61,360
Provision for Doubtful Debts	27,000	54,000
Inventories	1,35,000	81,000
Cash and Cash Equivalents	5,400	30,240

Additional information:

(i) Income tax provided during the year ₹1,62,000.

(ii) New debentures have been issued at the end of current financial year.

(iii) New investments have been acquired at the end of the current financial year.

You are required to calculate net Cash Flow from Operating Activities.

(*Question Paper May, 2024) (7 Marks*)

Question 23

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

Summary of Cash Account
for the year ended March 31, 2023

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

(*MTP Advanced Accounting March, 2024*) (*4 Marks*)

Answer

Cash Flow Statement of ……
for the year ended March 31, 2023(Direct Method)

Particulars	₹	₹
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

MCQs

Question - 1: As per AS 3, which one of the following is not a financing activity?

Answer:

1. *Cash proceeds from issuing equity instruments*
2. *Acquisition of an entity by means of an equity issue*
3. *Cash payments to owners to acquire own entitys shares;*
4. *Cash proceeds from issuing bonds.*

Question - 2: While preparing cash flow statement, conversion of debt to equity

Answer:

1. *Should be shown as a financing activity.*
2. *Should be shown as an investing activity.*
3. *Should not be shown as it is a non-cash transaction.*
4. *Should not be shown as operating activity*

Question - 3: As per AS 3, Long term bank borrowings are considered under _____ activities in the cash flow statement.

Answer:

1. *Financing*
2. *Investing*
3. *Operating*
4. *Not considered*

Question - 4: As per AS 3, which one of the following is not a financing activity?

Answer:

1. *Cash proceeds from issuing equity instruments*
2. *Acquisition of an entity by means of an equity issue*
3. *Cash payments to owners to acquire own entitys shares;*
4. *Cash proceeds from issuing bonds.*

Question - 5: A Ltd. is a non-financial enterprise and has given loans and advances to B Ltd. (subsidiary of A Ltd.). A Ltd. earned interest of ₹1,00,000 on these loans and advances. Under Accounting Standards, interest earned by A Ltd. will be shown in Cash Flow Statement as

Answer:

1. *Operating Cash Flow*
2. *Investing Cash Flow*
3. *Financing Cash Flow*
4. *Either (a) or (b)*

Question - 6: In the cash flow statement of a financial enterprise, interest paid and dividends received should be

Answer:

1. *classified as operating cash flows*
2. *classified as financing cash flows*
3. *Not shown in cash flow statement*
4. *classified as investing cash flows*

Question - 7: XYZ Co. Ltd is a financial institution and has given loans and advances to its subsidiary and earned interest of ₹5 lacs on that loan. Interest earned by XYZ Co. Ltd is shown as

Answer:

1. *Operating Cash Flow.*
2. *Investing Cash Flow.*
3. *Financing Cash Flow*
4. *cash and cash equivalent*

Question - 8: In the cash flow statement of a financial enterprise, interest paid and dividends received should be

Answer:

1. *classified as operating cash flows*
2. *classified as financing cash flows*
3. *Not shown in cash flow statement*
4. *classified as investing cash flows*

Question - 9: In the cash flow statement of a financial enterprise, interest paid and dividends received should be

Answer:

1. *classified as operating cash flows*
2. *classified as financing cash flows*
3. *Not shown in cash flow statement*
4. *classified as investing cash flows*

Question - 10: Which of the following items is not considered as cash or cash equivalent?

Answer:

1. *Cash on hand*
2. *Cash at Bank*
3. *Securities deposits for 4 months*
4. *Investments with a maturity of two months from the date of acquisition.*

Question - 11: Crown Ltd. wants to prepare its cash flow statement. It sold equipment of book value of ₹60,000 at a gain of ₹8,000. The amount to be reported in its cash flow statement under operating activities is

Answer:

1. *Nil*
2. *₹8,000*
3. *₹68,000*
4. *₹60,000*

Question - 12: While preparing cash flows statement, an entity (other than a financial institution) should disclose the dividends received from its investment in shares as

Answer:

1. *operating cash inflow*
2. *investing cash inflow*
3. *financing cash inflow*
4. *cash & cash equivalent*

Question - 13: XYZ Co. is a financial enterprise. In its cash flow statement, interest paid and dividends received should be

Answer:

1. *classified as operating cash flows.*
2. *classified as financing cash flows.*
3. *Not shown in cash flow statement.*
4. *classified as investing cash flows.*

Question - 14: In the cash flow statement, 'cash and cash equivalents' do not include

Answer:

1. *Bank balances.*
2. *Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value.*
3. *Cash balances.*
4. *Loan from bank.*

Question - 15: While preparing a Cash Flow Statement using the Indirect method as required under AS 3, which of the following will not be deducted from/added to the Net Profit to arrive at the "Cash flow from Operating activities"?

Answer:

1. *Interest income*
2. *Gain on sale of a fixed asset.*
3. *Depreciation.*
4. *Gain on sale of inventory*

Question - 16: As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as

Answer:

1. *Operating activity.*
2. *Financing activity.*
3. *Investing activity.*
4. *None of the above.*

Question - 17: All of the following are examples of cash flows arising from investing activities except

Answer:

1. *Cash payments to acquire fixed assets.*
2. *Cash receipts from disposal of fixed assets.*
3. *Cash payments to suppliers for goods and services.*
4. *Cash receipt from sale of investment.*

Question - 18: Cash repayments of amounts borrowed will be disclosed in the cash flow statement as

Answer:

1. *An operating activity.*
2. *A financing activity*
3. *An investing activity.*
4. *Non-cash transaction.*

Question - 19: Which of the following activities would generally be regarded as a financing activity in preparing a cash flow statement?

Answer:

1. *Dividend distribution.*
2. *Proceeds from the sale of shares of other companies.*
3. *Loans made by the financial enterprise to other businesses entities.*
4. *Sale of investment.*

Question - 20: While preparing cash flow statement, conversion of debt to equity

Answer:

1. *Should be shown as a financing activity.*
2. *Should be shown as an investing activity.*
3. *Should not be shown as it is a non-cash transaction.*
4. *Should not be shown as operating activity.*

Question - 21: Which of the following would be considered a 'cash-flow item from an "investing" activity'?

Answer:

1. *Cash outflow to the government for payment of taxes.*
2. *Cash outflow to purchase bonds issued by another company.*
3. *Cash outflow to shareholders as dividends.*
4. *Cash outflow to make payment to trade payables.*

Question - 22: All of the following would be included in a company's operating activities except:

Answer:

1. *Income tax payments*
2. *Collections from customers or Cash payments to suppliers*
3. *Dividend payments*
4. *Office and selling expenses.*

Question - 23: Hari Uttam, a stock broking firm, received ₹1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?

Answer:

1. *Operating Activities.*
2. *Investing Activities.*
3. *Financing Activities.*
4. *Non-cash transaction*

Question - 24: As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as

Answer:

1. *Operating activity.*
2. *Financing activity.*
3. Investing activity.
4. *Non-cash transaction*

Answer

Q1	***2***	***Q2***	***3***	***Q3***	***1***	***Q4***	***2***
Q5	***2***	***Q6***	***1***	***Q7***	***1***	***Q8***	***1***
Q9	***1***	***Q10***	***3***	***Q11***	***1***	***Q12***	***2***
Q13	***1***	***Q14***	***4***	***Q15***	***4***	***Q16***	***3***
Q17	***3***	***Q18***	***2***	***Q19***	***1***	***Q20***	***3***
Q21	***2***	***Q22***	***3***	***Q23***	***1***	***Q24***	***3***

CHAPTER 7

Cash Flow Statements

Question 1

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

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

(1) to suppliers

(2) to employees

(3) to its subsidiaries companies

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

(iii) Dividend paid for the year

(iv) TDS on interest income earned on investments made

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

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

(*Source: Illustration 1, Study Material*)

Solution

(i) Loans and advances given and interest earned

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

(ii) Investment made in subsidiary company and dividend received

Investing Cash flow

(iii) Dividend paid for the year

Financing Cash Outflow

(iv) TDS on interest income earned on investments made

Investing Cash Outflow

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

Operating Cash Outflow

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

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

Question 2

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

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

Notes to accounts

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

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

(*Source: Illustration 2, Study Material*)

Solution

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

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

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

Cash flows from financing activities:

Proceeds from debentures (Refer Working Note)	2,50,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,80,000

Working Note:

10% Debentures Account

Particulars	₹	*Particular*	₹
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,50,000
	7,50,000		7,50,000

Question 3

From the following information, calculate cash flow from operating activities:

Summary of Cash Account
for the year ended March 31, 20X1

Particulars	₹	*Particulars*	₹
To Balance b/d	*1,00,000*	*By Cash Purchases*	*1,20,000*
To Cash sales	*1,40,000*	*By Trade payables*	*1,57,000*
To Trade receivables	*1,75,000*	*By Office & Selling Expenses*	*75,000*
To Trade Commission	*50,000*	*By Income Tax*	*30,000*
To Sale of Investment	*30,000*	*By Investment*	*25,000*
To Loan from Bank	*1,00,000*	*By Repayment of Loan*	*75,000*
To Interest & Dividend	*1,000*	*By Interest on loan*	*10,000*
		By Balance c/d	*1,04,000*
	5,96,000		*5,96,000*

(*Source: Illustration 3, Study Material*)

Solution

Cash Flow Statement of ……
for the year ended March 31, 20X1(Direct Method)

Particulars	₹	₹
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

Question 4

The following summary cash account has been extracted from the company's accounting records:

Summary Cash Account

		(₹ '000)
Balance at 1.3.20X1		*35*
Receipts from customers		*2,783*
Issue of shares		*300*
Sale of fixed assets		*128*
Payments to suppliers	*2,047*	*3,246*

		(₹'000)
Payments for property, plant & equipment	*230*	
Payments for overheads	*115*	
Wages and salaries	*69*	
Taxation	*243*	
Dividends	*80*	(*3,034*)
Repayments of bank loan	*250*	
Balance at 31.3.20X2		*212*

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 20X2 in accordance with AS-3 (*Revised*).

The company does not have any cash equivalents.

(*Source: Illustration 4, Study Material*)

Solution

Hills Ltd.

Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)

		(₹'000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Question 5

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 20X1 with the help of the following information:

(1) *Company sold goods for cash only.*

(2) *Gross Profit Ratio was 30% for the year, gross profit amounts to ₹3,82,500.*

(3) *Opening inventory was lesser than closing inventory by ₹35,000.*

(4) *Wages paid during the year ₹4,92,500.*

(5) *Office and selling expenses paid during the year ₹75,000.*

(6) *Dividend paid during the year ₹30,000.*
(7) *Bank loan repaid during the year ₹2,15,000* (*included interest ₹15,000*).
(8) *Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by ₹25,000.*
(9) *Amount paid to trade payables during the year ₹4,60,000.*
(10) *Tax paid during the year amounts to ₹65,000* (*Provision for taxation as on 31.03.20X1 ₹45,000*).
(11) *Investments of ₹7,00,000 sold during the year at a profit of ₹20,000.*
(12) *Depreciation on fixed assets amounts to ₹85,000.*
(13) *Plant and machinery purchased on 15th November, 20X0 for ₹2,50,000.*
(14) *Cash and Cash Equivalents on 31st March, 20X0 ₹2,00,000.*
(15) *Cash and Cash Equivalents on 31st March, 20X1 ₹6,07,500.*

(*Source: Illustration 5, Study Material*)

Solution

M/s MNT Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	***₹***	***₹***
Cash flows from Operating Activities		
Cash sales (₹ 3,82,500/.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from investing activities		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash used in investing activities (B)		4,70,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,07,500
Cash and cash equivalents at beginning of the period		2,00,000
Cash and cash equivalents at end of the period		6,07,500

Question 6

Ryan Ltd provides you the following information at the year-end, March 31, 20X1:

	₹	*₹*
Sales		*6,98,000*
Cost of Goods Sold		(*5,20,000*)
Operating Expenses		*1,78,000*
(*including Depreciation Expense of ₹37,000*)		(*1,47,000*)
		31,000

	₹	₹
Other Income / (Expenses):		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	(3,000)	
		(8,000)
		23,000
Income tax		(7,000)
		16,000

Information available:

	31st March 20X1	**31st March 20X0**
	₹	**₹**
Plant	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (Long term)	1,15,000	1,27,000
Inventory	1,44,000	1,10,000
Trade receivables	47,000	55,000
Cash	46,000	15,000
Prepaid expenses	1,000	5,000
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Trade payables	50,000	43,000
Outstanding liabilities	12,000	9,000
Income taxes payable	3,000	5,000

Analysis of selected accounts and transactions during 20X0 -X1

1. *Purchased investments for ₹ 78,000.*
2. *Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000.*
3. *Purchased plant assets for ₹ 1,20,000.*
4. *Sold plant assets that cost ₹10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.*
5. *Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 20X1.*
6. *Repaid ₹ 50,000 of bonds at face value at maturity.*
7. *Issued 15,000 shares of ₹ 10 each.*
8. *Paid cash dividends ₹ 8,000.*

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

(*Source: Illustration 6, Study Material*)

Solution

Ryan Ltd.
Cash Flow Statement
for the year ending 31st March, 20X1

	₹	₹
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in trade receivables	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in trade payables	7,000	
Increase in outstanding liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash generated from operating activities		47,000
Cash flows from investing activities		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

Note: Significant non-cash adjustments: Issued ₹ 1,00,000 of bonds at face value for acquisition of plant on 31st March, 20X1.

***Working Note:**

Income taxes paid:	₹
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000
	12,000
Less: Income tax liability at the end of the year	(3,000)
	9,000

Question 7

The balance sheets of Sun Ltd. as at 31st March 20X1 and 20X0 were as:

		Particulars	Notes	20X1 ₹	20X0 ₹
		Equity and Liabilities			
1		***Shareholder's funds***			
	(*a*)	*Share capital*	*1*	*60,000*	*50,000*
	(*b*)	*Reserve & surplus*	*2*	*5,000*	*4,000*
2		***Current liabilities***			
	(*a*)	*Trade Payables*		*4,000*	*2,500*
	(*b*)	*Other current liabilities*	*3*	*-*	*1,000*
	(*c*)	*Short term provision (provision for tax)*		*1,500*	*1,000*
		Total		***70,500***	***58,500***
		Assets			
1		***Non-current assets***			
	(*a*)	*Property, Plant & Equipment*	*4*	*39,500*	*29,000*
2		***Current assets***			
	(*a*)	*Current investments*			*1,000*
	(*b*)	*Inventories*		*2,000*	*14,000*
	(*c*)	*Trade receivables*		*17,000*	*6,000*
	(*d*)	*Cash & cash equivalents*	*5*	*8,000*	*8,500*
				4,000	
				70,500	***58,500***

Notes to accounts

		20X1 ₹	20X0 ₹
1	***Share Capital***		
	Equity Shares of ₹10 each	*60,000*	*50,000*
2	***Reserve & surplus***		
	Profit and Loss Account	*5,000*	*4,000*
3	***Other current liabilities***		
	Dividend Payable	*-*	*1,000*
4	***Property, plant and equipment (at WDV)***		
	Building	*10,000*	*10,000*
	Fixtures	*17,000*	*11,000*

		20X1 ₹	***20X0*** ₹
	Vehicles	*12,500*	*8,000*
	Total	*39,500*	*29,000*
5	***Cash and cash equivalents***		
	Cash and Bank	*4,000*	*8,500*

The profit and loss statement for the year ended 31st March, 20X1 disclosed:

Particulars	₹
Profit before tax	*4,500*
Tax expense: Current tax	*(1,500)*
Profit for the year	*3,000*
Declared dividend	*(2,000)*
Retained Profit	*1,000*

Further information is available:

	Fixtures ₹	***Vehicles*** ₹
Depreciation for the year	*1,000*	*2,500*
Disposals:		
Proceeds on disposal of vehicles	—	*1,700*
Written down value	—	*(1,000)*
Profit on disposal		*700*

Prepare a Cash Flow Statement for the year ended 31st March, 20X1.

(*Source: Illustration 7, Study Material*)

Solution

Sun Ltd.
Cash Flow Statement
for the year ended 31st March, 20X1

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid (**W.N.1**)	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of current investments	(1,000)	

	₹	₹
Purchase of vehicles (**W.N.3**)	(8,000)	
Purchase of fixtures (**W.N.3**)	(7,000)	
Net cash used in investing activities		(14,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid **(W.N.2)**	(3,000)	
Net cash generated from financing activities		7,000
Net decrease in cash and cash equivalents		(4,500)
Cash and cash equivalents at beginning of period (See Note)		8,500
Cash and cash equivalents at end of period (See Note)		4,000
Note to the Cash Flow Statement		
Cash and Cash Equivalents	*31.3.20X1*	*31.3.20X0*
Bank and Cash	4,000	8,500
Cash and cash equivalents	4,000	8,500

Working Notes:

			₹
1.	**Income taxes paid**		
	Income tax expense for the year		1,500
	Add: Income tax liability at the beginning of the year		1,000
			2,500
	Less: Income tax liability at the end of the year		(1,500)
			1,000
2.	**Dividend paid**		
	Declared dividend for the year		2,000
	Add: Amount payable at the beginning of the year		1,000
			3,000
	Less: Amount payable at the end of the year		-
			3,000
3.	**Property, plant and equipment acquisitions**		
		Fixtures	*Vehicles*
		₹	₹
	W.D.V. at 31.3.20X1	17,000	12,500
	Add back:		
	Depreciation for the year	1,000	2,500
	Disposals	—	1,000
		18,000	16,000
	Less: W.D.V. at 31.12.20X0	(11,000)	(8,000)
	Acquisitions during 20X0-20X1	7,000	8,000

Note: Current investments may not be readily convertible to a known amount of cash and may not be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

Question 8

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 20X1:

	(₹ *in lakhs*)
Net Profit	*25,000*
Dividend paid	*8,535*
Provision for Income tax	*5,000*
Income tax paid during the year	*4,248*
Loss on sale of assets (net)	*40*
Book value of the assets sold	*185*
Depreciation charged to the Statement of Profit and Loss	*20,000*
Profit on sale of Investments	*100*
Carrying amount of Investment sold	*27,765*
Interest income received on investments	*2,506*
Interest expenses of the year	*10,000*
Interest paid during the year	*10,520*
Increase in Working Capital (excluding Cash & Bank Balance)	*56,081*
Purchase of Fixed assets	*14,560*
Investment in joint venture	*3,850*
Expenditure on construction work in progress	*34,740*
Proceeds from calls in arrear	*2*
Receipt of grant for capital projects	*12*
Proceeds from long-term borrowings	*25,980*
Proceeds from short-term borrowings	*20,575*
Opening cash and bank balance	*5,003*
Closing cash and bank balance	*6,988*

Prepare the Cash Flow Statement for the year ended 31 March 20X1 in accordance with AS 3. (Make necessary assumptions)

(*Source: Illustration 8, Study Material*)

Solution

Star Oils Limited Cash Flow Statement
for the year ended 31st March, 20X1

		(₹ *in lakhs*)
Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bank balance)	(56,081)	
Cash generated from operations	1,353	

		(₹ *in lakhs*)
Income taxes paid	(4,248)	
Net cash used in operating activities		
Cash flows from investing activities		(2,895)
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Receipt of grant for capital projects Interest income on investments	12	
	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,622)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	27,502
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note:

1. Book value of the assets sold	185
Less : Loss on sale of assets	(40)
Proceeds on sale	145

Question 9

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31 3.20X1

	₹*000*		₹*000*
Balance on 1.4.20X0	*50*	*Payment to Suppliers*	*2,000*
Issue of Equity Shares	*300*	*Purchase of Fixed Asset*	*200*
Receipts from Customers	*2,800*	*Overhead expense*	*200*
Sale of Fixed Assets	*100*	*Wages and Salaries*	*100*
		Taxation	*250*
		Dividend	*50*
		Repayment of Bank Loan	*300*
		Balance on 31.3.20X1	*150*
	3,250		*3,250*

(*Source: Illustration 9, Study Material*)

Solution

X Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash generated from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at the beginning of the year		50
Cash at the end of the year		150

Question 10

Given below are the relevant extracts of the Balance Sheet and the Statement of Profit and Loss of ABC Ltd. along with additional information:

Extract of Balance sheet

		Particulars	Notes	31.3.20X1 (₹ in lakhs)	31.3.20X0 (₹ in lakhs)
		Equity and Liabilities			
1		***Current liabilities***			
	(*a*)	*Trade Payables*		*250*	*230*
	(*b*)	*Short term Provisions*	*1*	*200*	*180*
	(*c*)	*Other current liabilities*	*2*	*70*	*50*
		Assets			
1		***Current assets***			
	(*a*)	*Inventories*		*200*	*180*
	(*b*)	*Trade Receivables*		*400*	*250*
	(*c*)	*Other current assets*	*3*	*195*	*180*

Statement of Profit and Loss of ABC Ltd. for the year ended 31st March, 20X1

	Particulars	***Notes***	***₹ in lakhs***
I	*Revenue from operations*		*4,150*
II	*Other income*	*4*	*100*
III	*Total Revenue (I + II)*		***4,250***
	***Expenses**:*		
	Purchases of Stock-in-Trade		*2,400*
	Change in inventories of finished goods		*(20)*
	Employee benefits expense		*800*
	Depreciation expense		*100*
IV	*Finance cost*	*5*	*60*
	Other expenses		*200*
	Total expenses		***3,540***
V	*Profit before tax (**III – IV**)*		*710*
VI	*Tax expense:*		
	Current tax		*200*
VII	*Profit for the year from continuing operations*		*510*

Appropriations

Balance of Profit and Loss account brought forward	*50*
Transfer to general reserve	*200*
Dividend paid	*330*

Notes to accounts:

		20X1 (₹ in lakhs)	***20X0 (₹ in lakhs)***
1	*Short term Provisions:*		
	Provision for Tax	*200*	*180*
2	*Other current liabilities:*		
	Outstanding wages	*50*	*40*
	Outstanding expenses	*20*	*10*
	Total	*70*	*50*
3	*Other current assets:*		
	Advance tax	*195*	*180*
4	*Other income:*		
	Interest and dividend	*100*	
5	*Finance cost:*		
	Interest	*60*	

Compute cash flow from operating activities using both direct and indirect method.

(*Source: Illustration 10, Study Material*)

Solution

Cash Flows from Operating Activities

	₹ in lakhs	***₹ in lakhs***
Using Direct Method Cash Receipts:		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 - 400	4,000

	₹ in lakhs	₹ in lakhs
Cash payments:		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables – Closing Trade payables	2,400 + 230 - 250	2,380
Wages and salaries paid	800 + 40 - 50	790
Cash expenses	200 + 10 - 20	190
Taxes paid – Advance tax		195
(B)		3,555
Cash flow from operating activities (A – B)		445
Using Indirect Method		
Profit before tax		710
Add: Non-cash items : Depreciation		100
Add: Interest : Financing cash inflow		60
Less: Interest and Dividend : Investment cash outflow		(100)
Less: Tax paid		(195)
Working capital adjustments		
Trade receivables	250 - 400 (150)	
Inventories	180 - 200 (20)	
Trade payables	250 - 230 20	
Outstanding wages	50 - 40 10	
Outstanding expenses	20- 10 10	(130)
Cash flow from operating activities		445

Question 11

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:

(1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.

(2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.

(3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.

(4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.

(5) Dividend paid during the year amounted to ₹ 11.7 crores.

(6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.

(7) ₹ 8 crores was paid towards income tax during the year.

(8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.

(9) The following balances are also provided:

	₹ in crores 1.4.20X0	₹ in crores 31.3.20X1
Debtors	*45*	*50*
Creditors	*21*	*23*
Bank	*6*	*18.2*

(*Source: Illustration 11, Study Material*)

Solution

Gamma Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	***₹ in crores***	***₹ in crores***
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors	49	
[45+ (135x40%) - 50]		
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers	(42)	
[21+ (55x80%) – 23]		
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	
Payments for purchase of fixed assets (21 – 10)	(11)	
Net cash generated from investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

Significant non-cash items:

(a) Debenture-holders received equity shares of ₹ 15 crores on redemption of the debentures.

(b) Plant having book value of ₹ 12 crores was given in exchange of an asset costing ₹ 21 crores. The said plant was transferred at a value of ₹ 10 crores only, and ₹ 11 crores was paid for the balance dues towards the plant.

Question 12

From the following information of Mr. Zen, prepare a Cash flow statement as per AS- 3 for the year ended 31.3.20X1:

Ledger balances of Mr. Zen as of 20X0 and 20X1

	As on 1.4.20X0 ***₹***	***As on 1.4.20X1*** ***₹***
Zen's Capital A/c	*10,00,000*	*12,24,000*
Trade payables	*3,20,000*	*3,52,000*
Mrs. Zen's loan	*2,00,000*	*--*
Loan from Bank	*3,20,000*	*4,00,000*
Land	*6,00,000*	*8,80,000*
Plant and Machinery	*6,40,000*	*4,40,000*

	As on 1.4.20X0 ₹	***As on 1.4.20X1*** ₹
Inventories	*2,80,000*	*2,00,000*
Trade receivables	*2,40,000*	*4,00,000*
Cash	*80,000*	*56,000*

Additional information:

A machine costing ₹ 80,000 (accumulated depreciation there on ₹24,000) was sold for ₹ 40,000. The provision for depreciation on 1.4.20X0 was ₹ 2,00,000 and 31.3.20X1 was ₹ 3,20,000. The net profit for the year ended on 31.3.20X1 was ₹ 3,60,000.

(*Source: Illustration 12, Study Material*)

Solution

Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.20X1

		₹
(i) Cash flow from operating activities		
Net Profit (given)		3,60,000
Adjustments for		
Depreciation on Plant & Machinery (W.N.2)	1,44,000	
Loss on Sale of Machinery (W.N.1)	16,000	1,60,000
Operating Profit before working capital changes		5,20,000
Decrease in inventories	80,000	
Increase in trade receivables	(1,60,000)	
Increase in trade payables	32,000	(48,000)
Net cash generated from operating activities		4,72,000
(ii) Cash *flow from* investing activities		
Sale of Machinery (W.N.1)	40,000	
Purchase of Land (8,80,000 – 6,00,000)	(2,80,000)	
Net cash used in investing activities		(2,40,000)
(iii) Cash *flow from* financing activities		
Repayment of Mrs. Zen's Loan	(2,00,000)	
Drawings (W.N.3)	(1,36,000)	
Loan from Bank	80,000	
Net cash used in financing activities		(2,56,000)
Net decrease in cash		(24,000)
Opening balance as on 1.4.20X0		80,000
Cash balance as on 31.3.20X1		56,000

Working Notes:

1. Plant & Machinery A/c

	₹		₹
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision for Depreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 64,000)	16,000
		By Balance c/d (4,40,000+3,20,000)	7,60,000
	8,40,000		8,40,000

2. Provision for depreciation on Plant and Machinery A/c

	₹		₹
To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c (Bal. fig.)	1,44,000
	3,44,000		3,44,000

3. To find out Mr. Zen's drawings:

	₹
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,000)
Drawings	1,36,000

Note: Students may note that in case there is an increase in the amount of debentures/ loans during the year and the interest is required to be computed, then in such a case, students may choose either to compute interest on the closing balance of the debentures or may compute interest on opening balance for full year (in case of no repayment) and proportionate interest on additions. Suitable note for assumption may be given in the solution for this.

Question 13

What is the significance of cash flow statement? Explain in brief.

(*Source: Question 6, Study Material*)

Answer

Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.

Question 14

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

(*Source: Question 7, Study Material*)

Answer

As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Question 15

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).

(a) Brokerage paid on purchase of investments

(b) Underwriting commission paid

(c) Trading commission received

(d) Proceeds from sale of investment

(e) Purchase of goodwill

(f) Redemption of preference shares

(g) Rent received from property held as investment

(h) Interest paid on long-term borrowings

(i) Marketable securities (having risk of change in value)

(j) Refund of income tax received

(*Source: Question 8, Study Material*)

Answer

Classification of activities with reference to AS 3

(a)	Brokerage paid on purchased of investments	Investing Activities
(b)	Underwriting Commission paid	Financing Activities
(c)	Trading Commission received	Operating Activities
(d)	Proceeds from sale of investment	Investing Activities
(e)	Purchase of goodwill	Investing Activities
(f)	Redemption of Preference shares	Financing Activities
(g)	Rent received from property held as investment	Investing Activities
(h)	Interest paid on long term borrowings	Financing Activities
(i)	Marketable securities	Not a Cash equivalent
(j)	Refund of Income tax received	Operating activities

Question 16

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?

(i) 10% Debentures issued: As on 01-04-20X1 ₹ 1,10,000
As on 31-03-20X2 ₹ 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

(iii) Unpaid Interest on Debentures: As on 01-04-20X1 ₹ 275
As on 31-03-20X2 ₹ 1,175

(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v) 10% Bonds (Investments): As on 01-04-20X1 ₹ 3,50,000
As on 31-03-20X2 ₹ 3,50,000

(vi) Accrued Interest on Investments: As on 31-03-20X2 ₹ 10,500

(*Source: Question 9, Study Material*)

Answer

Cash Flow Statement of M/s Gagan Ltd. for the year ended March 31, 20X2

A	Cash Flow from Operating Activities	
	Net Profit as per Profit & Loss A/c	xxxxx
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	Cash Flow from Investing Activities	
	Interest on Investments [35,000-10,500]	24,500
C	Cash Flow from Financing Activities	
	Interest on Debentures paid [11,000 - (1,175 - 275)] - outflow	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) at 5% premium] - outflow	(34,650)

Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.

Question 17

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1:

		Particulars	***Notes***	**31st March, *20X1***	**31st March, *20X0***
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		10,00,000	8,00,000
	B	Reserves and Surplus	1	3,00,000	2,10,000
2		**Non-current liabilities**			
		Long term borrowings	2	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		7,00,000	8,20,000
	B	Other current liabilities	3	-	1,00,000
	C	Short term provision (provision for tax)		1,00,000	70,000
		Total		**23,00,000**	**20,00,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	4	13,00,000	9,00,000
	B	Non-Current Investments		1,00,000	-
2		**Current assets**			
	A	Inventories		4,00,000	2,00,000
	B	Trade receivables		5,00,000	7,00,000
	C	Cash and Cash equivalents		-	2,00,000
		Total		**23,00,000**	**20,00,000**

Notes to accounts

No.	**Particulars**	**31st March, *20X1***	**31st March, *20X0***
1	**Reserves and Surplus**		
	Revenue reserve	2,00,000	1,50,000
	Profit and Loss account	1,00,000	60,000
	Total	**3,00,000**	**2,10,000**
2	**Long term borrowings**		
	Debentures	2,00,000	--
3.	**Other current liabilities**		
	Dividend payable	-	1,00,000
4	**Property, plant and equipment**		
	Plant and machinery	7,00,000	5,00,000
	Land and building	6,00,000	4,00,000
	Net carrying value	**13,00,000**	**9,00,000**

(i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing ₹ 50,000 (WDV ₹ 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.

(iii) ₹ 50,000 was paid towards Income tax during the year.

(iv) Construction of the building got completed on 31.03.20X1 and hence no depreciation may be charged on the same.

Prepare Cash flow Statement.

(*Source: Question 10, Study Material*)

Answer

Cash Flow Statement of Grow More Ltd for the year ended 31st March, 20X1

Cash Flow from Operating Activities

		₹
Increase in balance of Profit and Loss Account (1,00,000 – 60,000)	40,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	2,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	(1,20,000)	
Cash generated from operations	1,60,000	
Income tax paid	(50,000)	
Net Cash generated from operating activities		1,10,000

Cash Flow from Investing Activities

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

Cash Flow from Financing activities

Proceeds from issue of shares (10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	(1,00,000)	
Net cash generated from financing activities		3,00,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,00,000
Cash and Cash equivalents at the end of the year		Nil

Working Notes:

1. Provision for taxation account

		₹			₹
To	Cash (Paid)	50,000	By	Balance b/d	70,000
To	Balance c/d	1,00,000	By	Profit and Loss A/c (Balancing figure)	80,000
		1,50,000			1,50,000

2. Plant and Machinery account

		₹			₹
To	Balance b/d	5,00,000	By	Depreciation	1,25,000
To	Profit and Loss A/c (profit on sale of machine)	15000			
To	Cash (Balancing figure)	3,45,000	By	Cash (sale of machine)	35,000
			By	Balance c/d	7,00,000
		8,60,000			8,60,000

Question 18

From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

		Particulars	***Notes***	***31st March 20X1*** ₹	***31st March 20X0*** ₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	6,00,000	7,00,000
	B	Reserves and Surplus	2	4,20,000	3,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		1,15,000	1,10,000
	B	Other current liabilities	4	30,000	80,000
	C	Short term provision (provision for tax)		95,000	60,000
		Total		**14,60,000**	**12,50,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	9,15,000	7,00,000
	B	Non-Current Investments		50,000	80,000
2		**Current assets**			
	A	Inventories		95,000	90,000
	B	Trade receivables		2,50,000	2,25,000
	C	Cash and Cash equivalents		50,000	90,000
	D	Other Current assets		1,00,000	65,000
		Total		**14,60,000**	**12,50,000**

Notes to accounts

No.			**31st March, *20X1***	**31st March, *20X0***
1.	**Share capital**			
	Equity share capital		6,00,000	5,00,000
	10% Redeemable Preference share capital		--	2,00,000
	Total		**6,00,000**	**7,00,000**

No.			31st March, *20X1*	31st March, *20X0*
2	**Reserves and Surplus**			
	Capital redemption reserve		1,00,000	-
	Capital reserve		70,000	-
	General reserve		1,50,000	2,50,000
	Profit and Loss account		1,00,000	50,000
	Total		**4,20,000**	**3,00,000**
3	**Long term borrowings**			
	9% Debentures		2,00,000	--
4.	**Other current liabilities**			
	Dividend payable		-	60,000
	Liabilities for expenses		30,000	20,000
	Total		**30,000**	**80,000**
5	**Property, plant and equipment**			
	Plant and machinery		7,65,000	5,00,000
	Land and building		1,50,000	2,00,000
	Net carrying value		**9,15,000**	**7,00,000**

Additional Information:

(i) A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.

(ii) On 1st April, 20X0 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹1 lakh were issued at par as part consideration for plant of ₹4.5 lakhs acquired.

(iii) Part of the investments (Cost – ₹50,000) was sold for ₹70,000.

(iv) Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.

(v) Interim dividend was declared and paid @ 15% during the current year.

(vi) Income-tax liability for the current year was estimated at ₹1,35,000.

(vii) Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.

(*Source: Question 11, Study Material*)

Answer

Cash Flow Statement of Ryan Limited For the year ended 31st March, 20X1

	₹	₹
Cash flow from operating activities Net Profit before taxation (W.N.1)	2,75,000	
Adjustment for		
Depreciation (W.N.3)	1,35,000	
Profit on sale of land	(30,000)	
Profit on sale of plant (W.N.3)	(40,000)	
Profit on sale of investments (W.N.4)	(20,000)	
Interest on debentures (2,00,000 X 9%)	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	
Increase in trade receivables	(25,000)	
Increase in Other current assets (W.N.9) Increase in Trade payables	(35,000) 5,000	

	₹	₹
Increase in liabilities for expenses	10,000	
Cash generated from operations	2,88,000	
Income taxes paid (W.N.8)	(1,00,000)	
Net cash generated from operating activities		1,88,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.2)	1,50,000	
Proceeds from sale of plant (W.N.3)	90,000	
Proceeds from sale of investments (W.N.4)	70,000	
Purchase of plant (W.N.3)	(3,50,000)	
Purchase of investments (W.N.4)	(25,000)	
Pre-acquisition dividend received (W.N.4)	5,000	
Net cash used in investing activities		(60,000)
Cash flow from financing activities		
Proceeds from issue of equity shares (6,00,000 – 5,00,000)	1,00,000	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(1,50,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(1,68,000)
Net decrease in cash and cash equivalents		(40,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		50,000

Working Notes:

1.

	₹
Net profit before taxation	
Retained profit	1,00,000
Less: Balance as on 31.3.20X0	(50,000)
	50,000
Provision for taxation	1,35,000
Dividend	90,000
	2,75,000

2. **Land and Building Account**

		₹			₹
To	Balance b/d	2,00,000	By	Cash (Sale)	1,50,000
To	Profit and Loss A/c (Profit on sale)	30,000	By	Balance c/d	1,50,000
To	Capital reserve (Revaluation profit)	70,000			
		3,00,000			3,00,000

3. Plant and Machinery Account

		₹			₹
To	Balance b/d	5,00,000	By	Cash (Sale)	90,000
To	Profit and loss account	40,000	By	Depreciation	1,35,000
To	Debentures	1,00,000	By	Balance c/d	7,65,000
To	Bank	3,50,000			
		9,90,000			9,90,000

4. Investments Account

		₹			₹
To	Balance b/d	80,000	By	Cash (Sale)	70,000
To	Profit and loss account	20,000	By	Dividend	
To	Bank (Balancing figure)	25,000		(Pre-acquisition)	5,000
			By	Balance c/d	50,000
		1,25,000			1,25,000

5. Capital Reserve Account

		₹			₹
To	Balance c/d	70,000	By	Profit on revaluation of land	70,000
		70,000			70,000

6. General Reserve Account

		₹			₹
To	Capital redemption reserve	1,00,000	By	Balance b/d	2,50,000
To	Balance c/d	1,50,000			
		2,50,000			2,50,000

7. Dividend payable Account

		₹			₹
To	Bank (Balancing figure)	1,50,000	By	Balance b/d	60,000
To	Balance c/d	-	By	Profit and loss account	90,000
		1,50,000			1,50,000

8. Provision for Taxation Account

		₹			₹
To	Bank (Balancing figure)	1,00,000	By	Balance b/d	60,000
To	Balance c/d	95,000	By	Profit and loss account	1,35,000
		1,95,000			1,95,000

9. Other Current Assets Account

		₹			₹
To	Balance b/d	65,000			
To	Bank (Balancing figure)	35,000	By	Balance c/d	1,00,000
		1,00,000			1,00,000

Question 19

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

			Notes	₹ 31st March 20X0	₹ 31st March 20X1
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	16,00,000	18,80,000
	B	Reserves and Surplus	2	8,40,000	11,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	4,00,000	2,80,000
3		**Current liabilities**			
	A	Other current liabilities	4	6,00,000	5,20,000
	B	Short term provision (provision for tax)		3,60,000	3,40,000
		Total		**38,00,000**	**41,20,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	22,80,000	26,40,000
	B	Non-Current Investments		4,00,000	3,20,000
2		**Current assets**			
	A	Cash and Cash equivalents		10,000	10,000
	B	Other Current assets		11,10,000	11,50,000
		Total		**38,00,000**	**41,20,000**

Notes to accounts

No.	Particulars		31st March, *20X0*	31st March, *20X1*
1.	**Share capital**			
	Equity share capital		12,00,000	16,00,000
	10% Preference share capital		4,00,000	2,80,000
	Total		**16,00,000**	**18,80,000**
2	**Reserves and Surplus**			
	General reserve		6,00,000	7,60,000
	Profit and Loss account		2,40,000	3,40,000
	Total		**8,40,000**	**11,00,000**
3	**Long term borrowings**			
	9% Debentures		4,00,000	2,80,000
	Total		**4,00,000**	**2,80,000**
4.	**Other current liabilities**			
	Dividend payable		1,20,000	-
	Current Liabilities		4,80,000	5,20,000
	Total		**6,00,000**	**5,20,000**

No.	Particulars		31st March, *20X0*	31st March, *20X1*
5	**Property, plant and equipment**			
	Property, plant and equipment		32,00,000	38,00,000
	Less: Depreciation		(9,20,000)	(11,60,000)
	Net carrying value		**22,80,000**	**26,40,000**

Additional information:

(i) The company sold one property, plant and equipment for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹80,000.

(ii) The company also decided to write off another item of property, plant and equipment costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

(iii) Depreciation on property, plant and equipment provided ₹ 3,60,000.

(iv) Company sold some investment at a profit of ₹ 40,000.

(v) Debentures and preference share capital redeemed at 5% premium.

(vi) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was ₹ 2,16,000. The inventory on 31.3.20X1 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

(*Source: Question 12, Study Material*)

Answer

New Light Ltd.

Cash Flow Statement for the year ended 31st March, 20X1

A.	Cash Flow from operating activities	₹	₹
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [₹3,40,000 – (₹2,40,000 + ₹24,000)]	76,000	
	Transfer to general reserve	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	5,76,000	
	Adjustments for:		
	Depreciation	3,60,000	
	Loss on sale of property, plant and equipment	20,000	
	Decrease in value of property, plant and equipment	16,000	
	Profit on sale of investment	(40,000)	
	Premium on redemption of preference share capital	6,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	9,44,000	
	Increase in current liabilities (₹5,20,000 – ₹4,80,000)	40,000	
	Increase in other current assets [₹11,50,000 – (₹ 11,10,000 + ₹24,000)]	(16,000)	
	Cash generated from operations	9,68,000	
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		6,08,000

B.	**Cash Flow from investing activities**		
	Purchase of property, plant and equipment (W.N.3)	(8,56,000)	
	Proceeds from sale of property, plant and equipment (W.N.3)	1,00,000	
	Proceeds from sale of investments (W.N.2)	1,20,000	
	Net Cash used in investing activities		(6,36,000)
C.	**Cash Flow from financing activities**		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital (₹1,20,000 + ₹6,000)	(1,26,000)	
	Redemption of debentures (₹ 1,20,000 + ₹ 6,000)	(1,26,000)	
	Dividend paid	(1,20,000)	
	Net Cash generated from financing activities		28,000
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

Working Notes:

1. Revaluation of inventory will increase opening inventory by ₹ 24,000. 2,16,000/90 x 10 = ₹ 24,000

Therefore, opening balance of other current assets would be as follows:

₹ 11,10,000 + ₹ 24,000 = ₹ 11,34,000

Due to under valuation of inventory, the opening balance of profit and loss account be increased by ₹ 24,000.

The opening balance of profit and loss account after revaluation of inventory will be ₹ 2,40,000 + ₹ 24,000 = ₹ 2,64,000

2. **Investment Account**

		₹			₹
To	Balance b/d	4,00,000	By	Bank A/c (balancing figure being investment sold)	1,20,000
To	Profit and Loss A/c (Profit on sale of investment)	40,000	By	Balance c/d	3,20,000
		4,40,000			4,40,000

3. **Property, Plant and Equipment Account**

		₹			₹	₹
To	Balance b/d	32,00,000	By	Bank A/c (sale of assets)	1,00,000	
To	Bank A/c (balancing figure being assets purchased)	8,56,000	By	Accumulated depreciation A/c	80,000	
			By	Profit and loss A/c (loss on sale of assets)	20,000	2,00,000
			By	Accumulated depreciation A/c	40,000	
			By	Profit and loss A/c (assets written off)	16,000	56,000
			By	Balance c/d		38,00,000
		40,56,000				40,56,000

4. **Accumulated Depreciation Account**

		₹			₹
To	Property, plant and equipment A/c	80,000	By	Balance b/d	9,20,000
To	Property, plant and equipment A/c	40,000	By	Profit and loss A/c (depreciation for the year)	3,60,000
To	Balance c/d	11,60,000			
		12,80,000			12,80,000

Question 20

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

		Particulars	***Notes***	***₹ 31st March 20X0***	***₹ 31st March 20X1***
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		50,00,000	50,00,000
	B	Reserves and Surplus		26,50,000	36,90,000
2		**Non-current liabilities**			
		Long term borrowings	1	-	9,00,000
3		**Current liabilities**			
	A	Short-term borrowings (Bank loan)		1,50,000	3,00,000
	B	Trade payables		8,80,000	8,20,000
	C	Other current liabilities	2	4,80,000	2,70,000
		Total		**91,60,000**	**1,09,80,000**

		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	3	21,20,000	32,80,000
2		**Current assets**			
	A	Current Investments		11,80,000	15,00,000
	B	Inventory		20,10,000	19,20,000
	C	Trade receivables	4	22,40,000	26,40,000
	D	Cash and Cash equivalents		15,20,000	15,20,000
	E	Other Current assets (Prepaid expenses)		90,000	1,20,000
		Total		**91,60,000**	**1,09,80,000**

Notes to accounts

No.	**Particulars**		***₹20X0***	***20X1***
1	**Long term borrowings**			
	9% Debentures		-	9,00,000
	Total		**-**	**9,00,000**
2.	**Other current liabilities**			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		**4,80,000**	**2,70,000**

No.	Particulars		₹20X0	20X1
3	**Property, plant and equipment**			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		**21,20,000**	**32,80,000**
4	**Trade receivables**			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000)	(1,90,000)
	Total		**22,40,000**	**26,40,000**

Additional Information:

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

(ii) Trade receivables of ₹2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

(*Source: Question 13, Study Material*)

Answer

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities		₹	₹
Net Profit		10,40,000	
Add: Adjustment For Depreciation (₹7,90,000 – ₹6,10,000)		1,80,000	
Add: Adjustment for Provision for Doubtful Debts (₹ 4,20,000 – ₹1,50,000)		2,70,000	
Operating Profit Before Working Capital Changes		14,90,000	
Add: Decrease in Inventories (₹ 20,10,000 – ₹ 19,20,000)		90,000	
Less: Increase in Current Assets		15,80,000	
Trade Receivables (₹ 30,60,000 – ₹23,90,000)	6,70,000		
Prepaid Expenses (₹ 1,20,000 – ₹90,000)	30,000		
Decrease in Current Liabilities:			
Trade Payables (₹ 8,80,000 – ₹ 8,20,000)	60,000		
Expenses Outstanding (₹ 3,30,000 – ₹ 2,70,000)	60,000	(8,20,000)	
Net Cash generated from Operating Activities			7,60,000
Cash Flows from Investing Activities			
Investment in Current Investments		(3,20,000)	
Purchase of Plant & Machinery (₹ 40,70,000 – ₹ 27,30,000)		(13,40,000)	
Net Cash Used in Investing Activities			(16,60,000)
Cash Flows from Financing Activities			
Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000)		1,50,000	
Issue of Debentures		9,00,000	
Payment of Dividend		(1,50,000)	
Net Cash Used in Financing Activities			9,00,000
Net Increase in Cash During the Year			-
Add: Cash and Cash Equivalents as on 1.4.20X0			15,20,000
Cash and Cash Equivalents as on 31.3.20X1			15,20,000

Note:

1. Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

QUESTION BANK

Question 21

The following information was provided by M/s PQR Ltd. for the year ended 31st March, 2019:

(1) Gross Profit Ratio was 25% for the year, it amounts to ₹ 3,75,000.
(2) Company sold goods for cash only.
(3) Opening inventory was lesser than closing inventory by ₹ 25,000.
(4) Wages paid during the year ₹ 5,55,000.
(5) Office expenses paid during the year ₹ 35,000.
(6) Selling expenses paid during the year ₹ 15,000.
(7) Dividend paid during the year ₹ 40,000 (including dividend distribution tax).
(8) Bank Loan repaid during the year ₹ 2,05,000 (included interest ₹ 5,000)
(9) Trade payable on 31st March, 2018, were ₹ 50,000 and on 31st March, 2019 were ₹ 35,000.
(10) Amount paid to Trade payables during the year ₹ 6,10,000
(11) Income Tax paid during the year amounts to ₹ 55,000
(Provision for taxation as on 31st March, 2019, ₹ 30,000)
(12) Investments of ₹ 8,20,000 sold during the year at a profit of ₹ 20,000.
(13) Depreciation on other tangible assets amounts to ₹ 40,000.
(14) Depreciation on other tangible assets amounts to ₹ 20,000.
(15) Plant and Machinery purchases on 15th November, 2018 for ₹ 3,50,000.
(16) On 31st March, 2019 ₹ 2,00,000, 7% Debentures issued at face value in an exchange for a plant.
(17) Cash and Cash equivalents on 31st March, 2018 ₹ 2,25,000.

(A) Prepare cash flow statement for the ended 31st March, 2019, using direct method.
(B) Calculate cash flow from operating activities, using indirect method.

(*May 2019*) (*10 Marks*)

Answer

(i) **PQR Ltd.**

Cash Flow Statement for the year ended 31st March, 2019 (Using direct method)

Particulars	₹	₹
Cash flows from Operating Activities		
Cash sales (₹ 3,75,000/25%)		15,00,000
Less: Cash payments for trade payables	(6,10,000)	
Wages Paid	(5,55,000)	
Office and selling expenses ₹ (35,000 + 15,000)	(50,000)	(12,15,000)
Cash generated from operations before taxes		2,85,000
Income tax paid		(55,000)
Net cash generated from operating activities (A)		2,30,000
Cash flows from Investing activities		
Sale of investments ₹ (8,20,000 + 20,000)	8,40,000	
Payments for purchase of Plant & machinery	(3,50,000)	
Net cash used in investing activities (B)		4,90,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,05,000)	
Dividend paid (including dividend distribution tax)	(40,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,75,000
Cash and cash equivalents at beginning of the period		2,25,000
Cash and cash equivalents at end of the period		7,00,000

(ii) 'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year before tax and extraordinary items		2,80,000
Add: Non-Cash and Non-Operating Expenses:		
Depreciation		60,000
Interest Paid		5,000
Less: Non-Cash and Non-Operating Incomes:		
Profit on Sale of Investments		(20,000)
Net Profit after Adjustment for Non-Cash Items	15,000	3,25,000
Less: Decrease in trade payables	25,000	
Increase in inventory		(40,000)
Cash generated from operations before taxes		2,85,000

Working Note:

Calculation of net profit earned during the year

	₹	₹
Gross profit		3,75,000
Less: Office expenses, selling expenses	50,000	
Depreciation	60,000	
Interest paid	5,000	(1,15,000)
		2,60,000
Add: Profit on sale of investments		20,000
Net profit before tax		2,80,000

Question 22

Preet Ltd. presents you the following information for the year ended 31st March, 2019:

		(₹ in lacs)
(i)	Net profit before tax provision	72,000
(ii)	Dividend paid	20,404
(iii)	Income-tax paid	10,200
(iv)	Book value of assets sold	444
	Loss on sale of asset	96
(v)	Depreciation debited to P & L account	48,000
(vi)	Capital grant received-amortized to P & L A/c	20
(vii)	Book value of investment sold	66,636
	Profit on sale of investment	240
(viii)	Interest income from investment credited to P & L A/c	6,000
(ix)	Interest expenditure debited to P & L A/c	24,000
(x)	Interest actually paid (Financing activity)	26,084
(xi)	Increase in working capital [Excluding c ash and bank balance]	1,34,580
(xii)	Purchase of fixed assets	44,184
(xiii)	Expenditure on construction work	83,376
xiv)	Grant received for capital projects	36
(xv)	Long term borrowings from banks	1,11,732
(xvi)	Provision for Income-tax debited to P & L A/c	12,000
	Cash and bank balance on 1.4.2018	12,000
	Cash and bank balance on 31.3.2019	16,000

You are required to prepare a cash flow statement as per AS-3 (Revised).

(*RTP May 2019*)

Answer:

Cash Flow Statement as per AS 3

Cash flows from operating activities:		***₹ in lacs***
Net profit before tax provision		72,000
Add: Non c ash expenditures:		
Depreciation	48,000	
Loss on sale of assets	96	
Interest expenditure (non-operating activity)	24,000	72,096
		1,44,096
Less: Non cash income		
Amortisation of capital grant received	(20)	
Profit on sale of investments (non-operating income)	(240)	
Interest income from investments (non-operating income)	(6,000)	6,260
Operating profit		1,37,836
Less: Increase in working capital		(1,34,580)
Cash from operations		3,256
Less: Income tax paid		(10,200)
Net cash generated from operating activities		(6,944)
Cash flows from investing activities:		
Sale of assets (444 – 96)	348	
Sale of investments (66,636+240)	66,876	
Interest income from investments	6,000	
Purchase of fixed assets	(44,184)	
Expenditure on construction work	(83,376)	
Net cash used in investing activities		(54,336)
Cash flows from financing activities:		
Grants for capital projects	36	
Long term borrowings	1,11,732	
Interest paid	(26,084)	
Dividend paid	(20,404)	
Net c ash from financing activities		65,280
Net increase in c ash		4,000
Add: Cash and bank balance as on 1.4.2018		12,000
Cash and bank balance as on 31.3.2019		16,000

Question 23

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 were summarised as follows:

	2018 (₹)	**2017 (₹)**
Equity share capital	1,20,000	1,00,000
Reserves:		
Profit and Loss Account	9,000	8,000
Current Liabilities:		
Trade Payables	8,000	5,000
Income tax payable	3,000	2,000
Declared Dividends	4,000	2,000
	1,44,000	1,17,000
Fixed Assets (at W.D.V):		
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	25,000	16,000
Long Term Investments	32,000	28,000

	2018 (₹)	2017 (₹)
Current Assets:		
Inventory	14,000	8,000
Trade Receivables	8,000	6,000
Cash & Bank	12,000	17,000
	1,44,000	1,17,000

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

	₹
Profit before tax	8,000
Income Tax	(3,000)
Profit after tax	5,000
Declared Dividends	(4,000)
Retained Profit	1,000

Further Information is available:

1. Depreciation on Building ₹ 1,000.
2. Depreciation on Furniture & Fixtures for the year ₹ 2,000.
3. Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.
4. Purchase investments for ₹ 6,000.
5. Sold investments for ₹ 10,000, these investments cost ₹ 2,000.

You are required to prepare Cash Flow Statement as per AS-3 (revised) using indirect method.

(*RTP November 2018*)

Answer:

Harry Ltd.
Cash Flow Statement
for the year ended 31st March, 2018

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation (1,000 + 2,000 + 5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	(1,400)	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	3,000	
Cash generated from operations	1,600	
Income taxes paid	(2,000)	
Net cash generated from operating activities (A)		(400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	
Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	
Dividends paid*	(2,000)	
Net cash from financing activities(C)		18,000
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		12,000

*Dividend declared for the year ended 31st March, 2017 amounting ₹ 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

Working Notes:

1. Calculation of Income taxes paid

	₹
Income tax expense for the year	3,000
Add: Income tax liability at the beginning of the year	2,000
	5,000
Less: Income tax liability at the end of the year	(3,000)
	2,000

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (₹)	Car (₹)
W.D.V. at 31.3.2018	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	—	2,000
	36,000	32,000
Less: W.D.V. at 31.3. 2017	(22,000)	(16,000)
Acquisitions during 2016-2018	14,000	16,000

Question 24

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement for the year ended 31st March, 2021:

	31.03.2021 (₹)	31.03.2020 (₹)
Share Capital	14,00,000	11,20,000
General Reserve	5,60,000	3,50,000
Profit and Loss Account	1,40,000	84,000
Debentures	2,80,000	-
Provision for taxation	1,40,000	98,000
Trade payables	9,80,000	11,48,000
Plant and Machinery	9,80,000	7,00,000
Land and Building	8,40,000	5,60,000
Investments	1,40,000	-
Trade receivables	7,00,000	9,80,000
Inventories	5,60,000	2,80,000
Cash in hand and at Bank	2,80,000	2,80,000

(i) Depreciation @ 20% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing 70,000 (WDV 28,000) was sold for ₹ 49,000. Purchase of machinery was also made at the year end.

(iii) ₹ 70,000 was paid towards Income tax during the year.

(iv) Land & Building is not subject to any depreciation. Expenses on renovation of building amount ₹2,80,000 were incurred during the year.

Prepare Cash Flow Statement.

(RTP May, 2022)

Answer

Omega Ltd.

Cash Flow Statement for the year ended 31st March, 2021

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account	56,000	
Provision for taxation	1,12,000	
Transfer to General Reserve	2,10,000	
Depreciation	1,40,000	
Profit on sale of Plant and Machinery	(21,000)	
Operating Profit before Working Capital changes	4,97,000	
Increase in Inventories	(2,80,000)	
Decrease in Trade receivables	2,80,000	

Decrease in Trade payables	(1,68,000)	
Cash generated from operations	3,29,000	
Income tax paid	(70,000)	
Net Cash from operating activities		2,59,000
Cash Flow from Investing Activities		
Purchase of plant & machinery	(4,48,000)	
Expenses on building	(2,80,000)	
Increase in investments	(1,40,000)	
Sale of old machine	49,000	
Net Cash used in investing activities		(8,19,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	2,80,000	
Proceeds from issue of debentures	2,80,000	
Net cash from financing activities		5,60,000
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		2,80,000
Cash and Cash equivalents at the end of the year		2,80,000

Working Notes:

Provision for taxation account

		₹			₹
To	Cash (Tax Paid)	70,000	By	Balance b/d	98,000
To	Balance c/d	1,40,000	By	Profit and Loss A/c (Balancing figure)	1,12,000
		2,10,000			2,10,000

Plant and Machinery account

		₹			₹
To	Balance b/d	7,00,000	By	Depreciation	1,40,000
To	Profit and Loss A/c (profit on sale of machine)	21,000			
To	Cash (Balancing figure)	4,48,000	By	Cash (sale of machine)	49,000
			By	Balance c/d	9,80,000
		11,69,000			11,69,000

Question 25

Classify the following activities as

(i) Operating Activities,
(ii) Investing activities,
(iii) Financial activities and
(iv) Cash Equivalents.

(1) Cash receipts from Trade Receivables
(2) Marketable Securities
(3) Purchase of investment
(4) Proceeds from long term borrowings
(5) Wages and Salaries paid
(6) Bank overdraft
(7) Purchase of Goodwill
(8) Interim dividend paid on equity shares
(9) Short term Deposits
(10) Underwriting commission paid

(*May 2018*) (*4 Marks*)

Answer:

(a) Operating Activities: Items 1 and 5.
(b) Investing Activities: Items 3, 7 and 9
(c) Financing Activities: Items 4, 6, 8 and 10
(d) Cash Equivalent: 2

Question 26

A company provides you the following information:

(i) Total sales for the year were ₹ 398 crores out of which cash sales amounted to ₹ 262 crores.

(ii) Receipts from credit customers during the year, aggregated ₹ 134 crores.

(iii) Purchases for the year amounted to ₹ 220 crores out of which credit purchase was 80%.
Balance in creditors as on
1.4.2016 ₹ 84 crores
31.3.2017 ₹ 92 crores

(iv) Suppliers of other consumables and services were paid ₹ 19 crores in cash.

(v) Employees of the enterprises were paid 20 crores in cash.

(vi) Fully paid preference shares of the face value of ₹ 32 crores were redeemed. Equity shares of the face value of ₹ 20 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of ₹ 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) ₹ 26 crores were paid by way of income tax.

(ix) A new machinery costing ₹ 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹ 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 15 crores. The balance was paid in cash to the vendor.

(x) Investment costing ₹ 18 cores were sold at a loss of ₹ 2 crores.

(xi) Dividends amounting ₹ 15 crores (including dividend distribution tax of ₹ 2.7 crores) was also paid.

(xii) Debenture interest amounting ₹ 2 crore was paid.

(xiii) On 31st March 2016, Balance with Bank and Cash on hand was ₹ 2 crores.

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method).

(*RTP May 2018*)

Answer

Cash flow statement (using direct method) for the year ended 31st March, 2017

	(₹ in crores)	(₹ in crores)
Cash flow from operating activities		
Cash sales	262	
Cash collected from credit customers	134	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(251)	
Cash from operations	145	
Less: Income tax paid	(261	
Net cash generated from operating activities		119
Cash flow from investing activities		
Net Payment for purchase of Machine (25 - 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities		
Redemption of Preference shares	(32)	
Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net cash used in financing activities		(25)
Net increase in cash and cash equivalents		100
Add: Cash and cash equivalents as on 1.04.2016		2
Cash and cash equivalents as on 31.3.2017		102

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(₹ in crores)
Opening Balance in creditors Account	84
Add: Purchases (220 x .8)	176
Total	260
Less: Closing balance in Creditors Account	92
Cash paid to suppliers of goods	168
Add: Cash purchases (220 x .2)	44
Total cash paid for purchases to suppliers (a)	212
Add: Cash paid to suppliers of other consumables and services (b)	19
Add: Payment to employees (c)	20
Total cash paid to suppliers of goods & services and to employees [(a) + (b) + (c)]	251

Question 27

Classify the following activities as (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities:

(a) Purchase of Machinery.
(b) Proceeds from issuance of equity share capital
(c) Cash Sales.
(d) Proceeds from long-term borrowings.
(e) Proceeds from Trade receivables.
(f) Cash receipts from Trade receivables.
(g) Trading Commission received.
(h) Purchase of investment.
(i) Redemption of Preference Shares.
(j) Cash Purchases.

(*MTP October, 2018*) (*5 Marks*)

Answer:

(i) Operating Activities: c, e, f, g, j.
(ii) Investing Activities: a, h.
(iii) Financing Activities: b, d, i.

Question 28

Prepare Cash Flow from Investing Activities of Creative Furnishings Limited for the year ended 31-3-2017.

Particulars	₹
Plant acquired by the issue of 8% Debentures	1,56,000
Claim received for loss of plant in fire	49,600
Unsecured loans given to subsidiaries	4,85,000
Interest on loan received from subsidiary companies	82,500
Pre-acquisition dividend received on investment made	62,400
Debenture interest paid	1,16,000
Term loan repaid	4,25,000
Interest received on investment	68,000
(TDS of ₹ 8.200 was deducted on the above interest)	
Book value of plant sold (loss incurred ₹ 9,600)	84,000

(*MTP April, 2018*) (*5 Marks*)

Answer:

Cash Flow Statement from Investing Activities of
Creative Furnishings Limited for the year ended 31-03-2017

Cash generated from investing activities	₹	₹
Interest on loan received	82,500	
Pre-acquisition dividend received on investment made	62,400	
Unsecured loans given to subsidiaries	(4,85,000)	
Interest received on investments (gross value)	76,200	
TDS deducted on interest	(8,200)	
Sale of plant	74,400	
Cash used in investing activities (before extra ordinary item)		(1,97,700)
Extraordinary claim received for loss of plant		49,600
Net cash used in investing activities (after extra ordinary item)		(1,48,100)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Plant acquired by issue of 8% debentures does not amount to cash outflow, hence also not considered in the above cash flow statement.

Question 29

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2019.

Balance Sheets

	Particulars	Note	31.03.2019 (₹)	31.03.2018 (₹)
I	EQUITY AND LIABILITES			
	(1) Shareholder's Funds			
	(a) Share Capital	1	3,50,000	3,00,000
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities			
	(a) Trade Payables		65,000	44,000
	(b) Other Current Liabilities	3	37,000	27,000
	(c) Short term Provisions (provision for tax)		32,000	28,000
	Total		5,66,000	4,37,000
II	ASSETS			
	(1) Non-current Assets			
	(a) Tangible Assets	4	2,66,000	1,90,000
	(b) Intangible Assets (Goodwill)		47,000	60,000
	Non-Current Investments		35,000	10,000
	(2) Current Assets			
	(a) Inventories		78,000	85,000
	(b) Trade Receivables		1,08,000	75,000
	(c) Cash & Cash Equivalents		32,000	17,000
	Total		5,66,000	4,37,000

Note 1: Share Capital

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	1,00,000	1,50,000
Total	3,50,000	3,00,000

Note 2: Reserves and Surplus

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000
Capital Reserve	25,000	
Total	82,000	38,000

Note 3: Current Liabilities

Particulars	31.03.2019(₹)	31.03.2018 (₹)
Dividend declared	37,000	27,000

Note 4: Tangible Assets

Particulars	31.03.2019 (₹)	31.03.2018 (₹)
Land & Building	75,000	1,00,000
Machinery	1,91,000	90,000
Total	2,66,000	1,90,000

Additional Information:

(i) ₹ 18,000 depreciation for the year has been written off on plant and machinery and no depreciation has been charged on Land and Building.

(ii) A piece of land has been sold out for ₹ 50,000 and the balance has been revalued, profit on such sale and revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.
(iii) A plant was sold for ₹ 12,000 WDV being ₹ 15,000 on the date of sale (after charging depreciation).
(iv) Dividend received amounted to ₹ 2,100 which included pre-acquisition dividend of ₹ 600.
(v) An interim dividend of ₹ 10,000 including Dividend Distribution Tax has been paid.
(vi) Non-current investments given in the balance sheet represents investment in shares of other companies.
(vii) Amount of provision for tax existing on 31 3.2018 was paid during the year 2018 -19.

(*RTP November 2019*)

Answer

Cash flow Statement for the year ending 31st March, 2019

		Particulars	***₹***	***₹***
1		**Cash Flow from Operating Activities**		
	A.	Closing balance as per Profit and Loss Account		27,000
		Less: Opening balance as per Profit and Loss Account		(18,000)
		Add: Dividend declared during the year		37,000
		Add: Interim dividend paid during the year		10,000
		Add: Transfer to reserve		10,000
		Add: Provision for Tax		32,000
	B.	Net profit before taxation, and extra-ordinary item		98,000
	C.	*Add:* Items to be added		
		Depreciation	18,000	
		Loss on sale of Plant	3,000	
		Goodwill written off	13,000	34,000
	D.	*Less:* Dividend Income		(1,500)
	E.	Operating profit before working capital changes [B + C - D]		1,30,500
	F.	*Add:* Decrease in Current Assets and Increase in Current Liabilities		
		Decrease in Inventories	7,000	
		Increase in Trade Payables	21,000	28,000
	G.	*Less:* Increase in Trade Receivables		(33,000)
	H	Cash generated from operations (E+F-G)		1,25,500
	I	Less: Income taxes paid		(28,000)
	J	Net Cash from (used in) operating activities		97,500
II.		**Cash Flows from investing activities:**		
		Purchase of Plant		(1,34,000)
		Sale of Land		50,000
		Sale of plant		12,000
		Purchase of investments		(25,600)
		Dividend Received		2,100
		Net cash used in investing activities		(95,500)
III.		**Cash Flows from Financing Activities:**		
		Proceeds from issue of equity share capital		1,00,000
		Redemption of preference shares		(50,000)
		Interim Dividend (inclusive of DDT) paid		(10,000)
		Final dividend (inclusive of DDT) paid		(27,000)
		Net cash from financing activities		13,000
IV.		**Net increase in cash and cash equivalents (I+II+III)**		15,000
V.		**Cash and cash equivalents at beginning of period**		17,000
VI.		**Cash and cash equivalents at end of period (IV+V)**		32,000

1. Land and Building Account

Particulars	₹	*Particulars*	₹
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

2. Plant and Machinery Account

Particulars	₹	*Particulars*	₹
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss on sale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

3. Investments Account

Particulars	₹	*Particulars*	₹
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To bank A/c (Purchase	25,600	By Balance c/d	35,000
	35,600		35,600

Question 30

J Ltd. presents you the following information for the year ended 31st March, 2019:

		(₹ in lacs)
(i)	Net profit before tax provision	36,000
(ii)	Dividend paid	10,202
(iii)	Income-tax paid	5,100
(iv)	Book value of assets sold	222
	Loss on sale of asset	48
(v)	Depreciation debited to P & L account	24,000
(vi)	Capital grant received - amortized to P & L A/c	10
(vii)	Book value of investment sold	33,318
	Profit on sale of investment	120
(viii)	Interest income from investment credited to P & L A/c	3,000
(ix)	Interest expenditure debited to P & L A/c	12,000
(x)	Interest actually paid (Financing activity)	13,042
(xi)	Increase in working capital	67,290
	[Excluding cash and bank balance]	
(xii)	Purchase of fixed assets	22,092
(xiii)	Expenditure on construction work	41,688
(xiv)	Grant received for capital projects	18
(XV)	Long term borrowings from banks	55,866
(xvi)	Provision for Income-tax debited to P & L A/c	6,000
	Cash and bank balance on 1.4.2018	6,000
	Cash and bank balance on 31.3.2019	8,000

You are required to prepare a cash flow statement as per AS-3 (Revised). [*MTP October, 2019, 12 marks*]

Answer

Cash Flow Statement as per AS 3

		₹ in lacs
Cash flows from operating activities:		36,000
Net profit before tax provision		
Add: Non cash expenditures:		
Depreciation	24,000	
Loss on sale of assets	48	
Interest expenditure (non operating activity)	12,000	36,048
		72,048

		₹ in lacs
Less: Non cash income		
Amortisation of capital grant received	(10)	
Profit on sale of investments (non operating income)	(120)	
Interest income from investments (non operating income)	(3,000)	3,130
Operating profit		68,918
Less: Increase in working capital		(67,290)
Cash from operations		1,628
Less: Income tax paid		(5,100)
Net cash generated from operating activities		(3,472)
Cash flows from investing activities:		
Sale of assets (222-48)	174	
Sale of investments (33,318+120)	33,438	
Interest income from investments	3,000	
Purchase of fixed assets	(22,092)	
Expenditure on construction work	(41,688)	
Net cash used in investing activities		(27,168)
Cash flows from financing activities:		
Grants for capital projects	18	
Long term borrowings	55,866	
Interest paid	(13,042)	
Dividend paid	(10,202)	
Net cash from financing activities		32,640
Net increase in cash		2,000
Add: Cash and bank balance as on 1.4.2018		6,000
Cash and bank balance as on 31.3.2019		8,000

Question 31

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019.

Particulars	Amount (₹)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received form associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of ₹8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable within 3 mouths	3,00,000
Book value of plant & machinery sold (loss incurred ₹9,600)	90,000

(*November 2019*) (*5 Marks*)

Answer

Cash Flow Statement from Investing Activities of
Subham Creative Limited for the year ended 31-03-2019

Cash generated from investing activities	₹	₹
Interest on loan received	70,000	
Pre-acquisition dividend received on investment made	52,600	
Unsecured loans given to subsidiaries	(5,00,000)	
Interest received on investments (gross value)	82,000	
TDS deducted on interest	(8,200)	
Sale of Plant & Machinery ₹ (90,000 – 9,600)	80,400	
Cash used in investing activities (before extra-ordinary item)		(2,23,200)
Extraordinary claim received for loss of machinery		55,000
Net cash used in investing activities (after extra-ordinary item)		(1,68,200)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.
3. The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

Question 32

Prepare Cash Flow Statement of Light Ltd. for the year ended 31st March, 2020, in accordance with AS 3 (Revised) from the following Summary Cash Account:

Summary Cash Account

	₹ in '000	₹ in '000
Balance as on 01.04.2019		315
Receipts from Customers		24,894
Sale of Investments (Cost ₹ 1,35,000)		153
Issue of Shares		2,700
Sale of Fixed Assets		1,152
Payment to Suppliers	18,306	29,214
Purchase of Investments	117	
Purchase of Fixed Assets	2,070	,
Wages & Salaries	621	
Selling & Administration Expenses	1,035	
Payment of Income Tax	2,187	
Payment of Dividends	720	
Repayment of Bank Loan	2,250	
Interest paid on Bank Loan	450	(27,756)
Balance as on 31.03.2020		1,458

(*RTP, November 2020*)

Answer

Light Ltd.

Cash Flow Statement for the year ended 31st March, 2020

	(₹ '000)	(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	24,894	
Cash payments to suppliers	(18,306)	
Cash paid to employees	(621)	
Other cash payments (for Selling & Administrative expenses)	(1,035)	
Cash generated from operations	4,932	
Income taxes paid	(2,187)	
Net cash from operating activities		2,745
Cash flows from investing activities		
Payments for purchase of fixed asset	(2,070)	
Proceeds from sale of fixed assets	1,152	
Purchase of investments	(117)	
Sale of investments	153	
Net cash used in investing activities		(882)
Cash flows from financing activities		
Proceeds from issuance of share capital	2,700	
Bank loan repaid	(2,250)	
Interest paid on bank loan	(450)	
Dividend paid	(720)	
Net cash used in financing activities		(720)
Net increase in cash and cash equivalents		1,143
Cash and cash equivalents at beginning of period		315
Cash and cash equivalents at end of period		1,458

Question 33

Prepare Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31stMarch, 2020, in accordance with AS-3 (Revised) from the following Summary Cash Account:

Summary Cash Account

	₹ in '000	₹ in'000
Balance as on 01.04.2019		210
Receipts from Customers		16,596
Sale of Investments (Cost ₹ 90,000)		102
Issue of Shares		1,800
Sale of Fixed Assets		768
		19,476
Payment to Suppliers	12,204	
Purchase of Investments	78	
Purchase of Fixed Assets	1,380	,
Wages & Salaries	414	
Selling & Administration Expenses	690	
Payment of Income Tax	1,458	
Payment of Dividends	480	
Repayment of Bank Loan	1,500	
Interest paid on Bank Loan	300	(18,504)
Balance as on 31.03.2020		972

(8 Marks) (MTP, May 2020)

Answer

Cash Flow Statement of Tom & Jerry Ltd.
for the year ended 31st March, 2020

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	16,596	
Cash payments to suppliers	(12,204)	
Cash paid to employees	(414)	
Other cash payments (for Selling & Administrative expenses)	(690)	
Cash generated from operations	3,288	
Income taxes paid	(1,458)	
Net cash from operating activities		1,830
Cash flows from investing activities		
Payments for purchase of fixed asset	(1,380)	
Proceeds from sale of fixed assets	768	
Purchase of investments	(78)	
Sale of investments	102	
Net cash used in investing activities		(588)
Cash flows from financing activities		
Proceeds from issue of share capital	1,800	
Bank loan repaid	(1,500)	
Interest paid on bank loan	(300)	
Dividend paid	(480)	
Net cash used in financing activities		(480)
Net increase in cash and cash equivalents		762
Cash and cash equivalents at beginning of period		210
Cash and cash equivalents at end of period		972

Question 34

What do you mean by the term "cash and cash equivalent" as per AS 3? From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-2019.

Particulars	Amount (₹)
Cash balance with Bank	10,000
Fixed Deposit created on 01-11-2018 and maturing on15-07-2019	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund made on 01-03-2019 (having maturity period of less than 3 months)	1,00,000
Bank Balance in a Foreign Currency Account in India	$ 1,000
(Conversion Rate: on the day of deposit ₹ 69/USD; ₹ 70/USD as on 31-03-2019)	
Debentures purchased of ₹ 10 lacs of A Ltd., which are redeemable on 31st October, 2019	90,000
Shares of Alpha Ltd. purchased on 1st January, 2019	60,000

(MTP, October, 2020) (*5 Marks*)

Answer

As per AS 3, Cash and cash equivalents consists of: (i) Cash in hand and deposits repayable on demand with any bank or other financial institutions and (ii) Cash equivalents, which are short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value. A short-term investment is one, which is due for maturity within three months from the date of acquisition. Investments in shares are not normally taken as cash equivalent, because of uncertainties associated with them as to realizable value.

Computation of Cash and Cash Equivalents as on 31st March, 2019

	₹
Cash balance with bank	10,000
Short term investment in highly liquid sovereign debt mutual fund on 1.3.19	1,00,000
Bank balance in foreign currency account ($1,000 x ₹ 70)	70,000
	1,80,000

Note: Fixed deposit, Shares and Debentures will not be considered as cash and cash equivalents.

Question 35

Following information was extracted from the books of S Ltd. for the year ended 31st March, 2020 :

(1) Net profit before talking into account income tax and after talking into account the following items was ₹30 lakhs;
   - (i) Depreciation on Property, Plant & Equipment ₹7,00,000
   - (ii) Discount on issue of debentures written off ₹45,000.
   - (iii) Interest on debentures paid ₹4,35,000
   - (iv) Investment of Book value ₹3,50,000 sold for ₹3,75,000.
   - (v) Interest received on Investments ₹70,000

(2) Income tax paid during the year ₹ 12,80,000

(3) Company issued 60,000 Equity Shares of ₹10 each at a premium of 20% on 10th April, 2019.

(4) 20,000, 9% Preference Shares of ₹100 each were redeemed on 31st March, 2020 at a premium of 5%

(5) Dividend paid during the year amounted to ₹11 Lakhs (including dividend distribution tax)

(6) A new Plant costing ₹7 Lakhs was purchased in part exchange of an old plant on 1st January, 2020. The book value of the old plant was ₹8 Lakhs but the vendor took over the old plant at a value of ₹6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March, 2020.

(7) Company decided to value inventory at cost less 10%, whereas previously the practice was to value inventory at cost. The inventory according to books on 31.03.2020 was ₹ 14,76,000.
   The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

(8) Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

	As on 1st April, 2019 (₹)	As on 31st March, 2020 (₹)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash &Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method. (*Suggested January 2021*) (*12 marks*)

Answer

S Ltd.
Cash Flow Statement for the year ended 31st March, 2020

	₹	₹
Cash flows from operating activities		
Net profit before taxation*		30,00,000
Adjustments for:		
Depreciation on PPE	7,00,000	
Discount on debentures	45,000	
Profit on sale of investments	(25,000)	
Interest income on investments	(70,000)	
Interest on debentures	4,35,000	
Stock adjustment	1,64,000	
{14,76,000 less 16,40,000(14,76,000/90X100)}		
Operating profit before working capital changes		12,49,000
Changes in working capital		42,49,000
(Excluding cash and bank balance):		
Less: Increase in inventory	(2,90,000)	
{16,40,000(14,76,000/90X100) less 13,50,000}		
Add: Decrease in Trade receivables	13,800	
Increase in trade payables	2,600	
Increase in o/s expenses	4,400	(2,69,200)
Cash generated from operations		39,79,800
Less: Income taxes paid		(12,80,000)
Net cash generated from operating activities		26,99,800
Cash flows from investing activities		
Sale of investments	3,75,000	
Interest received	70,000	
Payments for purchase of fixed assets	(1,00,000)	
(7,00,000 – 6,00,000)		
Net cash used in investing activities		3,45,000
Cash flows from financing activities		
Redemption of Preference shares	(21,00,000)	
Issue of shares	7,20,000	
Interest paid	(4,35,000)	
Dividend paid	(11,00,000)	
Net cash used in financing activities		(29,15,000)
Net increase in cash		1,29,800
Cash at beginning of the period		2,40,700
Cash at end of the period		3,70,500

*Net profit given in the question is after considering only the items listed as information point (1) of the question; hence amount of loss on plant not added back.

Question 36

The following information is provided by Alpha Limited, for the year ended 31st March, 2022.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 40 lakhs.
(ii) Depreciation on Fixed Assets ₹ 10 lakhs.
(iii) Discount on issue of Debentures written off ₹ 60,000.
(iv) Interest on Debentures paid ₹ 7,00,000.
(v) Book value of investments ₹ 6 lakhs (Sale of Investments for ₹ 6,40,000).
(vi) Interest received on investments ₹ 1,20,000.
(vii) Compensation received ₹ 1,80,000 by the company in a suit filed.
(viii) Income tax paid ₹ 21,00,000
(ix) Current assets and current liabilities in the beginning and at the end of the year were as detailed below:

	As on 31.3.2021 ₹	As on 31.3.2022 ₹
Stock	24,00,000	26,36,000
Sundry Debtors	4,16,000	4,26,200
Cash in hand	3,92,600	70,600
Bills Receivable	1,00,000	80,000
Bills Payable	90,000	80,000
Sundry Creditors	3,32,000	3,42,600
Outstanding Expenses	1,50,000	1,63,600

You are required to prepare Cash Flow Statement from Operative Activities in accordance with AS-3 (revised) using the indirect method for the year ended 31st March, 2022

(*Question Paper, May 2022*) (*4 Marks*)

Question 37

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019.

Particulars	Amount (₹)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received from associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest)	73,800
Book value of plant & machinery sold (loss incurred ₹ 9,600)	90,000

(*MTP March, 2021*) (*MTP April, 2022*) (*4 Marks*)

Answer

Cash Flow Statement from Investing Activities of Subham Creative Limited for year ended 31-03-2019

Cash generated from investing activities	₹	₹
Interest on loan received	70,000	
Pre-acquisition dividend received on investment made	52,600	
Unsecured loans given to subsidiaries	(5,00,000)	
Interest received on investments (gross value)	82,000	
TDS deducted on interest	(8,200)	
Sale of Plant & Machinery ₹ (90,000 – 9,600)	80,400	
		(2,23,200)
Cash used in investing activities (before extra-ordinary item)		55,000
Extraordinary claim received for loss of machinery		
Net cash used in investing activities (after extra-ordinary item)		(1,68,200)

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.

Question 38

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2021:

Cash Flow (Abstract)

Inflows	₹	Outflows	₹
Opening cash and bank balance	80,000	Payment for Account Payables	90,000
Share capital – shares issued	5,00,000	Salaries and wages	25,000
Collection from Trade		Payment of overheads	15,000
Receivables	3,50,000	Machinery acquired	4,00,000
		Debentures redeemed	50,000
Sale of Machinery	70,000	Bank loan repaid	2,50,000
		Tax paid	1,55,000
		Closing cash and bank balance	15,000
	10,00,000		10,00,000

Prepare Cash Flow Statement for the year ended 31st March, 2021 in accordance with AS 3.

(*MTP April, 2021*) (*MTP March 2022*) (*5 Marks*)

Answer

Cash Flow Statement for the year ended 31.3.2021

	₹	₹
Cash flow from operating activities		
Cash received on account of trade receivables	3,50,000	
Cash paid on account of trade payables	(90,000)	
Cash paid to employees (salaries and wages)	(25,000)	
Other cash payments (overheads)	(15,000)	
Cash generated from operations	2,20,000	
Income tax paid	(1,55,000)	
Net cash generated from operating activities		65,000
Cash flow from investing activities		
Payment for purchase of machinery	(4,00,000)	
Proceeds from sale of machinery	70,000	
Net cash used in investment activities		(3,30,000)
Cash flow from financing activities		
Proceeds from issue of share capital	5,00,000	
Bank loan repaid	(2,50,000)	
Debentures redeemed	(50,000)	
Net cash used in financing activities		2,00,000
Net decrease in cash and cash equivalents		(65,000)
Cash and cash equivalents at the beginning of the year		80,000
Cash and cash equivalents at the end of the year		15,000

Question 39

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3 (Revised) from the following cash account summary:

Cash Summary Account

Inflows	₹('000)	Outflows	₹('000)
Opening Balance	945	Payment to suppliers	54,918
Receipts from Customers	74,682	Purchase of Investments	351
Sale of Investment (Cost ₹4,05,000)	459	Property, plant and equipment acquired	6,210
Issue of Shares	8,100	Wages and salaries	1,863
Sale of Property, Plant and equipment	3,456	Payment of Overheads	3,105
		Taxation	6,561
		Dividends	2,160
		Repayment of Bank Overdraft	6,750
		Interest paid on Bank Overdraft	1,350
		Closing Balance	4,374
	87,642		**87,642**

(*Question Paper July 2021*) (*5 Marks*)

Answer

Gama Limited
Cash Flow Statement
For the Year Ended 31st March 2021

Particulars	Amount (₹'000)	Amount (₹'000)
Cash flow from Operating Activities:		
Cash receipts from customers	74,682	
Cash payments to suppliers	(54,918)	
Cash payments for wages & salaries	(1,863)	

Particulars	Amount (₹'000)	Amount (₹'000)
Cash payments of overheads	(3,105)	
Cash Generated from Operations	14,796	
Payment of Taxation	(6,561)	
Net Cash from Operating Activities		8,235
Cash Flow from Investing Activities:		
Proceeds from sale of investments	459	
Proceeds from sale of Property, Plant and Equipment	3,456	
Purchase of Investments	(351)	
Purchase of Property, Plant and Equipment	(6,210)	
Net Cash Used in Investing Activities		(2,646)
Cash Flow from Financing Activities:		
Proceeds from issue of shares	8,100	
Payment of Dividend	(2,160)	
Repayment of Bank Overdraft	(6,750)	
Interest paid on Bank Overdraft	(1,350)	
Net Cash Used in Financing Activities		(2,160)
Net Increase in Cash & Cash Equivalent		3,429
Cash and Cash Equivalent in the Beginning of the year		945
Cash and Cash Equivalent in the end of the year		4374

Question 40

The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

Extract of Balance Sheet

		Particulars	*Notes*	*2021 (₹'000)*	*2020 (₹'000)*
		Equity and Liabilities			
1		**Shareholder's funds**			
	(a)	Share capital	1	500	200
2		**Non- current liabilities**			
	(a)	Long term loan from bank		---	250
3		**Current liabilities**			
	(a)	Trade Payables		1,000	3,047
		Assets			
1		**Non-current assets**			
	(a)	Property, Plant and Equipment		230	128
2		**Current assets**			
	(a)	Trade receivables		2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)		212	35

Extract of Statement of Profit and Loss

	Particulars	*Notes*	*2021 (₹'000)*	*2020 (₹'000)*
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			
	Current tax (paid during year)		243	140

Notes to accounts

		2021 (₹'000)	*2020 (₹'000)*
1	**Share Capital**		
	Equity Shares of ₹10 each, fully paid up	500	200
2	**Other expenses**		
	Overheads	115	110

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting ₹ 80,000 was paid during the year ended 31st March, 2021. (*RTP May 2021*)

Answer

Supriya Ltd.
Cash Flow Statement for the year ended 31st March, 2021
(Using direct method)

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of Property, Plant and Equipment	(102)	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

Question 41

The following figures have been extracted from the books of Manan Jo Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs:
  (a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.
  (b) Discount on issue of Debentures written off ₹ 45,000.
  (c) Interest on Debentures paid ₹ 5,25,000.
  (d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).
  (e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹1,35,000 by the company in a suit filed.

(iii) Income-tax paid during the year ₹ 15,75,000.

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs (including dividend distribution tax) and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.

(viii) Land was purchased on 02.4.2019 for ₹3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below :

	As on 01.04.2019	As on 31.3.2020
	₹	₹
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

(10 Marks) (November 2020)

Answer

Manan Ltd.
Cash Flow Statement
for the year ended 31st March, 2020

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments	(30,000)	12,00,000
Operating profit before working capital changes		42,00,000
Adjustments for:		
Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities;		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	(36,000)	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2019		3,94,450
Cash and cash equivalents as on 31.3.2020		16,950

Question 42

The following figures have been extracted from the books of X Limited for the year ended on 31.3.2019. You are required to prepare a cash flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 20 lakhs:
   (a) Depreciation on Property, Plant & Equipment ₹ 5 lakhs.
   (b) Discount on issue of Debentures written off ₹ 30,000.
   (c) Interest on Debentures paid ₹ 3,50,000.
   (d) Book value of investments ₹ 3 lakhs (Sale of Investments for ₹ 3,20,000).
   (e) Interest received on investments ₹ 60,000.
   (f) Compensation received ₹ 90,000 by the company in a suit filed.

(ii) Income tax paid during the year ₹ 10,50,000.

(iii) 15,000, 10% preference shares of ₹ 100 each were redeemed on 31.3.2019 at a premium of 5%. Further the company issued 50,000 equity shares of ₹ 10 each at a premium of 20% on 2.4.2018. Dividend on preference shares were paid at the time of redemption.

(iv) Dividend paid for the year 2017-2018 ₹ 5 lakhs and interim dividend paid ₹ 3 lakhs for the year 2018-2019.

(v) Land was purchased on 2 4.2018 for ₹ 2,40,000 for which the company issued 20,000 equity shares of ₹ 10 each at a premium of 20% to the land owner as consideration.

(vi) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 31.3.2018	**As on 31.3.2019**
	₹	₹
Inventory	12,00,000	13,18,000
Trade receivables	2,58,000	2,53100
Cash in hand	1,96,300	35,300
Trade payables	2,11,000	2,11,300
Outstanding expenses	75,000	81,800

(*RTP May 2020*)

Answer

X Ltd.

Cash Flow Statement

for the year ended 31st March, 2019

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		20,00,000
Adjustments for:		
Depreciation on PPE	5,00,000	
Discount on issue of debentures	30,000	
Interest on debentures paid	3,50,000	
Interest on investments received	(60,000)	
Profit on sale of investments	(20,000)	8,00,000
Operating profit before working capital changes		28,00,000
Adjustments for:		
Increase in inventory	(1,18,000)	
Decrease in trade receivable	4,900	
Increase in trade payables	300	
Increase in outstanding expenses	6,800	(1,06,000)
Cash generated from operations		26,94,000
Income tax paid		(10,50,000)
Cash flow from extraordinary items:		16,44,000
Compensation received in a suit filed		90,000
Net cash flow from operating activities		17,34,000
Cash flow from Investing Activities		
Sale proceeds of investments	3,20,000	
Interest received on investments	60,000	
Net cash flow from investing activities		3,80,000
Cash flow from Financing Activities		
Proceeds by issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(15,75,000)	
Preference dividend paid	(1,50,000)	
Interest on debentures paid	(3,50,000)	
Dividend paid (5,00,000 + 3,00,000)	(8,00,000)	
Net cash used in financing activities		(22,75,000)
Net decrease in cash and cash equivalents during the year		(1,61,000)
Add: Cash and cash equivalents as on 31.3.2018		1,96,300
Cash and cash equivalents as on 31.3.2019		35,300

Note: Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

Question 43

From the following information, prepare the Cash Flow from Financing activities as per AS 3 'Cash Flow Statements' as the accountant of XYZ Limited is not able to decide and seeks your advice:

(i) Received ₹ 4,00,000 as redemption of short -term deposit
(ii) Proceeds of ₹ 20,00,000 from issuance of equity share capital
(iii) Received interest of ₹ 70,000 on Govt. bonds.
(iv) An amount of ₹ 13,00,000 incurred for purchase of goodwill
(v) Proceeds of ₹ 5,00,000 from sale of patent.
(vi) Proceeds of ₹ 12,00,000 from long term borrowing.
(vii) Amount paid for redemption of debentures of ₹ 22,00,000
(viii) Underwriting commission of ₹ 40,000 paid on issue of equity share capital
(ix) Interest of ₹ 1,44,000 paid on long-term borrowing.

(MTP, October 2021) (5 Marks)

Answer

Statement showing Cash Flow from Financing Activities

		₹
Cash inflow from financing activity		
Proceeds from issuance of equity share capital	20,00,000	
Proceeds from long term borrowings	12,00,000	
Total cash inflow from financing activity		32,00,000
Less: Cash outflow from financing activity		
Amount paid for redemption of debentures	22,00,000	
Underwriting commission paid	40,000	
Interest paid on long-term borrowings	1,44,000	(23,84,000)
Net cash inflow from financing activity		8,16,000

Question 44

The following figures have been extracted from the books of Manan Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs :
   (a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.
   (b) Discount on issue of Debentures written off ₹ 45,000.
   (c) Interest on Debentures paid ₹ 5,25,000.
   (d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).
   (e) Interest received on investments ₹ 90,000.
(ii) Compensation received ₹1,35,000 by the company in a suit filed.
(iii) Income-tax paid during the year ₹ 15,75,000.
(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.
(v) Further the company issued 75,000 equity shares of ₹10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)
(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.
(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.
(viii) Land was purchased on 02.4.2019 for ₹3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.
(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 01.04.2019	**As on 31.3.2020**
	₹	**₹**
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

(*MTP, November, 2021*) (*10 Marks*)

Answer

Manan Ltd.
Cash Flow Statement
for the year ended 31st March, 2020

	₹	₹
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		30,00,000
Adjustments for:		
Depreciation on Property, plant and equipment	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments	(30,000)	12,00,000
Operating profit before working capital changes		42,00,000
Adjustments for:		
Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	
Increase in outstanding expenses	10,200	(1,59,000)
Cash generated from operations		40,41,000
Income tax paid		(15,75,000)
Cash flow from ordinary items		24,66,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities;		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	(36,000)	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2019		3,94,450
Cash and cash equivalents as on 31.3.2020		16,950

Question 45

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2021 (Using direct method):

(i) Total sales for the year were ₹ 597 crores out of which cash sales amounted to ₹ 393 crores.
(ii) Receipts from credit customers during the year, totalled ₹ 201 crores.
(iii) Purchases for the year amounted to ₹ 330 crores out of which credit purchases were 80%.
Balance in creditors as on
1.4.2020 ₹ 126 crores
31.3.2021 ₹ 138 crores
(iv) Suppliers of other consumables and services were paid ₹ 28.5 crores in cash.
(v) Employees of the enterprises were paid 30 crores in cash.
(vi) Fully paid preference shares of the face value of ₹ 48 crores were redeemed. Equity shares of the face value of ₹ 30 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of ₹ 30 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.
(viii) ₹ 39 crores were paid by way of income tax.
(ix) A new machinery costing ₹ 15 was purchased.
(x) Investment costing ₹ 27 cores were sold at a loss of ₹ 3 crores.
(xi) Dividends totalling ₹ 22.5 crores was also paid.
(xii) Debenture interest amounting ₹ 3 crore was paid.
(xiii) On 31st March 2020, Balance with Bank and Cash on hand totalled ₹ 3 crores.

(*RTP, November 2021*)

Answer

Cash flow statement (using direct method) for the year ended 31st March, 2021

	(*₹ in crores*)	(*₹ in crores*)
Cash flow from operating activities		
Cash sales	393	
Cash collected from credit customers	201	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(376.5)	
Cash from operations	217.5	
Less: Income tax paid	(39)	
Net cash generated from operating activities		178.5
Cash flow from investing activities		
Payment for purchase of Machine	(15)	
Proceeds from sale of investments	24	
Net cash used in investing activities		9
Cash flow from financing activities		
Redemption of Preference shares	(48)	
Proceeds from issue of Equity shares	36	
Debenture interest paid	(3)	
Dividend Paid	(22.5)	
Net cash used in financing activities		(37.5)
Net increase in cash and cash equivalents		150
Add: Cash and cash equivalents as on 1.04.2020		3
Cash and cash equivalents as on 31.3.2021		153

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(*₹ in crores*)
Opening Balance in creditors Account	126
Add: Purchases (330x .8)	264
Total	390
Less: Closing balance in Creditors Account	138
Cash paid to suppliers of goods	252
Add: Cash purchases (330x .2)	66
Total cash paid for purchases to suppliers (a)	318
Add: Cash paid to suppliers of other consumables and services (b)	28.5
Add: Payment to employees (c)	30
Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)]	376.5

Question 46

Following are the extracts from the Balance Sheet of ABC Ltd.

Liabilities	31.3.2020	31.3.2021
Equity Share Capital	25,00,000	35,60,000
10% Preference Share Capital	7,00,000	6,00,000
Securities Premium Account	5,00,000	5,50,000
Profit & Loss A/c	20,00,000	28,00,000

Equity Share Capital for the year ended 31st March, 2021 'includes ₹ 60,000 of equity shares issued to Grey Ltd at par for supply of Machinery of ₹ 60,000.

Profit & Loss account on 31st March, 2021 includes ₹50,000 of dividend received on Equity shares invested in X Ltd Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised)

(*Suggested December 2021*) (*5 Marks*)

Answer

The related items given in the question will appear in the Cash Flow Statement of ABC Limited for the year ended 31st March, 2021 as follows:

		₹	₹
Cash flows from operating activities			
Closing Balance as per Profit and Loss Account		28,00,000	
Less: Opening Balance as per Profit and Loss Account		(20,00,000)	
		8,00,000	
Less: Dividend received		50,000	
			7,50,000
Cash flows from investing activities			
Dividend received			50,000
Cash flows from financing activities			
Proceeds from issuance of share capital			
Equity shares issued for cash	₹ 10,00,000		
Proceeds from securities premium			
(₹ 5,50,000 – 5,00,000)	₹ 50,000	10,50,000	
Less: Redemption of Preference shares			
(₹ 7,00,000 – ₹ 6,00,000)		(1,00,000)	9,50,000

Note:

1. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the cash flow statement.
2. ABC Ltd. has been considered as a non-financial company in the given answer.

Cash Flow Statement - Additional Questions

Question 1

The Balance Sheet of New Light Ltd. for the years ended 31st March, 2014 and 2015 are as follows:

Liabilities	31st March 2014 (₹)	31st March 2015 (₹)	Assets	31st March 2014 (₹)	31st March 2015 (₹)
Equity share capital	12,00,000	16,00,000	Fixed Assets	32,00,000	38,00,000
10% Preference share capital	4,00,000	2,80,000	Less: Depreciation	9,20,000	11,60,000
				22,80,000	26,40,000
Capital Reserve	–	40,000	Investment	4,00,000	3,20,000
General Reserve	6,00,000	7,60,000	Cash	10,000	10,000
Profit and Loss A/c	2,40,000	3,00,000	Other current assets	11,10,000	13,10,000
9% Debentures	4,00,000	2,80,000			
Current liabilities	4,80,000	5,20,000			
Dividend payable	1,20,000	1,60,000			
Provision for Tax	3,60,000	3,40,000			
	38,00,000	42,80,000		38,00,000	42,80,000

Additional information:

(i) The company sold one fixed asset for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹ 80,000.

(ii) The company also decided to write off another fixed asset costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

(iii) Depreciation on fixed assets provided ₹ 3,60,000.

(iv) Company sold some investment at a profit of ₹ 40,000, which was credited to capital reserve.

(v) Debentures and preference share capital redeemed at 5% premium.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

(*Practice Manual*)

Question 2

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2014 and 2015:

Liabilities	As on 31.3.2014 (₹)	As on 31.3.2015 (₹)
Equity share capital	15,00,000	16,50,000
Capital Reserve	---	10,000
General Reserve	2,50,000	3,00,000
Profit and Loss A/c	1,50,000	1,80,000
Trade payables	5,00,000	4,00,000
Provision for Taxation	50,000	60,000
Dividends payable	1,00,000	1,25,000
	25,50,000	27,25,000

Assets	Year 2014 (₹)	Year 2015 (₹)
Land and Building	5,00,000	4,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
inventory	3,00,000	2,80,000
Trade receivables	4,00,000	4,20,000
Cash in Hand	2,00,000	1,65,000
Cash at Bank	3,00,000	4,10,000
	25,50,000	27,25,000

Additional Information:

(i) Dividend of ₹ 1,00,000 was paid during the year ended March 31, 2015.

(ii) Machinery during the year purchased for ₹ 1,25,000.

(iii) Machinery of another company was purchased for a consideration of ₹ 1,00,000 payable in equity shares.

(iv) Income-tax provided during the year ₹ 55,000.

(v) Company sold some investment at a profit of ₹ 10,000, which was credited to Capital reserve.

(vi) There was no sale of machinery during the year.

(vii) Depreciation written off on Land and Building ₹ 20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2015 as per AS 3 (Indirect method).

(*Practice Manual*)

Question 3

The Balance Sheets of X Ltd. as on 31st March, 2014 and 31st March, 2015 are as follows:

Liabilities	2014 Amount (₹)	2015 Amount (₹)	Assets	2014 Amount (₹)	2015 Amount (₹)
Share Capital	5,00,000	7,00,000	Land and Buildings	80,000	1,20,000
General Reserve	50,000	70,000	Plant and Machinery	5,00,000	8,00,000
Profit and Loss A/c	1,00,000	1,60,000	Inventory	1,00,000	75,000
Trade payables	1,93,000	240,000	Trade receivables	1,50,000	1,60,000
			Cash	20,000	20,000
Outstanding Expenses	7,000	5,000			
	8,50,000	11,75,000		8,50,000	11,75,000

Additional Information:

(a) ₹ 50,000 depreciation has been charged to Plant and Machinery during the year 2015.

(b) A piece of Machinery costing ₹ 12,000 (Depreciation provided there on ₹ 7,000) was sold at 60% profit on book value.

You are required to prepare Cash flow statement for the year ended 31st March 2015 as per AS 3 (revised).

(*Practice Manual*)

Question 4

The following are the summarized Balance Sheets of Lotus Ltd. as on 31st March 2014 and 2015:

Liabilities	**31-3-2014** ₹	**31-3-2015** ₹
Equity share capital (₹ 10 each)	10,00,000	12,50,000
Capital reserve		10,000
Profit and loss A/c	4,00,000	4,80,000
Long term loan from the bank	5,00,000	4,00,000
Trade payables	5,00,000	4,00,000
Provision for taxation	50,000	60,000
	24,50,000	26,00,000
Assets	₹	₹
Land and building	4,00,000	3,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
Inventory	3,00,000	2,80,000
Trade receivables	4,00,000	4,20,000
Cash in hand	2,00,000	1,40,000
Cash at bank	3,00,000	4,10,000
	24,50,000	26,00,000

Additional information:

(1) Depreciation written off on land and building ₹ 20,000.

(2) The company sold some investment at a profit of ₹ 10,000, which was credited to Capital Reserve.

(3) Income-tax provided during the year ₹ 55,000.

(4) During the year, the company purchased a machinery for ₹ 2,25,000. They paid ₹ 1,25,000 in cash and issued 10,000 equity shares of ₹ 10 each at par.

You are required to prepare a cash flow statement for the year ended 31st March 2015 as per AS 3 by using indirect method.

(*Practice Manual*)

Question 5

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2005 and 2006:

Liabilities	**As on 31.3.2005 (₹)**	**As on 31.3.2006 (₹)**
Equity share capital	10,00,000	12,50,000
Capital Reserve	—	10,000
General Reserve	2,50,000	3,00,000
Profit and Loss A/c	1,50,000	1,80,000
Long-term loan from the Bank	5,00,000	4,00,000
Sundry Creditors	5,00,000	4,00,000
Provision for Taxation	50,000	60,000
Dividends payable	1,00,000	1,25,000
	25,50,000	27,25,000

Cash Flow

Assets	Year 2005 (₹)	Year 2005 (₹)
Land and Building	5,00,000	4,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
Stock	3,00,000	2,80,000
Sundry Debtors	4,00,000	4,20,000
Cash in Hand	2,00,000	1,65,000
Cash at Bank	3,00,000	4,10,000
	25,50,000	27,25,000

Additional Information:

(i) Dividend of ₹1,00,000 was paid during the year ended March 31, 2006.

(ii) Machinery during the year purchased for ₹1,25,000.

(iii) Machinery of another company was purchased for a consideration of ₹1,00,000 payable in equity shares.

(iv) Income-tax provided during the year ₹55,000.

(v) Company sold some investment at a profit of ₹10,000, which was credited to Capital reserve.

(vi) There was no sale of machinery during the year.

(vii) Depreciation written off on Land and Building ₹20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2006 as per AS-3 (Indirect method).

(*November 2006, 16 Marks*)

Question 6

Balance Sheet of Raman Ltd. is given below:

					(₹ in'000)
Liabilities	**31.3.08**	**31.3.09**	**Assets**	**31.3.08**	**31.3.09**
Share capital	500	500	Land & building	300	300
9% Debentures	200	160	Machinery	164	180
Sundry creditors	230	216	Stock-in-trade	200	228
Profit and Loss A/c	40	54	Sundry debtors	170	162
Depreciation fund	80	88	Cash and bank balances	120	110
Contingency reserve	140	110	Current Investment	262	190
Outstanding expenses	30	48	Pre-paid expenses	4	6
	1,220	1,176		1,220	1,176

The following information is furnished:

(i) One old machinery which has original cost of ₹30,000 was sold for ₹10,000. The accumulated depreciation in respect of the said machinery amounts to ₹16,000.

(ii) One new machinery was acquired for ₹46,000.

(iii) 9% Debentures were redeemed at a discount of 4% of their face value.

(iv) Dividend at 12% was declared and paid in cash.

(v) Income-tax liability of ₹30,000 paid was debited to contingency reserve.

You are required to prepare Cash Flow Statement in accordance with the Accounting Standard 3.

(*November 2009, 16 Marks*)

Question 7

The following are the summarized Balance Sheet of Lotus Ltd. as on 31st March, 2011 and 2012:

Liabilities	31-3-2011 ₹	31-3-2012 ₹
Equity share capital (₹10 each)	10,00,000	12,50,000
Capital reserve		10,000
Profit and Loss Account	4,00,000	4,80,000
Long-term loan from the bank	5,00,000	4,00,000
Sundry creditors	5,00,000	4,00,000
Provision for taxation	50,000	60,000
	24,50,000	26,00,000
Assets		
Land and building	4,00,000	3,80,000
Machinery	7,50,000	9,20,000
Investment	1,00,000	50,000
Stock	3,00,000	2,80,000
Sundry debtors	4,00,000	4,20,000
Cash in hand	2,00,000	1,40,000
Cash at bank	3,00,000	4,10,000
	24,50,000	26,00,000

Additional information:

(1) Depreciation written off on land and building ₹20,000.

(2) The company sold some investment at a profit of ₹10,000 which was credited to Capital Reserve.

(3) Income-tax provided during the year ₹55,000.

(4) During the year, the company purchased a machinery for ₹2,25,000. They paid ₹1,25,000 in cash and issued 10,000 equity shares of ₹10 each at par.

You are required to prepare a cash flow statement for the year ended 31st March, 2012 as per AS3 by using indirect method.

(*May 2011, 16 Marks*)

Question 8

Balance Sheet of M/s Hero Ltd. as on 31st March, 2010 and 2011 are as follows:

(₹ 000)

Liabilities	31-03-10	31-03-11	Assets	31-03-10	31-03-11
Equity share capital	1,000	1,150	Land & buildings	500	480
Capital reserve	—	10	Machinery	750	820
General reserve	250	300	Investments	100	50
Profit and Loss Account	150	180	Stock	300	280
Long-term loan from bank	500	400	Sundry debtors	400	420
Sundry creditors	500	400	Cash in hand	200	165
Provision for taxation	50	60	Cash at bank	300	410
Payable dividends	100	125			
	2,550	2,625		2,550	2,625

Additional information:

(i) Dividend of ₹1,00,000 was paid during the year ended 31st March, 2011.

(ii) Machinery purchased during the year for ₹1,25,000.

(iii) Company sold some investment at a profit of ₹10,000 which was credited to capital reserve.

(iv) Depreciation written off on land and building ₹20,000.

(v) Income tax provided during the year ₹55,000.

From the above particulars, prepare a cash flow statement for the year ended 31st March, 2011 as per AS 3 using indirect method.

(*November 2011, 10 Marks*)

CHAPTER 8

Accounting Standard 7 Construction Contracts

Question 1

XYZ construction Ltd, a construction company undertakes the construction of an industrial complex. It has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should XYZ Ltd, treat construction of each unit as a separate construction contract according to AS 7?

(*Source: Illustration 1, Study Material*)

Answer

As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, XYZ Ltd. is required to treat construction of each unit as a separate construction contract.

Question 2

AB contactors enters into a contract on 1st January 20X1 with XY to construct a 5- storied building. Under the contract, AB is required to complete the construction in 3 years (i.e., by 31st December 20X3). The following information is relevant:

Fixed price (agreed) ₹5 crore

Material cost escalation (to the extent of 20% of increase in material cost) Labour cost escalation (up to 30% of increase in minimum wages)

In case AB is able to complete the construction in less than 2 years and 10 months, it will be entitled for an additional incentive of ₹50 lakh. However, in case the construction is delayed beyond 3 years and 2 months, XY will charge a penalty of ₹20 lakh. At the start of the contract, AB has a reason to believe that construction will be completed in 2 years and 8 months. Assume that the construction was actually completed in 2 years 9 months.

Labour cost was originally estimated to be ₹1.20 crore (based on initial minimum wages). However, the costs have increased by 25% during the construction period.

Material costs have increased by 40% due to short-supply. The total increase in material cost due to the 40% escalation is ₹80 lakh.

You are required to suggest what should be the contract revenue in above case?

Assume that in year 20X2, XY has requested AB to increase the scope of the contract. An additional floor is required to be constructed and there is an increase in contract fee by ₹1 crore.

AB has incurred a cost of ₹20 lakh for getting the local authority approvals which it will be entitled to claim from XY in addition to the increase in the fixed fee.

Also measure the total contract revenue in this case.

(*Source: Illustration 2, Study Material*)

Answer

Total Revenue after considering the escalation costs, claims and incentives:

	₹
Fixed Price:	5.00 crore
Incentive for early completion	0.50 crore
Material costs recovery (to the extent of 20%)	0.40 crore
Labour costs recovery (Actual increase is less than 30%) [1.20 crore x 25%]	0.30 crore
Total Contract Revenue	6.20 crore
Add: Variation to the contract	1.00 crore
Add: Claims recoverable from XY	0.20 crore
Total Contract Revenue	7.40 crore

Question 3

X Ltd. commenced a construction contract on 01-04-20X1. The fixed contract price agreed was ₹2,00,000. The company incurred ₹81,000 in 20X1-X2 for 45% work and received ₹79,000 as progress payment from the customer. The cost incurred in 20X2-X3 was ₹89,000 to complete the rest of work. Show the extract of the Profit and Loss Account and Customer's Account for the related years.

(*Source: Illustration 3, Study Material*)

Answer

Profit & Loss Account

Year		₹ 000	Year		₹ 000
20X1-X2	To Construction Costs (for 45% work)	81	20X1-X2	By Contract Price (45% of Contract Price)	90
	To Net profit (for 45% work)	9			
		90			90
20X2-X3	To Construction costs (for 55% work)	89	20X2-X3	By Contract Price (55% of Contract Price)	110
	To Net Profit (for 55% work)	21			
		110			110

Customer's Account

Year		*₹ 000*	*Year*		*₹ 000*
20X1-X2	To Contract Price	90	20X1-X2	By Bank	79
				By Balance c/d	11
		90			90
20X2-X3	To Balance b/d	11	20X2-X3		
	To Contract Price	110		By Bank	121
		121			121

AS 7 provides that the percentage completion method should not be applied if the outcome of a construction contract cannot be estimated reliably. In such cases:

(a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and

(b) contract costs should be recognised as an expense in the period in which they are incurred.

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

Question 4

PQ & Associates undertakes a construction contract the details of which are provided below:

Total Contract Value	*₹40 lakh*
Costs incurred to date	*₹3 lakh*
Estimated future costs of completion	*₹30 lakh*
Work completed	*10%*

The work has started some time ago and there is an uncertainty with respect to the outcome of the contract due to expected changes in regulations. PQ is certain that it would be able to recover the costs incurred to date.

(*Source: Illustration 4, Study Material*)

Answer

In the given case, revenue and costs can only be recognised to the extent of the costs incurred and those which are expected to be recovered. Therefore, the profit & loss statement would appear as under:

Contract Revenue	₹3 lakh
Contract Costs	₹3 lakh
Contract Profit	Nil

When the uncertainties that prevented the outcome of the contract being estimated reliably cease to exist, revenue and expenses associated with the construction contract should be recognised by the percentage completion method.

Question 5

X Ltd. commenced a construction contract on 01/04/X1. The contract price agreed was reimbursable cost plus 10%. The company incurred ₹1,00,000 in 20X1-X2, of which cost of ₹90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹5,000. The other costs to complete the contract could not be estimated reliably. The Profit & Loss A/c extract of X Ltd. for 20X1-X2 is shown below:

(*Source: Example 4, Study Material*)

Answer

Profit & Loss Account

	₹ 000		*₹ 000*
To Construction Costs	*100*	*By Contract Price (90+9)*	*99*
To Provision for loss	*5*	*Net loss*	*6*
	105		*105*

Question 6

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data for Year 1.

Information for Year 1	*₹ 000*
Contract price (Fixed)	*600*
Cost incurred to date	*390*
Estimated cost to complete	*260*

Assume that the contract period is 2 years. The contract is 100% completed by Year 2. Actual costs incurred is the same as total estimated costs to complete (Cost incurred to date plus estimated cost to complete).

(*Source: Illustration 5, Study Material*)

Answer

		Amount INR ₹ 000	
	Year (1)	***Total up to Year2 (2)***	***Year 2 (2) – (1)***
A. Cost incurred to date	*(390)*	*(650)*	*(260)*
B. Estimate of cost to completion	*(260)*	*-*	*-*

		Amount INR ₹ 000	
	Year (1)	***Total up to Year2 (2)***	***Year 2 (2) – (1)***
C. Estimated total cost	*(650)*	*650*	*650*
D. Degree of completion (A/C)	*60%*	*100%*	*40%*
E. Revenue Recognised			
(60% of 600)	*360*		
(100% of 600)		*600*	*240*
Total foreseeable loss (650 – 600)	*50*		
Less: Loss for current year (E – A)	*(30)*		
Expected loss to be recognised immediately	*(20)*		
Reversal of Loss provision in Year 2			*20*

Profit & Loss A/c (Year 1)

	₹		₹
To Construction costs To Provision for loss	*390* *20*	*By Contract Price By Net Loss*	*360* *50*
	410		*410*

Profit & Loss A/c (Year 2)

	₹		₹
To Construction costs	*260*	*By Contract Price* *By Reversal of Provision for loss*	*240* *20*
	260		*260*

Question 7

A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 20X1.

	(₹ in lakhs)
Total Contract Price	*1,000*
Work Certified for the cost incurred	*500*
Work yet not Certified for the cost incurred	*105*
Estimated further Cost to Completion	*495*
Progress Payment Received	*400*
To be Received	*140*

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 issued by your institute.

(*Source: Illustration 6, Study Material*)

Answer

(a)		**(₹ in lakhs)**
	Amount of foreseeable loss:	
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognized as expense	100

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(b)		(₹ in lakhs)
	Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs	
	Work certified	500
	Work not certified	105
		605

This is 55% (605/1,100 × 100) of total costs of construction.

(c) Proportion of total contract value recognized as revenue: 55% of ₹ 1,000 lakhs = ₹ 550 lakhs

(d) Gross Amount due from/to customers = (Contract costs + Recognized profits – Recognized Losses) – (Progress payments received + Progress payments to be received)

= (605 + Nil – 100) – (400 + 140)

₹ in lakhs

= [505 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 are given below:

	₹ in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35
Method of revenue recognition (use of percentage completion method) Method of determining state of completion (based on proportionate cost	

Question 8

On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)?

(*Source: Illustration 7, Study Material*)

Answer

	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	(85,00,000)
Total foreseeable loss	12,00,000

According to AS 7, the amount of ₹ 12,00,000 is required to be recognised as an expense.

Contract work in progress = $\frac{\text{Rs. } 64,99,000 \times 100}{\text{Rs. } 97,00,000} = 67\%$

Proportion of total contract value recognised as turnover:

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

The amount of expected loss will be split as under:

Particulars	Workings	Amount
Expected Loss	97,00,000– 85,00,000	12,00,000
Contract revenue	67% of 85,00,000	56,95,000
Contract cost	Given	64,99,000
Actual loss	56,95,000– 64,99,000	8,04,000
Amount of provision required [As per Para 35]	12,00,000– 8,04,000	3,96,000

Question 9

It is argued that profit on construction contracts should not be recognised until the contract is completed. Please explain whether you believe that this suggestion would improve the quality of financial reporting for long-term construction contracts.

(*Source: Theory Question 7, Study Material*)

Answer

Usually, construction contracts are long term nature i.e., the contracts are entered in one accounting period, however, the work performed will flow into more than one accounting year. If the profit on construction contracts is not recognised over the construction period, then the costs incurred during the earlier years of the contract would be recognised without any corresponding revenue. This will result in losses for initial years followed high profits in future years.

The current treatment under AS 7 results in matching of revenue and associated costs as they are recognised during the same period. Also, the current accounting incorporates the prudence concept as any foreseeable losses are accounted for immediately.

Therefore, AS 7 results in a fair representation of the underlying financial substance of the transaction.

Question 10

A contractor has entered into a contract with a municipal body for construction of a flyover. As per the contract terms, the contractor will receive an additional ₹ 2 Crore as incentive if the construction of the flyover were to be finished within a period of two years from the start of the contract. The contractor wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Explain whether the contractor's view-point is correct?

(*Source: Theory Question 8, Study Material*)

Answer

The contractor's view is not entirely correct in considering the variation as a part of contract revenue. There is an argument that he has been able to complete similar contracts within stipulated time. However, each contract needs to be assessed in isolation with respect to the specific challenges associated with the timing and uncertainty in completion.

Accordingly, the contractor needs to validate the assumptions with respect to the specific contract. Only after that assessment is done, the incentive of ₹ 2 crore may be included within the contract revenue.

Question 11

A construction contractor has a fixed price contract for ₹ 9,000 lakhs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lakhs)		
	Year 1	**Year 2**	**Year 3**
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	-	200	200
Contracts costs incurred up to the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lakhs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lakhs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(*Source: Practical Question 9, Study Material*)

Answer

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in ₹ lakhs)

	Up to the reporting date	***Recognized in previous years***	***Recognized in current year***
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	***Year 2***	***Year 3***
Revenue after considering variations	9,000 950	9,200 1,000	9,200 1,000
Less: Estimated profit for whole contract			
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

Question 12

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7.

(*Source: Practical Question 10, Study Material*)

Answer

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

	Cost of Construction	₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	38,00,000
Add:	Outstanding on 31.03.20X2		10,00,000
		2,00,000	15,00,000
	Hire Charges of Plant		
	Other Contract cost incurred		1,34,00,000
	Cost incurred upto 31.03.20X2		
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

Question 13

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.

During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1: ₹ 52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)

Year 3: ₹ 205 crore.

You are required to calculate:

(a) Stage of completion for each year.

(b) Profit to be recognised for each year.

(*Source: Practical Question 11, Study Material*)

Answer

(a) Stage of completion = Costs incurred to date / Total estimated costs

Year 1: 52.52 crore / 202 crore = 26%

Year 2: (154.20 crore – 2.50 crore) / 205 crore = 74%

Year 3: 205 crore / 205 crore = 100%

(b) Profit for the year

	Year 1	**Year 2**	**Year 3**
Contract Revenue (1)	57.20 crore	109.30 crore	58.50 crore
	(220 crore x 26%)	(225 crore x 74% - 57.20 crore)	(225 crore x 100% - 109.30 crore – 57.20 crore)
Contract Cost (2)	52.52 crore	99.18 crore	53.30 crore
	(202 crore x 26%)	(205 crore x 74% - 52.52 crore)	(205 crore x 100% - 99.18 crore – 52.52 crore)
Contract Profit (1) – (2)	4.68 crore	10.12 crore	5.20 crore

QUESTION BANK

Question 14

Sarita Construction Co. obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2018:

	₹ in lakhs
Total Contract Price	12,000
Work Certified	6,250
Work not certified	1,250
Estimated further cost to completion	8,750
Progress payment received	5,500
Progress payment to be received	1,500

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2018.
(ii) Contract work in progress as at end of financial year 2017-18.
(iii) Revenue to be recognized out of the total contract value.
(iv) Amount due from/to customers as at the year end.

(May 2018) (5 Marks)

Answer

(i)	Loss for the year ended, 31st March, 2018	(₹ in lakhs)
	Amount of foreseeable loss	
	Total cost of construction (6,250 + 1,250 + 8,750)	16,250
	Less: Total contract price	(12,000)
	Total foreseeable loss to be recognised as expense	4,250

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Loss for the year ended, 31st March, 2018 amounting ₹4,250 will be recognized.

(ii)	Contract work-in-progress as on 31.3.18	(₹ in lakhs)
	Contract work-in-progress i.e. cost incurred to date are ₹7,500 lakhs:	
	Work certified	6,250
	Work not certified	1,250
		7,500

(iii) Proportion of total contract value recognised as revenue

Cost incurred till 31.3.18 is 46.15% (7,500/16,250 x 100) of total costs of construction.

Proportion of total contract value recognised as revenue:

46.15% of ₹12,000 lakhs = ₹5,538 lakhs

(iv) Amount due from/to customers at year end

(Contract costs + Recognised profits - Recognised Losses) - (Progress payments received + Progress payments to be received)

= (7,500 + Nil - 4,250) - (5,500 + 1,500) ₹ in lakhs

= [3,250-7,000] 7 in lakhs

Amount due to customers = ₹3,750 lakhs

Question 15

Uday Constructions undertake to construct abridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹12 crores with an escalation clause. The costs to complete the whole contract are estimated at ₹9.50 crores of rupees. You are-given the following information for the year ended 31.03.2016:

Cost incurred upto 31.03.2016 ₹4 crores

Cost estimated to complete the contract ₹6 crores

Escalation in cost by 5% and accordingly the contract price is increased by 5%.

You are required to identify the state of completion and calculate the revenue and profit to be recognized for the year as per AS 7.

(*RTP May 2018*)

Answer

	₹ in crore
Cost of construction of bridge incurred 31.3.16	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

= (4/10) x 100 = 40%

Revenue and Profit to be recognized for the year ended 31st March, 2016 as per AS 7

Proportion of total contract value recognized as revenue = Contract price x percentage of completion

= ₹12.60 crore x 40% = ₹5.04 crore

Profit for the year ended 31st March, 2016 = ₹5.04 crore less ₹4 crore = 1.04 crore

Question 16

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹50 Lakh, ₹60 Lakh and ₹75 Lakh respectively. Agreement also lays down the completion time for each unit.

Comment, with reference to AS-7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹45 lakhs. On 31st March, 2018, the company found that it had already spent ₹32.50 lakhs on the construction. Additional cost of completion is estimated at ₹15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provision of AS-7?

(*May 2019*) (*5 Marks*)

Answer:

(i) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, Mr. AP Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

(ii)

	₹ *in lakhs*
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) × 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st Marc h, 2018 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹45 lakh x 68.28% = ₹30.73 lakhs.

	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

According to of AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

Question 17

On 1st December, 2018, "Sampath" Construction Company Limited undertook a contract to construct a building for ₹108 lakhs. On 31st March, 2019 the company found that it had already spent ₹83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹36.01 lakhs.

You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2019 based on AS 7 "Accounting for Construction Contracts."

(*RTP November 2019*)

Answer

Calculation of foreseeable loss for the year ended 31st March, 2019

(as per AS 7 "Construction Contracts")

	(₹ in lakhs)
Cost incurred till 31st March, 2019	83.99
Prudent estimate of additional cost for completion	36.01
Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31st March, 2019.

Question 18

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹3 Crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent ₹1 Crore 80 Lakhs on the construction. Prudent estimate of additional cost for completion was ₹1 Crore 40 Lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

(*May 2012, 5 Marks*)

Question 19

M/s. Highway Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹150 crores. Up to 31.03.2014 the company incurred ₹ 120 crores and the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Project & Loss A/c in the books of M/s. Highway Constructions.

(*May 2014, 5 Marks*)

Answer:

Statement showing the amount to be charged to Revenue as per AS 7

		₹ in crores
	Cost of construction incurred upto 31.03.2014	120
Add:	Estimated future cost	45
	Total estimated cost of construction	165
	Degree of completion (120/165 x 100)	72.73%
	Revenue recognized (72.73% of 150)	109 (approx)
	Total foreseeable loss (165 – 150)	15
Less:	Loss for the current year (120 – 109)	11
	Loss to be provided for	4

Profit and Loss Account (Extract)

	₹ in crores		₹ in crores
To Construction Costs	120	By Contract Price	109
To Provision for loss	4	By Net loss	15
	124		124

Question 20

A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lacs)		
	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	—	200	200
Contracts costs incurred up to the reporting date	2093	6168*	8100**
Estimated profit for whole contract	950	1,000	1,000

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(*May 2015, 5 Marks*)

Answer

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are shown below:

(Amount in ₹ lakhs)

	Upto the reporting date	Recognized in prior years	Recognized in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses (8,200 x 100%)	8,200	6,068	2,132
Profit	1,000	740	260

Working Note:

	Year 1	Year 2	Year 3
Revenue after consider variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068	8,200
		(6,168-100)	(8,100+100)
Degree of completion (B/A)	26%	74%	100%

Question 21

GTI Ltd. Negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹ 102 lacs. ₹ 150 lacs, ₹ 130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region.

Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

(*Group I, November 2016, 5 Marks*)

Answer

As per AS 7 'Construction Contracts', when a contract covers number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Offices, which can be separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one single agreement for contracts.

Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.

Question 22

Akar Ltd. signed on 01/04/19, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/20.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.20.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and additional provision for foreseeable loss to be recognized as per AS 7.

(*MTP, October, 2020*) (*5 marks*)

Answer

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

Cost of Construction		₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.2020	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2020		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
Loss to be provided for			3,50,000

Question 23

(a) Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract. As per the terms of the contract, Sky Limited will receive an additional ₹ 50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The Accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

(b) ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units i .e. ₹ 50 lakh, ₹ 60 lakh and ₹ 75 lakh respectively. Agreement also lays down the completion time for each unit. Comment, with reference to AS 7, whether ABC Ltd., should treat it as a single contract or three separate contracts.

(*RTP, May, 2021*)

Answer

(a) According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when both the conditions are met:

(i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

(ii) the amount of the incentive payment can be measured reliably.

In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing ₹ 50 lakhs as revenue is not correct.

(b) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

ABC Ltd. has submitted separate proposals for each of the 3 units of commercial complex. Also the revenue and completion time has been laid down for each unit separately which implies separate negotiation for them.

Therefore, ABC Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

Question 24

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed.
Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

(Suggested, November, 2020) (5 marks)

Answer

Year 1

	₹
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

$$\%\text{ of work compled} = \frac{8,60,000}{18,60,000} \times 100 = 46.24\% \text{ (rounded off)}$$

Revenue to be recognized = 20,00,000 x 46.24%
= ₹ 9,24,800

Year 2

Actual expenditure	4,75,000
Future Expenditure	4,00,000
Expenditure incurred in Year 1	8,60,000

% of work completed

$$= \frac{4,75,000 + 8,60,000}{17,35,000} = 76.95\% \text{ (rounded off)}$$

Revenue to be recognized (cumulative) = 20,00,000 x 76.95%
= 15,39,000
Less: revenue recognized in Year 1 = (9,24,800)
Revenue to be recognized in Year 2 ₹ 6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000.
Note: Calendar year has been considered as accounting year.

Question 25

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price - ₹ 85 lakhs
(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused at the end of the period.
(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)
(iv) Specific Contract Costs - ₹ 5 Lakhs
(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to sub-contractors - ₹ 4 Lakhs
(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

(*July, 2021 Suggested)* (*5 Marks*)

Answer

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost
= ₹ 45,00,000/₹ 80,00,000
= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000 x 56.25%) = ₹ 47,81,250 Contract costs = ₹ 45,00,000

Question 26

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

	(₹ crore)
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress payments in pipe line	300

Using the given data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2021.

(ii) Arrive at the contract work in progress as at the end of financial year 2020-21.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

(i)	**Calculation of profit/ loss for the year ended 31st March, 2021**	**(₹ *in crores*)**
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	**Contract work-in-progress i.e. cost incurred to date**	**(₹ *in crores*)**
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250) × 100 = 46.15%

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

(iv) Amount due from / to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= ₹ [1,500 + Nil – 850 – (1100 + 300)] crores

= ₹ [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = ₹ 750 crores.

Question 27

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.

(b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional ₹ 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss.

(*RTP November 2021*)

Answer

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;

(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

(b) According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

Question 28

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹ 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.

(*RTP May, 2022*)

Answer

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Therefore, the foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

Question 29

On 1st December, 2021, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2022, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2022 as per provisions of AS-7?

(*RTP May, 2023*)

Answer

	₹ in lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) x 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 2022 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs.

	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

According to of AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

Question 30

Fisher Construction Co. obtained a contract for construction of a 5 commercial complex. The following details are available in records of a company for the year ended 31st March, 2023:

Particulars	**Amount in lakhs**
Total contract price	24000
Work certified	12500
Work not certified	2500
Estimated further cost to completion of work	17500
Progress payment received	11000
Progress payment to be received	3000

Applying the provisions of AS 7, you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2023

(ii) Contract work in progress at the end of financial year 2022-2023

(iii) Revenue to be recognised out of the total contract value-

(iv) Amount due from/to customers as at the year end

(*G-II, May, 2023*) (*5 Marks*)

Question 31

Akar Ltd. signed on 01/04/22, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/23.

- *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 31.3.23.*
- *It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.*

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and additional provision for foreseeable loss to be recognized as per AS 7.

(*5 Marks*) (*MTP October, 2023*) (*Advance Accounts*)

Answer

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

Cost of Construction		₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.2023	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2023		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 32

Answer the following Questions:

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.

(*5 Marks*) (*MTP September, 2023*) (*Advance Accounts*)

Answer

Year 1	₹
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

$$\%\text{ of work completed} = \frac{8,60,000}{18,60,000} \times 100 = 46.24\% \text{ (rounded off)}$$

Revenue to be recognized = 20,00,000 x 46.24% = ₹ 9,24,800

Year 2	**₹**
Actual expenditure	4,75,000
Future Expenditure	4,00,000
Expenditure incurred in Year 1	8,60,000
	17,35,000

$$\%\text{ of work completed} = \frac{4,75,000 + 8,60,000}{17,35,000} = 76.95\% \text{ (rounded off}$$

Revenue to be recognized (cumulative) = 20,00,000 x 76.95%	= 15,39,000
Less: revenue recognized in Year 1	= (9,24,800)
Revenue to be recognized in Year 2	₹ 6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000.

Note: Calendar year has been considered as accounting year.

Question 33

AS 7 "Construction Contracts"

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price - ₹ 85 lakhs

(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused.at the end of the period.

(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)

(iv) Specific Contract Costs = ₹ 5 Lakhs

(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to Sub-Contractors - ₹ 4 Lakhs

(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

(*RTP May, 2024*)

Answer

Computation of contract cost

	₹ Lakh	**₹ Lakh**
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost given		5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

Question 34

Constructions Limited is engaged in the business of constructing Flyovers and Railway over bridges. It obtained a contract from Railway Authorities to construct a railway over bridge for ₹400 crores. The construction of the railway over bridge is expected to be completed in 4 years.

At the outset of the contract, it was estimated that the total costs to be incurred will be ₹ 370 crores but by the end of year 1, this estimate stands revised to ₹ 375 crores.

During year 3, the Construction Limited has requested for a variation in the contract which is approved by Railway Authorities and accordingly the total contract value will increase by ₹ 10 crores and costs will increase by ₹7 crores.

The Constructions Limited decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1 : ₹98.8 crores

Year 2 : ₹202.4 crores

Year 3 : ₹310 crores (including unused material of 3 crores)

Year 4 : ₹382 crores

You are required to:

(i) Calculate stage of completion of contract for each year

(ii) Profit to be recognised for each year.

(*Question Paper May, 2024) (7 Marks*)

MCQs

Question - 1: Which of the following does not form a part of contract costs as defined in AS 7 (Revised)?

Answer:

1. *Estimated warranty costs under the construction contract.*
2. *Comprehensive insurance policy premium for all open construction contracts.*
3. *Research and development costs incurred at the instance of the contractee and billed to his account.*
4. *General administration costs for which reimbursement is not specified in the contract.*

Question - 2: When fixed-price construction contracts require more than one accounting period for completion, and the contract costs can be reasonably estimated, revenue should be recognized

Answer:

1. *At the completion of contract*
2. *When cash is received from the buyer*
3. *When title to the project is transferred to the buyer*
4. *As per percentage of completion.*

The below information relates to Questions 3 – 5:

XY Ltd. agrees to construct a building on behalf of its client GH Ltd. on 1st April 20X1. The expected completion time is 3 years. XY Ltd. incurred a cost of ₹30 lakh up to 31st March 20X2. It is expected that additional costs of ₹90 lakh. Total contract value is ₹112 lakh. As at 31st March 20X2, XY Ltd. has billed GH Ltd. for ₹42 lakh as per the agreement. Assume that the work is completed to the extent of 75% by the end of Year 2.

Question - 3: Revenue to be recognized by XY Ltd. for the year ended 31st March 20X2 is

Answer:

1. *₹28 lakh*
2. *₹42 lakh*
3. *₹30 lakh*
4. *₹32 lakh*

Question - 4: Total expense to be recognised in Year 1 is

Answer:

1. *₹30 lakh*
2. *₹120 lakh*
3. *₹38 lakh*
4. *₹36 lakh*

Question - 5: Revenue to be recognised for year 2 is

Answer:

1. *₹84 lakh*
2. *₹42 lakh*
3. *₹56 lakh*
4. *₹28 lakh*

Below information relates to Questions 6 – 7

M/s AV has presented the information for Contract No. XY123:

Total contract value	₹370 lakh
Certified work completed	₹320 lakh
Costs incurred to date	₹360 lakh
Progress Payments received	₹300 lakh

Expected future costs to be incurred ₹50 lakh

Question - 6: Revenue to be recognised by M/s AV is

Answer:

1. *₹320 lakh*
2. *₹370 lakh*

3. *₹360 lakh*
4. *₹400 lakh*

Question - 7: Total expense to be recognised by M/s AV is

Answer:

1. *₹360 lakh*
2. *₹400 lakh*
3. *₹320 lakh*
4. *₹360 lakh*

Question - 8: LP Contractors undertakes a fixed price contract of ₹200 lakh. Transactions related to the contract include:

Material purchased: ₹80 lakh

Unused material: ₹30 lakh

Labour charges: ₹60 lakh

Machine used for 3 years for the contract. Original cost of the machine is ₹100 lakh. Expected useful life is 15 years.

Estimated future costs to be incurred to complete the contract: ₹80 lakh.

Loss on contract to be recognised is:

Answer:

1. *₹40 lakh*
2. *₹10 lakh*
3. *₹90 lakh*
4. *₹50 lakh*

Answer

Q1	***4***	***Q2***	***4***	***Q3***	***1***	***Q4***	***4***
Q5	***3***	***Q6***	***1***	***Q7***	***4***	***Q8***	***2***

CHAPTER 9

Accounting Standard 9
Revenue Recognition

Question 1

Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item	-	*₹ 200 lakhs*
Delivery charges	-	*₹ 60 lakhs*
GST -	-	*₹ 40 lakhs*
Total -	-	*₹ 300 lakhs*

Zigato has received ₹ 300 lakhs for the above orders from customers and the orders were delivered to the customer in stipulated time.

How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?

(*Source: Illustration 1, Study Material*)

Answer

The risks and rewards associated with the food item are not with Zigato. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare the food and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, Zigato is acting as an agent. Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹ 200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

Question 2

AB sells goods to CD on 1st March 20X1. CD is having significant cash flows issues since last few months. However, it is trying to raise funding through bank loan to be able to run its operations in future. On 5th of May 20X1, CD is able to seek the funding and is expected to be able to pay for the goods in future.

At the time of sale, it is difficult for AB to ascertain whether it will be able to collect the amount from CD due to poor financial conditions.

Explain how the recognition of revenue be done by AB?

(*Source: Illustration 2, Study Material*)

Answer

In the above case, AB should not recognise any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognised by AB on 5th of May 20X1. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Question 3

AB sells goods to CD on 1st January 20X1 for ₹ 2 lakhs. After the sale was made, CD is having significant cash flows issues. It is trying to raise funding through bank loan to be able to run its operations in future. However, it is unable to do so and has gone under liquidation on 15th of March 20 X1.

At the time of sale, there was no reason for AB to believe that it will not be able to collect the amount from CD in future.

Explain how the recognition of revenue be done by AB for the year ended 31st March 20X1?

(*Source: Illustration 3, Study Material*)

Answer

In the above case, at the time of sale, it was not unreasonable for AB to expect ultimate collection from CD. Therefore, AB should recognise the revenue of ₹ 2 lakhs on 1st of January 20X1 and recognise a receivable for the same amount.

Later, since CD went into liquidation, AB should write off the receivables and book a loss in his books.

Accounting in the books of AB 1st January 20X1

CD A/c (Receivables) To Revenue A/c (Being goods sold to CD Ltd)	Dr.	₹ 2 lakhs	₹ 2 lakhs

15th March 20X1

Bad Debts A/c To CD A/c (Receivables)A/c (Being receivables from CD written off due to its liquidation)	Dr.	₹ 2 lakhs	₹ 2 lakhs

Question 4

During the year ended 31st March 20X1, ZX Enterprises has recognized ₹ 100 lakhs on accrual basis income from dividend on units of mutual funds held by it. The dividends on mutual funds were declared on 15th June, 20X1. The dividend was proposed on 10th April, 20X1.

Whether the above treatment is as per the relevant Accounting Standard?

(*Source: Illustration 4, Study Material*)

Answer

Dividends from investments in shares are not recognized in the statement of profit and loss until a right to receive payment is established. In the given situation, the dividend is proposed on 10th April, 20X1, while it is declared on 15th June, 20X1. Thus, the right to receive the payment of dividend gets established on 15th June, 20X1.

The recognition of ₹ 100 lakhs on accrual basis in the financial year 20X0-20X1 is not correct as per AS 9 'Revenue Recognition'.

Question 5

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20 X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd.

(*Source: Illustration 5, Study Material*)

Answer

As per AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable. Therefore X Ltd. should recognize interest revenue of ₹ 10 Lakhs

(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.

Question 6

On 1st January 20X1, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of ₹ 6 Lac.

You are required to do the accounting for above transactions in the books of M/s KJ.

(*Source: Example 7, Study Material*)

Answer

1st Jan 20X1:

Bank A/c To Loan from M/s TH A/c (Being borrowing made under the Sale & Repurchase arrangement)	Dr.	₹5 lakhs	 ₹5 lakhs

31st March 20X1

Interest expense A/c To Loan from M/s TH A/c (Being interest cost recognised on the borrowing)	Dr.	₹1 lakhs	 ₹1 lakhs

31st March 20X1:

Loan from M/s TH A/c To Bank A/c (Being repayment of loan taken from TH)	Dr.	₹6 lakhs	 ₹6 lakhs

Question 7

In the year 20X1-X2, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹ 10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods.

During the year 20X1-X2, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 20X1-X2.

Answer

As per AS 9, consignment risk and rewards are not transferred to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party. Therefore, XYZ can recognize revenue of ₹ 5,50,000 only.

Question 8

The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2.

Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 20X1-20X2.Advise.

(*Source: Illustration 6, Study Material*)

Answer

Price revision was effected during the current accounting period 20 X1-20X2. As a result, the company stands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, only then additional revenue arising out of the said price revision may be recognized in 20X1-20X2.

If the company is not reasonably certain on ultimate collection ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2, it shall postpone recognition of revenue and disclose it in financial statements for year 20X1-20X2 as per AS 1

Question 9

A claim lodged with the Railways in March, 20X1 for loss of goods of ₹ 2,00,000 had been passed for payment in March, 20X3 for ₹ 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 20X3.

(*Source: Illustration 7, Study Material*)

Answer

AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is certain to be collected. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,50,000 were collected against a claim of ₹ 2,00,000. So this transaction can not be taken as a Prior Period Item.

Hence receipt of ₹ 1,50,000 shall be recognized as revenue in year ended 31st March, 20X3

In the light of AS 5, it will not be treated as extraordinary item. However, AS 5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

Question 10

GH manufactures and sells televisions. The televisions are shipped to the customer by sea. In order to transfer risk related to the shipment of the televisions, GH also gets an insurance coverage for the goods while they are in transit from the factory to customer's location.

The insurance policy will reimburse GH for the value of the goods in the event of loss or damage arising anytime up to these goods reaching customer's location. The legal title passes when the goods arrive at the customer's premises one month later.

When should Entity GH recognize revenue in its books?

(*Source: Practical Question 6, Study Material*)

Answer

GH should recognize revenue for the sale when the goods arrive at the customer's premises. GH has not transferred the televisions' significant risks and rewards of ownership to the customer when the goods depart from the factory. This is evidenced by the fact that any insurance proceeds received from the goods' damage or destruction will be repaid to GH. Further, the legal title does not pass until the goods arrive at the customer's premises.

Question 11

The following information of Meghna Ltd. is provided:

(i) Goods of ₹ 60,000 were sold on 20-3-20X2 but at the request of the buyer these were delivered on 10-4-20X2.

(ii) On 15-1-20X2 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-20X2.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1 -12-20X1. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X2 and no approval or disapproval received for the remaining goods till 31 -3- 20X2.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS 9.

(*Source: Practical Question 7, Study Material*)

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 20X2.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the ₹ 90,000 upon receipt of approval on 31-02-20X1 and for the balance ₹ 30,000 on 01-03- 20X1 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue.

Thus, revenue should be ₹ 7,41,000.

Question 12

For the year ended 31st March 20X1, KY Enterprises has entered into the following transactions.

On 31 March 20X1, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 20X1. Machine 1 was a machine that was routinely supplied by KY to many customers and the installation process was very simple.

Machine 1 was installed on 2 April 20X1 by ST's employees.

Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 20X1. Details of costs and sales prices are as follows:

	Machine 1	*Machine 2*
Sale Price	*3,20,000*	*3,00,000*
Cost of production	*1,60,000*	*1,50,000*
Installation fee	*nil*	*10,000*

How should above transactions be recognized by KY Enterprises for the year ended 31st March 20X1?

(*Source: Practical Question 8, Study Material*)

Answer

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

Revenue (Machine 1)	₹ 3,20,000
Cost of Goods Sold	₹ 1,60,000
Profit during the period	₹ 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 20X1. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to ST.

Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 20X1.

Revenue (Machine 2)	₹ 3,00,000
Cost of Goods Sold	₹ 1,50,000
Profit during the period	₹ 1,50,000

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges ₹10,000 needs to be recognized on 5 April 20X1 once the installation process gets completed.

QUESTION BANK

Question 13

Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014?

(*November 2014, 5 Marks*)

Answer

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2014, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2014. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2014 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2014 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2015 after the magazine is published on 02.04.2014**.** The amount received from sale of advertising space on 10.03.2014 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2014.

Question 14

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

(*May 2015, 4 Marks*)

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

<u>In case (i):</u>

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2015.

<u>In case (ii):</u>

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

<u>In case (iii):</u>

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, in case (iii) revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

In case (iv):

Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2015 in the books of M/s Paper Products Ltd.

Question 15

M/s Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard-9.

(*November 2015, 5 Marks*)

Answer

As per para 9.2 of AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made".

In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹ 1,72,000 should not be recognized in the books for the year ended 31st March, 2015. Thus the contention of accountant is incorrect.

However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹ 1,72,000 as interest amount.

Question 16

A manufacturing company has the following stages of production and sale in manufacturing Fine paper rolls:

Date	Activity	Costs to Date (₹)	Net Realizable Value (₹)
15.1.16	Raw material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state how much would be net profit for year ending 31-3-16 on this product according to AS-9.

(*Group I, November 2016, 5 Marks*)

Answer

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit ₹ 150,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2016.

Question 17

Ruby Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to ₹5 lakhs. The accountant of Ruby Ltd. booked ₹5 lakhs as interest income in the year ended 31st March, 2017.

Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition".

(*MTP April/October 2018 & April 2019*) (*5 Marks*)

Answer:

As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹5 lakhs as interest amount.

Question 18

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2017:

(i) On 15th January, 2017 garments worth ₹4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2017.

(ii) Garments worth ₹1,95,000 were sold to Shine boutique on 25th March, 2017 but at the request of Shine Boutique, these were delivered on 15th April, 2017.

(iii) On 1st November, 2016 garments worth ₹2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2016 and no approval or disapproval received for the remaining goods till 31st March, 2017.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9

(*RTP November 2018*)

Answer:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i): 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹3,00,000 (75% of ₹4,00,000) for the year ended on 31.3.17. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (ii): The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2017.

Case (iii): In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹2,50,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2017 in the books of Fashion Ltd.

Question 19

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth ₹15,00,000 ready for dispatch. Raj Ltd. accounted ₹15,00,000 as sales and transferred the balance to Advance received against Sales account.

Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9.

(*RTP May, 2019*)

Answer*:*

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognize the entire sale of ₹30,00,000 (₹5,00,000 × 6) and no part of the same is to be treated as Advance Received against Sales.

Question 20

Given below are the following informations of M/s B.S. Ltd.

(i) Goods of ₹50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.

(ii) On 13-01-2018 goods of ₹1,25,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.

(iii) ₹1,00,000 worth of goods were sold on approval basis 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of M/s B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9.

(*May 2019*) (*5 Marks*)

Answer:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should recognize the entire sale of ₹50,000 for the year ended 31st March, 2018.

Case (ii)

In case of consignment sale revenue should not be recognized until the goods are sold to a third party. 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹1,00,000 (80% of ₹1,25,000).

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹1,00,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.

Question 21

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include ₹15 lakhs in the sales for 2018-2019. Advise.

(*RTP November 2019*)

Answer

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognised in 2018-2019 vide para 10 of AS 9.

Question 22

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributor or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(5) On 11-03-2019 cloths worth ₹50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019.

(*November 2019, New Course, 5 Marks*)

Answer

(1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

Question 23

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2019:

(i) On 15th January, 2019 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2019.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2019 but at the request of Shine Boutique, these were delivered on 15th April, 2019.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9 .

(*RTP, November, 2020*)

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i): 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 3,00,000 (75% of ₹ 4,00,000) for the year ended on 31.3.19. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (ii): The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2019.

Question 24

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March, 2020:

(i) On 31st December, 2019 shoes worth ₹ 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March, 2020.

(ii) On 10th January, 2020, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.

(iii) On 21st March, 2020 shoes worth ₹ 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April, 2020.

You are required to advise the accountant of Tonk Tanners, when amount is to be recognised as revenue in 2019 -20 in above cases in the context of AS 9.

(*RTP, May, 2021*)

Answer

(i) Shoes sent to Mohan Shoes (consignee) for consignment sale

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2019- 2020, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for ₹ 3,20,000 x 75% = ₹ 2,40,000.

(ii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2019-2020. Hence, sale of ₹ 4,50,000 to Shani Shoes should not be recognized as revenue.

(iii) Delivery is delayed at buyer's request

On 21st March, 2020, if Shoe Shine takes title and accepts billing for the goods then it is implied that the sale is complete and all the risk and rewards of ownership has been transferred to the buyer. In case no significant

uncertainty exists regarding the amount of consideration for sale, revenue shall be recognized in the year 2019-2020 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

Question 25

Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2020 issue of the magazine was sold in the month of February, 2020. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2020 and ₹ 30,000 was received on 10th April, 2020 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2020.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

Definition: As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,70,000 will be treated as payment received against the sale.

Question 26

(a) An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

(b) Indicate in each case whether revenue can be recognized and when it will be recognized as per AS 9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributors or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(*RTP May, 2022*)

Answer

(a) AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

(b) (1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Question 27

(a) How will you recognize revenue in the following cases:

1. Installation Fees;
2. Advertising and insurance agency commissions;
3. Subscriptions for publications.

(b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9.

(*RTP November 2021*)

Answer

(a) **Installation Fees**: In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

Subscription for publications: Revenue received or billed should be deferred and recognized either on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

(b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

Question 28

Given the following information of Rainbow Ltd.

(i) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

(ii) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

(iii) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchase the same goods on 14th April.

(iv) Dew Ltd. used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 lakhs as interest and royalties respectively from Dew Ltd. during the year·2020-21.

(v) On 25th December goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.

(*Question Paper of December 2021*) *(5 Marks)*

Answer:

(i) As per AS 9 "Revenue Recognition", in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period for rejecting the goods had expired.

(ii) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 2,40,000 for the year ended 31st March.

(iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

(iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The royalty should be recognized on accrual basis in accordance with the terms of relevant agreement.

(v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Question 29

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(i) Delivery is delayed at buyer's request but buyer takes title and accepts billing.

(ii) Instalment Sales.

(iii) Trade discounts and volume rebates.

(iv) Insurance agency commission for rendering services.

(v) Advertising commission.

Answer

(i) Delivery is delayed at buyer's request and buyer takes title and accepts billing: Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

(ii) Instalment sales: When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the date of sale. The interest element should be recognized as revenue, proportionately to the unpaid balance due to the seller.

(iii) Trade discounts and volume rebates: Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(iv) Insurance agency commissions for rendering services: Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(v) Advertising commission: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

Question 30

When revenue will be recognized in the following situation:

(i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

(ii) Where seller concurrently agrees to repurchase the same goods at a later date.

(iii) Where goods are sold to distributors, dealers or others for resale.

(iv) Commissions on service rendered as agent on insurance business.

(*RTP November, 2022*)

Answer

(i) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

(ii) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

(iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

Question 31

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree?

(*RTP May, 2023*)

Answer

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, PQR Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

Question 32

Toy Ltd. is engaged in manufacturing toys. They provide you the following information as on 31st March, 2023 :

(i) On 15th January, 2023, Toys worth ₹ 5,00,90 were sent to A Ltd. on consignment basis of which 25% Toys unsold were lying with A Ltd. as on 31st March, 2023:

(ii) Toys worth ₹ 2,25,000 were sold to S Ltd. on 25th March, 2023 but at the request of S Ltd., these were delivered on 15th April, 2023.

(iii) On 1st November, 2022, toys worth ₹3,50,000 were sold on approval basis. The period of approval was 4 months' after which they were considered sold. Buyer sent approval for 5% goods upto 31st December, 2022 and no approval or disapproval received for the remaining goods till 31st March, 2023:

You are required to advise the accountant of Toy Ltd., the amount to be recognised as revenue in above cases in the context of AS-9

(*G-II, May, 2023*) (*5 Marks*)

Question 33

(a) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

(b) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

(c) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re- purchase the same goods on 14th April.

(d) Dew Ltd, used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 as interest and royalties respectively from Dew Ltd. during the year 2022-23.

(e) On 25th December, goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year-end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.

(*5 Marks*) (*MTP September, 2023*) (*Advance Accounts*)

Answer

(i) As per AS 9 "Revenue Recognition", in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period for rejecting the goods had expired.

(ii) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 2,40,000 for the year ended 31st March.

(iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

(iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The royalty should be recognized on accrual basis in accordance with the terms of relevant agreement.

(v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Question 34

New Era Publications publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2023 issue was made in February 2023. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2023 and ₹ 60,000 on 10.4.2023 for the March, 2023 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3. 2023. What will be the treatment if the publication is delayed till 2.4.2023?

(*5 Marks*) (*MTP October, 2023*) (*Advance Accounts*)

Answer

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished. In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.2023 is the date of

publication of the magazine. Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2023. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of ₹ 3,00,000 will be recognised in the March, 2023, ₹ 60,000 will be treated as amount due from advertisers as on 31.03.2023 and ₹ 2,40,000 will be treated as payment received against the sale. However, if the publication is delayed till 02.04.2023 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized in the year ended 31.03.2023 after the magazine is published on 02.04.2023**.** The amount received from sale of advertising space on 10.03.2023 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2023.

Question 35

Given below are the following information of B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2023 but at the request of the buyer these were delivered on 15-04-2023.

(ii) On 13-01-2023 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2023.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2022. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2023 and no approval or disapproval received for the remaining goods till 31-03-2023.

You are required to advise the accountant of B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2023 in above cases in the context of AS-9.

(5 Marks) (RTP November, 2023) (Advance Accounts)

Answer

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. Should recognize the entire sale of ₹ 50,000 for the year ended 31st March, 2023.

Case (ii)

In case of consignment sale revenue should not be recognized until the goods are sold to a third party.20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,00,000 (80% of ₹ 1,25,000).

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 1,00,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹ 2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2023 in the books of B.S. Ltd.

Question 36

AS 9 "Revenue Recognition"

Following information of BS Products Ltd. is given:

(i) Goods of ₹ 2,00,000 sold to Den Ltd. on 20-03-2023 but at the request of the buyer these were delivered on 10-04-2023. ·

(ii) On 15-01-2023 goods of ₹ 3,00,000 were sent on consignment basis, of which 20% of the goods unsold are lying with the consignee as on 31-03-2023.

(iii) ₹ 4,00,000 worth of goods were sold on approval basis on 01-12-2022. The period of approval was 3 months after which they were considered as sold. Buyer sent approval for 75% goods upto 31-01-2023 and no approval or disapproval received for the remaining goods till 31-03-2023.

(iv) Apart from the above, BS Products Ltd. sells goods to dealers also. One of the condition of sale is that interest is payable @ 2% p.m. for delayed payments by dealers. Percentage of interest recovery is only 10% i.e. ₹ 50,000 on such overdue outstanding due to various reasons. During the year 2022-23, company wants to recognize the entire interest receivable of ₹ 60,000.

You are required to advise the accountant of BS Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-03-2023.

(*RTP May, 2024*)

Answer

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. BS Products Ltd. should recognize the entire sale of ₹ 2,00,000 for the year ended 31st March, 2023.

Case (ii)

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹2,40,000 (80% of ₹ 3,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 4,00,000 as the time period for rejecting the goods had expired.

Case (iv)

As per the standard, "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, interest should be recognized only if the ultimate collection is certain and the company expects to realize interest for the delayed payments for ₹ 50,000 only. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is certain only to the extent of this amount and not ₹ 60,000. Therefore, the interest income of ₹ 50,000 should be recognized in the books for the year ended 31st March, 2023.

Thus total revenue amounting ₹ 8,90,000 (2,00,000 + 2,40,000 + 4,00,000 + 50,000) will be recognized for the year ended 31st March, 2023 in the books of BS Products Ltd.

Question 37

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and 15 lakhs as interest and royalties respective from Y Ltd. during the year 2022-23. You are required to state whether and on what basis these revenues can be recognized by X Ltd. (*MTP Advanced Accounting March, 2024*) (*4 Marks*)

Answer

As per AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable. Therefore X Ltd. should recognize interest revenue of ₹ 10 Lakhs.

(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.

MCQ

Question - 1: Which of the following transactions qualify as revenue for M/s AB Enterprises?

Answer:

1. *Sales of ₹20 lakhs made under consignment sales.*
2. *Sale of an old machine amounting ₹5 lakhs*
3. *Services provided to the customer in the normal course of business. Sales recorded is ₹50,000.*
4. *Sales of ₹25 lakhs made under consignment sales*

Question - 2: The Accounting Club has 100 members who are required to pay an annual membership fee of ₹5,000 each. During the current year, all members have paid the fee. However, 5 members have paid an amount of ₹ 10,000 each. Of these, 3 members paid the current year's fee and also the previous year's dues. Remaining 2 members have paid next years' fee of ₹ 5,000 in advance. Revenue from membership fee for the current year to be recognised will be:

Answer:

1. *₹5,25,000*
2. *₹5,10,000*
3. *₹5,00,000*
4. *₹5,15,000*

Question - 3: Entity X purchased a fixed asset of ₹ 160 Cr having useful life of 10 years. Government provided grant of ₹ 60 Cr. After 4 years, entity had to refund the grant of ₹ 20 Cr due to non-fulfilment of a condition. Kindly provide the amount of depreciation to be charged in year 5. Assume - Company follows SLM method of depreciation & grant amount is maintained separately under Deferred Grant account.

Answer:

1. *₹16 Cr*
2. *₹12 Cr*
3. *₹13.33 Cr*
4. *₹15 Cr*

Question - 4: Goods worth ₹4,00,000 were sold on approval basis on 01-12-2022 by ABC Ltd. The period of approval was 3 months after which they were to be considered as sold. Buyer sent approval for 75% goods up to 31-01-2023 and no approval or disapproval received for the remaining goods till 31-03-2023. For the year ended 31st March, 2023

Answer:

1. *Revenue should not be recognized at all.*
2. *Revenue should be recognized for only 75% of sales.*
3. *Revenue should be recognized for the total sales amounting ₹4,00,000 as the time period for rejecting the goods had expired.*
4. *Revenue should be recognized for only 25% of sales.*

Question - 5: Which of the conditions mentioned below must be met to recognize revenue from the sale of goods?

Answer:

(i) the entity selling does not retain any continuing influence or control over the goods;

(ii) when the goods are dispatched to the buyer;

(iii) revenue can be measured reliably;

(iv) the supplier is paid for the goods;

(v) it is reasonably certain that the buyer will pay for the goods;

(vi) the buyer has paid for the goods.

1. *(i), (ii) and (v)*
2. *(ii), (iii) and (iv)*
3. *(i), (iii) and (v)*
4. *(i), (iv) and (v)*

Question - 6: Consignment inventory is an arrangement whereby inventory is held by one party but owned by another party. Which of the following indicates that the inventory in question is a consignment inventory?

Answer:

1. *Manufacturer cannot require the dealer to return the inventory*
2. *Dealer has the right to return the inventory*
3. *Manufacture is responsible for the pricing of goods and any changes in the pricing can only be approved by the manufacturer .*
4. *Manufacture is responsible for the holding the goods and any changes in the pricing can only be approved by the dealer*

Question - 7: Which of the following transactions qualify as revenue for M/s AB Enterprises?

Answer:

1. *Sales of ₹20 lakhs made under consignment sales.*
2. *Sale of an old machine amounting ₹5 lakhs*
3. *Services provided to the customer in the normal course of business. Sales recorded is ₹50,000.*
4. *Sales of ₹25 lakhs made under consignment sales*

Question - 8: The Accounting Club has 100 members who are required to pay an annual membership fee of ₹5,000 each. During the current year, all members have paid the fee. However, 5 members have paid an amount of ₹10,000 each. Of these, 3 members paid the current year's fee and also the previous year's dues. Remaining 2 members have paid next years' fee of ₹5,000 in advance.

Revenue from membership fee for the current year to be recognised will be:

Answer:

1. *₹5,25,000*
2. *₹5,10,000*
3. *₹5,00,000*
4. *₹5,15,000*

Question - 9: FlixNet International offers a subscription fee model to allow the paid subscribers an annual viewing of movies, sports events and other content. It allows users to register for free and have access to limited content for one month without any charges. The customer has a right to cancel the subscription within a month's time but is required to pay for 1 year subscription fee after the free period.

XY has subscribed for free viewing on 1st March 20X1. After 1 month, he has agreed to pay the annual membership and has paid ₹1,200 on 31st March 20X1 for the subscription that is valid up to 31st of March 20X2.

Revenue that can be recognized by FlixNet for the year ended 31st March 20X2 is

Answer:

1. *₹100*
2. *₹1,200*
3. *Nil*
4. *₹1,100*

Question - 10: Sahil Ltd agreed to sell its factory located in Assam to Kali Ltd on 4.12.2023. It entered into a sale deed (transferring all significant risks and rewards of ownership) on 1.2.2024. But the transaction was registered with the registrar on 30.5.2024 When should the sale and gain be recognized?

Answer:

(a) Both sale and gain should be recognized as on the balance sheet date i.e. 31.3.2024.
(b) Both sale and gain should be recognized on 30.5.2024.
(c) The sale should be recognized as on balance sheet date but gain should be recognized on 30.5.2024.
(d) Both sale and gain should be recognized on 4.12.2023.

Question - 11: As per Accounting Standards, difference between the Gross Investment and the present value of Minimum Lease Payments under finance lease (from the standpoint of the lessor) and Unguaranteed Residual Value accruing to the lessor is recorded as

Answer:

(a) Unearned finance income
(b) Guaranteed Residual Value
(c) Profit on lease
(d) Loss on lease

Answer

Q1	***3***	***Q2***	***3***	***Q3***	***1***	***Q4***	***3***
Q5	***1***	***Q6***	***3***	***Q7***	***3***	***Q8***	***3***
Q9	***2***	***Q10***	***1***	***Q11***	***1***		

CHAPTER 10

Accounting Standard 10
Property, Plant and Equipment

Question 1 **(Capitalising the cost of "Remodelling" a Supermarket)**

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalised or not.

(*Source: Illustration 1, Study Material*)

Answer

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

Treatment of Spare Parts, Stand by Equipment and Servicing Equipment

Case I If they meet the definition of PPE as per AS 10 (Revised):

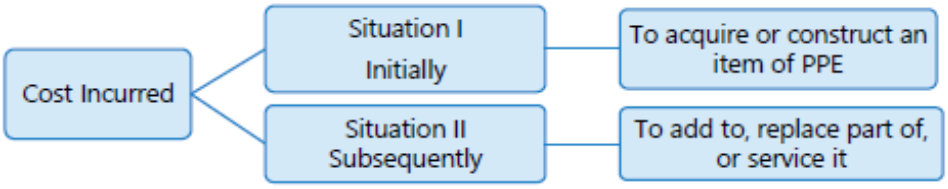
- Recognised as PPE as per AS 10 (Revised)

Case II If they do not meet the definition of PPE as per AS 10 (Revised):

- Such items are classified as Inventory as per AS 2 (Revised)

When do we apply the above criteria for Recognition?

An enterprise evaluates under this recognition principle all its costs on PPE at the time they are incurred. These costs include costs incurred:



Question 2

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. *Setup costs of ₹5,00,000 to install machinery in the new location.*
2. *Rent of ₹15,00,000*
3. *Removal costs of ₹3,00,000 to transport the machinery from the old location to the temporary location.*

Can these costs be capitalised into the cost of the new building?

(*Source: Illustration 2, Study Material*)

Answer

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they

are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

Question 3

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹45,000 per month. The machine was purchased at ₹1,58,00,000 and ₹50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized.

(*Source: Illustration 3, Study Material*)

Answer

Particulars			₹
Purchase Price		Given	1,58,00,000
Add:	Site Preparation Cost	Given	1,40,000
	Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x 3)	1,35,000
	Initial Delivery Cost	Transportation	50,000
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Machinery			1,61,55,000

Question 4 (Capitalisation of directly attributable costs)

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

(*Source: Illustration 4, Study Material*)

Answer

Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

Question 5 (Operating costs incurred in the start-up period)

An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

(*Source: Illustration 5, Study Material*)

Answer

The net operating costs should not be capitalised but should be recognised in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

A. Decommissioning, Restoration and similar Liabilities:

Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Exception: An enterprise applies AS 2 (Revised) "Valuation of Inventories", to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period.

Note: The obligations for costs accounted for in accordance with AS 2 (Revised) or AS 10 (Revised) are recognised and measured in accordance with AS 29 (Revised) "Provisions, Contingent Liabilities and Contingent Assets".

Question 6 (Consideration received comprising a combination of non-monetary and monetary assets)

Entity A exchanges land with a book value of ₹10,00,000 for cash of ₹20,00,000 and plant and machinery valued at ₹25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

(*Source: Illustration 6, Study Material*)

Answer

In the given case, Plant & Machinery is valued at ₹25,00,000, which is assumed to be fair value in absence of information. Further, since fair value of land (asset given up) is not given, the transaction will be recorded at fair value of assets acquired of ₹45,00,000 (₹ Cash 20,00,000 + ₹ Plant & Machinery 25,00,000). Since land of book value ₹10,00,000 is transferred in exchange of assets worth ₹45,00,000, a gain of ₹35,00,000 will be recognised in the books of Entity A.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	20,00,000	
Plant & Machinery A/c	Dr.	25,00,000	
To Land			10,00,000
To Profit on Sale of Land (balancing figure)			35,00,000

Question 7 (Exchange of assets that lack commercial substance)

Entity A exchanges car X with a book value of ₹13,00,000 and a fair value of ₹13,25,000 for cash of ₹15,000 and car Y which has a fair value of ₹13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

(*Source: Illustration 7, Study Material*)

Answer

Since the transaction lacks commercial substance, the entity recognises the assets received at the book value of car X. Therefore, it recognises cash of ₹15,000 and car Y as PPE with a carrying value of ₹12,85,000.

The following journal entry will be passed in the books of Entity A:

Cash/ Bank A/c	Dr.	15,000	
Car Y A/c (balancing figure)	Dr.	12,85,000	
To Car X A/c			13,00,000

Question 8

What happens if the cost of the previous part/inspection was/ was not identified in the transaction in which the item was acquired or constructed?

(*Source: Illustration 8, Study Material*)

Answer

De-recognition of the carrying amount occurs regardless of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

Question 9

What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

(*Source: Illustration 9, Study Material*)

Answer

It may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/existing inspection component was when the item was acquired or constructed.

Question 10 (Revaluation on a class by class basis)

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management want to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

State whether this is acceptable under AS 10 (Revised) or not with reasons?

(*Source: Illustration 10, Study Material*)

Answer

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location. AS 10 (Revised) permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

However, all properties within the class of office buildings must be carried at revalued amount.

Question 11

Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

(*Source: Illustration 11, Study Material*)

Answer

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

Question 12 (Change in estimate of useful life)

Entity A purchased an asset on 1st January 20X1 for ₹1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 20X5, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(*Source: Illustration 12, Study Material*)

Answer

The entity has charged depreciation using the straight-line method at ₹10,000 per annum i.e. (1,00,000/10 years).

On 1st January 20X5, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹60,000.

The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.

Consequently, it should charge depreciation for the next 4 years at ₹15,000 per annum i.e. (60,000 / 4 years).

Note: Depreciation is recognised even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

Question 13

Entity B constructs a machine for its own use. Construction is completed on 1st November 20X1 but the company does not begin using the machine until 1st March 20X2. Comment.

(*Source: Illustration 13, Study Material*)

Answer

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 20X1. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

Question 14 (Depreciation where residual value is the same as or close to Original cost)

A property costing ₹10,00,000 is bought in 20X1. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 20X1 prices, is: Case (a) ₹10,00,000

Case (b) ₹9,00,000.

Calculate the amount of depreciation.

Answer

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹9,00,000 and the depreciable amount is, therefore,

₹1,00,000.

Annual depreciation (on a straight-line basis) will be ₹5,000 [{10,00,000 – 9,00,000} ÷ 20].

Question 15 (Determination of appropriate Depreciation Method)

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.

However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

Answer

The straight-line depreciation method should be adopted because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

Changes in Existing Decommissioning, Restoration and other Liabilities

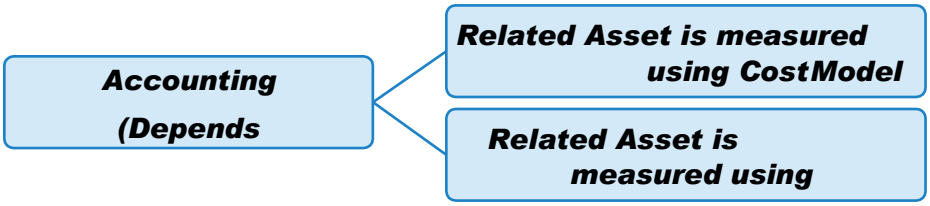
The cost of PPE may undergo changes subsequent to its acquisition or construction on account of:

- Changes in Liabilities
- Price Adjustments
- Changes in Duties
- Changes in initial estimates of amounts provided for Dismantling, Removing, Restoration, and
- Similar factors

The above are included in the cost of the asset.

Accounting for the above changes:

A. If the related asset is measured using the Cost model



Changes in the Liability should be added to, or deducted from, the cost of the related asset in the current period

Note: Amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the Statement of Profit and Loss.

Question 16

A company changed its method of depreciation from SLM to WDV. How should the change be recognised?

Answer

As per AS 10, Property, Plant and Equipment, the depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

Accordingly, the change in method of depreciation should be accounting for as a change in accounting estimate, prospectively.

(*Source: Question 7, Study Material*)

Question 17

A company has debited the Building Account with the Cost of the Land on which the building stands and has provided depreciation on such total cost. Comment on the accounting treatment.

(*Source: Question 8, Study Material*)

Answer

As per AS 10, Property, Plant and Equipment, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. Further, Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets.

In the given case, land should not be depreciated unless it has a limited useful life. Accordingly, it is incorrect to debit the cost of land to the Building Account and provide depreciation on the aggregate cost.

Question 18

An entity is setting up a manufacturing plant. Construction of the plant is completed in August and the plant is ready for commercial production in November. However, the entity commences production in March. When should be company start charging depreciation.

(*Source: Question 9, Study Material*)

Answer

As per AS 10, Property, Plant and Equipment, depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, since the plant is ready for commercial production in November, depreciation shall commence from November. The date of commencement of commercial production is irrelevant for charging depreciation.

Question 19

Which factors should be considered by a company while determining useful life?

(*Source: Question 10, Study Material*)

Answer

All the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the

expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Question 20

An entity gave the following Note in its Financial Statements:

The company chooses not to charge depreciation on Property, Plant and Equipment on account of:

(a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery.

(b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

(c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

(d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.

You are required to state the appropriateness of the above accounting policy in line with the relevant Accounting Standards.

(*Source: Question 11, Study Material*)

Answer

Depreciation refers to writing off the value of the asset over its useful life. Such write-off is necessitated on account of normal wear-and-tear, usage, or obsolescence. Since items of Property, Plant and Equipment are generally used in generating revenue, the pro-rated write-off in value of such item should be recorded in the books against the income earned by such an asset.

Providing depreciation is mandatory, in spite of the fact that repairs are expensed in the Statement of Profit and Loss, or the value of the Property is appreciating. Depreciation is a systematic allocation of cost of the asset against the income generated from the continued use of the asset. Further, the Companies Act, 2013 mandates depreciation to be charged in order to determine the correct profits. Thus, not charging depreciation would result in non-compliance with the Companies Act provisions as well.

The argument laid down by the company and the reasons for the same being invalid are discussed below.

(a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery:

The fact that the company enters into Annual Maintenance Contracts for timely repairs can be regarded as a running cost. Such expense is incurred in order to ensure that the machine continues to run as intended. Thus, it implies that because the machine is being utilized, it will need regular repairs. In other words, continuous use is resulting in normal wear-and-tear which is the reason why depreciation should be charged by the company. By stating that the company incurs Annual Maintenance Expenses, the company is recording only the 'maintenance expenses', but not the wear-and-tear requiring the maintenance in the first place. Hence, this argument put forth by the company is not valid.

(b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

When viewed from the prism of depreciation alone, it appears that the fact that depreciation is a non-cash item is correct. However, it must be noted that at the time of procurement of the asset, the company would have paid cash. Depreciation is after all writing off this amount over the life of the asset. Hence the argument that depreciation is a non-cash item is not valid. Depreciation is writing off the cost of the asset (which was already paid for) over the useful life of the asset, and hence is mandatory.

(c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

Certain assets like immovable property do increase in value with the passage of time. However, such assets are 'used for the purposes of business' and are not 'held for sale' or held as investment property. Accordingly, since the asset is being used for carrying on business, providing depreciation will give a true and fair view of the results of the company, and hence the argument that the value of the property appreciates is not valid.

If the company wants to show the fair market value of the PPE, then it has the option to apply Revaluation model. However, depreciation is mandatory to be charged in Revaluation model also.

(d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.

The value of any asset, after usage, will reduce. Accordingly, the argument that the 'exact profit or loss on sale of the asset' will be obtained is incorrect. Due to usage of the asset, the value of the asset would be lower than the cost. Charging depreciation would seek to bring the book value approximating to such reduced value. Thereafter, on sale of the asset, the true profit or loss would be available. Accordingly, this argument is also invalid.

It may be pertinent to note that Accounting Standard 1, Disclosure of Accounting Policies states that Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts. In other words, the company cannot be absolved of the fact that it has not complied with the relevant accounting standards merely by giving a disclosure of incorrect policies or practices being followed.

Thus, the company's stand of disclosing the incorrect policy as a remedy is not correct. The company is suggested to charge depreciation on a systematic basis over the useful life of the asset thereby complying with the Accounting Standards.

Question 21

With reference to AS-10 Revised, classify the items under the following heads:

HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) Import duties and non-refundable purchase taxes.

(2) Initial delivery and handling costs.

(3) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(4) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.

(5) Trade discounts and rebates.

(6) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(7) Installation and assembly costs.

(8) Administration and other general overhead costs.

(*Source: Question 12, Study Material*)

Answer

Heads

(i) Purchase price of PPE

(iii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

Items		Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5	Trade discounts and rebates (deducted for computing purchase price)	(i)
6	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
7	Installation and assembly costs	(ii)
8	Administration and other general overhead costs	(iii)

Question 22

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	*Cost of the plant (cost per supplier's invoice plus taxes)*	*₹25,00,000*
2.	*Initial delivery and handling costs*	*₹2,00,000*
3.	*Cost of site preparation*	*₹6,00,000*
4.	*Consultants used for advice on the acquisition of the plant*	*₹7,00,000*
5.	*Interest charges paid to supplier of plant for deferred credit*	*₹2,00,000*
6.	*Estimated dismantling costs to be incurred after 7 Years*	*₹3,00,000*
7.	*Operating losses before commercial production*	*₹4,00,000*

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*Source: Question 13, Study Material*)

Answer

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹25,00,000
2.	Initial delivery and handling costs	₹2,00,000
3.	Cost of site preparation	₹6,00,000
4.	Consultants' fees	₹7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹3,00,000
		₹43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹2,00,000 and operating losses before commercial production amounting to ₹4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 23

Arka Ltd. purchased machinery for ₹3,000 lakhs. Depreciation was charged at 10% on SLM basis for a useful life of 10 years. At the end of Year 4, the machinery was revalued to ₹2,700 lakhs and the same was adopted. What will be the carrying amount of the asset at the end of Year 5 and Year 6? Assume no change in the useful life.

(*Source: Question 14, Study Material*)

Answer

Particulars	***₹ in lakhs***
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years (₹3,000 lakhs x 10% x 4 years)	(1,200.00)
Book Value at the end of Year 4	1,800.00
Add: Revaluation Surplus (balancing figure)	900.00
Revalued Amount as given (= revised depreciable value)	2,700.00
Less: Depreciation for Year 5 (₹2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 (₹2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 6	1,800.00

Question 24

Skanda Ltd. acquired a machinery for ₹2,50,00,000 five years ago. Depreciation was charged at 10% p.a. on SLM basis, useful life being 10 years. At the beginning of Year 3, the machinery was revalued to ₹3,00,00,000 with the surplus on revaluation being credited to Revaluation Reserve. Depreciation was provided on the revalued amount over the balance useful life of 8 years. The machinery was sold in the current year for ₹1,12,50,000. Give the accounting treatment for the above in the Company's accounts. What will be the treatment if the machinery fetched only ₹42,50,000 now?

(*Source: Question 15, Study Material*)

Answer

Particulars	₹
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (₹2,50,00,000 x 10% x 2 years)	50,00,000
Book Value at the beginning of Year 3	2,00,00,000
Add: Revaluation Surplus (balancing figure)	1,00,00,000
Revalued Amount as given (= revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3-5 (₹3,00,00,000 ÷ 8 yrs x 3 yrs)	1,12,50,000
Carrying Amount at the end of Year 5	**1,87,50,000**

The treatment of Gain / Loss on Disposal / Revaluation is as below:

Particulars	Disposal Proceeds = ₹1,12,50,000	Disposal Proceeds = ₹42,50,000
Book Value Less Disposal Proceeds = Loss recognized in Profit or Loss	₹1,87,50,000 – ₹1,12,50,000 = ₹75,00,000 (**Loss**)	₹1,87,50,000 – ₹42,50,000 = ₹1,45,00,000 (**Loss**)
Revaluation Surplus directly transferred to Retained Earnings	₹1,00,00,000	₹1,00,00,000

Question 25

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

- *Cost of the Plant (as per supplier's invoice): ₹30,00,000*
- *Initial delivery and handling costs: ₹1,00,000*
- *Cost of site preparation: ₹2,00,000*
- *Consultant fee for advice on acquisition of Plant: ₹50,000*
- *Interest charges paid to supplier against deferred credit: ₹1,00,000*
- *Estimate of Dismantling and Site Restoration costs: ₹50,000 after 10 years (Present Value is ₹30,000)*
- *Operating losses before commercial production: ₹40,000*

The company identified motors installed in the Plant as a separate component and a cost of ₹5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of ₹6,00,000 and estimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is ₹25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a whole for ₹6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

(*Source: Question 16, Study Material*)

Answer

1. Cost at Initial Recognition:

Particulars	₹
Cost of the Plant (as per Invoice)	30,00,000
Initial Delivery and Handling Costs	1,00,000
Cost of Site Preparation	2,00,000
Consultants' Fees	50,000
Estimated Dismantling and Site Restoration Costs	30,000
Total Cost of Plant including Motors	33,80,000
Less: Cost of Motors identified as a separate component (1/6)*	5,63,333
Cost of the Plant (excluding Motors – balance 5/6)	**28,16,667**

* Purchase price of Motors = ₹5,00,000 out of ₹30,00,000 i.e., 1/6 of value of Plant

Note: Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of ₹40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

2. Recognition of Motors Replacement

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM) 5,63,333 ÷ 6 years x 4 years	3,75,555
Carrying Amount of Motors at the end of Year 4	**1,87,778**

Accounting: The company should derecognize the existing Carrying Amount of Motors replaced of ₹1,87,778. Further, the acquisition cost of new motors of ₹6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at ₹6,00,000 ÷ 5 years = ₹1,20,000 p.a.

3. Revaluation

Particulars	₹
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹28,16,667 ÷ 10 years x 4 years	11,26,667
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since the same is treated as a separate component: ₹25,00,000 – ₹6,00,000)	19,00,000
Therefore, Gain on Revaluation credited to Revaluation Reserve	**2,10,000**
Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years	**3,16,667**

4. Derecognition

Particulars	***Motors***	***Plant (excluding Motors)***
Cost/Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5-8	1,20,000 x 4 = 4,80,000	3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / De- recognition	1,20,000	6,33,332
Less: Disposal Proceeds ₹6,00,000 allocated in ratio of carrying amount	95,575	5,04,425
Loss to be written off to P/L	**24,425**	**1,28,907**

Notes:

(a) The Revaluation Surplus of ₹2,10,000 would be transferred directly to Retained Earnings.

(b) The allocation of disposal proceeds of ₹6,00,000 for the plant as whole is apportioned based on carrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on the reasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

Question 26

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of ₹1,000 lakhs, the breakdown of its components is not provided. The estimated useful life of the machinery is 10 years. At the end of Year 6, the turbine, which is a major component of the machinery, needed replacement, as further usage and maintenance was uneconomical. The remainder of the machine is in good condition and is expected to last for the remaining 4 years. The cost of the new turbine is ₹450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.

(*Source: Question 17, Study Material*)

Answer

As per AS 10, Property, Plant and Equipment, the derecognition of the carrying amount of components of an item of Property, Plant and Equipment occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

In the given case, the new turbine will produce economic benefits to Bharat Infrastructure Ltd. and the cost is measurable. Since the recognition criteria is fulfilled, the same should be recognised as a separate item of Property, Plant and Equipment. However, since the initial breakup of the components is not available, the cost of the replacement of ₹450 lakhs can be used as an indication based on the guidance given above, discounted at 8% for the 6-year period lapsed.

Thus, estimate of cost 6 years back = ₹450 lakhs ÷ 1.08^6 = ₹283.58 lakhs Current carrying amount of turbine (to be de-recognised) = Estimated cost ₹283.58 lakhs (–) SLM depreciation at 10% (useful life 10 years) for 6 years ₹170.15 lakhs= ₹113.43 lakhs.

Hence revised carrying amount of the machinery will be as under:

Particulars	**₹ in lakhs**
Historical Cost [₹1,000 lakhs (–) SLM Depreciation at 10% (10 year life) for 6 years]	400.00
Add: Cost of new turbine	450.00
Less: Derecognition of current carrying amount of old turbine	(113.43)
New Carrying Amount of Machinery	**736.57**

Question 27

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factor having an area of 5,000 acres at a cost of ₹60,000 per acre. Preet Ltd. has incurred ₹1.10 crores on demolishing the old Factory Building thereon. A sum of ₹63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹8,00,000 for land acquisition and incurred ₹1,25,000 on title guarantee insurance. Compute the value of the land acquired.

(*Source: Question 18, Study Material*)

Answer

Particulars	**₹**
Purchase Price: 5,000 acres x ₹60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7%	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income)	50.00
[₹110 lakhs (–)₹60 lakhs (₹63 lakhs x 100/105)]	
Cost of Land	**3,269.25**

QUESTION BANK

Question 28

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period—

Salaries of the staff engaged in preparation of restaurant before its opening	₹7,50,000
Construction and remodelling cost of restaurant	₹30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

(*November 2018*) (*5 Marks*)

Answer:

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

Question 29

Preet Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 50,00,000
2.	Initial delivery and handling costs	₹ 4,00,000
3.	Cost of site preparation	₹ 12,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 14,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 4,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 6,00,000
7.	Operating losses before commercial production	₹ 8,00,000

Please advise Preet Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*RTP May 2019*)

Answer:

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹ 50,00,000
2.	Initial delivery and handling costs	₹ 4,00,000
3.	Cost of site preparation	₹ 12,00,000
4.	Consultants' fees	₹14,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 6,00,000
		₹ 86,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 4,00,000 and operating losses before commercial production amounting to ₹ 8,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 30

ABC Ltd. is installing a new plant at its production facility. It provides you the following information:

	₹
Cost of the plant (cost as per supplier's invoice)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial Operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000

You are required to compute the costs that can be capitalised for plant by ABC Ltd., in accordance with AS 10: Property, Plant and Equipment.

(*RTP November 2018*)

Answer:

According to AS 10 on Property, Plant and Equipment, the costs which will be capitalized by ABC Ltd.:

	₹
Cost of the plant	31,25,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants' fees	6,50,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Total cost of Plant	46,60,000

Note: Operating losses before commercial production amounting to ₹3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 31

In the year 2016-17, an entity has acquired a new freehold building with a useful life of 50 years for ₹ 90,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	₹ 20,00,000
Roof	25	₹ 10,00,000
Lifts	20	₹ 5,00,000
Fixtures	10	₹ 5,00,000
Remainder of building	50	₹ 50,00,000
		₹ 90,00,000

You are required to calculate depreciation for the year 2016-17 as per componentization method.

(*RTP May 2018*)

Answer:

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum) (₹)
Land	Nil
Roof	40,000
Lifts	25,000
Fixtures	50,000
Remainder of Building	1,00,000
	2,15,000

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognized as a new component.

Question 32

Mohan Ltd. purchased an asset on 1st January 2013 for ₹ 5,00,000 and the asset had an estimated useful life of 5 years and a residual value of nil. On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

You are required to compute the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(*MTP April 2019*) (*5 Marks*)

Answer:

The entity has charged depreciation using the straight-line method at ₹ 1,00,000 per annum i.e (5,00,000/5 years). On 1st January 2017, the asset's net book value is [5,00,000–(1,00,000 x 4)] ₹ 1,00,000. The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at ₹ 25,000 per annum i.e. (1,00,000/4 years).

Question 33

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom -made machine amounting to ₹ 4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Explain the treatment of machine in the books of ABC Ltd.

(*MTP August, 2018*) (*5 Marks*)

Answer:

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense.

Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

Question 34

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
Initial delivery and handling costs	₹ 2,00,000
Cost of site preparation	₹ 6,00,000
Consultants used for advice on the acquisition of the plant	₹ 7,00,000
Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*MTP August, 2018*) (*5 Marks*)

Answer:

According to AS 10 (Revised), the following costs can be capitalized:

Cost of the plant	₹ 25,00,000
Initial delivery and handling costs	₹ 2,00,000
Cost of site preparation	₹ 6,00,000
Consultants' fees	₹ 7,00,000
Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
	₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 35

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of ₹ 5,00,000 to install machinery in the new location.

Rent of ₹ 15,00,000.

Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment".

(*MTP October, 2018*) (*5 Marks*)

Answer:

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 36

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom -made machine amounting to ₹ 4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

(*MTP October, 2018*) (*5 Marks*)

Answer:

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

Question 37

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of ₹ 5,00,000 to install machinery in the new location.

Rent of ₹ 15,00,000

Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

You are required to examine in line with AS 10 "Property, Plant and Equipment" whether these costs can be capitalized into the cost of the new building.

(*MTP March 2018*) (*5 Marks*)

Answer:

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 38

Ram Ltd. purchased machinery for ₹ 80 lakhs, (useful life 4 years and residual value ₹ 8 lakhs). Government grant received is ₹ 32 lakhs.

You are required to show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant is credited to Fixed Assets A/c.

(*MTP April, 2018*) (*5 Marks*)

Answer:

In the books of Ram Ltd.

If the grant is credited to Fixed Assets Account:

1. **Journal Entry (at the time of refund of grant)**

			In lakhs ₹	In lakhs ₹
I	Fixed Assets	Dr.	32	
	To Bank A/c			32
	(Being grant refunded)			

2. **Value of Fixed Assets after two years but before refund of grant**

Fixed assets initially recorded in the books = ₹ 80 lakhs - ₹ 32 lakhs
= ₹ 48 lakhs

Depreciation for each year = (₹ 48 lakhs - ₹8 lakhs)/4 years
= ₹ 10 lakhs per year for first two years.

Value of the assets before refund of grant = ₹ 48 lakhs - ₹ 20 lakhs
= ₹ 28 lakhs

3. **Value of Fixed Assets after refund of grant**

Value of Fixed Assets before refund of grant	₹ 28 lakhs
Add Refund of grant	₹ 32 lakhs
	₹ 60 lakhs

4. **Amount of depreciation for remaining two years**

Value of the fixed assets after refund of grant -residual value of the assets/No. of years
= ₹ 60 lakhs - ₹ 8 lakhs/2
= ₹ 26 lakhs per annum will be charged for next two years.

Question 39

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

(*RTP November 2019*)

Answer

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars			***₹***
Purchase Price		Given (₹ 158,34,000 x 100/112)	1,41,37,500
Add:	Site Preparation Cost	Given	1,41,870
	Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x3)	1,35,000
	Initial Delivery Cost	Transportation	55,770
	Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset			1,45,00,140

Question 40

(a) Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

(b) Entity A purchased an asset on 1st January 2016 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(c) The following items are given to you:

ITEMS

(1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training);

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management

(4) Costs of opening a new facility or business, such as, inauguration costs;

(5) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "Property, Plant and Equipment", classify the above items under the following heads:

HEADS

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

[*RTP May 2020*]

Answer

(a) The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

(b) The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (1,00,000/10 years). On 1st January 2020, the asset's net book value is [1,00,000 – (10,000 x 4)] = ₹ 60,000.

The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000/4 years). Depreciation is recognized even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

(c) (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE".

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carrying amount of an item of PPE.

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE

(4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.

(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

Question 41

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month.

The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

You are required to ascertain the amount at which the Machinery should be capitalized under AS 10.

[*RTP, November 2020*]

Answer

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		**₹**
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000
Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset		1,61,55,000

Question 42

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The details of the incremental costs which will be incurred are: Setup costs of ₹ 5,00,000 to install machinery in the new location; Rent of ₹ 15,00,000; Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment".

(MTP, May 2020)/(MTP April, 2022) (5 Marks)

Answer

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the company. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 43

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The details of the incremental costs which will be incurred are: Setup costs of ₹ 5,00,000 to install machinery in the new location; Rent of ₹ 15,00,000; Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment".

(*5 Marks*)

Answer

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

Question 44

(i) A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹35,000 per month. The machinery was purchased for ₹1,27,50,000 and a sum of ₹2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fees of ₹37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited.

(ii) B Limited, which operates a major chain of retail stores, has acquired a new store locations. The new location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited? (*5 Marks*)

Question 45

You are required to give the correct accounting treatment for the following in line with provisions of AS 10:

(a) Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this period, including expenditure related to construction and remodelling costs (₹ 18 lakhs), salaries of staff (₹ 2 lakhs) who will be preparing the store before its opening and related utilities costs (₹ 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?

(b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/ development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)?

Answer

(a) Trozen Ltd. should capitalize the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended. The supermarket cannot be opened without incurring the remodelling expenditure. Therefore, this construction and remodelling expenditure of ₹ 18 lakh should be considered as part of the cost of the asset. However, the cost of salaries of the staff ₹ 2 lakh and utilities cost ₹ 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by the management and should be expensed.

(b) AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

Question 46

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only.

(*5 Marks*) (*November 2020*)

Answer

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (50,000/5 years). On 1st April, 2019 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

Question 47

Explain 'Bearer Plant' and 'Biological Asset' as per Accounting Standard 10.

(*Old Study Material*)

Answer

As per AS 10 Property, Plant and Equipment, biological asset is a living animal or plant. Bearer plant is a plant that (a) is used in the production or supply of agricultural produce; (b)is expected to bear produce for more than a period of twelve months; and (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber); plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and annual crops (for example, maize and wheat) are not bearer plants.

Question 48

With reference to AS-10 Revised, classify the items under the following heads:

HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) Import duties and non-refundable purchase taxes.

(2) Initial delivery and handling costs.

(3) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(4) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.

(5) Trade discounts and rebates.

(6) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(7) Installation and assembly costs.

(8) Administration and other general overhead costs.

(*Old Study Material*)

Answer

Heads

(i) Purchase price of PPE
(ii) Directly attributable cost of PPE
(iii) Cost not included in determining the carrying amount of an item of PPE

	Items	Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
5	Trade discounts and rebates (deducted for computing purchase price)	(i)
6	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
7	Installation and assembly costs	(ii)
8	Administration and other general overhead costs	(iii)

Question 49

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
4. Inauguration costs for the factory
5. Professional fees charged by consulting engineer for the installation process
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs
8. Cost of site preparation.

(RTP May, 2022)

Answer

Included in Cost**:**

Point no. 1, 2, 3, 5, 8 Excluded from Cost:

Point no. 4, 6, 7

Question 50

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7.	Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*Old Study Material*)

Answer

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants' fees	₹ 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
		₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 51

A Ltd. has entered into a binding agreement with Gamma Ltd. to buy a custom-made machine ₹ 1,00,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.

You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2.

[*RTP May 2020*]

Answer

A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, A Ltd. should recognise a liability of ₹ 1,00,000 to Gamma Ltd..

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense.

Journal entry

Loss on change in production method	Dr.	1,00,000	
To Gamma Ltd.			1,00,000
(Loss due to change in production method)			
Profit and loss A/c	Dr.	1,00,000	
To Loss on change in production method			1,00,000
(Loss transferred to profit and loss account)			

Question 52

(i) In the year 2018-19, an entity has acquired a new freehold building with a useful life of 50 years for ₹75,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	Useful life (Years)	Cost
Land	Infinite	₹10,00,000
Roof	25	₹15,00,000
Lifts	20	₹7,50,000
Fixtures	10	₹2,50,000
Remainder of building	50	₹40,00,000
		₹75,00,000

Calculate depreciation for the year 2018-19 as per componentization method. Also state the treatment, in case Roof requires replacement at the end of its useful life.

(ii) Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether the remodeling cost will be capitalized or not as per provision of AS 10 "Property plant & Equipment".

[MTP October, 2019, 5 marks]

Answer

(i) Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum) (₹)
Land	Nil
Roof	60,000
Lifts	37,500
Fixtures	25,000
Remainder of Building	80,000
	2,02,500

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognised as a new component.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10 PPE.

Question 53

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

[*MTP October, 2019, 5 marks*] (*MTP March, 2022, 5 marks*)

Answer

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

Question 54

(i) Entity A carried plant and machinery in its books at ₹ 2,00,000 which were destroyed in a fire. These machines were insured 'New for old' and were replaced by the insurance company with new machines of fair value ₹ 20,00,000. The old destroyed machines were acquired by the insurance company and the company did not receive any cash compensation. State, how Entity A should account for the same?

(MTP, October, 2020) (MTP March, 2022) (*5 Marks*)

(ii) Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether Omega Ltd. can capitalize the remodelling cost or not as per provisions of AS 10 "Property plant & Equipment".

(MTP, October, 2020) (MTP March, 2022) (*5 Marks*)

Answer

(i) Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10 on Property, Plant and Equipment. Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets provided by the insurer.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10.

Question 55

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹ 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'. Show the treatment of machine in the books of ABC Ltd.

(MTP, October, 2020) (*5 marks*)

Answer

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

Question 56

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period –

Salaries of the staff engaged in preparation of restaurant before its opening	₹ 7,50,000
Construction and remodelling cost of restaurant	₹ 30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

Answer

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

Question 57

Arush Ltd. is installing a new plant in its factory. It provides you the following information:

Cost of the plant (cost as per supplier's invoice)	₹ 31,25,000
Estimated dismantling costs to be incurred after 5 years	₹ 2,50,000
Initial delivery and handling costs	₹ 1,85,000
Cost of site preparation	₹ 4,50,000
Consultants used for advice on the acquisition of the plant	₹ 6,50,000

You are required to advise Arush Ltd. on the costs that can be capitalised for plant in accordance with AS 10 'Property, Plant and Equipment'. (*MTP, November, 2021*) (*5 Marks*)

Answer

According to AS 10 'Property, Plant and Equipment', following costs will be capitalized by Arush Ltd.:

	₹
Cost of the plant	31,25,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants' fee	6,50,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Total cost of Plant	46,60,000

Question 58

A property costing ₹ 10,00,000 is bought on 1.4.2020. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 25 years.

The estimated residual value in 25 years' time, based on current year prices, is: Case (a) ₹ 10,00,000 Case (b) ₹ 9,00,000

You are required to compute the amount of depreciation charged for the year ended 31.3.2021.

(*RTP, November 2021*)

Answer

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. There is, therefore, no depreciable amount and depreciation is zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹9,00,000 and the depreciable amount is, therefore, ₹1,00,000.

Annual depreciation (on a straight line basis) will be ₹ 4,000 [{10,00,000 – 9,00,000} ÷ 25].

Question 59

XYZ Limited provided you the following information for the year ended 31st March. 2022:-

(i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance on the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

You are required to calculate the revaluation loss as per AS-10 (Revised) and give its treatment in the books of accounts.

(ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.

You are required to explain how the disposal should be accounted for in the financial statements as per AS-10 (Revised).

(*Question Paper, May 2022*) (*5 Marks*)

Question 60

(*i*) *Jared Limited purchased a Machine for US $ 20,000 on 31st December, 2021 payable after four months. It entered into a forward contract for four months @₹ 78.85 per US $. On 31st December, 2021 the exchange rate was ₹ 77.50 per US $.*

How will you recognize the Profit or Loss on Forward Contract for the yearended31st March, 2022 in the books of Jared Limited?

(ii) Trade Payables of Jared Limited includes amount due to Sterling Limited ₹9,75,000 recorded at the prevailing exchange rate on the date of purchase; transaction recorded at US$1 =₹75.00.The exchange rate on Balance Sheet date (31st March, 2022) was US $ 1 = 79.00 The payment was made on 1st May,2022 when the exchange rate was US $ 1 = ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as per AS 11 in the books of Jared Limited.

(Suggested November, 2022) (5 Marks)

Answer

(i)

	₹
Forward Rate	78.85
Less: Spot Rate	(77.50)
Premium on Contract	1.35
Contract Amount	US$ 20,000
Total Loss (20,000 x 1.35)	₹ 27,000

Contract period 4 months (3 months falling in the year ended 31st March, 2022)

Loss to be recognized (₹27,000x 3/4) = ₹ 20,250 in the year ended 31st March, 2022.

(ii) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Trade payables	***Foreign Currency Rate***	***Amount ₹***
Initial recognition US $13,000 (9,75,000/75)	1 US $ = ₹ 75	
Exchange Rate on Balance sheet date	1 US $ = ₹ 79	
Exchange Difference Loss US $ 13,000 X (79-75)		52,000
Exchange Rate on Settlement date	1 US $ = ₹ 78.30	
Exchange Difference Profit US $ 13,000x(79-78.30)		9,100

For the year ended 31st March, 2022 exchange difference loss amounting ₹ 52,000 will be charged to statement of Profit & Loss A/c.

However, there is exchange difference gain of ₹ 13,000 x (79-78.30) = 9,100 on 1st May, 2022. Thus gain of ₹ 9,100 will be credited to statement of Profit & Loss A/c for the year ended 31st March, 2023.

Question 61

RS Ltd. has acquired a heavy plant at a cost of ₹ 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e. the Boiler has become obsolete (which was acquired at price of ₹ 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000.

Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year?

(*RTP November, 2022*)

Answer

Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The cost old boiler should be de-recognized and the new boiler will be added.

Statement showing cost of new boiler and machine after year 2

Original cost of plant	₹ 2,00,00,000
Less: Accumulated depreciation [(2,00,00,000 /10) x 2]	₹ 40,00,000
Carrying value of the plant after two years	₹ 1,60,00,000
Less: Current Cost of Old Boiler to be derecognized	
Less: WDV of Boiler (replaced) after 2 years	
(50,00,000/10 x 8)	40,00,000
	1,20,00,000
Add: Cost of new Boiler to be recognized	60,00,000
Revised carrying amount of Plant	1,80,00,000

Question 62

Star Limited purchased machinery for ₹ 6,80,000 (inclusive of GST of ₹ 40,000). Input credit is available for entire amount of GST paid. The company incurred the following other expense for installation.

	₹
Cost of preparation of site for installation	21,200
Total Labour charges	56,000
(200 out of the total of 500 men hours worked, were spent on installation of the machinery)	
Spare parts and tools consumed in installation	5,000
Total salary of supervisor	26,000
(Time spent for installation was 25% of the total time worked)	
Total technical expense	34,000
(1/10 relates to the plant installation)	
Test run and experimental production expenses	18,000
Consultancy charges to architect for plant set up	11,000
Depreciation on assets used for installation	12,000

The machine was ready for use on 15.01.2021 but was used from 01.02.2021. Due to this delay further expenses of ₹ 8,900 were incurred. Calculate the value at which the plant should be capitalized in the books of Star Limited.

(*RTP May, 2023*)

Answer

Calculation of Cost of Plant

Particulars		***₹***
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour charges	(56,000×200/500) Given	22,400
Spare parts		5,000
Supervisor's Salary	25% of ₹ 26,000	6,500
Technical costs	1/10 of ₹ 34,000	3,400
Test run and experimental production charges	Given	18,000
Architect Fees for set up	Given	11,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		7,79,500
Less: GST credit receivable		(40,000)
Value to be capitalized		7,39,500

Note: Further Expenses of ₹ 8,900 from 15.1.2021 to 1.2.2021 to be charged to profit and loss A/c as plant was ready for production on 15.1.2021.

Question 63

In the books of Topmaker Limited, carrying amount of Plant and Machinery as on 1st April, 2022 is ₹56,30,000.

On scrutiny, it was found that a purchase of Machinery worth ₹21,12,000 was included in the purchase of goods on 1st June, 2022.

On 30th June, 2022 the company disposed a Machine having book value of ₹9,60,000 (as on 1st April, 2022) for ₹ 8,25,000 in part exchange of a new machine costing ₹15,65,000.

The company charges depreciation @ 10% p.a. on written down value method on Plant and Machinery.

You are required to compute:

(i) Depreciation to be charged to Profit & Loss Account;

(ii) Book value of Plant & Machinery as on 3st March, 2023; and

(iii) Profit/Loss on exchange of Plant & Machinery.

(*G-I, May, 2023*) (*5 Marks*)

Question 64

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2023 for each asset as per AS 10 (*Revised*)*:*

(*i*) *Machinery purchased for ₹ 10 lakhs on 1st April, 2018 and residual value after useful life of 5 years, based on 2018 prices is ₹ 10 lakhs.*

(*ii*) *Land for ₹ 50 lakhs.*

(*iii*) *A Machinery is constructed for ₹ 5,00,000 for its own use* (*useful life is 10 years*)*. Construction is completed on 1st April, 2022, but the company does not begin using the machine until 31st March, 2023.*

(*iv*) *Machinery purchased on 1st April, 2020 for ₹50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2022, management decided to use this asset for further 2 years only.*

(*5 Marks*) (*MTP September, 2023*) (*Accounts*)

Answer

Computation of amount of depreciation as per AS 10

		₹
(i)	Machinery purchased on 1/4/18 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April,2022. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life	15,000
	Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (50,000/5 years). On 1st April,2022 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	

MCQs

Question - 1: A plot of land with carrying amount of ₹1,00,000 was revalued to ₹90,000 at the end of Year 2. Subsequently, due to increase in market values, the land was determined to have a fair value of ₹1,05,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?

Answer:

1. *Initial downward valuation of ₹10,000 debited to Revaluation Reserve. Subsequent upward revaluation of ₹15,000 credited to P/L.*
2. *Initial downward valuation of ₹10,000 debited to P/L. Subsequent upward revaluation of ₹15,000 credited to P/L.*
3. *Initial downward valuation of ₹10,000 debited to P/L. Subsequent upward revaluation of ₹10,000 credited to P/L and ₹5,000 credited to Revaluation Reserve.*
4. *Initial downward valuation of ₹10,000 credited to P/L. Subsequent upward revaluation of ₹10,000 debited to P/L and ₹5,000 debited to Revaluation Reserve.*

Question - 2: As per AS 10 (Revised) 'Property, plant and equipment', which of the following costs is not included in the carrying amount of an item of PPE

Answer:

1. *Costs of site preparation*
2. *Costs of relocating*
3. *Installation and assembly costs.*
4. *initial delivery and handling costs*

Question - 3: As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property

Answer:

1. *as per fair value*
2. *under discounted cash flow model.*
3. *under cost model*
4. *under cash flow model*

Question - 4: A plot of land with carrying amount of ₹1,00,000 was revalued to ₹1,50,000 at the end of Year 2. Subsequently, due to drop in market values, the land was determined to have a fair value of ₹1,30,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?

Answer:

1. *Initial upward valuation of ₹50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹20,000 debited to P/L.*
2. *Initial upward valuation of ₹50,000 credited to P/L. Subsequent downward revaluation of ₹20,000 debited to P/L.*
3. *Initial upward valuation of ₹50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹20,000 debited to Revaluation Reserve.*
4. *Initial upward valuation of ₹50,000 debited to P/L. Subsequent downward revaluation of ₹20,000 credited to P/L.*

Question - 5: A plot of land with carrying amount of ₹1,00,000 was revalued to ₹90,000 at the end of Year 2. Subsequently, due to increase in market values, the land was determined to have a fair value of ₹1,05,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?

Answer:

1. *Initial downward valuation of ₹10,000 debited to Revaluation Reserve. Subsequent upward revaluation of ₹15,000 credited to P/L.*
2. *Initial downward valuation of ₹10,000 debited to P/L. Subsequent upward revaluation of ₹15,000 credited to P/L.*
3. *Initial downward valuation of ₹10,000 debited to P/L. Subsequent upward revaluation of ₹10,000 credited to P/L and ₹5,000 credited to Revaluation Reserve.*
4. *Initial downward valuation of ₹10,000 credited to P/L. Subsequent upward revaluation of ₹10,000 debited to P/L and ₹5,000 debited to Revaluation Reserve.*

Question - 6: On sale of an asset which was revalued upwards, what would be the treatment of Revaluation Reserve?

Answer:

1. *The Revaluation Reserve is credited to P/L since the profit on sale of such asset is now realized.*
2. *The Revaluation Reserve is credited to Retained Earnings as a movement in reserves without impacting the P/L.*
3. *No change in Revaluation Reserve since profit on sale of such asset is already impacting the P/L.*
4. *The Revaluation Reserve is reduced from the asset value to compute profit or loss.*

Question -7: A machinery was purchased having an invoice price ₹1,18,000 (including GST ₹18,000) on 1 April 20X1. The GST amount is available as input tax credit. The rate of depreciation is 10% on SLM basis. The depreciation for 20X2 -X3 would be

Answer:

1. *₹10,000.*
2. *₹11,800.*
3. *₹9,000.*
4. *₹10,500.*

Question - 8: As per AS 10 Property, Plant and Equipment , a change in the method of depreciation is

Answer:

1. *A change in the Accounting Policy*
2. *A change in the Accounting Estimate*
3. *A change in the Accounting procedure*
4. *A change in the valuation principal.*

Answer

Q1	***3***	***Q2***	***2***	***Q3***	***3***	***Q4***	***3***
Q5	***3***	***Q6***	***2***	***Q7***	***1***	***Q8***	***2***

CHAPTER 11

Accounting Standard 11 The Effects of Changes in Foreign Exchange Rates

Question 1

Classify the following items as monetary or non-monetary item: Inventories
Trade Receivables Investment in Equity shares
Property, Plant and Equipment.

(*Source: Illustration 1, Study Material*)

Answer

Inventories	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Property, Plant and Equipment	Non-monetary

Question 2

	Exchange Rate per $
Goods purchased on 1.1.20X1 for US $ 15,000 Exchange rate on	*₹ 75*
31.3.20X1	*₹ 74*
Date of actual payment 7.7.20X1	*₹ 73*

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 20X1 and 31st March, 20X2 as per AS 11.

(*Source: Illustration 2, Study Material*)

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.20X1 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.20X1 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year ended 31st March, 20X1.

On 7.7.20X1, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year ended 31st March, 20X2.

Question 3

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. prepares financial statement ending on 31/03/20X1. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/20X1 1 US$ = ₹ 48.00
31/03/20X1 1 US$ = ₹ 49.00
31/07/20X1 1 US$ = ₹ 49.50

(*Source: Illustration 3, Study Material*)

Answer

Journal Entries in the Books of Kalim Ltd.

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1			
Jan. 01	Bank Account (4,50,000 x 48) Dr.	216,00,000	
	To Foreign Loan Account		216,00,000
March 31	Foreign Exchange Difference Account Dr.	4,50,000	
	To Foreign Loan Account [4,50,000 x (49-48)]		4,50,000
July 01	Foreign Exchange Difference Account Dr. [4,50,000 x (49.5-49)]	2,25,000	
	Foreign Loan Account Dr.	220,50,000	
	To Bank Account		2,22,75,000

Question 4

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

(*Source: Illustration 4, Study Material*)

Answer

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised (30,000/3) x 2 = ₹ 20,000 in the year ended 31st March, 20X1. Rest ₹ 10,000 will be recognised in the following year.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Question 5

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1 st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.

(*Source: Illustration 5, Study Material*)

Answer

Since the forward contract was for speculation purpose the premium on contract

i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	₹ 47.18
Less: Contract Rate	(₹ 47.10)
Premium on Contract	₹ 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	₹ 8,000

Question 6

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to the statement of profit and loss. Comment.

(*Source: Illustration 6, Study Material*)

Answer

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

Question 7

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.20X4:

Account Name	***Amount in £***	
	Dr.	***Cr.***
Machinery (purchased on 01.04.20X1)	*5,000*	
Debtors	*1,600*	
Opening Stock	*400*	
Goods received from Head Office Account (Recorded in HO books as ₹ 4,02,000)	*6,100*	
Sales		*20,000*
Purchases	*10,000*	
Wages	*1,000*	
Salaries	*1,200*	
Cash	*3,200*	
Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	*2,900*	
Head Office Account (Recorded in HO books as ₹ 4,90,000)		*7,400*
Creditors		*4,000*

- *Closing stock at branch is £ 700 on 31.03.20X4.*
- *Depreciation @ 10% p.a. is to be charged on Machinery.*
- *Prepare the trial balance after been converted in Indian Rupees.*
- *Exchange rates of Pounds on different dates are as follow: 01.04.20X1 – ₹ 61; 01.04.20X3 – ₹ 63 & 31.03.20X4 – ₹ 67*

(*Source: Illustration 7, Study Material*)

Answer

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 20X4

Particulars	*£ (Dr.)*	*£ (Cr.)*	*Conversion Basis*	*₹ (Dr.)*	*₹ (Cr.)*
Machinery	5,000		Transaction date rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	
Wages	1,000		Average Rate	65,000	
Salaries	1,200		Average Rate	78,000	
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

Question 8

A Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for.

(*Source: Illustration 8, Study Material*)

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{\text{Rs. 300 lakhs}}{\text{Rs. 40}}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars ₹ (42.50 – 40.00) = ₹187.50 lakhs (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

Note: The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has done the correct treatment.

Question 9

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 20X1 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/20X1 1 US$ = ₹ 48.00

31/03/20X2 1 US$ = ₹ 51.00

You are required to pass the journal entries in the following cases:

(i) Option under Para 46A is not availed.

(ii) Option under *Para 46A is availed.*

(iii) The loan was taken to finance the operations of the entity (and not to procure a depreciable asset).

In all cases, assume interest accrued on 31 March 20X2 is paid on the same date.

(*Source: Illustration 9, Study Material*)

Answer

Journal Entries in the Books of A Ltd.

(i) Option under Para 46A is not availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account (P/L)	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000

In this case, since the option under Para 46A is **NOT** availed, the Exchange Loss of ₹ 30,000 is recognised as an expense in the Statement of Profit and Loss for the year ending 31 March 20X2.

(ii) Option under Para 46A is availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000
Mar 31	Property, Plant and Equipment	Dr.	30,000	
	To Foreign Exchange Difference Account			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is capitalized in the cost of Property, Plant and Equipment, which will indirectly get recognized in the Profit & Loss A/c by way of increased depreciation over the remaining useful life of the asset.

(iii) Option under Para 46A is availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000
Mar 31	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA)	Dr.	30,000	
	To Foreign Exchange Difference Account			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is accumulated in the FCMITD A/c, which will be subsequently spread over and debited to P&L A/c over the tenure of the loan.

Question 10

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Question 11

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date?

Answer

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation. For details, refer para 2.5 of chapter.

Question 12

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3. 20X1.

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	**Foreign Currency Rate**	₹
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50) Treatment: Credit Profit and Loss A/c by ₹ 23,077		23,077
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60) Treatment: Credit Loan A/c And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		6,04,317

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

QUESTION BANK

Question 13

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹30,00,000. It was recorded at US $1 = ₹60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., ₹10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹59.00. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd. (*November 2018*) (*5 Marks*)

Answer:

Amount of Exchange difference and its Accounting Treatment

Long term Loan		Foreign Currency Rate	₹
(i)	Initial recognition US $ 50,000 ₹ (30,00,000/60)	1 US $ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Loss US $ 50,000 x ₹ (62 – 60)		1,00,000
	Treatment: Credit Loan A/c		
	and Debit FCMIT D A/c or Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial recognition US $ 16,949.152* (₹10,00,000/59)		
	Rate on Balance sheet date	1 US $ = ₹ 59	10,00,000
	Exchange Difference Gain US $ 16,949.152* x ₹ (62-59)	1 US $ = ₹ 62	
	Treatment: Credit Profit and Loss A/c by ₹ 50,847.456*		50,847.456*
	And Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting ₹ 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting ₹ 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 14

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st January 2018 from an American company M/s M & M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2018	₹60.75 per dollar
On 31st March, 2018	₹63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(*November 2018*) (*4 Marks*)

Answer:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate	₹ 62.50
Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 1.75
Contract Amount	US$ 5,00,000
Total Loss (5,00,000 x 1.75)	₹ 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹ 5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

Question 15

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2017	**1 US$ =**	**₹ 68.50**
31/03/2017	1 US$ =	₹ 69.50
31/07/2017	1 US$ =	₹70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

(*May 2018*) (*5 Marks*)

Answer

Journal Entries in the Books of ABC Ltd.

Date	Particulars		₹ (Dr.)	₹ (Cr.)
Jan. 01,2017	Bank Account (5,00,000 × 68.50)	Dr.	342,50,000	
	To Foreign Loan Account			342,50,000
Mar. 31,2017	Foreign Exchange Difference Account	Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 × (69.50-68.50)]			5,00,000
Jul. 31,2017	Foreign Exchange Difference Account [5,00,000 × (70-69.5)]	Dr.	2,50,000	
	Foreign Loan Account	Dr.	347,50,000	
	To Bank Account			350,00,000

Question 16

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2016, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

(*RTP May 2019*)

Answer:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months

Two falling the year 2016-17; therefore loss to be recognised (30,000/3) x 2 = ₹ 20,000. Rest ₹ 10,000 will be recognised in the following year.

Question 17

(i) Classify the following items as monetary or non-monetary item:
Share Capital
Trade Receivables
Investment in Equity shares
Fixed Assets.

(ii)

	Exchange Rate per $
Goods purchased on 1.1.2017 for US $ 15,000	₹75
Exchange rate on 31.3.2017	₹74
Date of actual payment 7.7.2017	₹73

You are required to ascertain the loss/gain for financial years 2016-17 and 2017-18, also give their treatment as per AS 11.

(*RTP November 2018*)

Answer:

(i)

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

(ii) As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2017 and corresponding creditor would be recorded at ₹ 11,25,000 (i.e. $15,000 x ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.2017 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 - 11,10,000) should be credited to Profit and Loss account in the year 2016-17.

On 7.7.2017, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 - 10,95,000) will be credited to Profit and Loss account in the year 2017-18.

Question 18

Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2016 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2016, the exchange rate was ₹ 61.50 per Dollar.

You are required to calculate the amount of the profit or loss on forward contract to be recognized in the books of the company for the year ended 31st March, 2017.

(*RTP May 2018*)

Answer:

Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract = ($ 50,000 × ₹ 2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2016 to 31st March, 2017 i.e. 5 months falling in the year 2016-2017	5 months
Hence, Loss for 5 months will be ₹ 1,37,500 × 5/6 =	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2017.

Question 19

(i) Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50. US $ 1 = ₹ 61.20 on 31.3.2019.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019.

(ii) Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @₹ 64.25 per Dollar. On 31st October, 2018, the exchange rate was ₹ 61.50 per Dollar.

You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019.

(*RTP November 2019*)

Answer

(i) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Accordingly, exchange difference on trade receivables amounting ₹ 23,076 {₹5,23,076(US $ 8547* x ₹ 61.20) less ₹ 5,00,000} should be charged to profit & Loss account.

(ii) Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract= ($ 50,000 × ₹ 2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019	5 months
Hence, Loss for 5 months will be $₹1,37,500 \times \frac{5}{6} =$	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

Question 20

(i) AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

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* US $ 8,547 = 5,00,000/58.50

On 1st January, 2018 ₹ 60.75 per dollar
On 31st March, 2018 ₹ 63.00 per dollar
You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(ii) Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. You are required to comment in line with AS 11.

[*RTP May 2020*]

Answer

(i) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate		₹ 62.50
Less: Spot Rate		(₹ 60.75)
Premium on Contract		₹ 1.75
Contract Amount	US$ 5,00,000	
Total Loss (5,00,000 x 1.75)		₹ 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

(ii) Financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate. Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

Question 21

Classify the following items as monetary or non-monetary item:
Share Capital
Trade Receivables
Investment in Equity shares
Fixed Assets.

[*RTP, November 2020*]

Answer

Share capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Fixed assets	Non-monetary

Question 22

	Exchange Rate per $
Goods purchased on 1.1.2019 for US $ 15,000	₹ 75
Exchange rate on 31.3.2019	₹ 74
Date of actual payment 7.7.2019	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11.

[*RTP, November 2020*]

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2019 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.2019 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2018-19.

On 7.7.2019, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2019-20.

Question 23

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020

(i) Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 72.00
US $ 1=₹73.50 on 31st March,2020
US $ 1= ₹ 72.50 on 1st April,2019.

(ii) Long term loan taken on 1st April, 2019 from a U.S. company amounting to ₹ 75,00,000. ₹5,00,000 was repaid on 31st December, 2019, recorded at US $ 1 = ₹ 70.50. interest has been paid as and when debited by the US company.
US $1= ₹ 73.50 on 31st March,2020
US $1=1₹ 72.50 on 1st April, 2019. (*5 marks*)

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long - term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

	Foreign Currency Rate	***₹***
Debtors		
Initial recognition US $12,500 (9,00,000/72)	1 US $ = ₹72	9,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Gain US $ 12,500 X (73.50- 72)		18,750
Treatment: Credit Profit and Loss A/c by ₹ 18,750		
Long term Loan		
Initial recognition US $ 1,03,448.28 (75,00,000/72.50)	1 US $ = ₹ 73.50	75,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Loss after adjustment of exchange gain on repayment of ₹ 5,00,000		
₹ 67,987.48 [82,171.88 (US $ 96,356.08 X ₹ 73.5 less ₹ 70,00,000) less profit 14,184.40		
[US $ 7,092.2 (5,00,000/70.5) X ₹ 2)] NET LOSS		67,987.48*
Treatment: Credit Loan A/c and		
Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48		

Thus, Exchange Difference on Long term loan amounting ₹ 67,987.48 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of ₹ 9 lakhs has not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2020.

Question 24

(a) Classify the following items into Monetary and Non-monetary:
   (i) Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment

(b) Trade payables of CAT Ltd. include amount payable to JBB Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US $1 = ₹ 80.00. The exchange rate on balance sheet date (31.03.2020) was US $1 = ₹ 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd.

Answer

(a) Share capital - Non-monetary; Trade Payables - Monetary
Cash balance – Monetary; Property, plant and equipment - Non-monetary

(b) Amount of Exchange difference and its Accounting Treatment

	Foreign Currency Rate	**₹**
Trade payables		
Initial recognition US $ 12,500 (₹10,00,000/80)	1 US $ = ₹ 80	10,00,000
Rate on Balance sheet date	1 US $ = ₹ 85	
Exchange Difference loss US $ 12,500 x ₹ (85-80)		62,500
Treatment:		
Debit Profit and Loss A/c by ₹ 62,500 and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting ₹ 62,500 is required to be transferred to Profit and Loss.

Question 25

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2020 ₹ 62 per US $. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards.

Answer

(i) Interest for the period 2019-20
= US $ 10 lakhs x 4% × ₹ 62 per US $ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs. Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 26

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognised at each Balance Sheet date?

(*Old Study Material*)

Answer

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Question 27

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Answer

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation.

Question 28

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3.20X1. (*Old Study Material*)

Answer

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	***Foreign Currency Rate***	***₹***
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

Question 29

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Rau Ltd.?

(5 Marks) (MTP, May 2020)

Answer:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months

Two months falling in the year ended 31st March, 2020; therefore loss to be recognized (30,000/3) x 2 = ₹ 20,000.

Balance amount of ₹ 10,000 will be recognized in the following financial year.

Question 30

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

(MTP, October, 2020) (*5 Marks*)

Answer

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US $ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh US $ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item

of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 lakh + 100 lakh) = ₹ 620 lakh.

Question 31

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.20 20 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2021 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold by the accountant. Om Ltd. provides depreciation on an item of property, plant and equipment at 20% on WDV basis and wants to exercise the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment.

You are required to calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

(MTP, October 2021) (5 Marks)

Answer

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2021 on payment of US $ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2021 = ₹ 40 lakh US $ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2020 - 2021 = 20% of (₹ 3,000 lakh + 100 lakh) = ₹ 620 lakh.

Question 32

"Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

(i) Share Capital
(ii) Trade Receivables
(iii) Investments
(iv) Fixed Assets.

(*MTP, November, 2021*) (*5 Marks*)

Answer

As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 33

Mona Ltd. purchased a plant for US$ 1,00,000 on 01st December 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st December was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Mona Ltd for the year ended 31st March, 2021?

(*RTP, November 2021*)

Answer

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000

Total Loss (1,00,000 x 0.30) ₹ 30,000 to be recognized in year ended 31.3.2021.

Question 34

(i) PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd, a U.S. company, amounting to ₹ 40,88,952. The transaction was recorded at US $1 = ₹ 72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹73,60.

(ii) Trade receivables of PP Ltd. include amount receivable from Preksha Ltd, ₹20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹73.40. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60. Exchange rate on 1st April, 2020 is US $1= ₹74.00

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of PP Ltd.

(*Suggested December 2021*) (*5 Marks*)

Answer

(i) Long term Finance

	Foreign Currency Rate	₹
Initial recognition US $ 56,791 (40,88,952/72)	1 US $ = ₹ 72	40,88,952
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Loss [US $ 56,791 x (73.60 – 72)]		90,866 (rounded off)

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over t he balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit and Loss A/c by ₹ 90,866 and Credit Loan A/c

(ii) Trade Receivables

	Foreign Currency Rate	₹
Initial recognition US $ 27,250 (20,00,150/ 73.40)	1 US $ = ₹ 73.40	20,00,150
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Gain [US $ 27,250 X (73.60-73.40)]		5,450

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences on trade receivables amounting ₹ 5,450 is required to be transferred to Profit and Loss A/c.

Treatment needed in this case: Credit Profit and loss account by ₹ 5,450.

Question 35

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2020-21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2021 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

(*RTP May, 2023*)

Answer

(i) Interest for the period 2020-21
= US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 15 lakhs × ₹ 72 x 9.5% = ₹ 102.60 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 102.60 lakhs less ₹ 57 lakhs = ₹ 45.60 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45.60 lakhs.

Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 36

Explain "monetary item" as per Accounting Standard 11.

How are foreign currency monetary items to be recognized at each Balance Sheet date?

Classify the following as monetary or non-monetary item:

Share Capital.

Trade Receivables.

Investments.

Fixed Assets.

(*4 Marks*) (*RTP November, 2023*) (*Accounts*)

Answer

As per AS 11, Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date.

In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Classification of items as monetary or non-monetary item:

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary Fixed Assets (PPE)
Non-monetary	

Question 37

Answer the following Questions:

Karna Ltd., an Indian Company, has the following foreign currency transactions during the financial year 2022-23:

(*i*) *On 1st July, 2022, imported goods from Try Ltd., a German based company, amounting to ₹30,96,000.*

(*ii*) *On 1st October, 2022, imported plant and machinery from Lucy Ltd., a German based company, for € 18,500. The amount was paid on the date of import itself.* (*Ignore depreciation*).

(*iii*) *On 1st December, 2022, exported good on credit to Cream Ltd., a German based company, amounting to ₹ 50,40,000.*

All the above transactions were recorded in the books of account at the prevailing exchange rate on the date of the transactions. Ignore taxes and duty on the above transactions.

Payment due from Cream Ltd. and payment due to Try Ltd. is outstanding as on 31st March, 2023.

Rate of exchange between reporting currency (₹) *and foreign currency* (€) *on different dates are as under:*

On 1st July, 2022	*1€ = ₹86*
On 1st October, 2022	*1 € = ₹88*
On 1st December, 2022	*1 €= ₹84*
On 31st March, 2023	*1 € = ₹90*

You are required, as per AS-11:

(*i*) *To show value at which above items will appear in Balance sheet as on 31st March, 2023;*

(*ii*) *To calculate the amount of gain/loss on each of above transactions on account of exchange differences, if any.*

(*4 Marks*) (*November Exam., 2023*) (*Accounts*)

MCQs

Question - 1: What will be the treatment of the balance in the foreign currency translation reserve on disposal of the foreign operation?

Answer:

1. *Transfer the balance in foreign currency translation reserve to reserves without impacting P/L*
2. *Record the balance in foreign currency translation reserve as income or expense in P/L*
3. *Foreign currency translation reserve will continue; no change will be made to the balance and it will continue to appear as such even after disposal of the foreign operation*
4. *Any method from the above can be adopted*

Question - 2: What will be the treatment of the balance in the foreign currency translation reserve on disposal of the foreign operation?

Answer:

1. *Transfer the balance in foreign currency translation reserve to reserves without impacting P/L*
2. *Record the balance in foreign currency translation reserve as income or expense in P/L*
3. *Foreign currency translation reserve will continue; no change will be made to the balance and it will continue to appear as such even after disposal of the foreign operation*
4. *Any method from the above can be adopted*

Question - 3: What will be the treatment of the balance in the foreign currency translation reserve on disposal of the foreign operation?

Answer:

1. *Transfer the balance in foreign currency translation reserve to reserves without impacting P/L*
2. *Record the balance in foreign currency translation reserve as income or expense in P/L*
3. *Foreign currency translation reserve will continue; no change will be made to the balance and it will continue to appear as such even after disposal of the foreign operation*
4. *Any method from the above can be adopted*

Question - 4: As per AS 11 assets and liabilities of integral foreign operations should be converted at which rates?

Answer:

1. *Opening Rate for all assets and liabilities (monetary and non-monetary)*
2. *Closing Rate for all assets and liabilities (monetary and non-monetary)*
3. *Record transactions at the spot rate, monetary items at closing rate and non-monetary items at the rate on which the transaction was executed.*
4. *Average Rate for all assets and liabilities (monetary and non-monetary)*

Question - 5: As per AS 11 assets and liabilities of non-integral foreign operations should be converted at rate.

Answer:

1. *Opening*
2. *Average*
3. *Closing*
4. *Transaction*

Question - 6: The debit or credit balance of "Foreign Currency Monetary Item Translation Difference Account"

Answer:

1. *Is shown as "Miscellaneous Expenditure" in the Balance Sheet*
2. *Is shown under "Reserves and Surplus" as a separate line item*
3. *Is shown as "Other Non-current" in the Balance Sheet*
4. *Is shown as "Current Assets" in the Balance Sheet*

Question - 7: If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset is translated at

Answer:

1. *Average exchange rate*
2. *Closing exchange rate*
3. *Exchange rate at the date of purchase of asset*
4. *Opening exchange rate*

Question - 8: Which of the following can be classified as an integral foreign operation?

Answer:

1. *Branch office serving as an extension of the head office in terms of operations*
2. *Independent subsidiary of the parent company*
3. *Branch office independent of the head office in terms of operational decisions*
4. *None of the above*

Question - 9: Which of the following items should be converted to closing rate for the purposes of financial reporting?

Answer:

1. *Items of Property, Plant and Equipment*
2. *Inventory*
3. *Trade Payables, Trade Receivables and Foreign Currency Borrowings*
4. *All of the above*

Question - 10: Incomes and expenses of a Non-integral operation (NFO) is translated at

Answer:

1. *Average rate that approximates the actual exchange rates.*
2. *Exchange rate at the date of transaction.*
3. *Opening exchange rate.*
4. *Either (a) or (b).*

Question - 11: Costs of inventories of Integral foreign operation is translated at

Answer:

1. *Opening exchange rate*
2. *Closing exchange rate*
3. *Rate existing on the date when the cost was incurred*
4. *Average exchange rate*

Answer

Q1	***2***	***Q2***	***2***	***Q3***	***2***	***Q4***	***3***
Q5	***3***	***Q6***	***2***	***Q7***	***3***	***Q8***	***1***
Q9	***3***	***Q10***	***4***	***Q11***	***3***		

CHAPTER 12

Accounting Standard 12
Accounting for Government Grants

Question 1

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

(*Source: Illustration 1, Study Material*)

Answer

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being Fixed Assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account			10,00,000
	(Being grant received from the government)			
2nd	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P&L Account)			
	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P&L Account)			

Method II:

- Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
- Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.
- If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

Question 2

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

(*Source: Illustration 2, Study Material*)

Answer

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being fixed assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Deferred Government Grant Account			10,00,000
	(Being grant received from the government)			
	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account			9,00,000
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account			9,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grants Account	Dr.	2,00,000	
	To Profit & Loss Account			2,00,000
	(Being proportionate government grant taken to P/L			
2nd	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account			9,00,000
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account			9,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grant Account	Dr.	2,00,000	
	To Profit & Loss Account			2,00,000
	(Being proportionate government grant taken to P/L			

Question 3

Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.

(*Source: Illustration 3, Study Material*)

Answer

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS 12.

Question 4

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

You are required to pass the necessary journal entries in the books of the company for first year if the grant is:

(a) Shown separately as Other Income; and

(b) Deducted against the Salary costs.

(*Source: Illustration 4, Study Material*)

Answer

(a)

Particulars		**₹ (Dr.)**	**₹ (Cr.)**
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account To Bank Account	Dr.	30,00,000	
			30,00,000
(Being Salary expense paid for the year)			
Deferred Income Account	Dr.	18,00,000	
To Other Income Account			18,00,000
(Being Year 1 Grant income recognised in Profit & Loss)			

Note: The grant has been spread on a straight-line basis over a period of 5 years [₹90,00,000/5 years = ₹ 18,00,000].

(b)

Particulars		**₹ (Dr.)**	**₹ (Cr.)**
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	12,00,000	
To Bank Account			12,00,000
(Being Salary expense paid (net of grant income) for the year)			
Deferred Income Account	Dr.	18,00,000	
To Salary Expense Account			18,00,000
(Being Year 1 grant adjusted against Salary expense for the year)			

Question 5

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

(*Source: Illustration 5, Study Material*)

Answer

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

Question 6

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.

(*Source: Illustration 6, Study Material*)

Answer

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

Question 7

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

(*Source: Illustration 7, Study Material*)

Answer

Fixed Assets Account	Dr.	₹ 7,00,000	
To Bank Account			₹ 7,00,000
(Being government grant on asset refunded)			

Question 8

A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non- compliance with certain conditions. Pass journal entries for first two years.

(*Source: Illustration 8, Study Material*)

Answer

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account To Bank Account (Being fixed asset purchased)	Dr.	20	20
	Bank Account To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)	Dr.	8	8
	Depreciation Account (W.N.1) To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM))	Dr.	2	2
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	Dr.	2	2

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
2	Fixed Asset Account	Dr.	5	
	To Bank Account			5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.2)	Dr.	3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation $\left[\frac{12-4}{4}\right]$	2

2. Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less : Depreciation for the first year $\left[\frac{12-4}{4}\right]$	2 10
	5 15
Add: Government grant refundable	
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	3.67

Question 9

On 1.4.20X1, ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of machinery costing ₹ 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20X4 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4?

(*Source: Illustration 9, Study Material*)

Answer

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 20X1	Acquisition cost of machinery (₹ 1,500 – ₹ 300)	1,200.00
31st March, 20X2	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 20X3	Less: Depreciation @ 20%	(192.00)
	Book value	768.00
31st March, 20X4	Less: Depreciation @ 20%	(153.60)
1st April, 20X4	Book value	614.40
May, 20X4	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 10

A Ltd. purchased a machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

(*Source: Illustration 10, Study Material*)

Answer

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account:

I.

		₹	₹
Fixed Assets A/c	Dr.	16 lakhs	
To Bank A/c (Being grant refunded)			16 lakhs

II. The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = ₹12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹16 lakhs /4 years) = ₹4 lakhs p.a. x 2 years = ₹8 lakhs were credited to Profit and Loss Account and ₹8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

I

		₹	₹
Deferred Grant A/c	Dr.	8 lakhs	
Profit & Loss A/c	Dr.	8 lakhs	
To Bank A/c			16 lakhs
(Being Government grant refunded)			

II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at ₹24 lakhs (W.N.2) and depreciation will continue to be charged at ₹8 lakhs per annum for the remaining two years.

Working Notes:

1. **Balance of Fixed Assets after two years but before refund (under first alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs – ₹16 lakhs = ₹24 lakhs

   Depreciation p.a. = (₹24 lakhs – ₹8 lakhs)/4 years = ₹4 lakhs per year Value of fixed assets after two years but before refund of grant = ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under second alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs

   Depreciation p.a. = (₹40 lakhs – ₹8 lakhs)/4 years = ₹8 lakhs per year Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years) = ₹24 lakhs

Question 11

Co X runs a charitable hospital. It incurs salary of doctors, staff etc. to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required to refund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income.

(*Source: Illustration 11, Study Material*)

Answer

			₹	₹
	Deferred Grant A/c	Dr.	36 lakhs	
	Profit & Loss A/c	Dr.	54 lakhs	
	To Bank A/c			90 lakhs
	(Being Government grant refunded)			

Workings:

Total grant received:	₹ 90 Lakhs
Grant recognised as income for first 3 years:	₹ 18 lakhs × 3
	= ₹ 54 lakhs
Remaining Deferred Income	= ₹ 90 Lakhs – 54 lakhs
	= ₹ 36 lakhs

Reference: The students are advised to refer the full text of AS 12 "Accounting for Government Grants".

Question 12

AS 12 deals with recognition and measurement of government grants. Please elaborate the parameters which are required to be met before an entity can recognise government grants in its books?

(*Source: Theory Question 6, Study Material*)

Answer

A government grant is recognised when there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Question 13

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1- 20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

(*Source: Practical Question 7, Study Material*)

Answer

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be first adjusted against the unamortised deferred income in the books and the excess if any will be debited to profit & loss account of the company as an extraordinary item in the year 20X2-20X3.

QUESTION BANK

Question 14

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve. (*May 2019*) (*1 Marks*)

Answer

True: When grants in the nature of promoters' contribution becomes refundable, in part or in full to the government on non-fulfillment of some specified conditions, the relevant amount refundable to the government is reduced from the capital reserve.

Question 15

On 01.04.2014, XYZ Ltd. received Government grant of ₹100 Lakhs for an acquisition of new machinery costing ₹500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method.

The company had to refund the entire grant in 2nd April, 2017 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant.

How do you deal with the refund of grant to the Government in the books of XYZ Ltd., as per AS 12?

(*May 2018*) (*MTP March, 2022)* (*5 Marks*)

Answer

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 2014	Acquisition cost of machinery (₹ 500 - ₹ 100)	400.00
31st March, 2015	Less: Depreciation @ 20%	(80)
1st April, 2015	Book value	320.00
31st March, 2016	Less: Depreciation @ 20%	(64)
1st April, 2016	Book value	256.00
31st March, 2017	Less: Depreciation @ 20%	(51.20)
1st April, 2017	Book value	204.80
2nd April, 2017	Add: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 16

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2014- 15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(*RTP May 2019*)

Answer

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 17

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12. (*RTP November 2018*)

Answer

As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56 + 15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

Question 18

D Ltd. acquired a machine on 01-04-2012 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2012-13- to 2014-15 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

You are required to explain how should the company deal with this asset in its accounts for 2015-16?

(*RTP May 2018*)

Answer

From the above account, it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2015-16 or 2016-17 as the depreciable amount is now Nil.

Question 19

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the g rant had been credited to Deferred Grant A/c.

(*MTP April 2019)/(MTP April, 2022) (5 Marks)*

Answer

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹ 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		₹ lakhs	₹ lakhs
Deferred Grant A/c	Dr.	16	
Profit & Loss A/c	Dr.	16	
To Bank A/c			32
(Being Government grant refunded)			

1. Value of Fixed Assets after two years but before refund of grant

Fixed assets initially recorded in the books = ₹ 80 lakhs

Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year

Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs

2. Value of Fixed Assets after refund of grant

On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at ₹ 44 lakhs.

3. Amount of depreciation for remaining two years

Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

Question 20

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

(*RTP November 2019*)

Answer

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, *i.e.,* they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question 21

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area.

(iii) ₹ 10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment.

[*RTP May 2020*]

Answer

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

(iii) ₹ 10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, ₹ 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

Question 22

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area.

[*RTP, November 2020*]

Answer

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

Question 23

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2016- 17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2019-20, due to non- compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 in profit and loss account?

(5 Marks) (MTP, May 2020)

Answer:

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2019-20. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 24

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant had been credited to Deferred Grant A/c.

(*5 Marks*)

Answer

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		₹	₹
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
To Bank A/c			32 lakhs
(Being Government grant refunded)			

1. **Value of Fixed Assets after two years but before refund of grant**
   Fixed assets initially recorded in the books = ₹ 80 lakhs
   Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year
   Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs
2. **Value of Fixed Assets after refund of grant**
   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at ₹ 44 lakhs.
3. **Amount of depreciation for remaining two years**
   Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

Question 25

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

(i) ₹120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.

(ii) ₹15 Lacs Grant received from Central Government on installation of Effluent Treatment Plant.

(iii) ₹125 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants". (*5 Marks*)

Question 26

Suraj Limited provides you the following information:

(i) It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores,

(ii) It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region;

(iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.

(iv) It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.

(v) It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited. (*Question Paper, May 2022*) (*5 Marks*)

Question 27

(i) Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2020.

The company debited the said amount to its machinery account in 2020 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

(ii) ABC Ltd. received two acres of land received for set up of plant. It also received ₹2 lakhs received for purchase of machinery of ₹ 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis. How should ABC Ltd. recognize these government grants in its books of accounts?

Answer

(i) As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

(ii) ABC Ltd. should recognize the grants in the following manner:

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of ₹ 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹ 10 lakhs – ₹ 2 lakhs = ₹ 8 lakhs and depreciation will be charged on it as follows: ₹ 8 lakhs/ 5 years = ₹ 1.60 lakhs per year.

Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 40,000 [₹ 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 28

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019& 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation.

(*5 marks*)

Answer

As per 12 "Accounting for government grants", grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Amount of depreciation and grant to be recognized in the profit and loss account each year

Depreciation per year:

	₹ in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year **(**70lakhs/4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Question 29

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2016-17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2019-20, due to non- compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 in profit and loss account?

(*5 Marks*)

Answer

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2019-20. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

Question 30

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1-20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

(*Old Study Material*)

Answer

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

Question 31

On 01.04.2017, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method. The company had to refund the entire grant in 2nd April, 2020 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant. How do you deal with the refund of grant to the Government in the books of XYZ Ltd. as per AS 12?

(MTP, October, 2020) (*5 Marks*)

Answer

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 2017	Acquisition cost of machinery (₹ 500 – ₹ 100)	400.00
31st March, 2018	*Less*: Depreciation @ 20%	(80)
1st April, 2018	Book value	320.00
31st March, 2019	*Less*: Depreciation @ 20%	(64)

		(₹ in lakhs)
1st April, 2019	Book value	256.00
31st March, 2020	*Less*: Depreciation @ 20%	(51.20)
1st April, 2020	Book value	204.80
2nd April, 2020	*Add*: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 32

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non- compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20.

(*5 Marks*) (*November 2020*)

Answer

		(₹ in lakhs)
1st April, 2016	Acquisition cost of machinery Less: Government Grant	300.00
		60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253
(Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)			

Question 33

Caseworker Limited received a specific grant of ₹ 6 crore for acquiring the plant of ₹ 30 crore during financial year 2015-2016 having useful life of 10 years. During the financial year 2020- 2021, due to non-compliance of conditions laid down for the grant of ₹ 6 crore, the company had to refund the grant to the Government. What should be the treatment of the refund if grant was deducted from the cost of the plant during financial year 2015-2016? Assume depreciation is charged on fixed assets as per Straight Line Method.

(*MTP, November, 2021*) (*5 Marks*)

Answer

As per AS 12, the amount refundable in respect of grant related to specific fixed assets should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, *as appropriate*, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

Where grant was deducted from the cost of the asset, initial value of the plant after deduction of grant amount of ₹ 6 crore would have been = ₹ 30 crore – ₹ 6 crore = ₹ 24 crore.

Carrying value of the plant after 5 years on 1.4.2020 = [(₹ 24 crore/10 years) x 5 years] = ₹ 12 crore.

Annual depreciation charge would be ₹ 2.4 crore.

On refund of grant to the Government, the book value of the plant shall be increased by ₹ 6 crore i.e. ₹ 12 crore + ₹ 6 crore = ₹ 18 crore. The increased cost of ₹ 18 crore of the plant should be amortised prospectively over remaining 5 years of useful residual life. Depreciation charge in the year 2020-2021 would be ₹ 18 crore/5 years = ₹ 3.6 crore instead of earlier ₹ 2.4 crore.

Question 34

D Ltd. acquired a machine on 01-04-2017 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

You are required to explain how should the company deal with this asset in its accounts for 2020-21?

(*RTP, November 2021*)

Answer

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2020-21 or 2021-22 as the depreciable amount is now Nil.

Question 35

Ram Ltd. purchased machinery for ₹80 lakhs, (useful life 4 years and residual value ₹8 lakhs). Government grant received is ₹32 lakhs.

You are required to show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant is credited to Fixed Assets A/c.

(*MTP April, 2018*) (*5 Marks*)

Answer:

In the books of Ram Ltd.

If the grant is credited to Fixed Assets Account:

1. **Journal Entry (at the time of refund of grant)**

			In lakhs ₹	In lakhs ₹
I	Fixed Assets	Dr.	32	
	To Bank A/c			32
	(Being grant refunded)			

2. **Value of Fixed Assets after two years but before refund of grant**

Fixed assets initially recorded in the books = ₹80 lakhs - ₹32 lakhs
= ₹48 lakhs

Depreciation for each year = (₹48 lakhs - ₹8 lakhs)/4 years
= ₹10 lakhs per year for first two years.

Value of the assets before refund of grant = ₹48 lakhs - ₹20 lakhs
= ₹28 lakhs

3. **Value of Fixed Assets after refund of grant**

Value of Fixed Assets before refund of grant	₹28 lakhs
Add Refund of grant	₹32 lakhs
	₹60 lakhs

4. **Amount of depreciation for remaining two years**

Value of the fixed assets after refund of grant-residual value of the assets/No. of years
= ₹60 lakhs - ₹8 lakhs/2
= ₹26 lakhs per annum will be charged for next two years.

Question 36

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2022. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

(*RTP November, 2022*)

Answer

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Question 37

Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2022. The company debited the said amount to its machinery account in 2022 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2022 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

(*RTP May, 2023*)

Answer

As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

Question 38

On 1st April 2021, Eleanor Limited purchased a manufacturing Plant for ₹60 lakhs, which has an estimated useful life of 10 years with a salvage value of ₹10 lakhs. On purchase of the Plant, a grant of ₹20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

(i) If the grant amount is deducted from the value of Plant.
(ii) If the grant is treated as deferred income
(iii) If the grant amount is deducted from the value of Plant, but at the end of the year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions.
(iv) If the grant is treated as the promoter's contribution.

(Assume depreciation on the basis of Straight-Line Method.)

(*G-I, May, 2023*) (*5 Marks*)

Question 39

A Ltd. purchased a Machinery for ₹ 75 Lakhs. Government Grant received towards this Machinery is ₹ 10, Lakhs. Residual Value of Machinery at the end of useful life of 6 Years is ₹ 5 Lakhs.

Asset is shown in Balance Sheet at net of grant.

At the beginning of the 3rd year, an amount becomes refundable to the extent of ₹ 8 Lakhs due to non-compliance of certain conditions of grant.

You are required to give necessary Journal entries for the 1st year and the 3rd year in the books of A Ltd.

(*4 Marks*) (*Exam. November, 2023*) (*Accounts*)

MCQs

Question - 1: What is accounting treatment of government grant refundable which was in the nature of promoters' contribution?

Answer:

1. *Debited to profit & loss account*
2. *Added in the Cost of Fixed asset*
3. *Reduced from Deferred Government Grant account*
4. *Reduced from Capital Reserve*

Question - 2: What is accounting treatment of government grant refundable which was in the nature of promoters' contribution?

Answer:

1. *Debited to profit & loss account*
2. *Added in the Cost of Fixed asset*
3. *Reduced from Deferred Government Grant account*
4. *Reduced from Capital Reserve*

Question - 3: A government grant that becomes refundable is treated as:

Answer:

1. *Ordinary item*
2. *Prior Period Item*
3. *Change in Accounting Policy*
4. *Extra Ordinary item*

Question - 4: Entity X purchased a fixed asset of ₹160 Cr having useful life of 10 years. Government provided grant of ₹60 Cr. After 4 years, entity had to refund the grant of ₹20 Cr due to non-fulfilment of a condition. Kindly provide the amount of depreciation to be charged in year 5. Assume - Company follows SLM method of depreciation & grant amount is reduced from the gross block of fixed asset.

Answer:

1. *₹16 Cr*
2. *₹12 Cr*
3. *₹13.33 Cr*
4. *₹15 Cr*

Question - 5: Following is not a government grant:

Answer:

1. *Purchase of Diesel by Indian Railways*
2. *Amount from government for establishing setup in backward area*
3. *Land from Rajasthan government at a concessional rate*
4. *Subsidy from Ministry of External Affairs to purchase from Indian Vendor*

Question - 6: AS 12 "Accounting for Government Grants" is not applicable for following:

Answer:

1. *Subsidy from Government*
2. *Cash incentives from Government*
3. *Government participation in the ownership of the company*
4. *Duty Drawback from Government*

Question - 7: Entity A received government grant of ₹500 Cr on 01.10.2022 for investment in capital assets having useful life of 10 years. As on 31.03.2023, no amount could be capitalized in the books as the assets were not ready for use. What should be the amount to be credited to statement of Profit & Loss out of Deferred Government Grant account in FY 2022-23?

Answer:

1. *₹500 Cr*
2. *ZERO*
3. *₹50 Cr*
4. *₹25 Cr*

Question - 8: Entity X purchased a fixed asset of ₹160 Cr having useful life of 10 years. Government provided grant of ₹60 Cr. After 4 years, entity had to refund the grant of ₹20 Cr due to non-fulfilment of a condition. Kindly provide the amount of depreciation to be charged in year 5. Assume - Company follows SLM method of depreciation & grant amount is maintained separately under Deferred Grant account.

Answer:

1. *₹16 Cr*
2. *₹12 Cr*

3. *₹13.33 Cr*
4. *₹15 Cr*

Question - 9: At what value government grant is recorded in books in case a non-monetary asset is given free of cost?

Answer:

1. *Fair value*
2. *Nominal Value*
3. *Concessional rate*
4. *Should not be recorded*

Question - 10: To encourage industrial promotion, IDCI offers subsidy worth ₹50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy should be accounted in the books?

Answer:

1. *Credit it to capital reserve*
2. *Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations*
3. *Both (a) and (b) are permitted*
4. *Credit it to general reserve*

Question - 11: Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be

Answer:

1. *recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.*
2. *recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.*
3. *recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.*
4. *disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item*

Question - 12: Which of the following is an acceptable method of accounting presentation for a government grant relating to an asset?

Answer:

1. *Credit the grant immediately to Income statement*
2. *Show the grant as part of Capital Reserve*
3. *Reduce the grant from the cost of the asset or show it separately as a deferred income on the Liability side of the Balance Sheet.*
4. *Show the grant as part of general Reserve*

Question - 13: X Ltd. has received a grant of ₹20 crore for purchase of a qualified machine costing ₹80 crore. X Ltd has a policy to recognise the grant as a deduction from the cost of the asset. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of annual depreciation to be charged as an expense in Profit and Loss Statement will be:

Answer:

1. *₹10 crore*
2. *₹6 crore*
3. *₹2 crore*
4. *₹8 crore*

Question - 14: X Ltd has received a grant of ₹20 crore for purchase of a qualified machine costing ₹80 crore. X Ltd. has a policy to recognise the grant as deferred income. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of other income to be to be recognised in Profit and Loss Statement will be:

Answer:

1. *₹10 crore*
2. *₹6 crore*
3. *₹2 crore*
4. *₹8 crore*

Answer

Q1	***4***	***Q2***	***4***	***Q3***	***4***	***Q4***	***3***
Q5	***1***	***Q6***	***3***	***Q7***	***2***	***Q8***	***1***
Q9	***2***	***Q10***	***1***	***Q11***	***3***	***Q12***	***3***
Q13	***2***	***Q14***	***3***				

CHAPTER 13

Accounting Standard 16
Borrowing Costs

Question 1

PRM Ltd. obtained a loan from a bank for ₹120 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	***Amount (₹ in lakhs)***
Construction of a shed	*50*
Purchase of a machinery	*40*
Working Capital	*20*
Advance for purchase of truck	*10*

Construction of shed was completed in March 20X2. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-20X2 was ₹18 lakhs. Show the treatment of interest.

(*Source: Illustration 1, Study Material*)

Answer

Qualifying Asset as per AS 16 = ₹50 lakhs (construction of a shed) Borrowing cost to be capitalised = 18 x 50/120 = ₹7.5 lakhs

Interest to be debited to Profit or Loss account = ₹(18 – 7.5) lakhs = ₹10.5 lakhs

Question 2

X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹1 lakh special loan to finance the construction of the building on 1st January, 20X1 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	***Rate of Interest***
₹5,00,000	*11%*
₹9,00,000	*13%*

The expenditures that were made on the building project were as follows:

		₹
January	*20X1*	*2,00,000*
April	*20X1*	*2,50,000*
July	*20X1*	*4,50,000*
December	*20X1*	*1,20,000*

Building was completed by 31st December 20X1*. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.*

(*Source: Illustration 2, Study Material*)

Answer

(i) Computation of weighted average accumulated expenses

		₹
₹2,00,000 x 12 / 12	=	2,00,000
₹2,50,000 x 9 / 12	=	1,87,500
₹4,50,000 x 6 / 12	=	2,25,000
₹1,20,000 x 1 / 12	=	10,000
		6,22,500

(ii) Calculation of weighted average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)	
5,00,000	11%	=	55,000
9,00,000	13%	=	1,17,000
14,00,000			1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000}\times 100\right)$		=	12.285% (approx.)

(iii) Interest on weighted average accumulated expenses

		₹
Specific borrowings (₹1,00,000 x 10%)	=	10,000
Non-specific borrowings (₹5,22,500 x 12.285%)	=	64,189
Amount of interest to be capitalised	=	74,189

(iv) Total expenses to be capitalized for building

				₹
Cost of building ₹(2,00,000 + 2,50,000 + 1,20,000)	+	4,50,000	+	10,20,000
Add: Amount of interest to be capitalised				74,189
				10,94,189

(v) Journal Entry

Date	Particulars		Dr. (₹)	Cr. (₹)
31.12. 20X1	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building And borrowing cost thereon capitalised)			

Question 3

The company has obtained Institutional Term Loan of ₹580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to ₹406 lakhs, ₹58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹580 lakhs.

(*Source: Illustration 3, Study Material*)

Answer

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of ₹52.20 lakhs can be given as:

Purpose	Nature	Interest to be capitalised	Interest to be charged to profit and loss account
		₹ in lakhs	₹in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	$** 52.20 \times \frac{406}{580} = 36.54$	
Advance to Supplies for additional assets	Qualifying asset	$** 52.20 \times \frac{58}{580} = 5.22$	$** 52.20 \times \frac{116}{580} = 10.44$
Working Capital	Not a qualifying asset		
		41.76	10.44

** A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.*

*** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 20X2.*

Question 4

Take Ltd. has borrowed ₹30 lakhs from State Bank of India during the financial year 20X1-20X2. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹50 lakhs. As on 31st March, 20X2, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹4 lakhs and add it to the cost of investments. Comment.

(*Source: Illustration 4, Study Material*)

Answer

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 20X2.

Reference: The students are advised to refer the full text of AS 16 “Borrowing Costs” (issued 2000).

Question 5

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain the provision.

(*Source: Question 6, Study Material*)

Answer

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 6

H Ltd. incurs borrowing costs for the purpose of construction of a qualifying asset for its own use. The construction gets completed on May 31, 20X1. However, decoration work is under process which is expected to be completed by November 20X1 after which H Ltd. will be able to start using the said asset for its own use. H Ltd. wants to capitalize the eligible borrowing costs incurred up to November 20X1.

(*Source: Question 7, Study Material*)

Answer

The capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale is completed.

In the given case, H Ltd. should capitalize borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 20X1. The fact that decoration work was being carried out should not be considered as the asset was ready for its intended use on May 31, 20X1.

Question 7

ABC Ltd. is in the process of getting an entertainment park constructed. For this purpose, it has taken loan from a bank. The said park consists of several rides and facilities, each of which can be used individually. Three fourth part of the park has been constructed and can be opened up for public, while construction on the remaining part is continuing. Whether the capitalization of borrowing cost should continue for the whole park until construction continues?

(*Source: Question 8, Study Material*)

Answer

ABC Ltd. is in process of constructing an entertainment park which consists of several rides and facilities that can operate independently for their intended use. Even though the park as whole is not complete, the individual facilities are ready for their intended use.

The cessation of capitalization depends upon the nature of the qualifying assets, particularly where the qualifying assets consists of various parts. There are qualifying assets where each part is capable of being used while the construction continues on other parts. There are qualifying assets where all parts have to be completed before any earlier completed part can be put to use.

Since in the given scenario, the individual facilities are capable of operating independently and are ready for their intended use, therefore the borrowing costs shall cease to be capitalized for the three-fourth part of the project.

Question 8

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹32 crores to be utilised as under:

(i)	*Construction of sealink across two cities:* *(work was held up totally for a month during the year due to high water levels)*	*: ₹25 crores*
(ii)	*Purchase of equipments and machineries*	*: ₹3 crores*
(iii)	*Working capital*	*: ₹2 crores*
(iv)	*Purchase of vehicles*	*: ₹50,00,000*
(v)	*Advance for tools/cranes etc.*	*: ₹50,00,000*
(vi)	*Purchase of technical know-how*	*: ₹2 crores*
(vii)	*Total interest charged by the bank for the year ending 31st March, 20X2*	*: ₹80,00,000*

Show the treatment of interest by Amazing Construction Ltd.

(*Source: Question 9, Study Material*)

Answer

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalised ₹	Interest to be charged to Profit & Loss A/c ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000 x (25/32)]
Purchase of equipment and machineries	No		7,50,000	[80,00,000 x (3/32)]
Working capital	No		5,00,000	[80,00,000 x (2/32)]
Purchase of Vehicles	No		1,25,000	[80,00,000 x (0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000 x (0.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000 x (1/32)]
Total		62,50,000	17,50,000	

*It is assumed that work held up for a month due to high water level is normal during the construction of sealink and capitalization of borrowing cost should not be suspended for necessary temporary delay.

Question 9

Rainbow Limited borrowed an amount of ₹150 crores on 1.4.20X1 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹19.50 crores for the accounting period ending on 31.3.20X2. Due to surplus fund out of ₹150 crores, income of ₹3.50 crores were earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(*Source: Question 10, Study Material*)

Answer

Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings."

The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Thus, the treatment of accountant of Rainbow Ltd. is incorrect.

Amount of borrowing costs capitalized should be calculated as follows:

Particulars	₹ in crores
Actual interest for 20X1-20X2 (11% of ₹150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 20X1-20X2	13.00

Question 10

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I	***Phase II***	***Phase III***	***Phase IV***
	₹	₹	₹	₹
Cash expenditure	*10*	*30*	*25*	*30*
Building purchased	*24*	*34*	*30*	*38*
Total expenditure	*34*	*64*	*55*	*68*
Total expenditure of all phases				*221*
Loan taken @ 15% at the beginning of the year				*200*

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

(*Source: Question 11, Study Material*)

Answer

Computation of amount to be capitalized

No.	Particulars	₹
1.	Interest expense on loan ₹2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (₹34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹55,00,000 + ₹68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	3,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹6,65,158.50 (i.e. ₹13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹6,65,158.50 (i.e. ₹13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

For Phase III and Phase IV

Interest of ₹16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

QUESTION BANK

Question 11

M/s First Ltd. began construction of a new factory building on 1st April, 2017. It obtained ₹ 2,00,000 as a special loan to fiancé the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (₹)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (₹)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS-16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

(*May 2019*) (*5 Marks*)

Answer

(i) Computation of average accumulated expenses

		₹
₹ 3,00,000 x 12 / 12	=	3,00,000
₹ 2,40,000 x 10 / 12	=	2,00,000
₹ 4,00,000 x 8 / 12	=	2,66,667
₹ 3,60,000 x 3 / 12	=	90,000
		8,56,667

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	14%	= 42,000
		1,38,000
Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000}\times 100\right)$		= 11.5%

(iii) Amount of interest to be capitalized

		₹
Interest on average accumulated expenses:		
Specific borrowings (₹ 2,00,000 x 8%)	=	16,000
Non-specific borrowings (₹ 6,56,667* x 11.5%)	=	75,517
Amount of interest to be capitalized	=	91,517

* (₹ 8,56,667 – ₹ 2,00,000)

(iv) Total expenses to be capitalised for building

	₹
Cost of building ₹ (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517
	13,91,517

(v) **Journal Entry**

Date	Particulars		Dr. (₹)	Cr. (₹)
31.3.2018	Building A/c	Dr.	13,91,517	
	To Building WIP** A/c			13,00,000
	To Borrowing costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

*** Considering that ₹ 13,00,000 was debited to Building WIP A/c earlier.*

Question 12

Zebra Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

	₹
1st April, 2021	10,00,000
1st August, 2021	24,00,000
1st January, 2022	4,00,000

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2022.

You are required to:

(a) Calculate the amount of interest to be capitalized as per the provisions of AS-16 "Borrowing Cost".

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

(*Question Paper, May 2022*) (*5 Marks*)

Question 13

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores
(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ 1crore
(v)	Advances for tools/cranes etc .	₹ 1crore
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2018	₹ 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(*RTP May 2019*)

Answer:

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	***Interest to be capitalized ₹ in crores***	***Interest to be charged to Profit & Loss A/c ₹ in crores***	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No		0.05	1.6/64 x 2
Total		1.25	0.35	

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

Question 14

A company incorporated in June 2017, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

(*RTP November 2018*) (*MTP April, 2022*) (*5 Marks*)

Answer:

As per para 3.2 to AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Further, Explanation to the above para states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 15

In May, 2016, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2017 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2017 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP May 2018*)

Answer:

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2017) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 16

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US $ and the rate as on31st March, 2017 was ₹ 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(*MTP March 2019*) (*5 Marks*)

Answer

(i) Interest for the period 2016-17
= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 17

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

Particulars	Amount (₹ in lakhs)
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹11,00,000. During the year 2016-17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹2,00,000.

Explain the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(*MTP August, 2018*) (*5 Marks*)

Answer

As per AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be Capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
(i)	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
(ii)	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000 x 35/100 = ₹ 3,15,000
(iii)	Working Capital	Not a Qualifying Asset	NIL	9,00,000 x 25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 18

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

Particulars	*Amount (₹ in lakhs)*
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹ 11,00,000. During the year 2016 -17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(*MTP October, 2018*) (*5 Marks*)

Answer

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

Sr. No.	*Particulars*	*Nature of assets*	*Interest to be Capitalized (₹)*	*Interest to be charged to Profit & Loss Account (₹)*
(i)	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
(ii)	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000
(iii)	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 19

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2017 was ₹ 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(*MTP March 2018*) (*5 Marks*)

Answer:

(i) Interest for the period 2016-17
= US $ 10 lakhs x 4% x ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs x ₹ (62 - 56) = ₹60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs x ₹56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹58.80 lakhs 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 20

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath: (work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved)	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores
(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ Icrore
(v)	Advances for tools/cranes etc.	₹ Icrore
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2016	₹ 1.6 crores

You are required to show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(*MTP April, 2018*) (*5 Marks*)

Answer

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be Capitalized ₹ in crores	Interest to be charged to Profit & Loss A/c ₹ in crores	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64x6
Working capital	No		0.10	1.6/64x4
Purchase of vehicles	No		0.025	1.6/64x1
Advance for tools, cranes etc.	No		0.025	1.6/64x1
Purchase of technical know-how	No		0.05	1.6/64x2
Total		1.25	0.35	

***Note**: It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

Question 21

In May, 2018, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2019 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2019 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP November 2019*)

Answer

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2019) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 22

Govind Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.04.2018, to be utilized as under:

Particulars	*Amount (₹ in lakhs)*
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹ 12,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 3,00,000.

You are required to show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

[*RTP May 2020*]

Answer

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 12,00,000 – ₹ 3,00,000

= ₹ 9,00,000

Sr. No.	***Particulars***	***Nature of assets***	***Interest to be capitalized (₹)***	***Interest to be charged to Profit & Loss Account (₹)***
(i)	Construction of factory building	Qualifying Asset	9,00,000x40/100 = ₹ 3,60,000	NIL
(ii)	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000

Sr. No.	***Particulars***	***Nature of assets***	***Interest to be capitalized (₹)***	***Interest to be charged to Profit & Loss Account (₹)***
(iii)	Working Capital Total	Not a Qualifying Asset	NIL ₹ 3,60,000	9,00,000x25/100 = ₹ 2,25,000 ₹ 5,40,000

Question 23

Vital Limited borrowed an amount of ₹150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund out of ₹150 crores, an income of ₹ 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

[*RTP, November 2020*]

Answer

Para 10 of AS 16 'Borrowing Costs' states that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2019-20 should be calculated as follows:

Actual interest for 2019-20 (10% of ₹ 150 crores)	₹ 15.00 crores
Less: Income on temporary investment from specific borrowings	(₹ 1.50 crores)
Borrowing costs to be capitalized during year 2019-2020	₹ 13.50 crores

Question 24

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

[*RTP, November 2020*]

Answer

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 25

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

(*5 Marks*)

Answer

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 26

When capitalisation of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

Answer

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 27

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

	₹ (in lakhs)
Construction for factory shed	240
Purchase of Machinery	30
Working capital	24
Purchase of Vehicles	12
Advance for tools/cranes etc.	8
Purchase of technical know how	6

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was ₹ 40 lakhs.

In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets.

(5 Marks) (November 2020)

Answer

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are non-qualifying assets and related borrowing cost will be charged to Profit and Loss statement.

Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs.

Note: Assumed that construction of factory shed completed on 31st March, 2020.

Question 28

When capitalisation of borrowing cost should cease as per Accounting Standard 16?

(*Old Study Material*)

Answer

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Question 29

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under:

(i)	Construction of sealink across two cities: (work was held up totally for a month during the year due to high water levels)	:	₹ 25crores
(ii)	Purchase of equipments and machineries	:	₹ 3 crores
(iii)	Working capital	:	₹ 2 crores
(iv)	Purchase of vehicles	:	₹ 50,00,000
(v)	Advance for tools/cranes etc.	:	₹ 50,00,000
(vi)	Purchase of technical know-how	:	₹ 1 crores

(vii) Total interest charged by the bank for the year ending 31st March, 20X2 : ₹ 80,00,000

Show the treatment of interest by Amazing Construction Ltd.

(*Old Study Material*)

Answer

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	***Interest to be capitalised ₹***	***Interest to be charged to Profit & Loss A/c ₹***	
Construction of sea-link	Yes	62,50,000		[80,00,000x(25/32)]
Purchase of equipments and machineries	No		7,50,000	[80,00,000x(3/32)]
Working capital	No		5,00,000	[80,00,000x(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000x(0.5/32)]
Purchase of technical know- how	No		2,50,000	[80,00,000x(1/32)]
Total		62,50,000	17,50,000	

Question 30

Suhana Ltd. issued 12% secured debentures of ₹100 Lakhs on 01.05.2018, to be utilized as under:

Particulars	**Amount (₹ in lakhs)**
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹11,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

[MTP October, 2019, 5 marks]

Answer

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000-₹ 2,00,000

= ₹ 9,00,000

Sr. No.	**Particulars**	**Nature of assets**	**Interest to be Capitalized (₹)**	**Interest to be charged to Profit & Loss Account (₹)**
i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹3,60,000	Nil
ii	Purchase of Machinery	Not a Qualifying Asset	Nil	9,00,000x35/100 = ₹3,15,000
iii	Working Capital	Not a Qualifying Asset	Nil	9,00,000x25/100 = ₹2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Question 31

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment of loan exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2020 was ₹ 62 per US $. If Omega Limited had borrowed the loan in India in

Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards. (*4 Marks*)

Answer

(i) Interest for the period 2019-20
= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

Question 32

ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'.

(*MTP, November, 2021*) (*5 Marks*)

Answer

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	***Period of outstanding balance***	***Amount of loan (₹)***	***Rate of interest p.a.***	***Weighted average amount of interest (₹)***
	a	***b***	***c***	***d = [(b x c) x (a/12)]***
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		2,26,000

Weighted average cost of borrowings
= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest/Weighted average of general borrowings) x 100] = [(2,26,000/24,33,334) x 100] = 9.29% p.a.

Question 33

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2021 amounted to ₹ 25 lakhs. The company wants to treat ₹ 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP, November 2021*)

Answer

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 34

(a) An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally

commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?

(b) Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress?

(RTP May, 2022)

Answer

(a) As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

(b) As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete". The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the cost of the asset.

Question 35

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I	Phase II	Phase III	Phase IV
	₹	₹	₹	₹
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

(*RTP November, 2022*)

Answer

	Particulars	₹
1.	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (₹ 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹ 55,00,000 + ₹ 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate $\text{Loan amount} = \frac{30,00,000}{2,21,00,000} \times 98,00,000$	3,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on $\text{proportionate Loan amount} == \frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment:

1. For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to

respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.

2. For Phase III and Phase IV

Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Question 36

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2021. Money raised from debentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:

(i) Interest on debentures for the Financial Year 2021-2022 was paid by the Company.

(ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

(iii) In March, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).

(iv) In March 2022, Machinery was installed and ready for its intended use.

(v) Furniture was put to use at the end of March 2022.

(vi) Truck is going to be received in April, 2022.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2022 in the Books of Expert Limited.

(*RTP May, 2023*)

Answer

According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As per the Standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = ₹ 10,00,000 (100 lakhs x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory building	Qualifying Asset	9,50,000 x 40/100 = ₹ 3,80,000	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100 = 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	9,50,000x2/100 =19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100 = 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100 = ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

Question 37

On 1st April, 2022 Workhouse Limited took a loan from a Financial Institution for ₹25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

(i) 8% Debentures ₹15,00,000

(ii) 15% Term Loan ₹30,00,000

(iii) 10% Other Loans ₹18,00,000

The company has utilised the above funds in construction/purchase of the following assets :

(i)	Building	₹70,00,000
(ii)	Furniture	₹22,00,000
(iii)	Plant & Machinery	₹90,00,000
(iv)	Factory Shed	₹43,00,000

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 151 April 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets.

(*G-I, May, 2023*) (*5 Marks*)

Question 38

Glen Ltd. began construction of a new building on 1st January, 2022. On 1st April, 2022, following two loans were obtained to fund the construction cost:

- *Loan of ₹ 60,00,000 from Data Bank Ltd. was taken at interest rate of 8% per annum. This loan was fully utilized for construction of the new building.*
- *Loan of ₹ 20,00,000 from Satya Bank Ltd. Out of this, loan amount of ₹ 6,00,000 was utilized for working capital purpose. Total interest of ₹ 1,92,000 were paid to Satya Bank Ltd. for the financial year 2022-23.*

Construction of the new building was completed on 31st January, 2023 and was ready for its intended use on the same date.

None of the loan was repaid during the year. The building is a qualifying asset for the purpose of AS-16.

Out of loan from Data Bank Ltd., surplus funds were temporarily invested for the short period of time. This temporary investment earned interest of ₹ 30,000.

You are required to calculate the amount of interest (a) to be capitalized, (b) to be charged to profit and loss account from the total interest incurred as borrowing cost during the year 2022-23 (as per AS-16).

(*Suggested November, 2023*) (*5 Marks*)

Answer

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The standard also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost on Loan of data bank to be capitalized:

= ₹(60,00,000 x 8%)x 10/12 - ₹30,000

= ₹4,00,000 - ₹ 30,000

= ₹3,70,000

Loan	***Particulars***	***Nature of assets***	***(a) Interest to be Capitalized (₹)***	***(b) Interest to be charged to Profit & Loss Account (₹)***
Data bank	Construction of factory building	Qualifying Asset	3,70,000	(4,80,000 - 4,00,000) 80,000
Satya Bank	Construction Of factory building	Qualifying Asset	(1,92,000x14/20) x 10/12 = 1,12,000	(1,92,000 x 14/20) x 2/12 = 22,400
Satya Bank	Working Capital	Not a Qualifying Asset	NIL	(1,92,000x6/20) = ₹57,600
	Total		₹4,82,000	₹1,60,000

Note: Loan from Satya bank is considered to be specific borrowings.

(*5 Marks*) (*November, 2023*) (*Accounts*)

Question 39

Raj & Co. Has taken a loan of US$ 20,000 at the beginning of the financial year for a specific project at an interest rate of 6% per annum, payable annually. On the day of taking loan, the exchange rate between currencies was ₹ 48 per 1 US$. The Exhange rate at the closing of the financial year was ₹ 50 per 1 US$. The corresponding amount could have been borrowed by the company in indian Rupee at an interest rate of 11% per annum.

Determine the treatment of borrowing cost in the boks of accounts.

(4 Marks) (RTP November, 2023) (Accounts)

Answer

Interest on Foreign Currency Loan:

= US $ 20,000 x₹ 50 per US $ x 6% = ₹ 60,000.

Foreign Exchange Loss on Foreign currency loan:

= US$ 20,000 x₹ (50-48) = ₹ 40,000.

Interest that would have been if the loan was taken in Indian currency i.e. local currency:

= US $ 20,000 x 48 x 11% = ₹1,05,600

Difference between interest on local currency borrowing and foreign currency borrowing:

= ₹ 1,05,600 - ₹ 60,000 = ₹45,600

The entire exchange difference of 40,000 would be considered as borrowing costs. The total borrowing cost would be ₹ 100000 (₹ 60000+ ₹ 40000).

Question 40

H Ltd. began the construction of a new building on 1st April 2022. It obtained a special loan of ₹ 6,00,000 on 1st April 2022 at an interest of 12% to finance the construction of the building.

The company's other outstanding two non-specific loans on 1st April, 2022 were as follows:

Amount in ₹	Rate of Interest
30,00,000	14%
54,00,000	16%

The expenditure incurred on the building project was as per detail given below:

	Amount in ₹
1st May, 2022	12,00,000
1st July, 2022	15,00,000
1st October, 2022	27,00,000
1st March, 2023	7,20,000

The building was completed by 31st March 2023.

Following the provisions of Accounting Standard 16, you are required to calculate the amount of interest to be capitalized and also give one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

(*RTP May, 2024*)

Answer

Interest amount to be capitalized

		₹
Specific borrowings (₹ 6,00,000 x 12%)	=	72,000
Non-specific borrowings		
[₹ 30,35,000 (₹ 36,35,000 – ₹ 6,00,000) x 15.29%*]	=	4,64,052
Amount of interest to be capitalized	=	5,36,052

Journal Entry for capitalizing cost and borrowing cost

Date	Particulars		Dr. (₹)	Cr. (₹)
31.3.2023	Building account (Cost of building ₹ 61,20,000 + borrowing cost ₹ 5,36,052) To Bank account (Being amount of cost of building and borrowing cost thereon capitalized)	Dr.	66,56,052	 66,56,052

Working notes:

(i) **Computation of average accumulated expenses**

		₹
₹ 12,00,000 x 11 / 12	=	11,00,000
₹ 15,00,000 x 9 / 12	=	11,25,000
₹ 27,00,000 x 6 / 12	=	13,50,000
₹ 7,20,000 x 1 / 12	=	60,000

61,20,000		36,35,000

(ii) **Calculation of average interest rate other than for specific borrowings**

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
30,00,000	14%	=	4,20,000
54,00,000	16%	=	8,64,000
84,00,000			12,84,000
Weighted average rate of interest $\left(\frac{12,84,000}{84,00,000} \times 100\right)$		=	15.29%* (Rounded off)

Question 41

On 1st April, 2023, Green Limited started the construction of an Office Building (qualified asset). The land under the building is regarded as a separate asset and is not a part of qualifying asset.

For the purpose of construction of building, the company raised a specific loan of ₹14 lakhs from a Bank at an interest rate of 12% per annum. An interest income of ₹15,000 was earned on this loan while it was held in anticipation of payments.

The company's other outstanding loans on 1st April, 2023 were as follows

Amount of Loan	Rate of Interest per annum
₹ 20,00,000	15%
₹ 30,00,000	8%

The construction of building started on 1st April, 2023 and was completed on 31st January, 2024 when it was ready for its intended use. Up to the date of completion of the building, the following payments were made to the contractor:

Payment date	Amount in ₹
1st April, 2023	4,00,000
1st August, 2023	10,00,000
1st December, 2023	25,00,000
31st January, 2024	5,00,000

The life of building is estimated to be 20 years and depreciation is calculated on straight line method.

You are required to:

(i) Calculate the amount of borrowing cost to be capitalized.

(ii) Pass initial journal entry to recognise the cost of building.

(iii) Depreciation on building for the year ending 31st March, 2024.

(iv) Carrying value of building on 31st March, 2024.

(*Question Paper May, 2024) (7 Marks*)

MCQs

Question - 1: Following will not be considered as borrowing cost.

Answer:

1. *amortisation of discounts or premiums relating to borrowings*
2. *finance charges in respect of assets acquired under finance leases or under other similar arrangements*
3. *exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs*
4. *Interest and commitment charges on bank borrowings on non qualifying assets*

Question - 2: What is the correct treatment of income from temporary investment from borrowed fund pending expenditure on qualifying asset.

Answer:

1. *Income is deducted from borrowing cost.*
2. *Income is credited to P&L account.*
3. *Income is deducted from PPE.*
4. *Income is deducted from borrowing amount.*

Question - 3: Borrowing cost of a qualifying asset does not include

Answer:

1. *Finance charges in respect of assets acquired under finance lease*
2. *Exchange differences arising from foreign currency borrowing*
3. *Interest charges on bank borrowing*
4. *Loss on sale of investment*

Question - 4: As per AS 16, all the following are qualifying assets except

Answer:

1. *Manufacturing plants and Power generation facilities*
2. *Inventories that require substantial period of time*
3. *Assets those are ready for sale.*
4. *None of the above*

Question - 5: Which of the following statement is correct:

Answer:

1. *Entire exchange gain is reduced from the cost of the Qualifying asset.*
2. *Entire exchange loss is added to the cost of a Qualifying asset.*
3. *No adjustment is done for the exchange loss while computing cost of Qualifying asset.*
4. *None of the above*

Question - 6: Capitalisation rate considers:

Answer:

1. *Borrowing costs on general borrowings only.*
2. *Borrowing costs on general and specific borrowings both.*
3. *Borrowing costs on specific borrowings only*
4. *None of the above*

Question - 7: If the amount eligible for capitalisation in case of inventory as per AS 16 is ₹12,000 and cost of inventory is ₹40,000 and its net realizable value is ₹45,000; What amount can be capitalised as a part of inventory cost.

Answer:

1. *₹12,000.*
2. *₹5,000.*
3. *₹7,000.*
4. *₹10,000.*

Question - 8: X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

Answer:

(i) *15th May, 20X1: Loan interest relating to the project starts to be incurred*

(ii) *2nd June, 20X1: Technical site planning commences*

(iii) 19th June, 20X1: Expenditure on the project started to be incurred

(iv) 18th July, 20X1: Construction work commences

Identify the commencement date for capitalisation under AS 16.

1. *15th May, 20X1.*
2. *19th June, 20X1.*
3. *18th July, 20X1.*
4. 2nd June, 20X1

Question - 9: Gyan Ltd. borrowed ₹ 10 crore for construction of a plant at the rate of 10% per annum (interest paid annually ₹ 1 crore). The construction was being carried on and out of the borrowings, ₹ 4 crore was temporarily placed in a fixed deposit at the rate of 6% per annum (interest earned ₹ 24 lakh). At the year end, how much cost of borrowing Gyan Limited will capitalise?

Answer:

(a) Interest paid on ₹ 10 crore i.e. ₹ 1 crore

(b) Interest paid on ₹ 6 crore as only this amount was utilized i.e. ₹ 60 Lakh.

(c) Interest paid less income on temporary investment i.e. ₹ 76 lakh

(d) Nothing will be capitalized

Answer

Q1	***4***	***Q2***	***1***	***Q3***	***4***	***Q4***	***3***
Q5	***3***	***Q6***	***1***	***Q7***	***2***	***Q8***	***2***
Q9	***3***						

CHAPTER 14

Accounting Standard 17
Segment Reporting

Question 1

The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

₹ in lakhs

Particulars	***M***	***N***	***O***	***P***	***Q***	***R***	***Total***
Segment Assets	*40*	*80*	*30*	*20*	*20*	*10*	*200*
Segment Results	*50*	*(190)*	*10*	*10*	*(10)*	*30*	*(100)*
Segment Revenue	*300*	*620*	*80*	*60*	*80*	*60*	*1,200*

The Chief accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss.

(*Source: Illustration 1, Study Material*)

Answer

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

Its segment result whether profit or loss is 10% or more of:

- The combined result of all segments in profit; or
- The combined result of all segments in loss, whichever is greater in absolute amount; or

Its segment assets are 10% or more of the total assets of all segments.

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments.

On the basis of turnover criteria segments M and N are reportable segments.

On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of₹200 lakhs).

On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported in accordance with Accounting Standard (AS) 17. Hence the opinion of chief accountant is wrong.

Question 2

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

(*Source: Illustration 2, Study Material*)

Answer

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence the enterprise can have its own policy for pricing inter-segment transfers and hence inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 3

M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹10.00 crores. Segment X has ₹2.00 crores, segment Y has ₹3.00 crores and segment Z has ₹5.00 crores. Deferred tax assets included in the assets of each segments are X–₹0.50 crores, Y– ₹0.40 crores and Z– ₹0.30 crores. The accountant contends that all the three segments are reportable segments. Comment.

(*Source: Illustration 3, Study Material*)

Answer

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are ₹8.8 crores [₹10 crores – (₹0.5 + ₹0.4 +₹0.3)]. Segment X holds total assets of ₹1.5 crores (₹2 crores –₹0.5 crores); Segment Y holds ₹2.6 crores (₹3 crores – ₹0.4 crores); and Segment Z holds ₹4.7 crores (₹5 crores – ₹0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

Question 4

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	₹('000)
Forging Shop Division	
Sales to Bright Bar Division	*4,575*
Other Domestic Sales	*90*
Export Sales	*6,135*
Bright Bar Division	*10,800*
Sales to Fitting Division	*45*
Export Sales to Rwanda	*300*
Fitting Division	*345*
Export Sales to Maldives	*270*

Particulars	**Head Office ₹('000)**	**Forging Shop Division ₹('000)**	**Bright Bar Division ₹('000)**	**Fitting Division ₹('000)**
Pre-tax operating result		*240*	*30*	*(12)*
Head office cost reallocated		*72*	*36*	*36*
Interest costs		*6*	*8*	*2*
Fixed assets	*75*	*300*	*60*	*180*
Net current assets	*72*	*180*	*60*	*135*
Long-term liabilities	*57*	*30*	*15*	*180*

(*Source: Illustration 4, Study Material*)

Answer

Diversifiers Ltd. Segmental Report

(₹'000)

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging shop	Bright Bar	Fitting		
Segment Revenue					
Sales:					
Domestic	90	-	-	-	90
Export	6,135	300	270	-	6,705
External Sales	6,225	300	270	-	6,795
Inter-Segment Sales	4,575	45	-	4,620	-
Total Revenue	10,800	345	270	4,620	6,795
Segment Result (Given)	240	30	(12)		258
Head Office Expenses					(144)
Operating Profit					114
Interest Expense					(16)
Profit Before Tax					98
Information in Relation to Assets and Liabilities:					
Fixed Assets	300	60	180	-	540
Net Current Assets	180	60	135	-	375
Segment assets	480	120	315	-	915
Unallocated Corporate Assets (75 + 72)	-	-	-	-	147
Total assets					1,062
Segment liabilities	30	15	180	-	225
Unallocated corporate liabilities					57
Total liabilities					282

Sales Revenue by Geographical Market

(₹'000)

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	Consolidated Total
External sales	90	6,135	300	270	6,795

Question 5

Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?

(*Source: Illustration 5, Study Material*)

Answer

In case of Microtech Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobile batteries, the risks and returns are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS, the risks and returns are affected by power condition, standard of living, etc. Therefore, it can be said that Microtech Ltd. has two business segments viz- 'Automobile batteries' and 'batteries for Invertors and UPS'.

Reference: The students are advised to refer the full text of AS 17 "Segment Reporting".

Question 6

Nathan Limited has three segments namely P, Q and R. The assets of the company are ₹15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P - ₹1 crore, Q - ₹0.90 crores and R - ₹0.80 crores. The accountant contends all these three segments are reportable segments. Comment.

(*Source: Question 6, Study Material*)

Answer

According to AS 17 "Segment Reporting", segment assets do not include income tax assets.

Therefore, the revised total assets are 12.3 crores [₹15 - (₹1 +0.9 + 0.8).

Details of Segment wise assets:

Segment P holds total assets of ₹3 crores (₹4 crores - ₹1 crores); Segment Q holds ₹5.1 crores (₹6 crores - ₹0.9 crores);

Segment R holds ₹4.2 crores (₹5 crores - ₹0.8 crores).

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments.

Hence, the contention of the Accountant that all three segments are reportable segments is correct.

Question 7

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban.

Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.

(*Source: Question 7, Study Material*)

Answer

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country".

Accordingly, to identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement…". Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment.

Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

Question 8

PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA and UK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 per cent is sold in USA and the balance is sold in UK.

Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant?

(*Source: Question 8, Study Material*)

Answer

As per AS 17, if primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

Therefore, for the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 per cent or more of enterprise revenue threshold. However, other secondary segment information as per AS 17 should be disclosed in respect of this segment if the thresholds prescribed in the AS 17 are met.

Question 9

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March, 20X2 have been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	***Profit (Loss) ₹ in lakhs***
A	*225*
B	*25*
C	*(175)*
D	*(20)*
E	*(105)*

(*Source: Question 9, Study Material*)

Answer

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its segment results whether profit or loss is 10% or more of:

- The combined result of all segments in profit; i.e. ₹250 Lakhs or
- The combined result of all segments in loss; i.e. ₹300 Lakhs whichever is greater in absolute amount i.e. ₹300 Lakhs.

Operating Segment	**Absolute amount of Profit or Loss (₹In lakhs)**	**Reportable Segment Yes or No**
A	225	Yes
B	25	No
C	175	Yes
D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments (since their results in absolute amount is 10% or more of₹300 lakhs i.e. 30 lakhs).

Question 10

ABC Limited has 5 segments namely A, B, C, D and E. The profit/loss of each segment for the year ended March 31st, 20X2 is as follows:

Segment	***Profit/(Loss) (₹in crore)***
A	*780*
B	*1,500*
C	*(2,300)*
D	*(4,500)*
E	*6,000*
Total	*1,480*

Identify the Reportable segments.

(*Source: Question 10, Study Material*)

Answer

In compliance with AS 17, the segment profit/loss of respective segment will be compared with the greater of the following:

(i) All segments in profit, i.e., A, B and E - Total profit ₹8,280 crores.

(ii) All segments in loss, i.e., C and D - Total loss ₹6,800 crores.

Greater of the above - ₹8,280 crores.

Based on the above, reportable segments will be determined as follows:

Segment	**Profit/(Loss)**	**Absolute Profit/Loss as a % of 8,280**	**Reportable Segment**
A	780	9%	No
B	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes
E	6,000	72%	Yes
Total	**1,480**		

Question 11

Heavy Goods Ltd. has 6 segments namely L-Q (below).

The total revenues (internal and external), profits or losses and assets are set out below:

(In ₹)

Segment	***Inter Segment Sales***	***External Sales***	***Profit / loss***	***Total assets***
L	*4,200*	*12,300*	*3,000*	*37,500*
M	*3,500*	*7,750*	*1,500*	*23,250*
N	*1,000*	*3,500*	*(1,500)*	*15,750*
0	*0*	*5,250*	*(750)*	*10,500*
P	*500*	*5,500*	*900*	*10,500*
Q	*1,200*	*1,050*	*600*	*5,250*
	10,400	*35,350*	*3,750*	*1,02,750*

Heavy Goods Ltd. needs to determine how many reportable segments it has.

You are required to advice Heavy Goods Ltd. as per the criteria defined in AS 17.

(*Source: Question 11, Study Material*)

Answer

Quantitative Threshold Test:

Revenue Test:

Combined total sales of all the segment = ₹10,400 + ₹35,350 = ₹45,750.

10% thresholds = 45,750 x 10% = 4,575.

Profitability Test:

In the given situation, combined reported profit = ₹6,000 and combined reported loss (₹2,250). Hence, for 10% thresholds ₹6,000 will be considered.

10% thresholds = ₹6,000 x 10% = ₹600

Asset Test:

Combined total assets of all the segment = ₹1,02,750 10% thresholds = ₹1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:

Segments	L	M	N	O	P	Q	Reportable segments
% segment sales to total sales	36.66%	24.59%	9.84%	11.48%	13.11%	4.92%	L, M, O, P
% segment profit to total profits	50%	25%	25%	12.5%	15%	10%	L, M, N, O, P, Q
% segment assets to total assets	36.50%	22.63%	15.33%	10.22%	10.22%	5.11%	L, M, N, O, P

Conclusion:

Segments L, M, O and P clearly satisfy the revenue and assets tests and they are separate reportable segments.

Segment N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.

Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.

Hence all segments i.e. L, M, N, O, P and Q are reportable segments.

Question 12

Calculate the segment results of a manufacturing organization from the following information:

Segments	*A*	*B*	*C*	*Total*
Directly attributed revenue	*5,00,000*	*3,00,000*	*1,00,000*	*9,00,000*
Enterprise revenue				*1,10,000*
(allocated in 5 :4 : 2 basis)				
Revenue from transactions with				
other segments				
Transaction from B	*1,00,000*		*50,000*	*1,50,000*
Transaction from C	*10,000*	*50,000*		*60,000*
Transaction from A		*25,000*	*1,00,000*	*1,25,000*
Operating expenses	*3,00,000*	*1,50,000*	*75,000*	*5,25,000*
Enterprise expenses				*77,000*
(allocated in 5 :4 :2 basis)				

Segments	***A***	***B***	***C***	***Total***
Expenses on transactions with other segments				
Transaction from B	*75,000*		*30,000*	
Transaction from C	*6,000*	*40,000*		
Transaction from A		*18,000*	*82,000*	

(*Source: Question 12, Study Material*)

Computation of segment result:

Segments	**A** ₹	**B** ₹	**C** ₹	**Total** ₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 :4 :2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue (1)	**6,60,000**	**4,15,000**	**2.70,000**	**13,45,000**
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 :4 :2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses (2)	**4,16,000**	**2,36,000**	**2,01,000**	**8,53,000**
Segment result (1-2)	**2,44,000**	**1,79,000**	**69,000**	**4,92,000**

QUESTION BANK

Question 13

(a) Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.

(b) Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain.

(*RTP November 2021*)

Answer

(a) As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products of services;
(b) the nature of the productions processes;
(c) the type of class of customers for the products or services;
(d) the methods use to distribute the products or provide the services; and
(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors.

In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

(b) As per AS 17, "Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable." It also states that "some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand and impact of such changes, this Statement requires the disclosure of the nature of change and the financial effect of the change, if reasonably determinable".

In view of the above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting. Accordingly, if the change has a material financial effect on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, should be disclosed.

Question 14

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

(*RTP November, 2022*)

Answer

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 15

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

(₹ in lakhs)

Particulars	P	Q	R	S	T	Total
	(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
Segment Assets	80	30	20	20	10	160
Segment Results	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'.

(*RTP May, 2023*)

Answer

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:
   (1) The combined result of all segments in profit; or
   (2) The combined result of all segments in loss, whichever is greater in absolute amount; or

(iii) Its segment assets are 10% or more of the total assets of all segments.
   Accordingly,
   (a) On the basis of revenue from sales criteria, segment P is a reportable segment.
   (b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 Lakhs).
   (c) On the basis of asset criteria, all segments except T are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

Question 16

The Accountant of X. Ltd. provides the following data regarding its five segments:

Particulars	A	B	C	D	E	Total (₹in Crore)
Segment Assets	50	20	15	10	5	100
Segment Results	(85)	10	10	(15)	5	(75)
Segment Revenue	250	50	40	60	30	430

The accountant is of the opinion that segment 'A' alone should be reported,

Is he justified in his view ? Examine his option in the light' of provisions of AS-17 Segment Reporting.

(*G-II, May, 2023*) (*5 Marks*)

Question 17

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions:

(*₹ in Lakhs*)

Segment Revenue	*100*	*300*	*200*	*400*	*1,000*
Segment Result	*45*	(*70*)	*80*	(*10*)	*45*
Segment Assets	*39*	*51*	*48*	*12*	*150*

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17.

(*MTP September, 2023*) (*Advance Accounts*) (*4 Marks*)

Answer

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

Its segment result whether profit or loss is 10% or more of:

- The combined result of all segments in profit; or
- The combined result of all segments in loss, whichever is greater in absolute amount; or

Its segment assets are 10% or more of the total assets of all segments.

On the basis of revenue criteria, segments A, B, C and D - all are reportable segments.

On the basis of the result criteria, segments A, B and C are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs).

On the basis of asset criteria, all segments except D are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with Accounting Standard (AS) 17.

Question 18

Garnet Limited has 4 operating segments. The total revenue (internal and external) and assets are set out as below:

(*₹ in lakhs*)

Segment	Inter Segment Sales	External Sales	Total Assets
Fan	3,200	10,900	23,700
Light	200	1,400	13,200
Lamp	0	1,500	4,200
Printer	1,100	200	3,400
TOTAL	4,500	14,000	44,500

How many reportable segments does Garnet Limited have as per the Revenue and Assets criteria given in AS 17 ? State Reasons for your answer.

(*4 Marks*) (*November Exam., 2023*) (*Advance Accounts*)

MCQs

Question - 1: Under AS 17, segments must be reported separately if the reported revenues (internal and external) are more than _____of the combined revenues of all the segments.

Answer:

1. *10%*
2. *15%*
3. *20%*
4. *25%*

Question - 2: Following is not included in Segment Expense.

Answer:

1. *Income tax expense*
2. *The expense resulting from the operating activities of a segment that is directly attributable to the segment*
3. *The relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment*
4. *Expense relating to transactions with other segments of the enterprise*

Question - 3: As per AS 17, reportable segments are those whose total revenue from external sales and inter-segment sales is

Answer:

1. *10% or more of the total revenue of all segments*
2. *10% or more of the total revenue of all external segments*
3. *12% or more of the total revenue of all segments*
4. *12% or more of the total revenue of all external segments*

Question - 4: Which of the following statements is correct?

Answer:

1. *Management has a discretion to include a segment as a reportable segment even if it passes the 10% materiality test.*
2. *Management has a discretion to include any segment as a reportable segment if it fails the 12% materiality test.*
3. *It is mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.*
4. *It is not mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.*

Question - 5: Which of the following statements is correct?

Answer:

1. *The overall test of 75% considers only external revenue to compute the threshold limit.*
2. *The overall test of 75% considers only internal revenue to compute the threshold limit.*
3. *The overall test of 75% considers both internal and external revenue to compute the threshold limit.*
4. *It is management choice whether they want to include both external and internal revenue for computing threshold limit.*

Question - 6: Which of the following statements is correct?

Answer:

1. *The 10% test computed on the basis of revenue, considers both internal and external revenue to compute the threshold limit.*
2. *The 10% test computed on the basis of revenue, considers only external revenue to compute the threshold limit.*
3. *The 10% test computed on the basis of revenue, considers only internal revenue to compute the threshold limit.*
4. *It is management choice whether they want to include both external and internal revenue for computing threshold limit.*

Question - 7: Which of the following statements is correct?

Answer:

1. *In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or net loss respectively of all segments taken together becomes reportable segment.*
2. *In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit (after netting the losses) of all segments taken together becomes reportable segment.*

3. *In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or loss (whichever is higher in absolute figures) of all segments taken together becomes reportable segment.*
4. *In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or loss (whichever is lower in absolute figures) of all segments taken together becomes reportable segment.*

Answer

Q1	***1***	***Q2***	***1***	***Q3***	***1***	***Q4***	***3***
Q5	***1***	***Q6***	***1***	***Q7***	***3***		

CHAPTER 15

Accounting Standard 20 Earnings Per Share

Question 1

Date	*Particulars*			*Balance*
1st January	*Balance at beginning of year*	*1,800*	*-*	*1,800*
31st May	*Issue of shares for cash*	*600*	*-*	*2,400*
1st November	*Buy Back of shares*	*-*	*300*	*2,100*

Calculate Weighted Number of Shares.

(*Source: Illustration 1, Study Material*)

Answer

Computation of Weighted Average:

(1,800 x 5/12) + (2,400 x 5/12) + (2,100 x 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as follows: (1,800 x12/12) + (600 x 7/12) - (300 x 2/12) = 2,100 shares

Question 2

Date	*Particulars*	*No. of Shares*	*Face Value*	*Paid up Value*
1st January	*Balance at beginning of year*	*1,800*	*₹10*	*₹10*
31st October	*Issue of Shares*	*600*	*₹10*	*₹5*

Calculate Weighted Number of Shares.

(*Source: Illustration 2, Study Material*)

Answer

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.

Computation of weighted average would be as follows:

(1,800 x 12/12) + (300 x 2/12) = 1,850 shares.

Where an enterprise has equity shares of **different nominal values** but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

Question 3

Net profit for the year 20X1	*₹18,00,000*
Net profit for the year 20X2	*₹60,00,000*
No. of equity shares outstanding until 30th September 20X2	*20,00,000*

Bonus issue 1st October 20X2 was 2 equity shares for each equity share outstanding at 30th September, 20X2

Calculate Basic Earnings Per Share.

(*Source: Illustration 3, Study Material*)

Answer

No. of Bonus Issue 20,00,000 x 2 = 40,00,000 shares

$$\text{Earnings per share for the year 20X2} \quad \frac{₹60,00,000}{₹20,00,000 + 40,00,000} = ₹1.00$$

$$\text{Adjusted earnings per share for the year 20X1} \quad \frac{₹18,00,000}{₹20,00,000 + 40,00,000} = ₹0.30$$

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

Question 4

Net profit for the year 20X1	*₹11,00,000*
Net profit for the year 20X2	*₹15,00,000*
No. of shares outstanding prior to rights issue	*5,00,000*
shares Rights issue price	*₹15.00*
Last date to exercise rights	*1st March 20X2*

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was ₹21.00. Compute Basic Earnings Per Share.

(*Source: Illustration 4, Study Material*)

Answer

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise +Number of shares issued in the exercise}}$$

$$\frac{\text{(₹21.00×5,00,000 shares) + (₹15.00 ×1,00,000 Shares)}}{\text{5,00,000 Shares +1,00,000 Shares}}$$

Theoretical ex-rights fair value per share = ₹20.00

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} \quad \frac{\text{₹(21.00)}}{\text{₹(20.00)}} = 1.05$$

Computation of earnings per share:

EPS for the year 20X1 as originally reported: ₹11,00,000/5,00,000 shares = ₹2.20

EPS for the year 20X1 restated for rights issue: ₹11,00,000/ (5,00,000 shares x 1.05)

= ₹2.10

EPS for the year 20X2 including effects of rights issue:

(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12) = 5,87,500 shares

EPS = 15,00,000/5,87,500 = ₹2.55

Question 5

Net profit for the current year	*₹1,00,00,000*
No. of equity shares outstanding	*50,00,000*
Basic earnings per share	*₹2.00*

No. of 12% convertible debentures of ₹100 each	*1,00,000*
Each debenture is convertible into 10 equity shares	
Interest expense for the current year	*₹12,00,000*
Tax relating to interest expense (30%)	*₹3,60,000*

Compute Diluted Earnings Per Share.

(*Source: Illustration 5, Study Material*)

Answer

Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = ₹1,08,40,000

No. of equity shares resulting from conversion of debentures: 10,00,000 Shares No. of equity shares used to compute diluted EPS: (50,00,000 + 10,00,000) = 60,00,000 Shares

Diluted earnings per share: (1,08,40,000/60,00,000) = ₹1.81

Question 6

Net profit for the year 20X1	*₹12,00,000*
Weighted average number of equity shares outstanding during the year 20X1	*5,00,000 shares*
Average fair value of one equity share during the year 20X1	*₹20.00*
Weighted average number of shares under option during the year 20X1	*1,00,000 shares*
Exercise price for shares under option during the year 20X1	*₹15.00*

Compute Basic and Diluted Earnings Per Share.

(*Source: Illustration 6, Study Material*)

Answer

Computation of earnings per share

	Earnings ₹	***Shares***	***Earnings/Share*** ₹
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares during year 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (100,000 x 15.00)/20.00	—	(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 7

X Limited, during the year ended March 31, 20X1, has income from continuing ordinary operations of ₹ 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 20X1.

You are required to compute Basic and Diluted EPS?

(*Source: Illustration 7, Study Material*)

Answer

As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations".

As income from continuing ordinary operations, ₹ 2,40,000 would be considered and not ₹ (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹ 240 to ₹ 200. Thus, the basic E.P.S would be ₹ (120) and diluted E.P.S. would be ₹ (100).

Question 8

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

(*Source: Question 6, Study Material*)

Answer

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given cases:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles or may entitle its holder to equity shares.

Question 9

Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS.

Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

(*Source: Question 7, Study Material*)

Answer

As per AS 20 “A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares”.

Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

Question 10

Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?

(*Source: Question 8, Study Material*)

In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, *the issue is treated as if it had occurred prior to the beginning of the earliest period reported.*

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Question 11

NAT, a listed entity, as on 1st April, 20X1 had the following capital structure:

Particulars	*₹*
10,00,000 Equity Shares having face value of ₹1 each	*10,00,000*
10,00,000 8% Preference Shares having face value of ₹10 each	*1,00,00,000*

During the year 20X1-20X2, the company had profit after tax of ₹ 90,00,000.

On 1st January, 20X2, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December, 20X1.

On 1st January, 20X2, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.

NAT's shares were trading at ₹ 8.05 per share on 31st March, 20X2.

Further it has been provided that the basic earnings per share for the year ended 31st March, 20X1 was previously reported at ₹ 62.30.

You are required to:

(i) Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March, 20X2 including the comparative figure, in accordance with AS-20 Earnings Per Share.

(ii) Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?

(*Source: Question 9, Study Material*)

Answer

(i) Computation of Basic Earnings per share for the year ended 31st March, 20X2:

(including the comparative figure)

Working Note – I:

Earnings for the year ended 31st March, 20X1:

= EPS x Number of shares outstanding during 20X0-20X1

= ₹62.30 x 10,00,000 equity shares

= ₹6,23,00,000

Adjusted/Restated Earnings per share for the year ended 31st March 20X1:

(after taking into consideration bonus issue) Adjusted/Restated Basic EPS:

= Earnings for the year 20X0-20X1 / (Total outstanding shares +Bonus issue)

= ₹6,23,00,000 / (10,00,000+ 5,00,000)

= ₹6,23,00,000 / 15,00,000

= ₹41.53 per share

Computation of Basic EPS for the year 20X1-20X2:

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 20X2)

= (₹90,00,000 – ₹(1,00,00,000 x 8%)) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= ₹82,00,000 / 15,50,000 shares

= ₹5.29 per share

(ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, *the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.*

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

Question 12

X Ltd. supplied the following information. You are required to compute the basic earnings per share:

(Accounting year 1.1.20X1 – 31.12.20X1)		
Net Profit	:	*Year 20X1: ₹20,00,000*
	:	*Year 20X2: ₹30,00,000*
No. of shares outstanding prior to Right Issue	:	*10,00,000 shares*
Right Issue	:	*One new share for each four outstanding i.e., 2,50,000 shares.*
		Right Issue price – ₹20
		Last date of exercise rights – 31.3.20X2.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2	:	*₹25*

(*Source: Question 10, Study Material*)

Answer

Computation of Basic Earnings Per Share

(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 20X1 ₹	***Year 20X1*** ₹
EPS for the year 20X1 as originally reported		
$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (₹20,00,000 / 10,00,000 shares)	2.00	
EPS for the year 20X1 restated for rights issue		
= [₹20,00,000 / (10,00,000 shares ₹1.04[1])]	1.91 (approx.)	
EPS for the year 20X2 including effects of rights issue		
$\frac{\text{₹30,00,000}}{\text{(10,00,000shares ×1.04 × 3/12) + (12,50,000 shares × 9/12)}}$		
$\frac{\text{₹30,00,000}}{\text{11,97,500 shares}}$		2.51 (approx.)

1 Refer working note 2.

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise+ Number of shares issued in the exercise}}$$

$$= \frac{(₹25 \times 10,00,000 \text{ shares}) + (₹20 \times 2,50,000) \text{ shares}}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}} = \frac{₹30,000,000}{\text{shares } 000,50,12} \quad ₹24$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{₹25}{₹24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

Question 13

On 1st April, 20X1 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 20X1 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 20X2 was ₹21,96,000 after considering dividend on preference shares of ₹3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 20X2 as per Accounting Standard 20 "Earnings Per Share".

(*Source: Question 11, Study Material*)

Answer

11. Basic Earnings per share (EPS) =

$$\frac{\text{Weighted average number of equity shares outstanding during the year}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	***No. of equity shares***	***Amount paid per share***	***Weighted average no. of equity shares***
	₹	₹	₹
1.4.20X1	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.20X1	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.20X1	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 14

No. of equity shares outstanding = 30,00,000
Basic earnings per share ₹5.00
No. of 12% convertible debentures of ₹100 each; 50,000
Each debenture is convertible into 10 equity shares
Tax Rate 30%
Compute Diluted Earnings per Share.
Working notes should form part of the answer.

(*Source: Question 12, Study Material*)

Answer:

Earnings for the year:

= No. of Shares x Basic EPS
= 30,00,000 shares x ₹ 5 per share = ₹ 1,50,00,000

Computation of Adjusted Net Profit:

= Earnings for the year + Interest on debentures net of tax
= 1,50,00,000 + (6,00,000 - 1,80,000) = ₹ 1,54,20,000

Computation of Adjusted Denominator:

No. of equity shares resulting from conversion of debentures:
= 50,000 x 10 shares = 5,00,000 shares

No. of equity shares for diluted EPS = 30,00,000 + 5,00,000
= 35,00,000 shares

Computation of Diluted EPS:

= ₹ 1,54,20,000/35,00,000 shares = ₹ 4.4 per share.

QUESTION BANK

Question 15

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,
(ii) Equity Shares issued as a result of conversion of a debt instrument,
(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,
(iv) Equity Shares issued for rendering of services to the enterprise,
(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,
(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

(*November 2014, 4 Marks*)

Question 16

M/s. A Ltd. had 8,00,000 Equity Shares outstanding on 1st April, 2013. The Company earned a profit of ₹20,00,000 during the year 2013-14. The average fair value per share during 2013-14 was ₹40. The Company has given Share Option to its employees of 1,00,000 Equity Shares at option price of ₹20.

Calculate Basic EPS and Diluted EPS.

(*May, 2015, 5 Marks*)

Answer

Computation of Earnings Per Share

	Earnings ₹	*Shares*	*Earnings per share* ₹
Net Profit for the year 2013-14	20,00,000		
Number of shares outstanding during the year 2013-14		8,00,000	
Basic Earnings Per Share			2.50
$= \frac{20,00,000}{8,00,000}$			
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (Refer Note) [1,00,000 x 20/40]		(50,000)	
Diluted Earnings Per Share			
$= \frac{20,00,000}{8,50,000}$	20,00,000	8,50,000	2.35

Note:

The earnings have not been increased as the total number of shares has been increased only by the number of shares (50,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 17

What do you mean by "Weighted average number of equity shares outstanding during the period" and why is it required to be calculated? Compute weighted average number of equity shares in the following case:

		No. of shares
1st April, 2014	Balance of Equity Shares	5,00,000
30th June, 2014	Equity Shares issued for cash	1,00,000
15th January, 2015	Equity Shares bought back	50,000
31st March, 2015	Balance of Equity Shares	5,50,000

(*November 2015, 4 Marks*)

Answer

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time.

For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Computation of weighted average number of shares outstanding during the period

Date	No. of equity shares	Period outstanding	Weights (months)	Weighted average number of shares
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1st April, 2014	5,00,000 (Opening)	3 months	3 /12	1,25,000
30th June 2014	6,00,000 (after Additional issue)	6.5 months	6.5/12	3,25,000
15th Jan, 2015	5,50,000 (after Buy back)	2.5 months	2.5/12	1,14,583
31st March, 2015	5,50,000 (Balance)	0 month	0/12	-
Total				5,64,583

Question 18

"While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period." Explain this statement in the light of relevant AS.

Also calculate the diluted EPS from the following information:

Net Profit for the current year (After Tax)	₹1,00,00,000
No. of Equity shares outstanding	10,00,000
No. of 10% Fully Convertible Debentures of ₹100 each	1,00,000
(Each Debentures is compulsorily & fully convertible into 10 equity shares)	
Debenture interest expense for the current year	₹5,00,000
Assume applicable Income Tax rate @ 30%	

(*November, 2016, 5 Marks*)

Answer

As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year (after tax)	1,00,00,000
Add: Interest expense for the current year	5,00,000
Less: Tax relating to interest expense (30% of ₹5,00,000)	(1,50,000)
Adjusted net profit for the current year	1,03,50,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$= \frac{1,00,000 \times 100}{10}$ = 10,00,000 Equity shares

Weighted average number of equity shares used to compute diluted earnings per share

= [(10,00,000 x 12) + (10,00,000 x 6)]/12 = 15,00,000 equity shares

Diluted earnings per share = ₹1,03,50,000 / 15,00,000 shares = ₹6.90 per share

Note: Interest on debentures for full year amounts to ₹10,00,000 (i.e. 10% of ₹1,00,00,000). However, interest expense amounting ₹5,00,000 has been given in the question. It may be concluded that debentures have been issued at the mid of the year and interest has been provided for 6 months.

Question 19

From the following information, you are required to compute the basic and adjusted Earnings per share:

Net profit for 2015-16	11 lakh
Net profit for 2016-17	15 lakh
No. of shares issued before rights issue	5 lakhs
Right issue	One for every 5 held
Right issue price	15 per share
Last date of exercising right option	1-06-2016
Fair value of shares before right issue	21 per share

(MTP March 2018/MTP-March 2019) (5 Marks)

Answer:

Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$\frac{(₹\ 21.00 \times 5,00,000 \text{ shares}) + (₹15.00 \times 1,00,000 \text{ shares})}{5,00,000 \text{ shares} + 1,00,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹20.00

(a) Computation of adjustment factor

$$\frac{\text{Fair value per share prior b exercise of rights}}{\text{Theorelica lex - righte value per share}} = \frac{\text{Rs. (21.00)}}{\text{Rs. (20.00)}} = 1.05$$

Computation of earnings per share

	Year 2015-16	Year 2016-17
EPS for the year 2015-16 as originally reported: (₹11,00,000/5,00,000 shares)	₹2.20	
EPS for the year 2015-16 restated for rights issue: [₹11,00,000/(5,00,000 shares x 1.05)]	₹2.10	
EPS for the year 2016-17 including effects of rights issue $\frac{\text{Rs. } 15,00,000}{(5,00,000 \times 1.05 \times 2/12) + (6,00,000 \times 10/12)}$		₹2.55

Question 20

As at 1st April, 2016 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2016 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2017 was ₹21,96,000 after considering dividend on preference shares totalling to ₹3,40,000.

Compute Basic EPS for the year ended 31st March, 2017 as per Accounting Standard 20 "Earnings Per Share".

(May 2018) (5 Marks)

Answer:

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = \text{Rs. } 4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
	₹	₹	₹
1.4.2016	6,00,000	5	6,00,000x5/10x5/12 = 1,25,000
1.9.2016	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2016	60,000	5	60,000x5/10x7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 21

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2017:

Net Profit for the year after tax:	₹75,00,000
Number of Equity Shares of ₹10 each outstanding:	₹10,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹100 each	1,00,000
Equity Shares to be issued on conversion	1,10,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP May 2018*)

Answer:

Computation of basic earnings per share

Net profit for the current year/Weighted average number of equity shares outstanding during the year

₹75,00,000/10,00,000 = ₹7.50 per share

Computation of diluted earnings per share $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of ₹8,00,000)	8,00,000
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

= 80,60,000/11,10,000 = ₹7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 22

The following information is available for TON Ltd. for the accounting year 2015-16 and 2016-17:

	Net profit for	₹
Year	2015-16	35,00,000
Year	2016-17	45,00,000

No of shares outstanding prior to right issue 15,00,000 shares.

Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares.

: Right Issue price ₹25

: Last date to exercise rights 31st July, 2016

Fair value of one equity share immediately prior to exercise of rights on 31.07.2016 is ₹35.

You are required to compute:

(i) Basic earnings per share for the year 2015-16.

(ii) Restated basic earnings per share for the year 2015-16 for right issue.

(iii) Basic earnings per share for the year 2016-17.

(*RTP November 2018*)

Answer: Computation of Basic Earnings per Share

		Year 2015-16 (₹)	Year 2016-17 (₹)
(i)	EPS for the year 2015-16 as originally reported = Net profit for the year attributable to equity share holder/weighted average number of equity shares outstanding during the year ₹35,00,000/15,00,000 shares	2.33	
(ii)	EPS for the year 2015-16 restated for the right issue ₹35,00,000/15,00,0000 shares × 1.08	2.16	
(iii)	EPS for the year 2016-17 (including effect of right issue) ₹45,00,000/[(15,00,000 × 1.08 × 4/12) + (20,00,000 × 8/12)]		2.40

Working Notes:

1. Computation of theoretical ex-rights fair value per share =

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

[(₹35 × 15,00,000) + [₹25 × 5,00,000)]/(15,00,000 + 5,00,000) = ₹32.5

2. **Computation of adjustment factor**

Fair value per share prior to exercise of rights Theoretical ex-rights value per share = ₹35/32.50 = 1.08 (approx.)

Question 23

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2017:

Net Profit for the year after tax: ₹75,00,000

Number of Equity Shares of ₹10 each outstanding: 10,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹100 each	1,00,000
Equity Shares to be issued on conversion	1,10,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*MTP October 2018*) (*5 Marks*)

Answer:

Computation of basic earnings per share

Net profit for the current year/Weighted average number of equity shares outstanding during the year

₹75,00,000/10,00,000 = ₹7.50 per share

Computation of diluted earnings per share

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year

	₹
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of ₹8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

= 80,60,000/11,10,000 = ₹7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 24

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2019: Net Profit for the year after tax: ₹37,50,000

Number of Equity Shares of ₹10 each outstanding: ₹5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP November 2019*)

Answer:

Computation of basic earnings per share

Net profit for the current year/Weighted average number of equity shares outstanding during the year ₹37,50,000/ 5,00,000 = ₹7.50 per share

$$\text{Computation of diluted earnings per share} \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

= 40,30,000/ 5,55,000 = ₹7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 25

Following information is supplied by K Ltd.

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹98

Last date of exercising rights - 30-06-2018.

Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹102.

Net Profit to equity shareholders:

2017-2018 – ₹50,00,000

2018-2019 – ₹75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earning per Share.

(*November 2019, New Course, 5 Marks*)

Answer:

$$\frac{\text{Fair value of shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}}$$

$$\frac{102 \text{ x } 2,50,000 \text{ Shares} + ₹98 \times 1,00,000 \text{ shares}}{3,50,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹100.86

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = 102 / 100.86 = 1.01$$

Computation of earnings per share:

EPS for the year 2017-18 as originally reported: ₹50,00,000/2,50,000 shares = ₹20

EPS for the year 2017-18 restated for rights issue: =₹50,00,000/ (2,50,000 shares x 1.01)

= ₹19.80

EPS for the year 2018-19 including effects of rights issue:

EPS = 75,00,000/3,25,625* = ₹23.03

* *[(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] = 63,125 + 2,62,500 = 3,25,625 shares*

Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

Question 26

Net Profit for financial year 2018-2019	30,00,000
Net Profit for financial year 2019-2020	50,00,000
No. of shares outstanding prior to rights issue	20,00,000 shares
Rights Issue Price	₹20
Last day to exercise rights	1st June, 2019

Right issue is one new share for each five equity share outstanding (i.e. 4,00,000 new shares).
Fair value of one equity share immediately prior to exercise of rights on 1st June, 2019 was ₹26.00.
Compute Basic Earnings Per Share for financial year 2018-19, 2019-2020 and restated EPS for 2018-19.

(*MTP, May, 2020*) (*5 marks*)

Answer:

Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)

	Year 2018-19 ₹	**Year 2019-20 ₹**
EPS for the year 2018-19 as originally reported $= \frac{\text{Net Profitof the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ = (₹30,00,000 / 20,00,000 shares)	1.5	
EPS for the year 2018-19 restated for rights issue = [₹30,00,000 / (20,00,000 shares× 1.04 (W.N. 2)]	1.44 (approx.)	
EPS for the year 2019-20 including effects of rights issue $= \frac{\text{Rs. } 50,00,000}{(20,00,000\, shares \times 1.04 \times 2/12) + (24,00,000\, shares \times 10/12)}$ **₹50,00,000/ 23,46,667 shares**		2.13 (approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$= \frac{(\text{Rs. } 26 \text{ x } 20,00,000 \text{ shares}) + (\text{Rs. } 20 \text{ x } 4,00,000 \text{ shares})}{20,00,000 \text{ shares} + 4,00,000 \text{ shares}}$$

$$= \frac{\text{Rs. } 6,00,00,000}{24,00,000 \text{ shares}} = \text{Rs.}25$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share priorto exercise of rights}}{\text{Theoretical ex - rightsvalue per share}} = \frac{\textbf{\textit{Rs.26}}}{\textbf{\textit{Rs. (Refer Working Note1)}}} = 1.04(\text{approx.})$$

Question 27

On 1st April, 2019 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2019 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net pro fit for the year ended 31st March, 2020 was ₹21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

(*MTP, October, 2020*) (*5 marks*)

Answer

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	***No. of equity shares***	***Amount paid per share***	***Weighted average no. of equity shares***
	₹	₹	₹
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 28

A-One Limited supplied the following information. You are required to compute the basic earnings per share as per AS 20 'Earnings per Share':

Net profit attributable to equity shareholders — Year 2017-18: ₹1,00,00,000
Year 2018-19 : ₹1,50,00,000

Number of shares outstanding prior to Right Issue — 50,00,000 shares

Right Issue — One new share for each four outstanding shares i.e., 12,50,000 shares
Right Issue Price - ₹96
Last date of exercising rights - 30-06-2018

Fair value of one equity share immediately prior to exercise of rights on 30-06-2018 — ₹101

(*RTP, November, 2020*)

Answer

Computation of Basic earnings per share

	2017-18 ₹	2018-19 ₹
EPS for the year 2017-18 as originally reported: (₹1,00,00,000/ 50,00,000 shares)	2.00	
EPS for the year 2017-18 restated for rights issue: ₹1,00,00,000/ (50,00,000 shares x 1.01)*	1.98	
EPS for the year 2018-19 including effects of rights issue $\frac{\text{Rs.}1,50,00,000}{(50,00,000 \times 1.01 \times 3/12) + (62,50,000 \times 9/12)}$		2.52

* *Computation of Basic Earnings per share in case of Rights Issue requires computation of adjustment factor which is given as working note*.

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{(₹101 \times 50,00,000 \text{ shares}) + (₹96 \times 12,50,000 \text{ shares})}{50,00,000 \text{ shares} + 12,50,000 \text{ shares}}$$

= ₹62,50,00,000/62,50,000 = ₹100

Therefore, theoretical ex-rights fair value per share is = ₹100

2. Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = \frac{₹(101}{₹(100)} = 1.01$$

Question 29

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case:

		No. of shares
1st April, 2020	Balance of equity shares	7,20,000
31st August, 2020	Equity shares issued for cash	2,40,000
1st February, 2021	Equity shares bought back	1,20,000
31st March, 2021	Balance of equity shares	8,40,000

(*MTP, April, 2021*) (*5 marks*)

Answer

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares:

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	= 8,40,000 shares

Question 30

On 1st April, 2019 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2019 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2020 was ₹21,96,000 after considering dividend ₹3,40,000 on preference shares.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

(*MTP*, *October 2021*) (*5 Marks*)

Answer

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	***No. of equity shares***	***Amount paid per share***	***Weighted average no. of equity shares***
	₹	₹	₹
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Question 31

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20?

(*RTP November 2021*)

Answer

The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period". With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still attributable to equity shareholders. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

Question 32

(a) Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

(b) X Limited, as at March 31, 2021, has income from continuing ordinary operations of ₹2,40,000, a loss from discontinuing operations of ₹3,60,000 and accordingly a net loss of ₹1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

(*RTP May, 2022*)

Answer

(a) The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares". Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

(b) As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations". As income from continuing ordinary operations, ₹2,40,000 would be considered and not ₹(1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹240 to ₹200. Thus the basic E.P.S would be ₹(120) and diluted E.P.S. would be ₹(100).

Question 33

"At the time of calculating diluted earnings per share, effect is given to all dilutive potential equity shares that are outstanding during the period."

Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

(i)	Net profit after tax for the year	₹64,12,500
(ii)	No. of equity shares outstanding	15,00,000
(iii)	No. of 9% convertible debentures of ₹100 issued on 1st July, 2020	75,000
(iv)	Each debenture is convertible into 8 Equity Shares	
(v)	Tax relating to interest expenses	35%

(*Question Paper of December 2021*) *(5 Marks)*

Answer

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding* during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Basic EPS for the year 2020-21= 64,12,500/15,00,000 = ₹4.275 or ₹4.28

Computation of diluted earnings per share for year 2020-21

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹67,41,562

No. of equity shares resulting from conversion of debentures: 6,00,000 Shares (75,000 × 8)

Weighted average no. of equity shares used to compute diluted EPS: (15,00,000 X 12/12 + 6,00,000 X 9/12) = 19,50,000 Shares

Diluted earnings per share: (67,41,562/19,50,000) = ₹3.46

Working Note:

Interest expense for 9 months = 75,00,000 × 9% × 9/12 = ₹5,06,250 Tax expense 35% on interest is ₹1,77,188 (5,06,250 x 35%)

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* Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

Question 34

The following information is provided to you:

Net profit for the year 2022:	₹ 72,00,000
Weighted average number of equity shares outstanding during the year 2022:	30,00,000 shares
Average Fair value of one equity share during the year 2022:	₹ 25.00
Weighted average number of shares under option during the year 2022:	6,00,000 shares
Exercise price for shares under option during the year 2022:	₹ 20.00

You are required to compute Basic and Diluted Earnings Per Share as per AS 20.

(*Suggested November, 2022*) (*5 Marks*)

Answer

Computation of Basic earnings per share

	Earnings ***₹***	***Shares***	***Earnings/ Share*** ***₹***
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Basic earnings per share (72,00,000/30,00,000)			2.40

Computation of Diluted earnings per share

	Earnings ***₹***	***Shares***	***Earnings/Share*** ***₹***
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Number of shares under option		6,00,000	
Number of shares that would have been issued at fair value (6,00,000 x 20.00)/25.00		(4,80,000)	
Diluted earnings per share	72,00,000	31,20,000	2.31 (rounded-off)

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 35

The following information relates to XYZ Limited for the year ended 31st March, 2022: Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10 each outstanding: ₹ 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	**Nos.**
8% Convertible Debentures of ₹ 100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP November, 2022*)

Answer

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year ₹ 37,50,000/ 5,00,000 = ₹ 7.50 per share

Computation of diluted earnings per share $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

Weighted average number of equity shares

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹ 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures
= 55,000 Equity shares (given in the question)
Weighted average number of equity shares used to compute diluted earnings per share
= 5,55,000 shares (5,00,000 + 55,000)
Diluted earnings per share
= 40,30,000/ 5,55,000 = ₹ 7.26 per share
Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

Question 36

Following information is supplied by K Ltd.:
Number of shares outstanding prior to right issue - 2,50,000 shares.
Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)
Right issue price - ₹ 98
Last date of exercising rights - 30-06-2021.
Fair value of one equity share immediately prior to exercise of right on 30-06-2021 is ₹ 102.
Net Profit to equity shareholders:
2020-2021 - ₹ 50,00,000
2021-2022 -₹ 75,00,000
You are required to calculate the basic earnings per share as per AS-20 Earnings per Share.

(*RTP May, 2023*)

Answer

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{102 \times 2,50,000 \text{ Shares} + ₹\ 98 \times 1,00,000 \text{ shares}}{3,50,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 100.86
Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = 102/100.86 = 1.01$$

Computation of earnings per share:
EPS for the year 2020-21 as originally reported: ₹ 50,00,000/2,50,000 shares = ₹ 20
EPS for the year 2020-21 restated for rights issue: =₹ 50,00,000/ (2,50,000 shares x 1.01) = ₹ 19.80
EPS for the year 2021-22 including effects of rights issue:
EPS = 75,00,000/3,25,625* = ₹ 23.03
** [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] =63,125 + 2,62,500 = 3,25,625 shares*
Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

Question 37

Answer the following Questions:

Net Profit for FY 2021-22	*30,00,000*
Net Profit for FY 2022-23	*50,00,000*
No. of shares outstanding prior to rights issue	*20,00,000 shares*
Rights Issue Price	*₹ 20*
Last day to exercise rights	*1st June, 2022*

Right issue is one new share for each five equity share outstanding (*i.e. 4,00,000 new shares*)
Fair value of one equity share immediately prior to exercise of rights on 1st June, 2022 was ₹ 26.00.
Compute Basic Earnings Per Share for FY 2016-17, FY 2022-23 and restated EPS for FY 2021-22.

(*5 Marks*) (*RTP September, 2023*) (*Advance Accounts*)

Answer

Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)

	Year 2016-17 ₹	Year 2017-18 ₹
EPS for the year 2021-22 as originally reported $= \frac{\text{Net Profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (₹ 30,00,000/20,00,000 shares)	1.5	
EPS for the year 2021-22 restated for rights issue		
= [₹ 30,00,000/(20,00,000 shares x 1.04 (W.N. 2)]	1.44 (approx.)	
EPS for the year 2022-23 including effects of rights issue $\frac{₹50,00,000}{(20,00,000 \text{ shares} \times 1.04 \times 2/12) + (24,00,000 \text{ shares} \times 10/12)}$ (20, 00, 000 shares 1.04 x 2 / 12) x (24, 00, 000 shares x 10 / 12) ₹ 50,00,000/ 23,46,667 shares		2.13 (approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$= \frac{(₹\ 26 \text{ x } 20,00,000 \text{ shares}) + (₹\ 20 \text{ x } 4,00,000 \text{ shares})}{20,00,000 \text{ shares} + 4,00,000 \text{ shares}}$$

$$= \frac{₹6,00,00,000}{24,00,000 \text{ shares}} = ₹25$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = \frac{₹26}{₹25 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

Question 38

On 1st April 2023, ABC Limited has given the following information:

50,000 equity shares of ₹100 each (*80 paid up by all shareholders)	40,00,000
2,00,000, 8% Preference shares of ₹10 each	20,00,000
10,000, 12% Debentures of ₹100 each	10,00,000
(Each debenture is convertible into 3 equity shares of ₹100 each)	

On 1st July 2023, the remaining ₹20 was called up and paid by all the shareholders except one shareholder holding 10,000 equity shares. During the year 2023-24 the company had a profit after tax of ₹3,44,000. Tax rate is 30%.

You are required to compute Basic and Diluted EPS.

(*Question Paper May, 2024) (4 Marks*)

MCQs

Question - 1: Which of the following statements is correct? 1. Options are generally dilutive in nature. 2. Options are generally more dilutive as compared to other potential equity shares.

Answer:

1. *Both (1) and (2) are correct.*
2. *Both (1) and (2) are incorrect.*
3. *Only (1) is correct.*
4. *Only (2) is correct.*

Question - 2: Which of the following is not a Potential Equity Share?

Answer:

1. *Employee stock option*
2. *Share warrants*
3. *Cumulative Preference Shares*
4. *Shares issuable under a loan contract upon default of payment of principal or interest*

Question - 3: AB Company Ltd. had 1,00,000 shares of common stock outstanding on January Additional 50,000 shares were issued on July 1, and 25,000 shares were re- acquired on September 1. The weighted average number of shares outstanding during the year on Dec. 31 is

Answer:

1. *1,40,000 shares*
2. *1,25,000 shares*
3. *1,16,667 shares*
4. *1,20,000 shares*

Question - 4: As per AS 20, potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would

Answer:

1. *Decrease net profit per share from continuing ordinary operations.*
2. *Increase net profit per share from continuing ordinary operations.*
3. *Make no change in net profit per share from continuing ordinary operations.*
4. *Decrease net loss per share from continuing ordinary operations.*

Question - 5: As per AS 20, equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements are

Answer:

1. *Dilutive potential equity shares*
2. *Contingently issuable shares*
3. *Contractual issued shares*
4. *Potential equity shares*

Question - 6: In case potential equity shares have been cancelled during the year, they should be:

Answer:

1. *Ignored for computation of Diluted EPS.*
2. *Considered from the beginning of the year till the date they are cancelled.*
3. *The company needs to make an accounting policy and can follow the treatment in (a) or (b) as it decides.*
4. *Considered for computation of diluted EPS only if the impact of such potential equity shares would be material.*

Question - 7: Partly paid up equity shares are:

Answer:

1. *Always considered as a part of Basic EPS.*
2. *Always considered as a part of Diluted EPS.*
3. *Depending upon the entitlement of dividend to the shareholder, it will be considered as a part of Basic or Diluted EPS as the case may be.*
4. *Considered as part of Basic/ Diluted EPS depending on the accounting policy of the company.*

Question - 8: Which of the following statements is true?

Answer:

1. *Right issue always contains a bonus element.*
2. *Right issue may or may not contain a bonus element.*

3. *Right issue does not contain a bonus element.*
4. *Right issue may or may not be considered to contain a bonus element depending on the accounting policy of the company.*

Question - 9: In case potential equity shares have been cancelled during the year, they should be:

Answer:

1. *Ignored for computation of Diluted EPS.*
2. *Considered from the beginning of the year till the date they are cancelled.*
3. *The company needs to make an accounting policy and can follow the treatment in (a) or (b) as it decides.*
4. *Considered for computation of diluted EPS only if the impact of such potential equity shares would be material.*

Question - 10: Which of the following statements is correct?

Answer:

1. *Reported Diluted EPS is always less than reported Basic EPS.*
1. *Reported Diluted EPS can be greater than reported Basic EPS.*
2. *Reported Diluted EPS is always greater than reported Basic EPS.*
3. *Reported Diluted EPS is always equal to or more than reported Basic EPS.*

Answer

Q1	***1***	***Q2***	***3***	***Q3***	***3***	***Q4***	***1***
Q5	***2***	***Q6***	***2***	***Q7***	***3***	***Q8***	***1***
Q9	***2***	***Q10***	***1***				

CHAPTER 16

Accounting Standard 24 Discontinuing Operations

Question 1

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

Answer

(i) An enterprise should include prescribed information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15 of AS 24) occurs. For details, please refer Section 6.5 of this Chapter above.

(ii) Examples of activities that do not necessarily satisfy criterion (a) of the definition, but that might do so in combination with other circumstances, include:

(a) Gradual or evolutionary phasing out of a product line or class of service;

(b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(c) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(d) Closing of a facility to achieve productivity improvements or other cost savings.

Question 2

What are the initial disclosure requirements of AS 24 for discontinuing operations?

Answer

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) A description of the discontinuing operation(s)

(b) The business or geographical segment(s) in which it is reported as per AS 17.

(c) The date and nature of the initial disclosure event.

(d) The date or period in which the discontinuance is expected to be completed if known or determinable

(e) The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.

(f) The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.

(g) The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.

(h) The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 3

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the

division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner.

You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to (ii) above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

Answer

(i) A discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

QUESTION BANK

Question 4

A consumer goods producer has changed the product line as follows:

	Dish washing Bar (Per month)	Clothes washing Bar (Per month)
January 2016 - September 2016	2,00,000	2,00,000
October 2016 - December 2016	1,00,000	3,00,000
January 2017 - March 2017	Nil	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The Board of Directors has passed a resolution in March 2016 to this effect. The company follows calendar year as its accounting year. You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24?

(*MTP August 2018/April 2019 & RTP May 2018*)

Answer:

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

(i) that the enterprise, pursuant to a single plan, is:
  (1) disposing of substantially in its entirety,
  (2) disposing of piecemeal, or
  (3) terminating through abandonment; and
(ii) that represents a separate major line of business or geographical area of operations; and
(iii) that can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

Question 5

What are the initial disclosure requirements of AS 24 for discontinuing operations?

(November 2018) (5 marks)

Answer*:*

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

A. A description of the discontinuing operation(s)
B. The business or geographical segment(s) in which it is reported as per AS 17
C. The date and nature of the initial disclosure event.
D. The date or period in which the discontinuance is expected to be completed if known or determinable
E. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled
F. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period
G. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto
H. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period

Question 6

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

(*RTP November 2018*)

Answer:

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;
(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 7

What do you understand by Discontinuing Operations? What are the disclosure and presentation requirements of AS 24 for discontinuing operations? Explain in brief.

(*RTP, November, 2020*)

Answer

As per AS 24 "Discontinuing Operations", a discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:
  (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
  (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
  (iii) Terminating through abandonment and
(b) That represents a separate major line of business or geographical area of operations.
(c) That can be distinguished operationally and for financial reporting purposes.

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s);
- The business or geographical segment(s) in which it is reported as per AS 17;
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable,
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 8

Arzoo Ltd. is in the business of manufacture of passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment to the commercial vehicles segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan, it has planned that it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

Answer

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service;
(2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(3) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(4) Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above, mere gradual phasing out in itself cannot be considered as discontinuing operation. The companies' strategic plan also has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

Question 9

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its

prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

(*July, 2021 Suggested*) (*5 Marks*)

Answer

(i) As per AS 24, a discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(a) Gradual or evolutionary phasing out of a product line or class of service;

(b) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(c) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

(iii) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Question 10

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

(*RTP November 2021*)

Answer

A discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:

(i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

(ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

(iii) Terminating through abandonment and

(b) That represents a separate major line of business or geographical area of operations.

(c) That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

Question 11

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

(*RTP May, 2022*)

Answer

(i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17 'Segment Reporting';
(c) the date and nature of the initial disclosure event;
(d) the date or period in which the discontinuance is expected to be completed if known or determinable;
(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and
(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

(ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:
(i) Gradual or evolutionary phasing out of a product line or class of service;
(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 12

What are the disclosure requirement in interim financial reports as per AS 24 for discontinuing operations?

(*RTP November, 2022*)

Answer

Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

(a) Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and
(b) Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Question 13

AS 24 "Discontinuing Operations"

Arzoo Ltd. is in the business of manufacture of passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment to the commercial vehicles segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan, it has planned that it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

(*RTP May, 2024*)

Answer

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circum- stances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service;
(2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(3) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(4) Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above, mere gradual phasing out in itself cannot be considered as discontinuing operation. The companies' strategic plan also has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

MCQs

Question - 1: AB decided to dispose of its Clothing division as part of its long-term strategy.

Answer:

1. *Date of Board approval - 1st March 20X1;*
2. *Date of formal announcement made to affected parties - 15th March 20X1;*
3. *Date of Binding Sale agreement – 1st July 20X1;*
4. *Reporting date – 31st March 20X1*

The date of initial disclosure event would be:

(a) 1st March 20X1
(b) 15th March 20X1
(c) 31st March 20X1
(d) 31st July 20X1

Question - 2: To qualify as a component that can be distinguished operationally and for financial reporting purposes, the condition(s) to be met is (are):

Answer:

1. *The operating assets and liabilities of the component can be directly attributed to it.*
2. *Its revenue can be directly attributed to it.*
3. *At least a majority of its operating expenses can be directly attributed to it.*
4. *All of the above.*

Question - 3: Identify which of the following statements is incorrect?

Answer:

1. *A discontinuing operation is a component of an enterprise that represents a separate major line of business or geographical area of operations.*
2. *A discontinuing operation is a component of an enterprise that can be distinguished operationally and for financial reporting purposes.*
3. *A discontinuing operation is a component of an enterprise that may or may not be distinguished operationally and for financial reporting purposes.*
4. *A discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.*

Question - 4: Identify the incorrect statement.

Answer:

1. *Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations.*
2. *The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 would always raise a question regarding the enterprise's ability to continue as a going concern.*
3. *For recognising and measuring the effect of discontinuing operations, AS 24 does not provide any guidelines, but for the purpose the relevant Accounting Standards should be referred.*
4. *An enterprise shall include a description of the discontinuing operation, in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs.*

Answer

Q1	***2***	***Q2***	***4***	***Q3***	***3***	***Q4***	***2***

CHAPTER 17

Preparation of Financial Statements

Question 1

In the financial statements of the financial year 20X1-20X2, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of ₹ 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is such non-disclosure a violation of the Schedule III to the Companies Act? Comment.

(*Source: Example 1, Study Material*)

Solution

Schedule III has come into force for the Balance Sheet and Profit and Loss Account prepared for the financial year commencing on or after 1st April, 20X1. As per Part I of the Schedule III, a company should, inter alia, disclose in notes to accounts for the period of 5 years immediately preceding the balance sheet date (31st March, 20X2 in the instant case) the aggregate number and class of shares allotted as fully paid-up bonus shares. Schedule III does not require a company to disclose the source from which bonus shares have been issued. Therefore, non- disclosure of source from which bonus shares have been issued does not violate the Schedule III to the Companies Act.

Question 2

The management of Loyal Ltd. contends that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved. They opine that the value of opening and closing work in process would be more or less the same. Accordingly, the management had not separately disclosed work in process in its financial statements. Comment in line with Schedule III.

(*Source: Example 2, Study Material*)

Solution

Schedule III to the companies Act does not require that the amounts of WIP at the beginning and at the end of the accounting period to be disclosed in the statement of profit and loss. Only changes in inventories of WIP need to be disclosed in the statement of profit and loss. Non-disclosure of such change in the statement of profit and loss by the company may not amount to violation of Schedule III if the differences between opening and closing WIP are not material.

Question 3

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 20X1:

	Amount ₹ in lakhs
Securities Premium Account	*80*
Capital Reserve	*60*
General Reserve	*90*

The company had an accumulated loss of ₹ 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013.

(*Source: Example 3, Study Material*)

Solution

Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) should be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, should be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus, the presentation by the company is incorrect.

Question 4

Sumedha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30 09.20X1 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 20X1 according to Schedule III.

(*Source: Example 4, Study Material*)

Solution

In the given case, instalments due on 30.09.20X1 and 31.03.20X2 will be shown under the head 'short term borrowings' as current maturities of loan from bank as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Therefore, in the balance sheet as on 31.3.20X1, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'short term borrowings'.

Question 5

Prince Ltd. presents its provisions for contingencies under "Reserves and Surplus" in Notes to Accounts in its financial statements. Whether this presentation is correct?

(*Source: Example 5, Study Material*)

Solution

The ICAI's Glossary of Terms Used in Financial Statements defines the term 'Reserve' as "the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability." 'Reserves' should be distinguished from 'provisions'. For this purpose, reference may be made to the definition of the expression ₹provision' in AS-29 Provisions, Contingent Liabilities and Contingent Assets.

As per AS-29, a ₹provision' is "a liability which can be measured only by using a substantial degree of estimation". A 'liability' is "a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits." Present obligation' – "an obligation is a present obligation if, based on the evidence available, its existence at the Balance Sheet date is considered probable, i.e., more likely than not."

Question 6

Anek Ltd. is a company that is required to present its financial statements as per the Division I of Schedule III. The company has trade receivables at the balance sheet date. What are the disclosures that are applicable with respect to trade receivables in the financial statements?

(*Source: Example 6, Study Material*)

Solution

Under Schedule III, trade receivables are required to be classified into long-term (non-current) trade receivables and short-term (current) trade receivables. Trade Receivables, shall be sub-classified as:

(i) (a) Secured, considered good;

(b) Unsecured considered good;

(c) Doubtful

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

For trade receivables outstanding, following ageing schedule shall be given:

Particulars	Outstanding for following periods from due date of payment#					Total
	Less than 6 months	6 months- 1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade Receivables – considered good						
(ii) Undisputed Trade Receivables – considered doubtful						
(iii) Disputed Trade Receivables– considered good						
(iv) Disputed Trade Receivables– considered doubtful						

similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Note: Students may note that the questions based on preparation of Statement of Profit and Loss and Balance Sheet and explanatory notes as per Schedule III have been given in this Unit. However, questions requiring preparation of cash flow statements have been separately given in the next unit of this chapter.

Question 7

Due to inadequacy of profits during the year ended 31st March, 20X2, XYZ Ltd. proposes to declare 10% dividend out of general reserves. From the following particulars, ascertain the amount that can be utilised from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

	₹
17,500 9% Preference shares of ₹ 100 each, fully paid up	*17,50,000*
8,00,000 Equity shares of ₹ 10 each, fully paid up	*80,00,000*
General Reserves as on 1.4.20X1	*25,00,000*
Capital Reserves as on 1.4.20X1	*3,00,000*
Revaluation Reserves as on 1.4.20X1	*3,50,000*
Net profit for the year ended 31st March, 20X2	*3,00,000*
Average rate of dividend during the last three years has been 12%.	

(*Source: Illustration 1, Study Material*)

Solution

Amount that can be drawn from reserves for 10% dividend		
10% dividend on ₹ 80,00,000		₹ 8,00,000
Profits available		
Current year profit	3,00,000	
Less: Preference dividend	(1,57,500)	(1,42,500)
Amount which can be utilised from reserves		6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves i.e. ₹ 12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III

The balance of reserves after drawl ₹ 18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15 % of its paid up capital i.e. ₹ 14,62,500 (15% of ₹ 97,50,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated reserves (as per Declaration and Payment of Dividend Rules, 2014.)

Question 8

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures in ₹ '000)

	Debit		***Credit***
Land at cost	*220*	*Equity Capital (Shares of ₹ 10 each)*	*300*
Plant & Machinery at cost	*770*	*10% Debentures*	*200*
Trade Receivables	*96*	*General Reserve*	*130*
Inventories (31.3.X2)	*86*	*Profit & Loss A/c*	*72*
Bank	*20*	*Securities Premium*	*40*
Adjusted Purchases	*320*	*Sales*	*700*
Factory Expenses	*60*	*Trade Payables*	*52*
Administration Expenses	*30*	*Provision for Depreciation*	*172*
Selling Expenses	*30*	*Suspense Account*	*4*
Debenture Interest	*20*		
Interim Dividend Paid	*18*		
	1670		*1670*

Additional Information:

(i) The authorised share capital of the company is 40,000 shares of ₹ 10 each.

(ii) The company on the advice of independent valuer wish to revalue the land at ₹ 3,60,000.

(iii) Declared final dividend @ 10% on 2nd April, 20X2.

(iv) Suspense account of ₹ 4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Balance Sheet as on 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous years' figures & taxation.

(*Source: Illustration 2, Study Material*)

Solution

Omega Limited

Balance Sheet as at 31st March, 20X2

Particulars	***Note No.***	***(₹ in 000)***
Equity and Liabilities		
1. Shareholders' funds		
A Share capital	1	300
B Reserves and Surplus	2	530
2. Non-Current liabilities		
A Long term borrowings	3	200
3. Current liabilities		
A Trade Payables		52
Total		**1082**

Particulars	*Note No.*	*(₹ in 000)*
Assets		
1. Non-current assets		
A PPE (Property, Plant & Equipment)	4	880
2. Current assets		
A Inventories		86
B Trade receivables		96
C Cash and bank balances		20
Total		**1082**

Omega Limited

Statement of Profit and Loss for the year ended 31st March, 20X2

Particulars		*Notes*	*(₹ in 000)*
I.	Revenue from operations		700
II.	Other Income	5	2
III	**Total Revenue**		**702**
IV	Expenses:		
	Purchases		320
	Finance costs	6	20
	Depreciation (10% of 760)*		76
	Other expenses	7	120
	Total Expenses		**536**
V.	**Profit (Loss) for the period** (III – IV)		**166**

Notes to accounts

				(₹ in 000)
1.	**Share Capital**			
	Equity share capital			
	Authorised			
	40,000 shares of ₹ 10 each			400
	Issued & subscribed & called up			
	30,000 shares of ₹ 10 each			300
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	Revaluation reserve (360 – 220)			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	220
				530

* 770 (Plant and machinery at cost) – 10 (Cost of plant and machinery sold)

			(₹ in 000)
3.	**Long term borrowing**		
	10% Debentures		200
4.	**PPE**		
	Land		
	Opening balance	220	
	Add: Revaluation adjustment	140	
	Closing balance		360
	Plant and Machinery		
	Opening balance	770	
	Less: Disposed off	(10)	
		760	
	Less: Depreciation (172-8+76)	(240)	
	Closing balance		520
	Total		880
5.	**Other Income**		
	Profit on sale of machinery:		
	Sale value of machinery	4	
	Less: Book value of machinery (10-8)	(2)	2
6.	**Finance costs**		
	Debenture interest		20
7.	**Other expenses:**		
	Factory expenses	60	
	Selling expenses	30	
	Administrative expenses	30	120

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 9

You are required to prepare Balance sheet and statement of Profit and Loss from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 20X1.

Haria Chemicals Ltd.

Trial Balance as at 31st March, 20X1

Particulars	*₹*	*Particulars*	*₹*
Inventory	*6,80,000*	*Equity Shares*	
Furniture	*2,00,000*	*Capital (Shares of ₹10 each)*	*25,00,000*
Discount	*40,000*	*11% Debentures*	*5,00,000*
Loan to Directors	*80,000*	*Bank loans*	*6,45,000*
Advertisement	*20,000*	*Trade payables*	*2,81,000*
Bad debts	*35,000*	*Sales*	*42,68,000*
Commission	*1,20,000*	*Rent received*	*46,000*
Materials consumed	*23,19,000*	*Transfer fees*	*10,000*

Particulars	***₹***	***Particulars***	***₹***
Plant and Machinery	*8,60,000*	*Profit & Loss account*	*1,39,000*
Rentals	*25,000*	*Depreciation provision:*	
Current account	*45,000*	*Machinery*	*1,46,000*
Cash	*8,000*		
Interest on bank loans	*1,16,000*		
Preliminary expenses	*10,000*		
Fixtures	*3,00,000*		
Wages	*9,00,000*		
Consumables	*84,000*		
Freehold land	*15,46,000*		
Tools & Equipment	*2,45,000*		
Goodwill	*2,65,000*		
Trade receivables	*4,40,000*		
Dealer aids	*21,000*		
Transit insurance	*30,000*		
Trade expenses	*37,000*		
Distribution freight	*54,000*		
Debenture interest	*55,000*		
	85,35,000		*85,35,000*

Additional information: Closing Inventory on 31-3-20X1: ₹ 8,23,000.

(*Source: Illustration 3, Study Material*)

Solution

Haria Chemicals Ltd.
Balance Sheet as at 31st March, 20X1

	Schedule No. (1)	***Rupees as at* the *end of 31st March 20X1 (2)***
Equity and Liabilities		
(1) Shareholders' funds:		
(a) Share Capital	1	25,00,000
(b) Reserves and Surplus	2	7,40,000
(2) Non Current Liabilities		
(a) Long term borrowings	3	11,45,000
(3) Current Liabilities		
(a) Trade payables		2,81,000
Total		**46,66,000**
Assets		
(1) Non current assets		
(a) PPE	4	30,05,000
(b) Intangible assets (goodwill)		2,65,000
(2) Current assets		
(a) Inventories		8,23,000
(b) Trade receivables		4,40,000
(c) Cash and bank balances	5	53,000
(d) Short term loans and advances	6	80,000
Total		**46,66,000**

Haria Chemicals Ltd.

Statement of Profit and Loss for the year ended 31st March, 20X1

		Schedule	*Figures*	
Revenue from operations			42,68,000	
Other income		7	56,000	
	(A)		43,24,000	
Expenses				
Cost of materials consumed			23,19,000	
Change in inventory of finished goods		8	(1,43,000)	
Employee benefit expenses		9	9,00,000	
Finance cost		10	1,71,000	
Other expenses		11	4,76,000	
	(B)		37,23,000	
Profit before tax (A – B)				6,01,000
Provision for tax				—
Profit for the period				6,01,000

Notes to Accounts

1. Share capital ₹

Authorised:	
Equity share capital of ₹ 10 each	25,00,000
Issued and Subscribed:	
Equity share capital of ₹ 10 each	25,00,000

2. Reserves and Surplus

Balance as per last balance sheet	1,39,000
Balance in profit and loss account	6,01,000
	7,40,000

3. Long term Borrowings

11% Debentures	5,00,000
Bank loans (assumed long-term)	6,45,000
	11,45,000

4. PPE

	Gross block	*Depreciation*	*Net Block*
Freehold land	15,46,000		15,46,000
Furniture	2,00,000		2,00,000
Fixtures	3,00,000		3,00,000
Plant & Machinery	8,60,000	1,46,000	7,14,000
Tools & Equipment	2,45,000		2,45,000
Total	31,51,000	1,46,000	30,05,000

5. Cash and bank balances

Cash and cash equivalents	
Current account balance	45,000
Cash	8,000
Other bank balances	Nil
	53,000

6. Short-term loans and Advances		
Loan to directors		80,000
7. Other Income		
Rent received		46,000
Transfer fees		10,000
		56,000
8. Changes in inventory of finished goods, WIP & Stock in trade		
Opening inventory	6,80,000	
Closing inventory	(8,23,000)	(1,43,000)
9. Employee benefit expense		
Wages		9,00,000
10. Finance cost		
Interest on bank loans		1,16,000
Debenture interest		55,000
		1,71,000
11. Other Expenses		
Consumables		84,000
Preliminary expenses		10,000
Bad debts		35,000
Discount		40,000
Rentals		25,000
Commission		1,20,000
Advertisement		20,000
Dealers' aids		21,000
Transit insurance		30,000
Trade expenses		37,000
Distribution freight		54,000
		4,76,000

Question 10

You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 20X2:

	Dr. ***₹***	***Cr.*** ***₹***
Authorised Capital-divided into 5,000 6% Preference Shares of ₹100 each and 10,000 equity Shares of ₹100 each		*15,00,000*
Subscribed Capital -		
5,000 6% Preference Shares of ₹100 each		*5,00,000*
Equity Capital		*8,05,000*
Purchases - Wines, Cigarettes, Cigars, etc.	*45,800*	
- Foodstuffs	*36,200*	
Wages and Salaries	*28,300*	
Rent, Rates and Taxes	*8,900*	
Laundry	*750*	
Sales - Wines, Cigarettes, Cigars, etc.		*68,400*
- Food		*57,600*
Coal and Firewood	*3,290*	
Carriage and Cooliage	*810*	

		Dr. ₹	Cr. ₹
Sundry Expenses		*5,840*	
Advertising		*8,360*	
Repairs		*4,250*	
Rent of Rooms			*48,000*
Billiard			*5,700*
Miscellaneous Receipts			*2,800*
Discount received			*3,300*
Transfer fees			*700*
Freehold Land and Building		*8,50,000*	
Furniture and Fittings		*86,300*	
Inventory on hand, 1st April, 20X1			
Wines, Cigarettes. Cigars, etc.		*12,800*	
Foodstuffs		*5,260*	
Cash in hand		*2,200*	
Cash with Bankers		*76,380*	
Preliminary and formation expenses		*8,000*	
2,000 Debentures of ₹ 100 each (6%)			*2,00,000*
Profit and Loss Account			*41,500*
Trade payables			*42,000*
Trade receivables		*19,260*	
Investments		*2,72,300*	
Goodwill at cost		*5,00,000*	
General Reserve			*2,00,000*
		19,75,000	*19,75,000*
Wages and Salaries Outstanding	*1,280*		
Inventory on 31st March, 20X2			
Wines, Cigarettes and Cigars, etc.	*22,500*		
Foodstuffs	*16,400*		

Depreciation : Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.

The Equity capital on 1st April, 20X1 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹60 paid. The directors made a call of ₹ 40 per share on 1st October 20X1. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid. The Directors declared a dividend of 8% on equity shares on 2nd April, 20X2, transferring any amount that may be required from General Reserve. Ignore Taxation. (*Source: Illustration 4, Study Material*)

Solution

Balance Sheet of International Hotels Ltd. as at 31st March, 20X2

Particulars	*Note No*	₹
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	13,00,000
(b) Reserves and Surplus	2	2,68,745
2 Non-current liabilities		
(a) Long-term borrowings	3	2,00,000
3 Current liabilities		
(a) Trade Payables	4	42,000
(b) Other current liabilities	5	13,280
Total		**18,24,025**

Particulars	*Note No*	₹
ASSETS		
1 Non-current assets		
(i) PPE	6	9,14,985
(ii) Intangible assets (Goodwill)		5,00,000
(iii) Non-current investments		2,72,300
2 Current assets		
(i) Inventories	7	38,900
(ii) Trade receivables		19,260
(iii) Cash and bank balances	8	78,580
Total		**18,24,025**

Statement of Profit and Loss of International Hotels Ltd.
for the year ended 31st March, 20X2

	Particulars	*Notes*	*Amount*
I.	Revenue from operations	9	1,79,700
II.	Other income	10	6,800
III.	**Total Income (I + II)**		**1,86,500**
IV.	**Expenses:**		
	Cost of materials consumed	11	25,060
	Purchases of Inventory-in-Trade	12	45,800
	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	13	(9,700)
	Employee benefits expense	14	29,580
	Other operating expenses	15	18,000
	Selling and administrative expenses	16	14,200
	Finance costs	17	12,000
	Depreciation and amortisation expense	18	21,315
	Other expenses (Preliminary expenses written off)		8,000
	Total expenses		**1,64,255**
V.	**Profit (Loss) for the period (III - IV)**		**22,245**

Notes to accounts

	₹
1 Share Capital	
Equity share capital	
Authorised	
10,000 Equity shares of ₹ 100 each	10,00,000
Issued & subscribed	
8,000 Equity Shares of ₹ 100 each (A)	8,00,000
Preference share capital	
Authorised	
5,000 6% Preference shares of ₹ 100 each	5,00,000
Issued & subscribed	
5,000 6% Preference shares of ₹ 100 each (B)	5,00,000
Total (A + B)	**13,00,000**

			₹
2	**Reserves and Surplus**		
	Capital reserve [100 x (90 – 40)]		5,000
	General reserve	2,00,000	
	Surplus (Profit & Loss A/c)	22,245	2,00,000
	Add: Balance from previous year	41,500	
			63,745
	Total		**2,68,745**
3	**Long-term borrowings**		
	Secured		
	6% Debentures		2,00,000
	Total		**2,00,000**
4	**Trade Payables**		42,000
5	**Other current liabilities**		
	Wages and Salaries Outstanding	1,280	
	Interest on debentures	12,000	13,280
	Total		**13,280**
6	**PPE**		
	Freehold land & Buildings	8,50,000	
	Less: Depreciation	(17,000)	8,33,000
	Furniture and Fittings	86,300	
	Less: Depreciation	(4,315)	81,985
	Total		**9,14,985**
7	**Inventories**		
	Wines, Cigarettes & Cigars, etc.		22,500
	Foodstuffs		16,400
	Total		**38,900**
8	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		76,380
	Cash in hand		2,200
	Other bank balances		Nil
	Total		**78,580**
9	**Other expenses**		
	Preliminary Expenses*		8,000
	Total		**8,000**
10	**Revenue from operations**		
	Sale of products		
	Wines, Cigarettes, Cigars etc.	68,400	
	Food	57,600	1,26,000
	Sale of services		
	Room Rent	48,000	
	Billiards	5,700	
	Transfer fees	700	
	Miscellaneous Receipts	2,800	
			57,200
	Total		**1,83,200**

* As per AS 26, preliminary expenses are not shown in the balance sheet.

		₹
11 Cost of materials consumed		
Opening Inventory	5,260	
Add: Purchases during the year	36,200	
Less: Closing Inventory	(16,400)	25,060
Total		**25,060**
12 Purchases of Inventory-in-Trade		
Wines, Cigarettes etc.		45,800
Total		**45,800**
13. Changes in inventories of finished goods work-in-progress and Inventory-in-Trade		
Wines, Cigarettes etc.		
Opening Inventory	12,800	
Less: Closing Inventory	(22,500)	(9,700)
Total		**(9,700)**
14 Employee benefits expense		
Wages and Salaries	28,300	
Add: Wages and Salaries Outstanding	1,280	29,580
Total		**29,580**
15 Other operating expenses		
Rent, Rates and Taxes		8,900
Coal and Firewood		3,290
Laundry		750
Carriage and Cooliage		810
Repairs		4,250
Total		**18,000**
16 Selling and administrative expenses		
Advertising		8,360
Sundry Expenses		5,840
Total		**14,200**
17 Finance costs		
Interest on Debentures (2,00,000 x 6%)		12,000
Total		**12,000**
18 Depreciation and amortisation expense		
Land and Buildings (8,50,000 x 2%)	17,000	
Furniture & Fittings (86,300 x 5%)	4,315	21,315
Total		**21,315**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 11

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 20X1 as required by Schedule III of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary –

		Debit	Credit
		₹	₹
Equity Capital (Face value of ₹ 100)			*10,00,000*
Calls in Arrears		*1,000*	
Land		*2,00,000*	
Building		*3,50,000*	
Plant and Machinery		*5,25,000*	
Furniture		*50,000*	
General Reserve			*2,10,000*
Loan from State Financial Corporation			*1,50,000*
Inventory :			
Finished Goods	*2,00,000*		
Raw Materials	*50,000*	*2,50,000*	
Provision for Taxation			*68,000*
Trade receivables		*2,00,000*	
Advances		*42,700*	
Dividend Payable			*60,000*
Profit and Loss Account			*86,700*
Cash Balance		*30,000*	
Cash at Bank		*2,47,000*	
Loans (Unsecured)			*1,21,000*
Trade payables (For Goods and Expenses)			*2,00,000*
		18,95,700	*18,95,700*

The following additional information is also provided :

(1) 2,000 equity shares were issued for consideration other than cash.

(2) Trade receivables of ₹ 52,000 are due for more than six months.

(3) The cost of assets:

Building	*₹ 4,00,000*
Plant and Machinery	*₹ 7,00,000*
Furniture	*₹ 62,500*

(4) The balance of ₹ 1,50,000 in the loan account with State Finance Corporation is inclusive of ₹ 7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.

(5) Balance at Bank includes ₹ 2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(6) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

(*Source: Illustration 5, Study Material*)

Solution

Pioneer Ltd.

Balance Sheet as at 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	9,99,000
	(b)	Reserves and Surplus	2	2,96,700
2		**Non-current liabilities**		
	(a)	Long-term borrowings	3	2,63,500

		Particulars	Notes	₹
3		**Current liabilities**		
	(a)	Trade Payables		2,00,000
	(b)	Other current liabilities	4	67,500
	(c)	Short-term provisions	5	68,000
		Total		**18,94,700**
		Assets		
1		**Non-current assets**		
	(a)	PPE	6	11,25,000
2		**Current assets**		
	(a)	Inventories	7	2,50,000
	(b)	Trade receivables	8	2,00,000
	(c)	Cash and bank balances	9	2,77,000
	(d)	Short-term loans and advances		42,700
		Total		**18,94,700**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	10,000 Equity Shares of ₹ 100 each (Of the above 2,000 shares have been issued for consideration other than cash)	10,00,000	
	Less: Calls in arrears	(1,000)	9,99,000
	Total		**9,99,000**
2	**Reserves and Surplus**		
	General Reserve		2,10,000
	Surplus (Profit & Loss A/c)		86,700
	Total		**2,96,700**
3	**Long-term borrowings**		
	Secured		
	Term Loans		
	Loan from State Financial Corporation (1,50,000–7,500) (Secured by hypothecation of Plant and Machinery)		1,42,500
	Unsecured loan		1,21,000
	Total		**2,63,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		7,500
	Dividend Payable		60,000
	Total		**67,500**
5	**Short-term provisions**		
	Provision for taxation		68,000
	Total		**68,000**

			₹
6	**PPE**		
	Land		2,00,000
	Buildings	4,00,000	
	Less: Depreciation	(50,000) (b.f.)	3,50,000
	Plant & Machinery	7,00,000	
	Less: Depreciation	(1,75,000) (b.f.)	5,25,000
	Furniture & Fittings	62,500	
	Less: Depreciation	(12,500) (b.f.)	50,000
	Total		**11,25,000**
7	**Inventories**		
	Raw Material		50,000
	Finished goods		2,00,000
	Total		**2,50,000**
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		52,000
	Other Debts		1,48,000
	Total		**2,00,000**
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		
	with Scheduled Banks	2,45,000	
	with others (Perfect Bank Ltd.)	2,000	2,47,000
	Cash in hand		30,000
	Other bank balances		Nil
	Total		**2,77,000**

Note: Estimated amount of contract remaining to be executed on capital account and not provided for ₹1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Question 12

Following is the trial balance of Delta limited as on 31.3.20X2.

(Figures in ₹ '000)

Particulars	***Debit***	***Particulars***	***Credit***
Land at cost	*800*	*Equity share capital (shares of ₹ 10 each)*	*500*
Calls in arrears	*5*	*10% Debentures*	*300*
Cash in hand	*2*	*General reserve*	*150*
Plant & Machinery at cost	*824*	*Profit & Loss A/c (balance on 1.4.X1)*	*75*
Trade receivables	*120*	*Securities premium*	*40*
Inventories (31-3-X2)	*96*	*Sales*	*1200*
Cash at Bank	*28*	*Trade payables*	*30*
Adjusted Purchases	*400*	*Provision for depreciation*	*150*
Factory expenses	*80*	*Suspense Account*	*10*
Administrative expenses	*45*		
Selling expenses	*25*		
Debenture Interest	*30*		
	2455		*2455*

Additional Information:

(i) The authorized share capital of the company is 80,000 shares of ₹ 10 each.

(ii) The company revalued the land at ₹ 9,60,000.

(iii) Equity share capital includes shares of ₹ 50,000 issued for consideration other than cash.

(iv) Suspense account of ₹ 10,000 represents cash received from the sale of some of the machinery on 1.4.20X1. The cost of the machinery was ₹ 24,000 and the accumulated depreciation thereon being ₹ 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Balance at bank includes ₹ 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.

(vii) Make provision for income tax @30%.

(viii) Trade receivables of ₹ 50,000 are due for more than six months.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.20X2 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.20X2 as per Schedule III. Ignore previous year's figures & taxation.

(*Source: Illustration 6, Study Material*)

Solution

Delta Limited

Balance Sheet as at 31st March 20X2

Particulars	Note No.	(₹ in '000)
A. Equity and Liabilities		
1. Shareholders' funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00
(b) Short- term provision	4	163.80
Total		1,796.00
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00
(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 20X2

Particulars	Note No.	(₹ in '000)
I. Revenue from Operations		1200.00
II. Other Income	8	6.00
III. Total Income (I +II)		1,206.00
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)		80.00
Other expenses	10	150.00
Total Expenses		660.00
V. Profit / (Loss) for the period before tax (III – IV)		546.00
VI. Tax expenses @30%		163.80
VII Profit for the period		382.20

Notes to Accounts

	Particulars		(₹ in '000)
1	Share Capital		
	Equity Share Capital Authorised 80,000 Shares of ₹10/- each		800
	Issued, Subscribed and Called -up		
	50,000 Shares of ₹ 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve ₹ (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance		
	Opening Balance	75.00	
	Add: Profit for the period	382.20	457.20
			807.20
3	Long-Term Borrowings		
	10% Debentures		300
4.	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	
		800	
	Less: Depreciation ₹ (150 – 20 + 80)	(210)	
	Closing Balance		590
	Total		1,550
6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less : Book value of machinery (24 – 20)	(4)	6
9	Finance Costs		
	Debenture Interest		30

Question 13

State under which head these accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

(i) Share application money received in excess of issued share capital.
(ii) Share option outstanding account.
(iii) Unpaid matured debenture and interest accrued thereon.
(iv) Uncalled liability on shares and other partly paid investments.
(v) Calls unpaid.
(vi) Money received against share warrant.

(*Source: Question 6, Study Material*)

Answer

(i) Current Liabilities/Other Current Liabilities
(ii) Shareholders' Fund/Reserve & Surplus
(iii) Current liabilities/Other Current Liabilities
(iv) Contingent Liabilities and Commitments
(v) Shareholders' Fund/Share Capital
(vi) Shareholders' Fund/Money received against share warrants

Question 14

On 31st March, 20X1 Bose and Sen Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 20X1:

***Credit Balances**:*

	₹
Equity shares capital, fully paid shares of ₹10 each	*70,00,000*
General Reserve	*15,49,100*
Loan from State Finance Corporation	*10,50,000*
(Secured by hypothecation of Plant & Machinery Repayable	
within one year ₹2,00,000)	
Loans: Unsecured (Long term)	*8,47,000*
Sundry Creditors for goods &expenses	*14,00,000*
(Payable within 6 months)	
Profit & Loss Account	*7,00,000*
Provision for Taxation	*8,16,900*
	1,33,63,000

Debit Balances:

	₹
Calls in arrear	*7,000*
Land	*14,00,000*
Buildings	*20,50,000*
Plant and Machinery	*36,75,000*
Furniture& Fixture	*3,50,000*
Inventories: Finished goods	*14,00,000*
Raw Materials	*3,50,000*
Trade Receivables	*14,00,000*
Advances: Short-term	*2,98,900*
Cash in hand	*2,10,000*
Balances with banks	*17,29,000*
Preliminary Expenses	*93,100*
Patents & Trademarks	*4,00,000*
	1,33,63,000

The following additional information is also provided in respect of the above balances:

(i) 4,20,000 fully paid equity shares were allotted as consideration for land & buildings.

(ii) Cost of Building ₹ 28,00,000

(iii) Cost of Plant & Machinery ₹ 49,00,000 Cost of Furniture & Fixture ₹ 4,37,500

(iv) Trade receivables for ₹ 3,80,000 are due for more than 6 months.

(v) The amount of Balances with Bank includes ₹ 18,000 with a bank which is not a scheduled Bank and the deposits of ₹ 5 lakhs are for a period of 9 months.

(vi) Unsecured loan includes ₹ 2,00,000 from a Bank and ₹ 1,00,000 from related parties.

(vii) Entire amount of Preliminary expenses to be written off, by adjusting from opening balance of General Reserve.

You are not required to give previous year's figures. You are required to prepare the Balance Sheet of the Company as on 31stMarch, 20X1 as required under Schedule III to the Companies Act, 2013.

(*Source: Question 7, Study Material*)

Answer

Bose and Sen Ltd.

Balance Sheet as at 31st March, 20X1

		Particulars	***Notes***	***Figures at the end of current reporting period (₹)***
Equity and Liabilities				
1		**Shareholders' funds**		
	(a)	Share capital	1	69,93,000
	(b)	Reserves and Surplus	2	21,56,000
2		Non-current liabilities		
	(a)	Long-term borrowings	3	16,97,000
3		**Current liabilities**		
	(a)	Trade Payables		14,00,000
	(b)	Other current liabilities	4	2,00,000
	(c)	Short-term provisions	5	8,16,900
		Total		1,32,62,900
Assets				
1		**Non-current assets**		
	(a)	PPE	6	74,75,000
	(b)	Intangible assets (Patents & Trade Marks)		4,00,000
2		**Current assets**		
	(a)	Inventories	7	17,50,000
	(b)	Trade receivables	8	14,00,000
	(c)	Cash and bank balances	9	19,39,000
	(d)	Short-term loans and advances		2,98,900
		Total		1,32,62,900

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up	70,00,000	
	7,00,000 Equity Shares of ₹ 10 each (Out of the above 4,20,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(7,000)	69,93,000
	Total		69,93,000
2	**Reserves and Surplus**		
	General Reserve		15,49,100
	Surplus (Profit & Loss A/c)		
	Less: Preliminary expenses	7,00,000	
	Total	(93,100)*	6,06,900
			21,56,000
	Long-term borrowings		
	Secured Term Loans		
3	Loan from State Finance Corporation (₹ 10,50,000 - ₹ 2,00,000) (Secured by hypothecation of Plant and Machinery)		8,50,000
	Unsecured		
	Bank Loan	2,00,000	
	Loan from related parties	1,00,000	
	Others	5,47,000	
	Total		8,47,000
			16,97,000
4	**Other current liabilities**		
	Current maturities of long-term debt- loan Instalment repayable within one year		2,00,000
5	**Short-term provisions**		
	Provision for taxation		8,16,900
6	**Property, plant and equipment**		
	Land		14,00,000
	Buildings	28,00,000	
	Less: Depreciation	(7,50,000) (b.f.)	20,50,000
	Plant & Machinery	49,00,000	
	Less: Depreciation	(12,25,000) (b.f.)	36,75,000
	Furniture & Fittings	4,37,500	
	Less: Depreciation	(87,500) (b.f.)	3,50,000
	Total		74,75,000
7	**Inventories**		
	Raw Material		3,50,000
	Finished goods		14,00,000
			17,50,000

* *Preliminary expenses have been written off in line with Accounting Standards.*

			₹
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		3,80,000
	Other Debts		10,20,000
	Total		14,00,000
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank with Scheduled Banks	12,11,000	
	with others	18,000	12,29,000
	Cash in hand		2,10,000
	Other bank balances	5,00,000	
	Bank deposits for period of 9 months		5,00,000
	Total		19,39,000

Question 15

From the following particulars furnished by Alpha Ltd., prepare the Balance Sheet as on 31st March 20X1 as required by Part I, Schedule III to the Companies Act, 2013.

Particulars		***Debit ₹***	***Credit ₹***
Equity Share Capital (Face value of ₹100 each)			*50,00,000*
Call in Arrears		*5,000*	
Land & Building		*27,50,000*	
Plant & Machinery		*26,25,000*	
Furniture		*2,50,000*	
General Reserve			*10,50,000*
Loan from State Financial Corporation			*7,50,000*
Inventory:			
Raw Materials	*2,50,000*		
Finished Goods	*10,00,000*	*12,50,000*	
Provision for Taxation			*6,40,000*
Trade receivables		*10,00,000*	
Short term Advances		*2,13,500*	
Profit & Loss Account			*4,33,500*
Cash in Hand		*1,50,000*	
Cash at Bank		*12,35,000*	
Unsecured Loan			*6,05,000*
Trade payables (for Goods and Expenses)			*8,00,000*
Loans & advances from related parties			*2,00,000*
		94,78,500	*94,78,500*

The following additional information is also provided:

(i) 10,000 Equity shares were issued for consideration other than cash.

(ii) Trade receivables of ₹2,60,000 are due for more than 6 months.

(iii) The cost of the Assets were:

Building ₹30,00,000, Plant & Machinery ₹35,00,000 and Furniture ₹3,12,500

(iv) The balance of ₹7,50,000 in the Loan Account with State Finance Corporation is inclusive of ₹37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

(v) Balance at Bank includes ₹10,000 with Omega Bank Ltd., which is not a Scheduled Bank.

(vi) Transfer ₹20,000 to general reserve is proposed by Board of directors.

(vii) Board of directors declared dividend of 5% on the paid up capital on 2nd April, 20X1.

(*Source: Question 8, Study Material*)

Answer

Alpha Ltd.
Balance Sheet as at 31st March, 20X1

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	49,95,000
	(b)	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	(a)	Trade Payables		8,00,000
	(b)	Other current liabilities	4	37,500
	(c)	Short-term provisions	5	6,40,000
	(d)	Short-term borrowings		2,00,000
		Total		**94,73,500**
		Assets		
1		**Non-current assets**		
		PPE	6	56,25,000
2		**Current assets**		
	(a)	Inventories	7	12,50,000
	(b)	Trade receivables	8	10,00,000
	(c)	Cash and bank balances	9	13,85,000
	(d)	Short-term loans and advances		2,13,500
		Total		**94,73,500**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	50,000 Equity Shares of ₹ 100 each (of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000
	Total		**49,95,000**
2	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	4,13,500
	Total		**14,83,500**
3	**Long-term borrowings**		
	Secured Term Loan		

			₹
	State Financial Corporation Loan (7,50,000- 37,500)		
	(Secured by hypothecation of Plant and Machinery)		7,12,500
	Unsecured Loan		6,05,000
	Total		**13,17,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		37,500
			37,500
5	**Short-term provisions**		
	Provision for taxation		6,40,000
6	**Property, plant and equipment**		
	Land and Building	30,00,000	
	Less: Depreciation	(2,50,000)	27,50,000
		(b.f.)	
	Plant & Machinery	35,00,000	
	Less: Depreciation	(8,75,000)	26,25,000
		(b.f.)	
	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500)	2,50,000
		(b.f.)	
	Total		**56,25,000**
7	**Inventories**		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		**12,50,000**
8	**Trade receivables**		
	Outstanding for a period exceeding six months		2,60,000
	Other Amounts		7,40,000
	Total		**10,00,000**
9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank		
	with Scheduled Banks	12,25,000	
	with others (Omega Bank Ltd.)	10,000	12,35,000
	Cash in hand		1,50,000
	Other bank balances		Nil
	Total		**13,85,000**

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X1. Such dividends will be disclosed in notes only.

Question 16

Ring Ltd. was registered with a nominal capital of ₹ 10,00,000 divided into shares of ₹ 100 each. The following Trial Balance is extracted from the books on 31st March, 20X2:

Particulars	*₹*	***Particulars***	*₹*
Buildings	*5,80,000*	*Sales*	*10,40,000*
Machinery	*2,00,000*	*Outstanding Expenses*	*4,000*
Closing Stock	*1,80,000*	*Provision for Doubtful*	*6,000*
Loose Tools	*46,000*	*Debts (1-4-20X1)*	
Purchases (finished goods)	*4,20,000*	*Equity Share Capital*	*4,00,000*

Particulars	*₹*	*Particulars*		*₹*
Salaries	*1,20,000*	*General Reserve*		*80,000*
Directors' Fees	*20,000*	*Profit and Loss A/c*		*50,000*
Rent	*52,000*	*(1-4-20X1)*		
Depreciation	*40,000*	*Creditors*		*1,84,000*
Bad Debts	*12,000*	*Provision for depreciation:*		
Investment	*2,40,000*	*On Building*	*1,00,000*	
Interest accrued on investment	*4,000*	*On Machinery*	*1,10,000*	*2,10,000*
Debenture Interest	*56,000*	*14% Debentures*		*4,00,000*
Advance Tax	*1,20,000*	*Interest on Debentures*		*28,000*
Sundry expenses	*36,000*	*accrued but not due*		
Debtors	*2,50,000*	*Interest on Investments*		*24,000*
Bank	*60,000*	*Unclaimed dividend*		*10,000*
	24,36,000			*24,36,000*

You are required to prepare statement of Profit and Loss for the year ending 31st March, 20X2 and Balance sheet as at that date after taking into consideration the following information:

(a) Closing stock is more than opening stock by ₹1,60,000.

(b) Provide to doubtful debts @ 4% on Debtors.

(c) Make a provision for income tax @30%.

(d) Depreciation expense included depreciation of ₹16,000 on Building and that of ₹24,000 on Machinery.

(e) The directors declared a dividend @ 25% on 2nd April, 20X2 and transfer to General Reserve @ 10%.

(f) Bills Discounted but not yet matured ₹20,000.

(*Source: Question 9, Study Material*)

Answer

Ring Ltd.

Profit and Loss Statement for the year ended 31st March, 20X2

	Particulars	*Note No.*	*(₹In lacs)*
I	**Revenue from operations**		10,40,000
II	**Other income** (interest on investment)		24,000
III	**Total Revenue [I + II]**		**10,64,000**
IV	**Expenses:**		
	Cost of purchase [4,20,000+ 1,60,000]		5,80,000
	Changes in inventories [20,000-1,80,000]		(1,60,000)
	Employee Benefits Expense		1,20,000
	Finance Costs (debenture interest)		56,000
	Depreciation and Amortisation Expenses		40,000
	Other Expenses	**8**	1,24,000
	Total Expenses		**7,60,000**
V	Profit before Tax (III-IV)		3,04,000
VI	**Tax Expenses @ 30%**		(91,200)
VII	**Profit for the period**		**2,12,800**

Balance Sheet of Ring Ltd. as at 31ST March, 20X2

		Particulars	*Note No.*	*₹*
I	**EQUITY AND LIABILITIES**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	4,00,000
		(b) Reserves and Surplus	2	3,42,800
	(2)	**Non-Current Liabilities**		
		(a) Long-term Borrowings (14% debentures)		4,00,000
	(3)	**Current Liabilities**		
		(a) Trade Payable (Sundry Creditors)		1,84,000
		(b) Other Current Liabilities	3	42,000
		(c) Short-Term Provisions	4	91,200
		Total		**14,60,000**
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) PPE	5	5,70,000
		(b) Non-current Investments		2,40,000
	(2)	**Current Assets**		
		(a) Inventories	6	2,26,000
		(b) Trade Receivables	7	2,40,000
		(c) Cash and bank balances		60,000
		(d) Short Term Loans and Advances (Advance Payment of Tax)		1,20,000
		(e) Other Current Assets		4,000
		(Interest accrued on investments)		
		Total		**14,60,000**

Note: There is a Contingent Liability for bills discounted but not yet matured amounting to ₹ 20,000.

Notes to Accounts:

1.	**Share Capital**		
	Authorised Capital		
	10,000 Equity Shares of ₹ 100 each		10,00,000
	Issued Capital		
	4,000 Equity Shares of ₹ 100 each		4,00,000
	Subscribed Capital and fully paid		
	4,000 Equity Shares of ₹ 100 each		4,00,000
2.	**Reserve and Surplus**		
	General Reserve [₹ 80,000 + ₹ 21,280]		1,01,280
	Balance of Statement of Profit & Loss Account		
	Opening Balance	50,000	
	Add: Profit for the period	2,12,800	
	Appropriations	2,62,800	
	Transfer to General Reserve @ 10%	(21,280)	2,41,520
3.	**Other Current Liabilities**		3,42,800
	Unclaimed Dividend		10,000
	Outstanding Expenses		4,000
	Interest accrued on Debentures		28,000
4.	**Short-Term Provision**		42,000
	Provision for Tax		91,200
5	**Property, plant and equipment**		
	Buildings	5,80,000	
	Less: Provision for Depreciation	1,00,000	4,80,000

	Plant and Equipment	2,00,000	
	Less: Provision for Depreciation	1,10,000	90,000
6	**Inventories**		5,70,000
	Closing Stock of Finished Goods	1,80,000	
	Loose Tools	46,000	2,26,000
7	**Trade Receivables**		
	Sundry Debtors	2,50,000	
	Less: Provision for Doubtful Debts	(10,000)	2,40,000
8.	**Other Expenses**		
	Rent		52,000
	Directors' Fees		20,000
	Bad Debts		12,000
	Provision for Doubtful Debts (4% of ₹ 2,50,000 less ₹ 6,000)		4,000
	Sundry Expenses		36,000
			1,24,000

Note: The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 20X2. Such dividends will be disclosed in notes only.

Question 17

On 31st March, 20X1, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 20X1.

Particulars	***Amount (₹)***	
	Debit	*Credit*
Equity Share Capital, fully paid shares of ₹ 50 each		*80,00,000*
Calls in arrear	*15,000*	
Land	*25,00,000*	
Buildings	*30,00,000*	
Plant & Machinery	*24,00,000*	
Furniture & Fixture	*13,00,000*	
Securities Premium		*15,00,000*
General Reserve		*9,41,000*
Profit & Loss Account		*5,80,000*
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		*26,30,000*
Other Long Term Loans		*22,50,000*
Short Term Borrowings		*4,60,000*
Inventories: Finished goods	*45,00,000*	
Raw materials	*13,00,000*	
Trade Receivables	*17,50,000*	
Advances: Short Term	*3,75,000*	
Trade Payables		*8,13,000*
Provision for Taxation		*3,80,000*
Unpaid Dividend		*70,000*
Cash in Hand	*70,000*	
Balances with Banks	*4,14,000*	
Total	*1,76,24,000*	*1,76,24,000*

The following additional information was also provided in respect of the above balances:

(1) 50,000 fully paid equity shares were allotted as consideration for land.

(2) The cost of assets were:

Building	₹ 32,00,000
Plant and Machinery	₹ 30,00,000
Furniture and Fixture	₹ 16,50,000

(3) Trade Receivables for ₹ 4,86,000 due for more than 6 months.

(4) Balances with banks include ₹ 56,000, the Naya bank, which is not a scheduled bank.

(5) Loan from Public Finance Corporation repayable after 3 years.

(6) The balance of ₹ 26,30,000 in the loan account with Public Finance Corporation is inclusive of ₹1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

(7) Other long term loans (unsecured) includes:

Loan taken from Nixes Bank	₹ 13,80,000
(Amount repayable within one year	₹ 4,80,000)
Loan taken from Directors	₹ 8,50,000

(8) Bills Receivable for ₹ 1,60,000 maturing on 15th June, 20X1 has been discounted.

(9) Short term borrowings includes:

Loan from Naya bank	₹ 1,16,000 (Secured)
Loan from directors	₹ 48,000

(10) Transfer of ₹ 35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.

(11) Inventory of finished goods includes loose tools costing ₹ 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 20X1 as required under Part - I of Schedule III of the Companies Act, 2013.

You are not required to give previous year figures.

(*Source: Question 10, Study Material*)

Answer

SR Ltd.

Balance Sheet as at 31st March, 20X1

Particulars		***Notes***	***Figures at the end of current reporting period (₹)***
Equity and Liabilities			
1	**Shareholders' funds**		
(a)	Share capital	1	79,85,000
(b)	Reserves and Surplus	2	30,21,000
2	**Non-current liabilities**		
(a)	Long-term borrowings	3	42,66,000
3	**Current liabilities**		
(a)	Short-term borrowings	4	4,60,000
(b)	Trade Payables		8,13,000
(c)	Other current liabilities	5	6,84,000
(d)	Short-term provisions	6	3,80,000
	Total		1,76,09,000
Assets			
1	**Non-current assets**		
(a)	PPE	7	92,00,000

	Particulars	Notes	Figures at the end of current reporting period (₹)
2	**Current assets**		
(a)	Inventories	8	58,00,000
(b)	Trade receivables	9	17,50,000
(c)	Cash and cash equivalents	10	4,84,000
(d)	Short-term loans and advances		3,75,000
	Total		1,76,09,000

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up		
	1,60,000 Equity Shares of ₹ 50 each (Out of the above 50,000 shares have been issued for consideration other than cash)	80,00,000	
	Less: Calls in arrears	(15,000)	79,85,000
2.	**Reserves and Surplus**		
	General Reserve	9,41,000	
	Add: Transferred from Profit and loss account	35,000	9,76,000
	Securities premium		15,00,000
	Surplus (Profit & Loss A/c)	5,80,000	
	Less: Appropriation to General Reserve (proposed)	(35,000)	5,45,000
			30,21,000
3.	**Long-term borrowings**		
	Secured: Term Loans		24,96,000
	Loan from Public Finance Corporation [repayable after 3 years (₹ 26,30,000 - ₹ 1,34,000 for interest accrued but not due)] (secured by hypothecation of land)		
	Unsecured		
	Bank Loan (Nixes bank) 9,00,000 (₹ 13,80,000 - ₹ 4,80,000 repayable within 1 year)		
	Loan from Directors 8,50,000		
	Others 20,000		17,70,000
	Total		42,66,000
4.	**Short-term borrowings**		
	Loan from Naya bank (Secured)	1,16,000	
	Loan from Directors	48,000	
	Others	2,96,000	4,60,000
5.	**Other current liabilities**		
	Loan from Nixes bank repayable within one year	4,80,000	
	Unpaid dividend	70,000	
	Interest accrued but not due on borrowings	1,34,000	6,84,000

			₹
6.	**Short-term provisions**		
	Provision for taxation		3,80,000
7.	**PPE**		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	**Trade receivables**		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	**Cash and cash equivalents**		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000

Note: There is a contingent liability amounting to ₹ 1,60,000

QUESTION BANK

Question 18

Shweta Ltd. has the Authorised Capital of ₹15,00,000 consisting of 6,000 6% Preference shares of ₹100 each and 90,000 equity Shares of ₹10 each. The following was the Trial Balance of the Company as on 31st March, 2018:

Particulars	Dr.	Cr.
Investment in Shares at cost	1,50,000	
Purchases	14,71,500	
Selling Expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and Wages	1,56,000	
Cash on Hand	36,000	
Interim Preference dividend for the half year to 30th September	18,000	
Bills Receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on Debentures upto 30th Sep (1st half year)	11,250	
Debtors	1,50,300	
Trade payables		2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of ₹ 45,000	1,05,000	
6% Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on Freehold properties		4,50,000
Income tax paid in advance for the current year	30,000	
Dividends		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft secured by hypothecation of stocks and receivables		4,50,000
Technical knowhow fees at cost paid during the year	4,50,000	
Audit fees	18,000	
Total	**44,72,850**	**44,72,850**

You are required to prepare the Profit and Loss Statement for the year ended 31st March, 2018 and the Balance Sheet as on 31st March, 2018 as per Schedule III of the Companies Act, 2013 after taking into account the following –

1. Closing Stock was valued at ₹ 4,27,500.
2. Purchases include ₹ 15,000 worth of goods and articles distributed among valued customers.
3. Salaries and Wages include ₹ 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".
4. Bills Receivable include ₹ 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of ₹ 6,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Down Value.
7. Investment in shares is to be treated as non-current investments.
8. Interest on Debentures for the half year ending on 31st March was due on that date.
9. Provide Provision for taxation ₹12,000.
10. Technical Knowhow Fees is to be written off over a period of 10 years.
11. Salaries and Wages include ₹ 30,000 being Director's Remuneration.
12. Trade receivables include ₹ 18,000 due for more than six months.

(*RTP May 2019*)

Answer:

Statement of Profit and Loss of Shweta Ltd. for the year ended 31st March, 2018

	Particulars	***Note***	₹
I	Revenue from Operations		20,11,050
II	Other income (Divided income)		12,750
III	Total Revenue (I &+ II)		20,23,800

	Particulars	***Note***	₹
IV	Expenses:		
	(a) Purchases (14,71,500–Advertisement Expenses 15,000)		14,56,500
	(b) Changes in Inventories of finished Goods/Work in progress (4,35,600 – 4,27,500)		8,100
	(c) Employee Benefits expense	**9**	1,20,000
	(d) Finance costs	**10**	51,900
	(e) Depreciation & Amortization Expenses [10% of (1,05,000 + 6,000)]		11,100
	(f) Other Expenses	**11**	3,47,550
	Total Expenses		19,95,150
V	Profit before exceptional, extraordinary items and tax (III-IV)		28,650
VI	Exceptional items		-
VII	Profit before extra-ordinary items and tax (V-IV)		28,650
VIII	Extraordinary items		-
IX	Profit before tax (VII-VIII)		28,650
X	Tax expense: Current Tax		12,000
XI	Profit/Loss for the period (after tax)		16,650

Balance sheet of Shweta Ltd. as on 31st March, 2018

	Particulars as on 31st March	***Note***	
I			
(1)	**Shareholders' funds:**		
	(a) Share capital	**1**	12,00,000
	(b) Reserves and surplus	**2**	66,150
(2)	**Non-current liabilities:**		
	Long term borrowings	**3**	4,50,000
(3)	**Current liabilities:**		
	(a) Short term borrowings	**4**	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	**5**	29,250
	Total		24,58,950
II	**ASSETS**		
(1)	**Non-current Assets**		
	(a) Property, Plant & Equipment		
	(i) Tangible assets	**6**	11,49,900
	(ii) Intangible assets	**7**	4,05,000
	(b) Non-current investments (Shares at cost)		1,50,000
	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	**8**	2,72,550
	(c) Cash and Cash equivalents–Cash on hand		36,000
	(d) Short term loans and advances – Income tax (paid 30,000-Provision 12,000)		18,000
	Total		24,58,950

Note: There is a Contingent liability for Bills receivable discounted with Bank ₹ 6,000.

Notes to accounts

			(₹)
1.	**Share Capital**		
	Authorized		
	90,000 Equity Shares of ₹ 10 each	9,00,000	
	6,000 6% Preference shares of ₹ 100 each	6,00,000	15,00,000
	Issued, subscribed & called up		
	60,000, Equity Shares of ₹ 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	12,00,000

			(₹)
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2017	85,500	
	Add: Surplus for current year	16,650	1,02,150
	Less: Preference Dividend		36,000
	Balance as on 31st March, 2018		66,150
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		4,50,000
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		4,50,000
5.	**Other Current liabilities**		
	Interest Ac c rued and due on Borrowings (5% Debentures)	11,250	
	Unpaid Preference Dividends	18,000	29,250
6.	**Tangible Fixed assets**		
	Furniture		
	Furniture at Cost Less depreciation ₹ 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electric al Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Ac cumulated Depreciation Account: Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year:		
	On Opening WDV at 10% i.e. (10% x 1,05,000) 10,500		
	On additional purchase during the year at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Fixed Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors		
	(a) Debt outstanding for more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 -4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Amount as per Trial Balance	1,56,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors' Remuneration shown separately	30,000	
	Balance amount		1,20,000
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	51,900
11.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director's remuneration	30,000	
	Selling expenses	2,37,300	
	Technical knowhow written of (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x 50%)	2,250	3,47,550

Working Note

Calculation of Sundry Debtors-Other Debts

Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonoured	4,500
	1,54,800
Less: Bad Debts written off – 50% ₹ 4,500	(2,250)
Adjusted Sundry Debtors	1,52,550
Less: Debts due for more than 6 months (as per information given)	(18,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550

Managerial Remuneration – Effective Capital

Question 19

From the following particulars furnished by Megha Ltd., prepare the Balance Sheet as on 31st March 20X1 as required by Part I, Schedule III of the Companies Act, 2013.

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory:			
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000

The following additional information is also provided:

(i) 10,000 Equity shares were issued for consideration other than cash.

(ii) Trade receivables of ₹ 2,60,000 are due for more than 6 months.

(iii) The cost of the Assets were:
Building ₹ 30,00,000, Plant & Machinery ₹ 35,00,000 and Furniture ₹ 3,12,500

(iv) The balance of ₹ 7,50,000 in the Loan Account with State Finance Corporation is inclusive of ₹ 37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

(v) Balance at Bank includes ₹ 10,000 with Omega Bank Ltd., which is not a Scheduled Bank.

(vi) Transfer of ₹ 20,000 to general reserve is proposed by the Board of directors.

(*MTP August, 2018*) (*16 Marks*)

Answer:

Megha Ltd.

Balance Sheet as on 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	49,95,000
	(b)	Reserves and Surplus	2	14,83,500
2		**Non-current liabilities**		
		Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	(a)	Trade Payables		8,00,000
	(b)	Other current liabilities	4	37,500

	Particulars	Notes	₹
	(c) Short-term provisions	5	6,40,000
	(d) Short-term borrowings		2,00,000
	Total		**94,73,500**
	Assets		
1	**Non-current assets**		
	Fixed assets		
	Tangible assets	6	56,25,000
2	**Current assets**		
	(a) Inventories	7	12,50,000
	(b) Trade receivables	8	10,00,000
	(c) Cash and bank balances	9	13,85,000
	(d) Short-term loans and advances		2,13,500
	Total		**94,73,500**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	50,000 Equity Shares of ₹ 100 each		
	(of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000
	Total		49,95,000
2	**Reserves and Surplus**		
	General Reserve	10,50,000	
	Add: current year transfer	20,000	10,70,000
	Profit & Loss balance		
	Profit for the year	4,33,500	
	Less: Appropriations:		
	Transfer to General reserve	(20,000)	4,13,500
	Total		14,83,500
3	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan (7,50,000-37,500)		7,12,500
	(Secured by hypothecation of Plant and Machinery)		6,05,000
	Unsecured Loan		13,17,500
	Total		
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		37,500
5	**Short-term provisions**		
	Provision for taxation		6,40,000
6	**Tangible assets**		
	Land and Building	30,00,000	27,50,000
	Less: Depreciation	(2,50,000) (b.f.)	
	Plant & Machinery	35,00,000	
	Less: Depreciation	(8,75,000) (b.f.)	26,25,000
	Furniture & Fittings	3,12,500	
	Less: Depreciation	(62,500)(b.f.)	2,50,000
	Total		56,25,000
7	**Inventories**		
	Raw Materials		2,50,000
	Finished goods		10,00,000
	Total		12,50,000

				₹
8	**Trade receivables**			2,60,000
	Outstanding for a period exceeding six months			7,40,000
	Other Amounts	Total		10,00,000
9	**Cash and bank balances**			
	Cash at bank			
	with Scheduled Banks		12,25,000	
	with others (Omega Bank Ltd.)		10,000	12,35,000
	Cash in hand			1,50,000
	Other bank balances			Nil
		Total		13,85,000

Question 20

State under which head the following accounts should be classified in Balance Sheet, as per Schedule III of the Companies Act, 2013:

(i) Share application money received in excess of issued share capital.
(ii) Share option outstanding account.
(iii) Unpaid matured debenture and interest accrued thereon.
(iv) Uncalled liability on shares and other partly paid investments.
(v) Calls unpaid.
(vi) Intangible Assets under development.
(vii) Money received against share warrant.
(viii) Cash equivalents.

(*MTP April 2019*) (*5 Marks*)

Answer:

(i) Current Liabilities/Other Current Liabilities
(ii) Shareholders' Fund/Reserve & Surplus
(iii) Current liabilities/Other Current Liabilities
(iv) Contingent Liabilities and Commitments
(v) Shareholders' Fund/Share Capital
(vi) Fixed Assets
(vii) Shareholders' Fund/Money received against share warrants
(viii) Current Assets

Question 21

Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2019:

	Amount ₹ in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of ₹250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013.

(*MTP October, 2019*) (*4 Marks*)

Answer

Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet. Thus the treatment done by the company is incorrect.

Question 22

On 31st March, 2020, SR Ltd. provides the following ledger balances after preparing its Profit & Loss Account for the year ended 31st March, 2020.

Particulars	**Amount (₹)**	
	Debit	**Credit**
Equity Share Capital, fully paid shares of ₹ 50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	

Particulars	Amount (₹)	
	Debit	Credit
Plant & Machinery	24,00,000	
Furniture &Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		26,30,000
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	
Trade Payables		8,13,000
Provision for Taxation		3,80,000
Dividend payable		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	**1,76,24,000**	**1,76,24,000**

The following additional information was also provided in respect of the above balances:

(1) 50,000 fully paid equity shares were allotted as consideration for land.

(2) The cost of assets were:

Building	₹ 32,00,000
Plant and Machinery	₹ 30,00,000
Furniture and Fixture	₹ 16,50,000

(3) Trade Receivables for ₹ 4,86,000 due for more than 6 months.

(4) Balances with banks include ₹ 56,000, the Naya bank, which is not a scheduled bank.

(5) Loan from Public Finance Corporation repayable after 3 years.

(6) The balance of ₹ 26,30,000 in the loan account with Public Finance Corporation is inclusive of ₹1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

(7) Other long-term loans (unsecured) include:

Loan taken from Nixes Bank	₹ 13,80,000
(Amount repayable within one year	₹ 4,80,000)
Loan taken from Directors	₹ 8,50,000

(8) Bills Receivable for ₹ 1,60,000 maturing on 15th June, 2020 has been discounted.

(9) Short term borrowings include:

Loan from Naya bank	₹ 1,16,000 (Secured)
Loan from directors	₹ 48,000

(10) Transfer of ₹ 35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.

(11) Inventory of finished goods includes loose tools costing ₹ 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 2020 as required under Part-I of Schedule III of the Companies Act, 2013. Ignore previous year figures.

(20 Marks) (MTP, May 2020)

Answer:

SR Ltd.

Balance Sheet as on 31st March, 2020

Particulars	Notes	Figures at the end of current reporting period (₹)
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	79,85,000
(b) Reserves and Surplus	2	30,21,000

Particulars	Notes	Figures at the end of current reporting period (₹)
2 Non-current liabilities		
(a) Long-term borrowings	3	42,66,000
3 Current liabilities		
(a) Short-term borrowings	4	4,60,000
(b) Trade Payables		8,13,000
(c) Other current liabilities	5	6,84,000
(d) Short-term provisions	6	3,80,000
Total		1,76,09,000
Assets		
1 Non-current assets		
A PPE	7	92,00,000
2 Current assets		
A Inventories	8	58,00,000
B Trade receivables	9	17,50,000
C Cash and cash equivalents	10	4,84,000
D Short-term loans and advances		3,75,000
Total		1,76,09,000

Notes to accounts

				₹
1.	**Share Capital**			
	Equity share capital			
	Issued, subscribed and called up			
	1,60,000 Equity Shares of ₹ 50 each (Out of the above 50,000 shares have been issued for consideration other than cash)		80,00,000	
	Less: Calls in arrears		(15,000)	79,85,000
2.	**Reserves and Surplus**			
	General Reserve		9,41,000	
	Add: Transferred from Profit and loss account		35,000	9,76,000
	Securities premium			15,00,000
	Surplus (Profit & Loss A/c)		5,80,000	
	Less: Appropriation to General Reserve (proposed)		(35,000)	5,45,000
				30,21,000
3.	**Long-term borrowings**			
	Secured: Term Loans			
	Loan from Public Finance Corporation [repayable after 3 years (₹ 26,30,000 - ₹ 1,34,000 for interest accrued but not due)]			24,96,000
	Secured by hypothecation of land			
	Unsecured			
	Bank Loan (Nixes bank) (₹ 13,80,000 - ₹ 4,80,000 repayable within 1 year)	9,00,000		
	Loan from Directors	8,50,000		
	Others	20,000		17,70,000
		Total		42,66,000
4.	**Short-term borrowings**			
	Loan from Naya bank (Secured)		1,16,000	
	Loan from Directors		48,000	
	Others		2,96,000	4,60,000
5.	**Other current liabilities**			
	Loan from Nixes bank repayable within one year		4,80,000	
	Dividend payable		70,000	
	Interest accrued but not due on borrowings		1,34,000	6,84,000

			₹
6.	**Short-term provisions**		
	Provision for taxation		3,80,000
7.	**PPE**		
	Land		25,00,000
	Buildings	32,00,000	
	Less: Depreciation	(2,00,000)	30,00,000
	Plant & Machinery	30,00,000	
	Less: Depreciation	(6,00,000)	24,00,000
	Furniture & Fittings	16,50,000	
	Less: Depreciation	(3,50,000)	13,00,000
	Total		92,00,000
8.	**Inventories**		
	Raw Material	13,00,000	
	Finished goods	40,00,000	
	Loose tools	5,00,000	58,00,000
9.	**Trade receivables**		
	Outstanding for a period exceeding six months		4,86,000
	Others		12,64,000
	Total		17,50,000
10.	**Cash and cash equivalents**		
	Balances with banks		
	with Scheduled Banks	3,58,000	
	with others banks	56,000	4,14,000
	Cash in hand		70,000
	Total		4,84,000

Note: There is a Contingent Liability amounting ₹ 1,60,000

Question 23

Shree Ltd. has authorized capital of ₹ 50 lakhs divided into 5,00,000 equity shares of ₹ 10 each. Their books show the following balances as on 31st March, 2020:

	₹		₹
Inventory 1.4.2019	6,65,000	Bank balance in Current Account	20,000
Discounts & Rebates allowed	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Interest (bank overdraft)	1,11,000
Patterns	3,75,000	Calls in Arrear @ ₹2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of ₹ 10 each)	
Purchases	12,32,500	Bank Overdraft	12,67,000
Wages	13,68,000		
Freehold Land	16,25,000	Trade Payables (for goods)	2,40,500
Plant & Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rent (Cr.)	30,000
Trade Receivables	4,00,500	Transfer fees received	6,500
Advertisement	15,000	Profit & Loss A/c (Cr.)	67,000
Commission & Brokerage (Dr.)	67,500	Repairs to Building	56,500
Business Expenses	56,000	Bad debts	25,500

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2020 and Balance Sheet as on that date in line with Schedule III to the Companies Act, 2013 after considering the following:

The inventory (valued at cost or market value, which is lower) as on 31st March, 2020 was ₹ 7,08,000. Outstanding liabilities for wages ₹ 25,000 and business expenses ₹ 36,000.

Charge depreciation on closing written down value of Plant & Machinery @ 5%, Engineering Tools @ 20%; Patterns @ 10%; and Furniture & Fixtures @10%. Provide 25,000 as doubtful debts after writing off ₹ 16,000 as additional bad debts. Provide for income tax @ 30%.

(MTP, October, 2020) (MTP March, 2022) (*16 Marks*)

Answer

Balance Sheet of Shree Ltd. as at 31st March, 2020

		Particulars	Note No.	(₹)
I	**Equity and Liabilities**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	19,90,000
		(b) Reserves and Surplus	2	3,47,000
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	13,28,000
		(c) Short-Term Provisions	4	1,20,000
		Total		40,25,500
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(i) Property, plant and Equipment (PPE)	5	29,30,000
	(2)	**Current Assets**		
		(a) Inventories		7,08,000
		(b) Trade Receivables	6	3,59,500
		(c) Cash and Cash Equivalents	7	28,000
		Total		40,25,500

Shree Ltd.

Statement of Profit and Loss for the year ended 31st March, 2020

	Particulars	Note No.	(₹)
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,08,000]		(43,000)
	Employee Benefits Expenses	9	13,93,000
	Finance Costs	10	1,11,000
	Depreciation and Amortization Expenses		1,20,000
	Other Expenses	11	4,40,000
	Total Expenses		**32,53,500**
V	**Profit before Tax (III-IV)**		4,00,000
VI	**Tax Expenses @ 30%**		(1,20,000)
VII	**Profit for the period**		2,80,000

Notes to Accounts:

1. Share Capital

Authorised Capital	
5,00,000 Equity Shares of ₹ 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of ₹ 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of ₹10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of ₹10 each ₹ 8 paid	40,000
(Call unpaid ₹10,000)	19,90,000

2. Reserves and Surplus

Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	2,80,000	3,47,000

3. Other Current Liabilities

Bank Overdraft	12,67,000
Outstanding Expenses [25,000+36,000]	61,000
	13,28,000

4. Short-term Provisions

Provision for Tax	1,20,000

5. PPE

Particulars	Value given (₹)	Depreciation rate	Depreciation Charged (₹)	Written down value at the end (₹)
Land	16,25,000		-	16,25,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Patterns	3,75,000	10%	37,500	3,37,500
Engineering Tools	1,50,000	20%	30,000	1,20,000
	30,50,000		1,20,000	29,30,000

6. Trade Receivables

Trade receivables (4,00,500-16,000)	3,84,500
Less: Provision for doubtful debts	(25,000)
	3,59,500

7. Cash & Cash Equivalent

Cash Balance	8,000
Bank Balance in current A/c	20,000
	28,000

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	30,000
	36,500

9. Employee benefits expenses

Wages	13,68,000
Add: Outstanding wages	25,000
	13,93,000

10. Finance Cost

Interest on Bank overdraft	1,11,000

11. Other Expenses

Carriage Inward	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,000] (Business Expenses)	92,000
Bad Debts [25,500+16,000]	41,500
Provision for Doubtful Debts	25,000
	4,40,000

Question 24

Medha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.20 20 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Medha Ltd. for the year ended 31st March, 2020 according to Schedule III.

(MTP, October, 2020) (*4 Marks*)

Answer

As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria:

(i) it is expected to be settled in the company's normal operating cycle;

(ii) it is held primarily for the purpose of being traded;

(iii) it is due to be settled within twelve months after the reporting date; or

(iv) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

In the given case, instalments due on 30.09.2020 and 31.03.2021 will be shown under the head 'other current liabilities'. Therefore, in the balance sheet as on 31.3.2020, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown under the heading 'Other Current Liabilities' as current maturities of loan from bank.

Question 25

XYZ Ltd. proposes to declare 10% dividend out of General Reserves due to inadequacy of profits in the year ending 31-03-2020.

From the following particulars ascertain the amount that can be utilized from general reserves, according to the Companies Rules, 2014:

	(₹)
8,00,000 Equity Shares of ₹ 10 each fully paid up	80,00,000
General Reserves	25,00,000
Revaluation Reserves	6,50,000
Net profit for the year	1,42,500

Average rate of dividend during the last five years has been 12%. (*MTP April, 2021*) (*5 marks*)

Answer

Amount that can be drawn from reserves for (10% dividend on ₹ 80,00,000 i.e. ₹ 8,00,000)

Profits available

Current year profit	₹ 1,42,500
Amount which can be utilized from reserves (₹ 8,00,000 – 1,42,500)	₹ 6,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 2014:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves i.e. ₹ 10,50,000 [10% of (80,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl ₹ 18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15 % of its paid up capital i.e. ₹ 12,00,000 (15% of ₹ 80,00,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated reserve (as per Declaration and Payment of Dividend Rules, 2014).

Question 26

The following is the Trial Balance of H Ltd., as on 31st March, 2021.

	Dr.	Cr.
Equity Capital (Shares of 100 each)		8,05,000
5,000, 6% preference shares of ₹ 100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000
Profit & Loss A/c. (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2020)	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	**1,30,29,000**

Additional Information:

(i) The authorised share capital of the company is:

5000, 6% preference shares of ₹100 each	5,00,000
10,000 equity shares of ₹100 each	10,00,000

Issued equity capital as on 1st April, 2020 stood at ₹7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹60 paid. The directors made a call of ₹40 per share on 1st October, 2020. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹90 per share as fully paid.

(ii) On 31st March, 2021, the Directors declared a dividend of 5% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

(iii) The company on the advice of independent valuer wishes to revalue the land at ₹36,00,000.

(iv) Suspense account of ₹ 40,000 represents amount received for the sale of some of the machinery on 1-4-2020. The cost of the machinery was ₹1,00,000 and the accumulated depreciation thereon being ₹ 30,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Amortize 1/5th of Goodwill.

You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures & taxation. (*Question Paper, July 2021*) (*20 Marks*)

Answer

H Ltd

Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in ₹
Equity and Liabilities		
I. Shareholders' Funds		
(a) Share Capital	1	13,00,000
(b) Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
(a) Long Term Borrowings	3	4,00,000
III. Current Liabilities		
(a) Trade Payables	4	10,40,000
(b) Other Current Liabilities	5	70,000
Total		82,01,900
Assets		
I. Non-Current Assets		
(a) Property, Plant and Equipment	6	40,61,000
(b) Intangible Assets	7	10,00,000
II. Current Assets		
(a) Inventories		9,50,000
(b) Trade Receivables		19,60,000
(c) Cash and Cash equivalents		2,30,900
Total		82,01,900

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No	Amount in ₹
I. Revenue from operations		60,00,000
Total Revenue		60,00,000
II. Expenses		
Purchases (adjusted)		22,32,100
Finance Costs	8	36,000
Depreciation and Amortization	9	3,17,000
Other Expenses	10	32,30,000
Total Expenses		58,15,100
III. Profit/(Loss) for the period		1,84,900

Notes to Accounts **(Amount in ₹)**

1	**Share Capital**		
	(a) Authorized Capital		
	5,000, 6% Preference shares of ₹ 100/- each		5,00,000
	10,000 Equity Shares of ₹100/- each		10,00,000

	(b) Issued & Subscribed Capital		15,00,000
	5,000, 6% Preference shares of ₹100/- each		5,00,000
	8,000, Equity shares of ₹100/- each		8,00,000
	Total		13,00,000
2	**Reserves & Surplus**		
	Capital Reserve (100 X (90-40))		5,000
	Revaluation Reserve (36,00,000-24,00,000)		12,00,000
	General Reserve		40,00,000
	Surplus	1,84,900	
	Add: Balance from previous year	72,000	
	Less:		
	Dividends declared	(70,000)	
	Profit/(Loss) carried forward to Balance Sheet		1,86,900
	Total		53,91,900
3	**Long-Term Borrowings**		
	Secured		
	9% Debentures		4,00,000
4	**Trade Payables**		10,40,000
5	**Other Current Liabilities**		
	Dividend Payable		
	Preference Dividend	30,000	
	Equity Dividend	40,000	
	Total		70,000
6	**Property, Plant and Equipment**		
	Land		
	Opening balance	24,00,000	
	Add: Revaluation Adjustment	12,00,000	
	Closing Balance		36,00,000
	Plant and Machinery		
	Opening Balance	7,70,000	
	Less: Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	
	Closing Balance		4,61,000
	Total		40,61,000
7	**Intangible Assets**		
	Goodwill	12,50,000	
	Less: Amortized (1/5th)	(2,50,000)	
	Total		10,00,000
8	**Finance Costs**		
	Debenture Interest	36,000	
9	**Depreciation and Amortization**		
	Plant and Machinery	67,000	
	Goodwill	2,50,000	
	Total		3,17,000
10	**Other Expenses**		
	Factory Expenses	15,00,000	
	Selling Expenses	14,00,000	
	Administrative Expenses	3,00,000	
	Loss on sale of Plant and Machinery		
	Book Value		
	(1,00,000-30,000) 70,000		
	Less: Sale Value (40,000)	30,000	
	Total		32,30,000

Note

1. The inventories (31.3.20) amounting ₹ 9,50,000 (given in the trial balance of the question) should have been as closing inventory i.e. as on 31.3.21. In the above solution, this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on 31.3.21 and in that case, the balance sheet will not tally without using suspense account amounting ₹ 9,50,000.
2. The financial statements given in the above answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the question. However, practically dividends are declared in the annual general meetings which take place after the reporting date.

Question 27

Om Ltd. has authorized capital of ₹ 50 lakhs divided into 5,00,000 equity shares of ₹ 10 each. Their books show the following ledger balances as on 31st March, 2021:

	₹		₹
Inventory 1.4.2020	6,65,000	Bank Current Account (Dr. balance)	20,000
Discounts & Rebates allowed	30,000	Cash in hand	11,000
Carriage Inwards	57,500		
Purchases	12,32,500	Calls in Arrear @ ₹ 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of ₹ 10 each)	
Business Expenses	56,000	Trade Payables	2,40,500
Wages	14,79,000	Sales	36,17,000
Freehold Land	7,30,000	Rent (Cr.)	30,000
Plant & Machinery	7,50,000	Transfer fees received	6,500
Engineering Tools	1,50,000	Profit & Loss A/c (Cr.)	67,000
Trade Receivables	4,00,500	Repairs to Building	56,500
Advertisement Expenses	15,000	Bad debts	25,500
Commission & Brokerage Expenses	67,500		

The inventory (valued at cost or market value, which is lower) as on 31st March, 2021 was ₹ 7,05,000. Outstanding liabilities for wages ₹ 25,000 and business expenses ₹ 36,500. It was decided to transfer ₹10,000 to reserves.

Charge depreciation on written down values of Plant & Machinery @ 5%, Engineering Tools @ 20% and Furniture & Fixtures @10%. Provide ₹ 25,000 as doubtful debts for trade receivables. Provide for income tax @ 30%. It was decided to transfer ₹ 10,000 to reserves.

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2021 and Balance Sheet as at that date. (*RTP, May, 2021*)

Answer

Balance Sheet of Om Ltd. as at 31st March, 2021

		Particulars	Note No.	(₹)
I	**Equity and Liabilities**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	19,90,000
		(b) Reserves and Surplus	2	3,82,000
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	61,500
		(c) Short-Term Provisions	4	1,35,000
		Total		28,09,000
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) Property, Plant and Equipment	5	16,97,500
	(2)	**Current Assets**		
		(a) Inventories		7,05,000
		(b) Trade Receivables	6	3,75,500
		(c) Cash and Cash Equivalents	7	31,000
		Total		28,09,000

Statement of Profit and Loss of Om Ltd. for the year ended 31st March, 2021

	Particulars	Note No.	(₹)
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		**36,53,500**
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,05,000]		(40,000)
	Employee Benefits Expenses	9	15,04,000
	Depreciation and Amortization Expenses		82,500
	Other Expenses	10	4,24,500
	Total Expenses		**32,03,500**
V	**Profit before Tax (III-IV)**		4,50,000
VI	**Tax Expenses @ 30%**		(1,35,000)
VII	**Profit for the period**		3,15,000

Notes to Accounts:

1. Share Capital

Authorized Capital	
5,00,000 Equity Shares of ₹ 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of ₹ 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of ₹10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of ₹10 each ₹ 8 paid	40,000
(Call unpaid ₹10,000)	19,90,000

2. Reserves and Surplus

General Reserve		10,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	3,15,000	
Less: Transfer to Reserve	(10,000)	3,72,000
		3,82,000

3. Other Current Liabilities

Outstanding Expenses [25,000+36,500]	61,500

4. Short-term Provisions

Provision for Tax	1,35,000

5. Property, Plant and Equipment

Particulars	Value given (₹)	Depreciation rate	Depreciation Charged (₹)	Written down value at the end (₹)
Land	7,30,000		-	7,30,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Engineering Tools	1,50,000	20%	30,000	1,20,000
	17,80,000		82,500	16,97,500

6. Trade Receivables

Trade receivables	4,00,500
Less: Provision for doubtful debts	(25,000)
	3,75,500

7. Cash & Cash Equivalent

Cash Balance	11,000
Bank Balance in current A/c	20,000
	31,000

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	30,000
	36,500

9. Employee benefits expenses

Wages	14,79,000
Add: Outstanding wages	25,000
	15,04,000

10. Other Expenses

Carriage Inwards	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,500] (Business Expenses)	92,500
Bad Debts	25,500
Provision for Doubtful Debts	25,000
	4,24,500

Question 28

XYZ Ltd. is having inadequacy of profits in the year ending 31-03-2021 and it proposes to declare 10% dividend out of General Reserves.

From the following particulars ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of Dividend out of Reserves) Rules, 2014:

5,00,000 Equity Shares of ₹ 10 each fully paid up	50,00,000
General Reserves	25,00,000
Revaluation Reserves	6,50,000
Net profit for the year	1,42,500

Average rate of dividend during the last five years has been 12%. (*RTP, May, 2021*)

Answer

Amount that can be drawn from reserves for (10% dividend on ₹ 50,00,000 i.e. ₹ 5,00,000)

Profits available

Current year profit	₹ 1,42,500
Amount which can be utilized from reserves (₹ 5,00,000 – 1,42,500)	₹ 3,57,500

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1:

Condition I

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves ie. ₹ 7,50,000 [10% of (50,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl ₹ 21,42,500 (₹ 25,00,000 - ₹ 3,57,500) should not fall below 15 % of its paid up capital ie. ₹ 7,50,000 (15% of ₹ 50,00,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 3,57,500 from accumulated reserve (as per Declaration and Payment of Dividend Rules, 2014).

Question 29

From the following information, prepare extract of Balance Sheet of A Limited along with notes making necessary compliance of Schedule III to the Companies Act, 2013:

		Amount (₹)
Loan Funds		
(a) Secured Loans		18,12,000
(b) Unsecured Loan - Short term from bank		2,25,000
Other information is as under:		
Secured Loans		
Term Loans from:		
Banks		8,95,000
Others		9,17,000
		18,12,000
Current Maturities of long-term loan from Bank		1,24,000
Current Maturities of long- term loan from Others		85,000

There was no interest accrued/due as at the end of the year. Current maturities of long-term loans amounting ₹ 2,09,000 is included in the value of secured loans of ₹ 18,12,000.

(*MTP, November, 2021*) (*5 Marks*)

Answer

Extract of Balance Sheet of A Ltd.

Particulars	Note No	Amount
Non - Current Liabilities		
Long term borrowings	1	16,03,000
Current Liabilities		
Short term borrowings	2	2,25,000
Other current liabilities	3	2,09,000

Notes to Accounts

1.	**Long-Term Borrowings**	
	Term loans – Secured	
	- From banks	8,95,000
	- From other parties	9,17,000
		18,12,000
	Less: Current maturities of long-term debt (Refer Note 3)	(2,09,000)
		16,03,000
2.	**Short-Term Borrowings**	
	(Unsecured loan)	
	- from bank	2,25,000
3.	**Other Current Liabilities**	
	Current maturities of long-term debt	
	- From banks	1,24,000
	- From others	85,000
		2,09,000

Question 30

Om Ltd. has the Authorised Capital of ₹ 15,00,000 consisting of 6,000 6% Redeemable Preference shares of ₹ 100 each and 90,000 equity Shares of ₹10 each. The following was the Trial Balance of the Company as on 31st March, 2021:

Particulars	Dr.	Cr.
Investment in shares at cost (non-current investment)	1,50,000	
Purchases	14,71,500	
Selling expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and wages (included ₹ 30,000 being Director's Remuneration)	1,56,000	
Cash on hand	84,000	
Bills receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on debentures upto 30th Sep (1st half year)	11,250	
Sundry Debtors and Sundry Creditors	1,50,300	2,63,550
Freehold property at cost	10,50,000	
Furniture at cost less depreciation of ₹ 45,000	1,05,000	
6% Redeemable Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on freehold properties		4,50,000
Dividends received		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft (secured by hypothecation of stocks and receivables)		4,50,000
Technical knowhow fees (cost paid during the year)	4,50,000	
Audit fees	18,000	
Total	44,72,850	44,72,850

Other Information:

1. Closing Stock was valued at ₹ 4,27,500.
2. Purchases include ₹ 15,000 worth of goods and articles distributed among valued customers.
3. Salaries and Wages include ₹ 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".
4. Bills Receivable include ₹ 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of ₹ 6,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Down Value.
7. Interest on Debentures for the half year ending on 31st March was due on that date.
8. Technical Knowhow Fees is to be written off over a period of 10 years.
9. Trade receivables include ₹ 18,000 due for more than six months.

You are required to prepare the Balance Sheet as at 31st March, 2021 and Statement of Profit and Loss for the year ended 31st March, 2021 as per Schedule III to the Companies Act, 2013 after taking into account the above information. Ignore taxation.

(*RTP, November 2021*)

Answer

Balance sheet of Om Ltd. as at 31st March, 2021

		Note	(₹)
I	**Equity and Liabilities**		
(1)	Shareholders' funds:		
	(a) Share capital	1	12,00,000
	(b) Reserves and surplus	2	1,14,150
(2)	Non-current liabilities:		
	Long term borrowings	3	4,50,000
(3)	Current liabilities:		
	(a) Short term borrowings	4	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	5	11,250
	Total		24,88,950
II	**ASSETS**		
(1)	Non- Current Assets:		
	(a) Property, plant and equipment	6	11,49,900
	(b) Intangible assets	7	4,05,000
	(c) Non-current investments (Shares at cost)		1,50,000
(2)	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	8	2,72,550
	(c) Cash and Cash equivalents – Cash on hand		84,000
	Total		24,88,950

Note: There is a Contingent liability for Bills receivable discounted with Bank ₹ 6000.

Statement of Profit and Loss of Om Ltd. for the year ended 31st March, 2021

	Particulars	*Note*	₹
I	Revenue from Operations		20,11,050
II	Other income (Dividend income)		12,750
III	Total Revenue (I &+ II)		20,23,800
IV	Expenses:		
	(a) Purchases of Inventory (14,71,500 – Advertisement Expenses 15,000)		14,56,500
	(b) Changes in Inventories of finished Goods/Work in progress & inventory (4,35,600 – 4,27,500)		8,100
	(c) Employee Benefits expense	9	1,20,000
	(d) Finance costs	10	51,900
	(e) Depreciation & Amortization Expenses	11	56,100
	(f) Other Expenses	12	3,02,550
	Total Expenses		19,95,150

	Particulars	***Note***	***₹***
V	Profit before exceptional, extraordinary items and tax		28,650
VI	Exceptional items		-
VII	Profit before extra-ordinary items and tax		28,650
VIII	Extraordinary items		-
IX	Profit before tax		28,650

Notes to accounts

			(₹)
1.	**Share Capital**		
	Authorized capital:		
	90,000 Equity Shares of ₹ 10 each.	9,00,000	
	6,000 6% Preference shares of ₹ 100 each	6,00,000	
	Issued, subscribed & called up:		
	60,000, Equity Shares of ₹ 10 each	6,00,000	
	6,000 6% Redeemable Preference Shares of 100 each	6,00,000	12,00,000
2.	**Reserves and Surplus**		
	Balance as on 1st April, 2020	85,500	
	Add: Surplus for current year	28,650	
	Balance as on 31st March, 2021		1,14,150
3.	**Long Term Borrowings**		
	5% Mortgage Debentures (Secured against Freehold Properties)		4,50,000
4.	**Short Term Borrowings**		
	Secured Borrowings: Loans Repayable on Demand Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)		4,50,000
5.	**Other Current liabilities**		
	Interest due on Borrowings (5% Debentures)		11,250
6.	**Property, plant and equipment**		
	Furniture		
	Furniture at Cost Less depreciation ₹ 45,000 (as given in Trial Balance	1,05,000	
	Add: Depreciation	45,000	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages	6,000	
	Total Gross block of Furniture A/c	1,56,000	
	Accumulated Depreciation Account:		
	Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year:		
	On Opening WDV at 10% i.e.		
	(10% x 1,05,000) 10,500		
	On additional purchase during the year		
	at 10% i.e. (10% x 6,000) 600		
	Less: Accumulated Depreciation	56,100	99,900
	Freehold property (at cost)		10,50,000
			11,49,900
7.	**Intangible Assets**		
	Technical knowhow	4,50,000	
	Less: Written off	45,000	4,05,000
8.	**Trade Receivables**		
	Sundry Debtors (a) Debt outstanding due more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 - 4,500)	1,20,000	2,72,550
9.	**Employee benefit expenses**		
	Salaries & Wages	1,56,000	
	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors' Remuneration shown separately	30,000	
	Balance amount		1,20,000

			(₹)
10.	**Finance Costs**		
	Interest on bank overdraft	29,400	
	Interest on debentures	22,500	
			51,900
11.	**Depreciation & Amortisation Expenses**		
	Depreciation [10% of (1,05,000 + 6,000)]	11,100	
	Technical knowhow written of (4,50,000/10)	45,000	56,100
12.	**Other Expenses**		
	Payment to the auditors	18,000	
	Director's remuneration	30,000	
	Selling expenses	2,37,300	
	Advertisement (Goods and Articles Distributed)	15,000	3,02,550
	Bad Debts (4,500 x 50%)	2,250	

Working Note:

Calculation of Sundry Debtors-Other Debts	
Sundry Debtors as given in Trial Balance	1,50,300
Add Back: Bills Receivables Dishonoured	4,500
	1,54,800
Less: Bad Debts written off – 50% ₹ 4,500	(2,250)
Adjusted Sundry Debtors	1,52,550
Less: Debts due for more than 6 months (as per information given)	(18,000)
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550

Question 31

The following is the Trial Balance of Anmol Limited as on 31st March, 2022:

Debit Balance	***Amount (₹)***	***Credit Balances***	***Amount (₹)***
Purchases	*82,95,000*	*Sales*	*1,25,87,000*
Wages and Salaries	*12,72,000*	*Commission*	*72,500*
Rent	*2,20,000*	*Equity Share Capital*	*10,00,000*
Rates and Taxes	*50,000*	*General Reserve*	*10,00,000*
Selling &Distribution Expenses	*4,36,000*	*Surplus (P&L A/c) 01.04.2021*	*8,75,500*
Directors Fees	*32,000*	*Securities Premium*	*2,50,000*
Bad Debts	*38,500*	*Term Loan from Public Sector Bank*	*1,02,00,000*
Interest on Term Loan	*8,05,000*		
Land	*24,00,000*	*Trade Payables*	*55,08,875*
Factory Building	*36,80,000*	*Provision for Depreciation:*	
Plant and Machinery	*62,50,000*	*On Plant& Machinery*	*9,37,500*
Furniture and Fittings	*8,25,000*	*On Furniture and Fittings*	*82,500*
Trade Receivables	*64,75,000*	*On Factory Building*	*1,84,000*
Advance Income Tax Paid	*37,500*	*Provision for Doubtful Debts*	*25,000*
Stock (1st April,2021)	*9,25,000*	*Bills Payable*	*1,25,000*
Bank Balances	*9,75,000*		
Cash on Hand	*1,31,875*		
Total	*3,28,47,875*	*Total*	*3,28,47,875*

Following information is provided:

(1) The Authorized Share Capital of the Company is 2,00,000 Equity Shares of ₹ 10 each. The Company has issued 1,00,000 Equity Shares of ₹ 10 each.

(2) Rent of ₹ 20,000 and Wages of ₹ 1,56,500 are outstanding as on 31st March, 2022.

(3) Provide Depreciation @ 10% per annum on Plant and Machinery, 10% on Furniture and Fittings and 5% on Factory Building on written down value basis.

(4) Closing Stock as on 31st March, 2022 is ₹ 11,37,500.

(5) Make a provision for Doubtful Debt @ 5% on Debtors.

(6) Make a provision of 25% for Corporate Income Tax.

(7) Transfer ₹ 1,00,000 to General Reserve.

(8) Term Loan from Public Sector Bank is secured against Hypothecation of Plant and Machinery. Installment of Term Loan falling due within one year is ₹ 17,00,000.

(9) Trade Receivables of ₹ 85,600 are outstanding for more than six months.

(10) The Board declared a dividend @10% on Paid up Share Capital on 5th April, 2022.

You are required to prepare Balance Sheet as on 31st March 2022 and Statement of Profit and Loss with Note to Accounts for the year ending 31st March, 2022 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures. (*20 Marks*)

Answer

Balance Sheet of Anmol Ltd. as at 31st March, 2022

Particulars	*Note No*	*₹*
Equity and Liabilities		
1 **Shareholders' funds**		
a Share capital	1	10,00,000
b Reserves and Surplus	2	24,76,462
2 **Non-current liabilities**		
a Long-term borrowings	3	85,00,000
3 **Current liabilities**		
a Short term borrowings (Installment of term loan falling due in one year)		17,00,000
b Trade Payables	4	56,33,875
c Other current liabilities	5	1,76,500
d Short term provisions (provision for tax)		1,16,988
Total		1,96,03,825
ASSETS		
1 **Non-current assets**		
a PPE	6	1,11,70,700
2 **Current assets**		
a Inventories		11,37,500
b Trade receivables	7	61,51,250
c Cash and bank balances	8	11,06,875
d Short term loans & advances (Advance tax paid)		37,500
		1,96,03,825

Statement of Profit and Loss of Anmol Ltd.
for the year ended 31st March, 2022

	Particulars	*Notes*	*Amount*
I.	Revenue from operations		1,25,87,000
II.	Other income (Commission income)		72,500
III.	Total Income (I + II)		1,26,59,500
IV.	Expenses:		
	Purchases of Inventory-in-Trade		82,95,000
	Changes in inventories of finished goods work-in- progress and Inventory-in-Trade	9	(2,12,500)
	Employee benefits expense	10	14,28,500
	Finance costs (interest on term loan)		8,05,000
	Depreciation		7,80,300
	Other operating expenses	11	10,95,250
	Total expenses		1,21,91,550
V.	Profit (Loss) for the period (III - IV)		4,67,950
VI.	(-) Tax (25%)		(1,16,988)
VII.	PAT		3,50,962

Notes to accounts

	₹
1 Share Capital	
Equity share capital	
Authorized	

			₹
	2,00,000 equity shares of ₹ 10 each		20,00,000
	Issued & subscribed		
	1,00,000 equity shares of ₹ 10 each		10,00,000
2	Reserves and Surplus		
	General Reserve	10,00,000	
	Add: current year transfer	1,00,000	11,00,000
	Profit & Loss balance		
	Opening balance: Surplus P & L A/c	8,75,500	
	Profit for the year	3,50,962	
	Less: Appropriations:		
	Transfer to General reserve	(1,00,000)	11,26,462
	Securities premium		2,50,000
			24,76,462
3	Long-term borrowings		
	Term loan from public sector bank (Secured by hypothecation)		1,02,00,000
	Less: Installment of Term loan falling due within one year		(17,00,000)
	Total		85,00,000
4	Trade payables		
	Trade payables	55,08,875	
	Bills payable	1,25,000	56,33,875
5	Other current liabilities		
	Rent outstanding	20,000	
	Wages and Salaries Outstanding	1,56,500	1,76,500
6	PPE (Note 2)		
	Land		24,00,000
	Factory Buildings		33,21,200
	Plant & Machinery		47,81,250
	Furniture & Fittings		6,68,250
	Total		1,11,70,700
7	Trade receivables		
	Debtors Outstanding for period exceeding 6 months	85,600	
	Other debts	63,89,400	
	Less: Provision for doubtful debt	(3,23,750)	61,51,250
8	Cash and bank balances		
	Cash and cash equivalents		
	Bank balance	9,75,000	
	Cash on hand	1,31,875	11,06,875
9	Changes in Inventories		
	Opening Inventory	9,25,000	
	Less: Closing Inventory	(11,37,500)	
	Change		(2,12,500)
10	Employee benefit expense		
	Wages and Salaries	12,72,000	
	Add: Wages and Salaries Outstanding	1,56,500	14,28,500
11	Other operating expenses		
	Rent	2,20,000	
	Add: outstanding	20,000	2,40,000
	Rates and Taxes		50,000
	Selling & Distribution expenses		4,36,000
	Bad debts		38,500
	Provision for Doubtful Debts (3,23,750-25,000)		2,98,750
	Director's fee		32,000
	Total		10,95,250

Note:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2022. Such dividends will be disclosed in notes only.
2. **Calculation of depreciation:**

	Book value	Accumulated depreciation	WDV	Current year Depreciation	Current year WDV
Land	24,00,000	-	24,00,000	-	24,00,000
Factory building	36,80,000	1,84,000	34,96,000	1,74,800	33,21,200
Plant & Machinery	62,50,000	9,37,500	53,12,500	5,31,250	47,81,250
Furniture & Fittings	8,25,000	82,500	7,42,500	74,250	6,68,250
Total				7,80,300	1,11,70,700

Question 32

Preparation of Balance Sheet of a Company

On 31st March 2022, Hari Ltd. provides you the following particulars:

Particulars		Debit ₹	Credit ₹
Equity Share Capital (Face value of ₹ 100 each)			12,50,000
Call in Arrears		1,250	
Land & Building		6,87,500	
Plant & Machinery		6,56,250	
Furniture		62,500	
General Reserve			2,62,500
Loan from State Financial Corporation			1,87,500
Inventory:			
Raw Materials			
Finished Goods	62,500	3,12,500	
	2,50,000		
Provision for Taxation			1,60,000
Trade Receivables		2,50,000	
Advances		53,375	
Profit & Loss Account			1,08,375
Cash in Hand		37,500	
Cash at Bank		3,08,750	
Unsecured Loan (Long-term)			1,51,250
Trade Payables			2,50,000

The following additional information is also provided:

(i) 2,500 Equity shares were issued for consideration other than cash.

(ii) Debtors of ₹ 65,000 (included in trade receivables) are due for more than 6 months.

(iii) The cost of the assets were:
Building ₹ 7,50,000, Plant & Machinery ₹ 8,75,000 and Furniture ₹ 78,125

(iv) The balance of ₹ 1,87,500 in the Loan Account with State Finance Corporation is inclusive of ₹ 9,375 for Interest accrued but not due. The loan is secured by hypothecation of Plant & Machinery.

(v) Balance at Bank includes ₹ 2,500 with Global Bank Ltd., which is not a Scheduled Bank.

You are required to prepare the Balance sheet of Hari Ltd. as on 31st March, 2022 as per Schedule III to the Companies Act, 2013. (*RTP May, 2023*)

Answer

Hari Ltd.

Balance Sheet as on 31st March, 2022

		Particulars	*Notes*	*₹*
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,48,750
	b	Reserves and Surplus	2	3,70,875
2		**Non-current liabilities**		
		Long-term borrowings	3	3,29,375

		Particulars	Notes	₹
3		**Current liabilities**		
	a	Trade Payables		2,50,000
	b	Other current liabilities	4	9,375
	c	Short-term provisions	5	1,60,000
		Total		**23,68,375**
		Assets		
1		**Non-current assets**		
		Property, Plant & Equipment (PPE)	6	14,06,250
2		**Current assets**		
	a	Inventories	7	3,12,500
	b	Trade receivables	8	2,50,000
	c	Cash and cash equivalents	9	3,46,250
	d	Short-term loans and advances		53,375
		Total		**23,68,375**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up		
	12,500 Equity Shares of ₹ 100 each (of the above 2,500 shares have been issued for consideration other than cash)	12,50,000	
	Less: Calls in arrears	(1,250)	12,48,750
	Total		**12,48,750**
2	**Reserves and Surplus**		
	General Reserve		2,62,500
	Surplus (Profit & Loss A/c)		1,08,375
	Total		**3,70,875**
3	**Long-term borrowings**		
	Secured Term Loan		
	State Financial Corporation Loan (1,87,500–9,375) (Secured by hypothecation of Plant and Machinery)		1,78,125
	Unsecured Loan		1,51,250
	Total		**3,29,375**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		9,375
5	**Short-term provisions**		
	Provision for taxation		1,60,000
6	**PPE**		
	Land and Building	7,50,000	
	Less: Depreciation	(62,500)	6,87,500
	Plant & Machinery	8,75,000	
	Less: Depreciation	(2,18,750)	6,56,250
	Furniture & Fittings	78,125	
	Less: Depreciation	(15,625)	62,500
	Total		**14,06,250**
7	**Inventories**		
	Raw Materials		62,500
	Finished goods		2,50,000
	Total		**3,12,500**
8	**Trade receivables**		
	Outstanding for a period exceeding six months		65,000
	Other Amounts		1,85,000
	Total		**2,50,000**

			₹
9	**Cash and cash equivalents**		
	Cash at bank		
	with Scheduled Banks	3,06,250	
	with others (Global Bank Ltd.)	2,500	3,08,750
	Cash in hand		37,500
	Total		**3,46,250**

Question 33

Preparation of Statement of Profit and Loss and Balance Sheet

The following balance appeared in the books of Oliva Ltd. As on 31-03-2022.

Particulars		₹	Particulars		₹
Inventory 01-04-2021			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	46,500	76,500	Profit and Loss A/c		21,000
Purchases of raw material		12,60,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans:		
			Short–term		
			Long-term	4,500	25,500
				21,000	
Salaries and wages		40,200	Fixed Deposits (unsecured):		
			Short-term	1,500	
General Charges		16,500	Long-term	3,300	4,800
			Trade payables		3,27,000
Building		1,01,000			
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Investments:					
Current	4,500				
Non-Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,07,200			24,07,200

From the above balance and the following information, prepare the company's statement of Profit and Loss for the year ended 31st March, 2022 and company's Balance Sheet as on that date:

1. Inventory on 31st March,2022-Raw material ₹ 25,800 and finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. Current maturity of long term loan is ₹ 1,000.
7. The Taxation provision of 40% on net profit is considered.

(*RTP November, 2022*)

Answer

Oliva Ltd.

Balance Sheet as at 31.03.2022

	Particulars		Note	Amount
(1)	**Equity and Liabilities**			
	(i) Shareholders' funds			
	(a) Share Capital			3,15,000
	(b) Reserves and surplus		1	50,430
(2)	**Non-current liabilities**			
	(a) Long-term borrowings		2	23,300
(3)	**Current Liabilities**			
	(a) Short -term borrowings		3	7,000
	(b) Trade payables			3,27,000
	(c) Other current liability		4	72,000
	(d) Short term provision		5	19,620

	Particulars		Note	Amount
II	**ASSETS**			8,14,350
(1)	**Non-current assets**			
	(a) Property, Plant & equipment		6	2,04,160
	(b) Non-current investments			7,500
(2)	**Current assets**			
	(a) Current investments			4,500
	(b) Inventories		7	85,800
	(c) Trade receivables			2,38,500
	(d) Cash and cash equivalents			2,71,100
	(e) Short-term loans and advances		8	2,490
	(f) Other current assets		9	300
				8,14,350

Oliva Ltd.

Statement of Profit and loss for the year ended 31.03.2022

(₹)

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200
III	**Total income (I +II)**		17,14,200
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	3,51,510
	Total Expenses		16,65,150
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Notes to accounts

No.	Particulars		Amount	Amount
1.	**Reserve & Surplus**			
	Profit & Loss Account: Balance b/f		21,000	
	Net Profit for the year		29,430	50,430
2.	**Long term borrowings**			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits: Unsecured		3,300	23,300
3.	**Short term borrowings**			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	
	Current maturities of long term borrowings		1,000	7,000
4.	**Other current liabilities**			
	Expenses Payable (67,500 + 4,500)		72,000	72,000
5.	**Short term provisions**			
	Provision for Income tax			19,620
6.	**Property, plant and equipment**			
	Building	1,01,000		
	Less: Depreciation @ 2%	(2,020)	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation @10%	(7,040)	63,360	
	Furniture	10,200		
	Less: Depreciation @10%	(1,020)	9,180	
	Motor vehicles	40,800		
	Less: Depreciation @20%	(8,160)	32,640	2,04,160

No.	Particulars		Amount	Amount
7	**Inventory**			
	Raw Material		25,800	
	Finished goods		60,000	85,800
8.	**Short term Loans & Advances**			
	General Charges prepaid			2,490
9.	**Other Current Assets**			
	Interest accrued			300
10.	**Cost of material consumed**			
	Opening inventory of raw Material	30,000		
	Add: Purchases	12,60,000	12,90,000	
	Less: Closing inventory		(25,800)	12,64,200
11.	**Changes in inventory of Finished Goods & WIP**			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		(46,500)	13,500
12.	**Employee Benefit expenses**			
	Salary & Wages (40,200 + 4,500)			44,700
13.	**Other Expenses:**			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	3,51,510

Question 34

The following balances are extracted from the books of Travese Limited as on 31st March 2023:

Particulars	Amount (₹)	
	Debit	Credit
7% Debentures		48,45,000
Plant & Machinery (at cost)	37,43,400	
Trade Receivables	35,70,000	
Land	97,37,000	
Debenture Interest	3,39,150	
Bank Interest	13,260	
Sales		47,22,600
Transfer Fees		38,250
Discount received		66,300
Purchases		28,86,600
Inventories 1.04.2022	4,97,250	
Factory Expenses	2,58,060	
Rates, Taxes and Insurance	65,025	
Repairs	1,49,685	
Sundry Expenses	1,27,500	
Selling Expenses	26,520	
Directors Fees	38,250	
Interest on Investment for the year 2022-2023		55,000
Provision for depreciation		5,96,700
Miscellaneous receipts		1,42,800

Additional information:

(i) Closing inventory on 31.03.2023 is ₹4,76,850.

(ii) Miscellaneous receipts represent cash received from the sale of the Plant on 01.04.2022. The cost of the Plant was ₹1,65,750 and the accumulated depreciation thereon is ₹24,865.

(iii) The Land is re-valued at ₹1,08,63,000.

(iv) Depreciation is to be provided on Plant & Machinery at 10% p.a. on cost.

(v) Make a provision for income tax @ 25%.

(vi) The Board of Directors declared a dividend of 10% on Equity shares on 4th April, 2023.

You are required to prepare a Statement of Profit and Loss as per Schedule III of the .Companies Act, 2013 for the year ended 31.03.2023. (Ignore previous year figures)

(*G-I, May, 2023*) (*10 Marks*)

Question 35

Preparation of Financial Statements of Companies

Aqua ltd. has authorized capital of ₹ 50 lakhs divided into 5,00,000 equity shares of ₹ 10 each. Their books show the following ledger balances as on 31st March, 2023:

	₹		₹
Inventory 1.4.2022	6,65,000	Bank Current Account (Dr. balance)	20,000
Discounts & Rebates allowed	30,000	Cash in hand	11,000
Carriage Inwards	57,500		
Purchases	12,32,500	Calls in Arrear @ ₹ 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of ₹ 10 each)	
Business Expenses	56,000	Trade Payables	2,40,500
Wages	14,79,000	Sales	36,17,000
Freehold Land	7,30,000	Rent (Cr.)	30,000
Plant & Machinery	7,50,000	Transfer fees received	6,500
Engineering Tools	1,50,000	Profit & Loss A/c (Cr.)	67,000
Trade Receivables	4,00,500	Repairs to Building	56,500
Advertisement Expenses	15,000	Bad debts	25,500
Commission & Brokerage Expenses	67,500		

The inventory (valued at cost or market value, which is lower) as on 31st March, 2023 was ₹ 7,05,000. Outstanding liabilities for wages ₹ 25,000 and business expenses ₹ 36,500.

Charge depreciation on written down values of Plant & Machinery @ 5%, Engineering Tools @ 20% and Furniture & Fixtures @10%. Provide ₹ 25,000 as doubtful debts for trade receivables. Provide for income tax @ 30%. It was decided to transfer ₹ 10,000 to reserves.

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2023 and Balance Sheet as at that date.

(*RTP May, 2024*)

Answer

Balance Sheet of Aqua ltd. as at 31st March, 2023

		Particulars	Note No.	(₹)
I	**Equity and Liabilities**			
	(1)	**Shareholders' Funds**		
		(a) Share Capital	1	19,90,000
		(b) Reserves and Surplus	2	3,82,000
	(2)	**Current Liabilities**		
		(a) Trade Payables		2,40,500
		(b) Other Current Liabilities	3	61,500
		(c) Short-Term Provisions	4	1,35,000
		Total		28,09,000
II	**ASSETS**			
	(1)	**Non-Current Assets**		
		(a) Property, Plant and Equipment	5	16,97,500
	(2)	**Current Assets**		
		(a) Inventories	6	7,05,000
		(b) Trade Receivables	7	3,75,500
		(c) Cash and Cash Equivalents		31,000
		Total		28,09,000

Statement of Profit and Loss of Aqua Ltd. for the year ended 31st March, 2023

	Particulars	Note No.	(₹)
I	Revenue from Operations		36,17,000
II	Other Income	8	36,500
III	**Total Revenue [I + II]**		36,53,500
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories		(40,000)
	[6,65,000-7,05,000]		
	Employee Benefits Expenses	9	15,04,000
	Depreciation and Amortization Expenses		82,500
	Other Expenses	10	4,24,500
	Total Expenses		32,03,500
V	**Profit before Tax (III-IV)**		4,50,000
VI	**Tax Expenses @ 30%**		(1,35,000)
VII	**Profit for the period**		3,15,000

Notes to Accounts:

1. Share Capital

Authorized Capital	
5,00,000 Equity Shares of ₹ 10 each	50,00,000
Issued Capital	
2,00,000 Equity Shares of ₹ 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of ₹10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of ₹10 each ₹ 8 paid	40,000
(Call unpaid ₹10,000)	19,90,000

2. Reserves and Surplus

General Reserve		10,000
Surplus i.e. Balance in Statement of		
Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	3,15,000	
Less: Transfer to Reserve	(10,000)	3,72,000
		3,82,000

3. Other Current Liabilities

Outstanding Expenses [25,000+36,500]	61,500

4. Short-term Provisions

Provision for Tax	1,35,000

5. Property, Plant and Equipment

Particulars	Value given (₹)	Depreciation rate	Depreciation Charged (₹)	Written down value at the end (₹)
Land	7,30,000		-	7,30,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Engineering Tools	1,50,000	20%	30,000	1,20,000
	17,80,000		82,500	16,97,500

6. Trade Receivables

Trade receivables	4,00,500
Less: Provision for doubtful debts	(25,000)
	3,75,500

7. Cash & Cash Equivalent

Cash Balance	11,000
Bank Balance in current A/c	20,000
	31,000

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	30,000
	36,500

9. Employee benefits expenses

Wages	14,79,000
Add: Outstanding wages	25,000
	15,04,000

10. Other Expenses

Carriage Inwards	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,500] (Business Expenses)	92,500
Bad Debts	25,500
Provision for Doubtful Debts	25,000
	4,24,500

Question 36

The following balance appeared in the books of Oliva Company Ltd. as on 31-03-2024.

Particulars		₹	Particulars		₹
Inventory 01-04-2023			Sales		17,10,000
- Raw Material	30,000		Interest		3,900
- Finished goods	46,500	76,500	Profit and Loss A/c		48,000
Purchases		12,15,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secure Loans:		
			Short–term	4,500	
			Long-term	21,000	25,500
Salaries and wages		40,200	Deposits (unsecured):		
General Charges		16,500	Short -Term	1,500	
Interim Dividend paid		27,000	Long-term	3,300	4,800
			Trade payables		3,27,000
Building		1,01,000			
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Stores and Spare Parts Consumed		45,000			
Investments: Current					

Particulars		₹	Particulars		₹
	4,500				
Non Current	7,500	12,000			
Trade receivables		2,38,500			
Cash in Bank		2,71,100			
		24,34,200			24,34,200

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 2024 and Company's Balance Sheet as on that date:

1. Inventory on 31st March, 2024 Raw material ₹ 25,800 & finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. The Taxation provision of 40% on net profit is considered.

(*MTP Advanced Accounting April, 2024*) (*14 Marks*)

Answer

Oliva Company Ltd.

Statement of Profit and loss for the year ended 31.03.2024

	Particulars	Note	Amount (₹)
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200
III	**Total Revenue (I +II)**		17,14,200
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	3,51,510
	Total Expenses		16,65,150
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Oliva Company Ltd.

Balance Sheet for the year ended 31.03.2024

	Particulars	Note	Amount
1	**Equity and Liabilities**		
	(i) Shareholders' funds		
	(a) Share Capital		3,15,000
	(b) Reserves and surplus	1	50,430
2)	**Non-current liabilities**		
	(a) Long-term borrowings	2	24,300

	Particulars	Note	Amount
(3)	**Current Liabilities**		
	(a) Short -term borrowings	3	6,000
	(b) Trade payables		3,27,000
	(c) Other current liability	4	72,000
	(d) Short term provision	5	19,620
			8,14,350
II	**ASSETS**		
(1)	**Non current assets**		
	(a) Property, Plant & equipment	6	2,04,160
	(b) Non-current investments		7,500
(2)	**Current assets**		
	(a) Current investments		4,500
	(b) Inventories	7	85,800
	(c) Trade receivables		2,38,500
	(d) Cash and cash equivalents		2,71,100
	(e) Short-term loans and advances	8	2,490
	(f) Other current assets	9	300
			8,14,350

Notes to accounts

No.	Particulars		Amount	Amount
1.	**Reserve & Surplus**			
	Profit & Loss Account: Balance b/f		48,000	
	Net Profit for the year		29,430	
	Less: Interim Dividend		(27,000)	50,430
2.	**Long term borrowings**			
	Secured loans		21,000	
	Fixed Deposits: Unsecured		3,300	24,300
3.	**Short term borrowings**			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	6,000
4.	**Other current liabilities**			
	Expenses Payable (67,500 + 4,500)			72,000
5.	**Short term provisions**			
	Provision for Income tax			19,620
6.	**PPE**			
	Building	1,01,000		
	Less: Depreciation @ 2%	(2,020)	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation @ 10%	(7,040)	63,360	
	Furniture	10,200		
	Less: Depreciation @ 10%	(1,020)	9,180	
	Motor vehicles	40,800		
	Less: Depreciation @ 20%	(8,160)	32,640	2,04,160
7	**Inventory**			
	Raw Material		25,800	
	Finished goods		60,000	85,800

No.	Particulars		Amount	Amount
8.	**Short term Loans & Advances**			
	General Charges prepaid			2,490
9.	**Other Current Assets**			
	Interest accrued			300
10.	**Cost of material consumed**			
	Opening inventory of raw material	30,000		
	Add: Purchases	12,15,000		
	Stores & spare parts consumed	45,000	12,90,000	
	Less: Closing inventory		(25,800)	12,64,200
11.	**Changes in inventory of Finished Goods & WIP**			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		46,500	13,500
12.	**Employee Benefit expenses**			
	Salary & Wages (40,200 + 4,500)			44,700
13.	**Other Expenses**			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	3,51,510

Question 37

Following is the trial balance of Delta limited as on 31.3.2023.

(Figures in ₹ '000)

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital (shares of ₹ 10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.22)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-23)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information:

(i) The authorized share capital of the company is 80,000 shares of ₹ 10 each.

(ii) The company revalued the land at ₹ 9,60,000.

(iii) Equity share capital includes shares of ₹ 50,000 issued for consideration other than cash.

(iv) Suspense account of ₹ 10,000 represents cash received from the sale of some of the machinery on 1.4.2022. The cost of the machinery was ₹ 24,000 and the accumulated depreciation thereon being ₹ 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

(vi) Balance at bank includes ₹ 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.

(vii) Make provision for income tax @30%.

(viii) Trade receivables of ₹ 50,000 are due for more than six months.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.2023 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.2023 as per Schedule III. Ignore previous year's figures & taxation.

(*MTP Advanced Accounting March, 2024*) (*14 Marks*)

Answer

Delta Limited
Balance Sheet as at 31st March 2023

Particulars	Note No.	(₹ in '000)
A. Equity and Liabilities		
1. Shareholders' funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00
(b) Short- term provision	4	163.80
Total		1,796.00
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00
(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	30.00
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 2023

Particulars	Note No.	(₹ in '000)
I. Revenue from Operations		1200.00
II. Other Income	8	6.00
III. Total Income (I +II)		1,206.00
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)		80.00
Other expenses	10	150.00
Total Expenses		660.00
V. Profit / (Loss) for the period before tax (III – IV)		546.00
VI. Tax expenses @30%		163.80
VII Profit for the period		382.20

Notes to Accounts

	Particulars		(₹ in '000)
1	Share Capital		
	Equity Share Capital		
	Authorised		
	80,000 Shares of ₹ 10/- each		800
	Issued, Subscribed and Called-up		
	50,000 Shares of ₹ 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495

	Particulars		(₹ in '000)
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve ₹ (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance		
	Opening Balance	75.00	
	Add: Profit for the period	382.20	457.20
			807.20
3	Long-Term Borrowings		
	10% Debentures		300
4.	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	160	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	(24)	
		800	
	Less: Depreciation ₹ (150 – 20 + 80)	(210)	
	Closing Balance		590
	Total		1,550
6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	
	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less: Book value of machinery (24 – 20)	(4)	6
9	Finance Costs		
	Debenture Interest		30
10	Other Expenses:		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	45	150

Question 38

Following information are available in respect of Z Limited as on 31st March, 2024

1. Equity shares of 100 each	₹ 500 lakhs
2. General Reserve	₹ 100 lakhs
3. Loss for the year ending 31" March, 2024	₹ 5 lakhs

Due to absence of profits during the year 2023-24, the management recommends to declare dividend of 10% on equity share capital out of general reserve.

The rates of equity dividend for the last 5 years immediately preceding the year 2023-24 are as follows:

2022-23	2021-22	2020-21	2019-20	2018-19
12%	14%	10%	10%	7%

As an accountant of the company, you are required to suggest whether the recommendation of the management is justified? If, you do not agree, then suggest the rate of dividend.

(*Question Paper May, 2024) (4 Marks*)

MCQs

Question - 1: Deferred payment liabilities will be shown in the balance sheet of a company under the heading

Answer:

1. *Other long term liability*
2. *Long term borrowings.*
3. *Short term borrowings*
4. *Current Liabilities*

Question - 2: Which item will form part of Share capital as per Schedule III to the Companies Act, 2013?

Answer:

1. *Share options outstanding account*
2. *Forfeited Shares*
3. *Share application money pending allotment*
4. *Capital work-in-progress.*

Question - 3: Which of the following is not a current liability as per Schedule III?

Answer:

1. *Bank overdraft*
2. *Net deferred tax liability*
3. *Dividend declared.*
4. *Provisions for employee benefits*

Question - 4: Few friends created a start-up and formed private company for production and marketing of product. At the end of financial year, their company is not required to prepare:

Answer:

1. *Cash flow statement*
2. *Balance Sheet and Profit and Loss Account*
3. *Notes to Accounts.*
4. *Statement of profit and loss Account*

Question - 5: As per the Schedule III, separate disclosure is required for an item of income or expenditure which exceeds:

Answer:

1. *1 percentage of Revenue from operations or ₹1,00,000 whichever is lower*
2. *1 percentage of Revenue or ₹5,000*
3. *1 percentage of Revenue from operations or ₹1,00,000 whichever is higher.*
4. *1 percentage of Revenue or ₹50,000*

Question - 6: Ageing analysis is required to be disclosed in the financial statements for which of the following items:

Answer:

1. *Trade receivables*
2. *Property, plant and equipment*
3. *Intangible assets*
4. *Investments*

Question - 7: Which of the following is not a current liability as per Schedule III?

Answer:

1. *Bank overdraft*
2. *Net deferred tax liability*
3. *Dividend declared.*
4. *Provisions for employee benefits*

Question - 8: Division I of Schedule III applies to:

Answer:

1. *Companies following Accounting Standards*
2. *Companies following Indian Accounting Standards*
3. *Non-Banking Finance Companies*
4. *All of the above*

Question - 9: As per the Schedule III, separate disclosure is required in the financial statements for an item of income or expenditure which exceeds

Answer:

1. *5 % of Revenue from operations or ₹1,00,000 whichever is lower*
2. *1% of Revenue or ₹5,000*
3. *1% of Revenue from operations or ₹1,00,000 whichever is higher.*
4. *1% of Revenue from operations or ₹50,000 whichever is higher.*

Question - 10: Trade payables as per Schedule III will include:

Answer:

1. *Dues payable in respect to statutory obligation*
2. *Interest accrued on trade payables*
3. *Bills payables.*
4. *Bills receivables*

Question - 11: Securities Premium Account is shown on the liabilities side in the Balance Sheet under the heading:

Answer:

1. *Reserves and Surplus.*
2. *Current Liabilities.*
3. *Share Capital.*
4. *Share application money pending allotment*

Question - 12: "Fixed assets held for sale" will be classified in the company's balance sheet as

Answer:

1. *Current asset*
2. *Non-current asset*
3. *Capital work- in- progress*
4. *Deferred tax assets*

Question - 13: Current maturities of long- term debt will come under

Answer:

1. *Current Liabilities.*
2. *Short term borrowings.*
3. *Long term borrowings.*
4. *Short term provisions*

Question - 14: Declaration of dividends for current year is made after providing for

Answer:

1. *Depreciation of past years only.*
2. *Depreciation on assets for the current year and arrears of depreciation of past years (if any).*
3. *Depreciation on current year only and by forgoing arrears of depreciation of past years.*
4. *Excluding current year depreciation*

Question - 15: Pratham and Associates is a manufacturer of steel rods. It invests its profits by purchasing shares of listed companies in order to earn dividend income. It had purchased shares of Bharti Airtel Limited in FY 2018-19. However, it sold all the shares of Bharti Airtel Limited during the current year i.e. FY 2023-24. What amount would be disclosed in the profit and loss account for FY 2023-24?

(a) This transaction would not affect the profit and loss account since the primary business of the company is manufacturing, and not investment.
(b) The carrying amount net of expenses would be disclosed in the profit and loss account.
(c) The disposal proceeds net of expenses would be disclosed in the profit and loss account.
(d) The difference between the carrying amount and the disposal proceeds, net of expenses, would be disclosed in the profit and loss account.

Answer

Q1	***2***	***Q2***	***2***	***Q3***	***2***	***Q4***	***1***
Q5	***3***	***Q6***	***1***	***Q7***	***2***	***Q8***	***1***
Q9	***3***	***Q10***	***1***	***Q11***	***1***	***Q12***	***1***
Q13	***2***	***Q14***	***2***	***Q15***	***4***		

Intermediate
Course: Paper 1

ADVANCED ACCOUNTING

(New Scheme of Education and Training)

Part 2

By

CA. PARVEEN SHARMA

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Post Graduation in Accounting Standards, US GAAP & Certified Valuer

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Dedicated

To My Parents

Late Sh. SATPAL SHARMA

Smt. JANKI DEVI

Syllabus

PAPER 1: ADVANCED ACCOUNTING

(One paper – Three hours – 100 Marks)

Objective:

To acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities.

Contents:

1. Process of formulation of Accounting Standards including Indian Accounting Standards (IFRS converged standards) and IFRSs; Convergence vs Adoption; Objective and Concepts of carve outs.
2. Framework for Preparation and Presentation of Financial Statements (as per Accounting Standards).
3. (i) Applicability of Accounting Standards to various entities

   (ii) Application of Accounting Standards:

   AS 1: Disclosure of Accounting Policies

   AS 2: Valuation of Inventories

   AS 3: Cash Flow Statements

   AS 4: Contingencies and Events Occurring After the Balance Sheet Date

   AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

   AS 7: Construction Contracts

   AS 9: Revenue Recognition

   AS 10: Property, Plant and Equipment

   AS 11: The Effects of Changes in Foreign Exchange Rates

   AS 12: Accounting for Government Grants

   AS 13: Accounting for Investments

   AS14: Accounting for Amalgamations (excluding inter- company holdings)

   AS 15: Employee Benefits

   AS 16: Borrowing Costs

   AS 17: Segment Reporting

   AS 18: Related Party Disclosures

   AS 19: Leases

AS 20: Earnings Per Share

AS21: Consolidated Financial Statements of single subsidiaries (excluding problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries).

AS 22: Accounting for Taxes on Income

AS 23: Accounting for Investment in Associates in Consolidated Financial Statements

AS 24: Discontinuing Operations

AS 25: Interim Financial Reporting

AS 26: Intangible Assets

AS 27: Financial Reporting of Interests in Joint Ventures

AS 28: Impairment of Assets

AS 29: Provisions, Contingent Liabilities and Contingent Assets

4. Company Accounts
   (i) Schedule III to the Companies Act, 2013 (Division I)
   (ii) Preparation of financial statements – Statement of Profit and Loss, Balance Sheet and Cash Flow Statement
   (iii) Buy back of securities
   (iv) Accounting for reconstruction of companies.
5. Accounting for Branches including foreign branches.

Note: If either new Accounting Standards (AS), Announcements and Limited Revisions to AS are issued or the earlier ones are withdrawn or new AS, Announcements and Limited Revisions to AS are issued in place of existing AS, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

Contents

Buy-Back of Securities	27.1
QUESTION BANK	27.22
MCQs	27.57
Amalgamation of Companies (AS 14: Accounting for Amalgamations)	28.1
QUESTION BANK	28.49
MCQs	28.128
Accounting for Reconstruction of Companies	29.1
QUESTION BANK	29.34
MCQs	29.99
Accounting for Branches including Foreign Branches	30.1
QUESTION BANK	30.44
MCQs	30.83

Buy-Back of Securities

Question 1

M Ltd. furnishes the following Balance Sheet as at 31st March, 20X1:

Particulars			Notes	₹ (in 000)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,000
	B	Reserves and Surplus	2	6,310
2		**Non-current liabilities**		
		Long term borrowings	3	400
3		**Current liabilities**		
	A	Trade Payables		40
		Total		11,750
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment	4	2,750
	B	Non-Current Investments (at cost)		5,000
2		**Current assets**		
	A	Inventories		1,000
	B	Trade receivables		2,000
	C	Cash and Cash equivalents		1,000
		Total		11,750

Notes to accounts

No.	Particulars		₹ in ('000)
1	**Share Capital**		
	Authorized, Issued and Subscribed Capital:		
	3,00,000 Equity shares of ₹ 10 each fully paid up		3,000
	20,000 9% Preference Shares of 100 each		2,000
	Total		5,000
2	**Reserves and Surplus**		
	Capital reserve		10
	Revenue reserve		4,000
	Securities premium		500
	Profit and Loss account		1,800
	Total		6,310

No.	Particulars		₹ in ('000)
3	***Long term borrowings***		
	10% Debentures		*400*
4	***Property, Plant and Equipment (PPE)***		
	PPE: Cost		*3,000*
	Less: Provision for depreciation		*(250)*
	Net carrying value		*2,750*

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹30 lakhs for ₹ 25 lakhs.

You are required to pass necessary Journal entries.

(*Source: Illustration 1, Study Material*)

Solution

Journal Entries in the books of M Ltd.

₹ in '000

	Particulars		Dr.	Cr.
1.	Bank A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	500	
	To Investment A/c			3,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	Equity share capital A/c Premium payable on buy-back	Dr.	600	
	To Equity shares buy-back A/c	Dr.	300	
	(Being the amount due on buy-back of equity shares)			900
3.	Equity shares buy-back A/c To Bank A/c	Dr.	900	
	(Being payment made for buy-back of equity shares)			900
4.	Securities Premium A/c	Dr.	300	
	To Premium payable on buy-back			300
	(Being premium payable on buy-back charged from Securities premium)			
5.	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c			600
	(Being creation of capital redemption reserve to the extent of the equity shares bought back)			

Question 2

Anu Ltd. (*a non-listed company*) *furnishes you with the following balance sheet as at 31st March, 20X1:*

(in crores ₹)

		Particulars	Notes	₹
1		***Equity and Liabilities***		
		Shareholders' funds		
	A	*Share capital*	*1*	*100*
	B	*Reserves and Surplus*	*2*	*300*
2		***Current liabilities***		
	A	*Trade Payables*		*40*
		Total		*440*

		Particulars	Notes	₹
1		***Assets***		
	A	***Non-current assets***	*3*	-
	B	*Property, plant and equipment*	*4*	*100*
2		*Non-Current Investments*		
	A	***Current assets***		*140*
	B	*Trade receivables*		*200*
		Cash and Cash equivalents		
		Total		*440*

Notes to accounts

No.	Particulars		₹
1	***Share Capital***		
	Authorized, issued and subscribed share capital*:*		
	12% Redeemable preference shares of ₹ 100 each, fully paid up		*75*
	Equity shares of ₹ 10 each, fully paid up		*25*
	Total		*100*
2	***Reserves and Surplus***		
	Capital reserve		*15*
	Securities premium		*25*
	Revenue reserves		*260*
	Total		*300*
3	***Property, Plant and Equipment***		
	PPE Cost		*100*
	Less: Provision for depreciation		*(100)*
	Net carrying value		*NIL*
4	***Non-Current Investments***		
	Non-current investments at cost (*Market value ₹ 400 Cr.*)		*100*

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

(i) Pass journal entries to record the above.

(ii) Prepare balance sheet as at 1.4.20X1.

(*Source: Illustration 2, Study Material*)

Solution

Journal entries in the books of Anu Ltd.

₹ in crores

	Particulars	Dr.	Cr.
1st April, 20*X1*	12% Preference share capital A/c Dr. To Preference shareholders A/c (Being preference share capital account transferred to shareholders account)	75	75
	Preference shareholders A/c Dr. To Bank A/c (Being payment made to shareholders)	75	75

	Particulars		Dr.	Cr.
	Shares buy-back A/c	Dr.	25	
	To Bank A/c			25
	(Being 50 lakhs equity shares bought back @ ₹ 50 per share)			
	Equity share capital A/c (50 lakhs x ₹ 10)	Dr.	5	
	Securities premium A/c (50 lakhs x ₹ 40)	Dr.	20	
	To Shares buy-back A/c			25
	(Being cancellation of shares bought back)			
	Revenue Reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5)			80
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

(ii) **Balance Sheet of Anu Ltd as at 1.4.20X1**

(in crores ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	20
	B	Reserves and Surplus	2	280
2		**Current liabilities**		
	A	Trade Payables		40
		Total		340
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
2		**Current assets**		
	A	Trade receivables		140
	B	Cash and Cash equivalents	5	100
		Total		340

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed share capital		
	200 lakhs Equity shares of ₹ 10 each fully paid		20
	Total		20
2	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280

No.	Particulars		₹
3	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		—
4	**Non-Current Investments**		
	Non-current investments at cost		100
	(Market value ₹ 400 Crores)		
5	**Cash and Cash Equivalents**		
	Cash and Cash Equivalents as on 31.3.20X1		200
	Less: Bank payment for redemption and buy-back		(100)
	Total		100

Question 3

Dee Limited (*a non-listed company*) *furnishes the following Balance Sheet as at 31st March, 20*X1*:*

(in thousand ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*2,700*
	B	*Reserves and Surplus*	*2*	*9,700*
2		***Current liabilities***		
	A	*Trade Payables*		*1,400*
		Total		*13,800*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and Equipment*		*9,300*
	B	*Non-Current Investments*		*3,000*
2		***Current assets***		
	A	*Inventories*		*500*
	B	*Trade receivables*		*200*
	C	*Cash and Cash equivalents*		*800*
		Total		*13,800*

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,500
	2,000, 10% Preference shares of ₹ 100 each		200
	(*Issued two months back for the purpose of buy-back*)		
	Total		2,700
2	**Reserves and Surplus**		
	Capital reserve		1,000
	Revenue reserve		3,000
	Securities premium		2,200
	Profit and loss account		3,500
	Total		9,700

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 50 per share. For this purpose, it sold all of its investment for ₹ 22,00,000.

You are required to pass necessary journal entries and prepare the Balance Sheet.

(*Source: Illustration 3, Study Material*)

Solution

Journal Entries in the books of Dee Limited

(in thousand ₹)

	Particulars		***Dr.***	***Cr.***
(i)	Bank Account	Dr.	2,200	
	Profit and Loss Account	Dr.	800	
	To Investment Account			3,000
	(Being the investments sold at loss for the purpose of buy-back)			
(ii)	Equity Share buy-back Account	Dr.	2,500	
	To Bank Account			2,500
	(Being the payment made on buy-back)			
(iii)	Equity Share Capital Account	Dr.	500	
	Premium Payable on Buy-Back Account	Dr.	2,000	
	To Equity Shares Buy-Back Account			2,500
	(Being the buy-back amount allocated to equity share capital)			
(iv)	Securities premium Account	Dr.	2,000	
	To Premium payable on buy-back Account			2,000
	(Being the premium payable on buy-back adjusted against securities premium account)			
(v)	Revenue reserve Account	Dr.	300	
	To Capital Redemption Reserve Account			300
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)			

Balance Sheet of Dee Limited as at 1st April, 20X1
(After buy-back of shares)

(in thousand ₹)

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,200
	B	Reserves and Surplus	2	6,900
2		**Current liabilities**		
	A	Trade Payables		1,400
		Total		10,500
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		9,300
2		**Current assets**		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		500
		Total		10,500

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹ 10 each fully paid up		2,000
	2,000, 10% Preference shares of ₹ 100 each		200
	(Issued two months back for the purpose of buy- back)		
	Total		2,200
2	**Reserves and Surplus**		
	Capital reserve		1,000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	
	Less: Loss on investment	(800)	2,700
	Total		6,900

Question 4

Extra Ltd. (*a non-listed company*) *furnishes you with the following Balance Sheet as at 31st March, 20*X1*:*

(in lakhs ₹)

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*120*
	B	*Reserves and Surplus*	*2*	*118*
2		***Non-current liabilities***		
		Long term borrowings	*3*	*4*
3		***Current liabilities***		
	A	*Trade Payables*		*70*
		Total		*312*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and Equipment*		*50*
	B	*Non-current Investments*		*120*
2		***Current assets***		
	A	*Cash and Cash equivalents*		*142*
		Total		*312*

Notes to accounts

No.	***Particulars***		***₹***
1	***Share Capital***		
	Authorized, issued and subscribed capital:		
	Equity shares of ₹ 10 each fully paid		*100*
	9% Redeemable preference shares of ₹ 100 each fully paid		*20*
	Total		*120*

No.	Particulars		₹
2	***Reserves and Surplus***		
	Capital reserves		*8*
	Revenue reserves		*50*
	Securities premium		*60*
	Total		*118*
3	***Long term borrowings***		
	10% Debentures		*4*

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share. The payment for the above was made out of huge bank balances.

(iii) Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.

(iv) The company had 1,00,000 equity stock options outstanding on the above- mentioned date, to the employees at ₹ 20 when the market price was ₹30 (This was included under current liabilities). On 1.04.20X1 employees exercised their options for 50,000 shares.

(v) Pass the journal entries to record the above.

(vi) Prepare Balance Sheet as at 01.04.20X1.

(*Source: Illustration 4, Study Material*)

Solution

(*₹ in lakhs*)

Date	Particulars		Debit	Credit
20*X1* *1st April*	9% Redeemable preference share capital A/c	Dr.	20.00	
	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	22.00	
	To Bank A/c			22.00
	(Being payment made to shareholders)			
	Equity shares buy-back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs equity shares of ₹ 10 each bought back @ ₹ 30 per share)			
	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy-back A/c			90.00
	(Being cancellation of shares bought back)			
	Revenue reserve A/c	Dr.	50.00	
	To Capital redemption reserve A/c			50.00
	(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)			
	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debentures A/c			0.20
	(Being cancellation of own debentures costing ₹ 2 lakhs, face value being ₹ 2.20 lakhs and the balance being profit on cancellation of debentures)			

Date	Particulars		Debit	Credit
	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00
	To Securities premium A/c			10.00
	(Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)			
	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preference shares A/c			2.00
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of Extra Ltd. as at 01.04.20X1

(in lakhs ₹)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	75.00
	B	Reserves and Surplus	2	66.20
2		**Non-current liabilities**		
		Long term borrowings	3	1.80
3		**Current liabilities**		
	A	Other Current Liabilities	4	65.00
		Total		208
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50.00
	B	Non-current Investments	5	118.00
2		**Current assets**		
	A	Cash and Cash equivalents	6	40.00
		Total		208

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Equity shares of ₹ 10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-
	Securities Premium		

No.	Particulars		₹
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
	Total		66.20
3	**Long term borrowings**		
	10% Debentures		4.00
	Less: Cancellation of own debentures		(2.20)
	Total		1.80
4.	**Other Current liabilities**		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		(5.00)
	Total		65.00
5.	**Non-current investments**		
	Opening balance		120.00
	Less: Investment in own debentures		(2.00)
	Total		118.00
6.	**Cash and Cash Equivalents**		
	Opening balance		142.00
	Less: Payment to preference shareholders		(22.00)
	Less: Payment to equity shareholders		(90.00)
	Add: Share price received against ESOP		10.00
	Total		40.00

Question 5

Pratham Ltd. (*a non-listed company*) *has the following Capital structure as on 31st March, 20X1:*

Particulars	₹	₹
Equity Share Capital (*shares of ₹10 each fully paid*		*30,00,000*
Reserves & Surplus		
General Reserve	*32,50,000*	
Security Premium Account	*6,00,000*	
Profit & Loss Account	*4,30,000*	
Revaluation Reserve	*6,20,000*	*49,00,000*
Loan Funds		*42,00,000*

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy-back is ₹30 per share.

(*Source: Illustration 5, Study Material*)

Solution

Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹ in crores)	21,00,000
(c)	Present equity shareholders fund (₹ in crores)	72,80,000

	Particulars	***₹***
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	***₹***
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

   Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

   Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity

   (72,80,000 –x)-21,00,000 = y (1)

   Since 51,80,000 – x = y

   $$\text{Equation 2}: \left(\frac{\text{Maximum buy - back}}{\text{Offer price for buy - back}} \times \text{Nominal Value}\right)$$

   = Nominal value of the shares bought –back to be transferred to CRR

   $$= \left(\frac{y}{30} \times 10\right) = x$$

   3x = y (2)

   x = ₹ 12,95,000 crores and y = ₹ 38,85,000 crores

Question 6

Perrotte Ltd. (*a non-listed company*) *has the following Capital Structure as on 31.03.20X1:*

	Particulars	***(₹ in crores)***	
(1)	*Equity Share Capital* (*Shares of ₹ 10 each fully paid*)	*-*	*330*
(2)	*Reserves and Surplus*		
	General Reserve	*240*	*-*
	Securities Premium Account	*90*	*-*
	Profit & Loss Account	*90*	*-*
	Infrastructure Development Reserve	*180*	*600*
(3)	*Loan Funds*		*1,800*

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.20X1 a proposal to buy-back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is ₹ 25 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Development Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,200 crores or ₹ 1,500 crores.

Assuming that the entire buy-back is completed by 09.12.20X1, show the accounting entries in the company's books in each situation.

(*Source: Illustration 6, Study Material*)

Solution

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	***When loan fund is***		
	₹ 1,800 crores	***₹ 1,200 crores***	***₹ 1,500 crores***
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy-Back
(applicable only when loan fund is ₹ 1,200 crores)

₹ in crores

	Particulars		***Debit***	***Credit***
(a)	Equity share buy-back account	Dr.	112.5	
	To Bank account			112.5
	(Being buy-back of 3.75 crores equity shares of ₹ 10 each @ ₹ 30 per share)			
(b)	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
	To Equity share buy-back account			112.5
	(Being cancellation of shares bought back)			
(c)	General reserve account	Dr.	37.5	
	To Capital redemption reserve account			37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. Shares Outstanding Test

Particulars	***(Shares in crores)***
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	330
Free reserves (₹ in crores)	420
Shareholders' funds (₹ in crores)	750
25% of Shareholders fund (₹ in crores)	₹ 187.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3. Debt Equity Ratio Test

	Particulars	***When loan fund is***		
		₹ 1,800 crores	***₹ 1,200 crores***	***₹ 1,500 crores***
(a)	Loan funds (₹ in crores)	1,800	1,200	1,500
(b)	Minimum equity to be maintained **after** buy-back in the ratio of 2:1 (₹ in crores)	900	600	750

	Particulars	***When loan fund is***		
		₹ 1,800 crores	***₹ 1,200 crores***	***₹ 1,500 crores***
(c)	Present equity shareholders fund (₹ in crores)	750	750	750
(d)	Future equity shareholder fund (₹ in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (**See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.

2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. In the question, it is stated that the company has surplus funds to dispose of therefore, it is presumed that buy- back is out of free reserves or securities premium and hence a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from present equity.

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buy-back of equity

(750 –x)-600 = y (1)

Since 150 – x = y

$$\text{Equation 2}: \left(\frac{\text{Maximum buy - back}}{\text{Offer price for buy - back}} \times \text{Nominal Value}\right)$$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10\right) = x$$

[here (30 = 25% x 120]

Or 3x = y (2)

by solving the above two equations we get

x = ₹ 37.5 crores

y = ₹ 112.5 crores

Question 7

What are the conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares as per Companies Act, 2013? Explain in brief.

(*Source: Question 7, Study Material*)

Answer

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares. For details, refer Para 1.1 and 1.2 of the chapter.

Question 8

SMM Ltd. has the following capital structure as on 31st March, 20X1: ₹ in crore

	Particulars	Situation I	Situation II
(i)	Equity share capital (shares of ₹ 10 each)	1,200	1,200
(ii)	Reserves:		
	General Reserves	1,080	1,080
	Securities Premium	400	400
	Profit & Loss	200	200
	Infrastructure Development Reserve (Statutory Reserve)	320	320
(iii)	Loan Funds	3,200	6,000

The company has offered buy-back price of ₹ 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries.

(*Source: Question 8, Study Material*)

Answer

Statement determining the maximum number of shares to be bought back

Number of shares (in crores)

Particulars	When loan fund is	
	₹ 3,200 crores	₹ 6,000 crores
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil
Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹3,200 crores)

			₹ in crores	
	Particulars		Debit	Credit
(a)	Equity shares buy-back account	Dr.	720	
	To Bank account			720
	(Being payment for buy-back of 24 crores equity shares of ₹ 10 each @ ₹ 30 per share)			
(b)	Equity share capital account	Dr.	240	
	Premium Payable on buy-back account	Dr.	480	
	To Equity share buy-back account			720
	(Being cancellation of shares bought back)			
	Securities Premium account General Reserve/Profit & Loss A/c	Dr.	400	
	To Premium Payable on buy-back account	Dr.	80	
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)			480
(c)	General Reserve/Profit & Loss A/c	Dr.	240	
	To Capital redemption reserve account			240
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. Shares Outstanding Test

Particulars	**(*Shares in crores*)**
Number of shares outstanding	120
25% of the shares outstanding	30

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	1,200
Free reserves (₹ in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (₹ in crores)	2,880
25% of Shareholders fund (₹ in crores)	₹ 720 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back	24 crores shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	**When loan fund is**	
		₹ 3,200 crores	₹ 6,000 crores
(a)	Loan funds (₹)	3,200	6,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	1,600	3,000
(c)	Present equity shareholders fund (₹)	2,880	2,880
(d)	Future equity shareholders fund (₹) (see W.N.4)	2,560 (2,880 320)	N.A.
(e)	Maximum permitted buy- back of Equity (₹) [(d) – (b)]	960	Nil
(f)	Maximum number of shares	32 crore shares	
	that can be bought back @ ₹ 30 per share		Nil
	As per the provisions of the		
	Companies Act, 2013, company	Qualifies	Does not Qualify

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted

buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy-Back *X* Nominal Value Per Share/Offer Price Per Share

y/30 x 10 = x

or

3x = y (2)

by solving the above two equations we get

x= ₹ 320

y = ₹ 960

Question 9

KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,200
	B	Reserves and Surplus	2	810
2		**Non-current liabilities**		
		Long term borrowings	3	750
3		**Current liabilities**		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,700
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026
	B	Non-current Investments		74
2		**Current assets**		
	A	Inventories		600
	B	Trade receivables		260
	C	Cash and Cash equivalents		740
		Total		3,700

Notes to accounts

No.	**Particulars**		**₹**
1	**Share Capital**		
	Authorized, issued and subscribed capital		
	Equity share capital (fully paid up shares of ₹ 10 each)		1,200
2	**Reserves and Surplus**		
	Securities premium		175
	General reserve		265
	Capital redemption reserve		200
	Profit & loss A/c		170
	Total		810
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, plant and equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

On 1st April, 20X1, the company announced the buy-back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 75 lakhs.

On 5th April, 20X1, the company achieved the target of buy-back. On 30th April, 20X1 the company issued one fully paid up equity share of ₹ 10 by way of bonus for every four equity shares held by the equity shareholders.

You are required to:

(1) Pass necessary journal entries for the above transactions.

(2) Prepare Balance Sheet of KG Limited after bonus issue of the shares.

(*Source: Question 9, Study Material*)

Answer

In the books of KG Limited
Journal Entries

Date 20X1	Particulars		Dr. (₹ in lakhs)	Cr. (₹ in lakhs)
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment (Being investment sold on profit)			1
April 5	Equity share capital A/c	Dr.	300	
	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450
	(Being the amount due to equity shareholders on buy-back)			
	Equity shares buy-back A/c	Dr.	450	
	To Bank A/c			450
	(Being the payment made on account of buy-back of 30 Lakh Equity Shares)			
April 5	General reserve A/c	Dr.	265	
	Profit and Loss A/c	Dr.	35	
	To Capital redemption reserve A/c			300
	(Being amount equal to nominal value of buy-back shares from free reserves transferred to capital redemption reserve account as per the law)			
April 30	Capital redemption reserve A/c	Dr.	225	
	To Bonus shares A/c (W.N.1)			225
	(Being the utilization of capital redemption reserve to issue bonus shares)			
	Bonus shares A/c	Dr.	225	
	To Equity share capital A/c			225
	(Being issue of one bonus equity share for every four equity shares held)			

Balance Sheet (After buy-back and issue of bonus shares)

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,125
	B	Reserves and Surplus	2	436
2		**Non-current liabilities**		
		Long term borrowings	3	750
3		**Current liabilities**		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,251
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	2,026
2		**Current assets**		
	A	Inventories		600
	B	Trade receivables		260
	C	Cash and Cash equivalents		365
		Total		3,251

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		1,125
2	**Reserves and Surplus**		
	General Reserve	265	
	Less: Transfer to CR	(265)	-
	Capital Redemption Reserve	200	
	Add: Transfer due to buy-back of shares from P/L	35	
	Add; Transfer due to buy-back of shares from General Reserve	265	
	Less: Utilisation for issue of bonus shares	(225)	275
	Securities premium	175	
	Less: Adjustment for premium paid on buy-back	(150)	25
	Profit & Loss A/c	170	
	Add: Profit on sale of investment	1	
	Less: Transfer to CRR	(35)	136
	Total		436
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, Plant and Equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working Notes:

1. Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹ 225 lakhs
2. Cash at bank after issue of bonus shares

Particulars	₹ in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

Note: In the given Answer, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

Question 10

Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:

Particulars			*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	12,50,000
	B	Reserves and Surplus	2	18,75,000
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000

		Particulars	Notes	₹
3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		76,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets		30,00,000
		Total		76,50,000

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		12,50,000
2	**Reserves and Surplus**		
	Securities premium		2,50,000
	Profit and loss account		1,25.000
	Revenue reserve		15,00,000
	Total		18,75,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

The company wants to buy-back 25,000 equity shares of ₹ 10 each, on 1st April, 20X1 at ₹ 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy-back of shares by company is within the provisions of the Companies Act, 2013. If yes, pass necessary journal entries towards buy-back of shares and prepare the Balance Sheet after buy-back of shares. (*Source: Question 10, Study Material*)

Answer

Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	(*Shares*)
Number of shares outstanding	1,25,000
25% of the shares outstanding	31,250

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	₹
Paid up capital (₹)	12,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	18,75,000
Shareholders' funds (₹)	31,25,000
25% of Shareholders fund (₹)	7,81,250
Buy-back price per share	₹ 20
Number of shares that can be bought back (shares)	39,062
Actual Number of shares for buy-back	25,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	***₹***
(a)	Loan funds (₹) (18,75,000+10,00,000+16,50,000)	45,25,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	22,62,500
(c)	Present equity/shareholders fund (₹)	31,25,000
(d)	Future equity/shareholders fund (₹) (see W.N.) (31,25,000 – 2,87,500)	28,37,500*
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	5,75,000
(f)	Maximum number of shares that can be bought back @ ₹ 20 per share	28,750 shares
(g)	Actual Buy-Back Proposed	25,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	***Number of shares***
Shares Outstanding Test	31,250
Resources Test	39,062
Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

	Particulars		***Debit (₹)***	***Credit (₹)***
(a)	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy-back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd.
as at 31st March, 20X1

Particulars			***Notes***	***₹***
1		**Equity and Liabilities**		
		Shareholders' funds		
	A	Share capital	1	10,00,000
	B	Reserves and Surplus	2	16,25,000

* *As per Section 68(2) (d) of the Companies Act 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69(1), on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69(2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.*

		Particulars	Notes	₹
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000
3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		71,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets (30,00,000 – 5,00,000)		25,00,000
		Total		71,50,000

Notes to accounts

No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		10,00,000
2	**Reserves and Surplus**		
	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	(2,50,000)	12,50,000
	Securities premium	2,50,000	
	Less: Utilization for share buy-back	(2,50,000)	-
	Capital Redemption Reserves		2,50,000
	Total		16,25,000
3	**Long term borrowings**		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	**Property, plant and equipment**		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

Working Note

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is ‘x’ and maximum permitted buy-back of equity is ‘y’.

Then

$(31,25,000 – x) – 22,62,500 = y$ (1)

$\left(\frac{y}{20} \times 10\right) = x$ or $2x = y$ (2)

by solving the above equation, we get

x = ₹2,87,500

y = ₹ 5,75,000

QUESTION BANK

Question 11

Following is the summarized Balance Sheet of M/s Complicated Ltd. as on 31st March, 2016:

Liabilities	**Amount (₹)**
Equity shares of ₹ 10 each fully paid up	12,50,000
Bonus shares	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	1,00,000
Revaluation Reserve	1,00,000
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
Assets	**Amount (₹)**
Fixed Assets	46,50,000
Current Assets	40,00,000
	86,50,000

The Company wants to buy back 25000 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 payment for buy back of shares will be made by the Company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy back of shares by the Company is within the provisions of the Companies Act, 2013. If yes, pass necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back of shares. (*May 2016, 12 Marks*)

Answer

Determination of Buy back of maximum no. of shares as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	*(Shares)*
Number of shares outstanding (₹12,50,000 + ₹1,00,000)/ ₹ 10	1,35,000
25% of the shares outstanding	33,750

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (₹)	₹ 13,50,000
Free reserves (₹) (15,00,000 + 2,50,000 + 1,25,000)	₹ 18,75,000
Shareholders' funds (₹)	₹ 32,25,000
25% of Shareholders fund (₹)	₹ 8,06,250
Buy back price per share	₹ 20
Number of shares that can be bought back (shares)	40,312
Actual Number of shares for buy back	25,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy Back

Particulars	₹
(a) Loan funds (₹) (18,75,000+10,00,000+16,50,000 + 1,00,000 + 2,00,000)	48,25,000
(b) Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	24,12,500
(c) Present equity/shareholders fund (₹)	32,25,000
(d) Future equity/shareholders fund (₹) (see W.N.) (32,25,000 – 2,70,833)	29,54,167*
(e) Maximum permitted buy back of Equity (₹) [(d) – (b)]	5,41,667
(f) Maximum number of shares that can be bought back @ ₹ 20 per share	27,083 Shares
(g) Actual Buy Back Proposed Shares	25,000

∗As per Section 68 (2) (d) of the Companies Act 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69 (1), on buy-back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69 (2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.

Summary statement determining the maximum number of shares to be bought back

Particulars	*Number of shares*
Shares Outstanding Test	33,750
Resources Test	40,312
Debt Equity Ratio Test	27,083
Maximum number of shares that can be bought back [least of the above]	27,083

Company qualifies all tests for buy-back of shares and conclusion is that it can buy maximum 27,083 shares on 1st April, 2016.

However, company wants to buy-back only 25,000 equity shares @ ₹ 20. Therefore, buy-back of 25,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

		Debit (₹)	*Credit (₹)*
(a)	Equity shares buy-back account Dr.	5,00,000	
	To Bank account		5,00,000
	(Being buy back of 25,000 equity shares of ₹ 10 each @ ₹ 20 per share)		
(b)	Equity share capital account Dr.		
	Securities premium account Dr.	2,50,000	
	To Equity shares buy-back account	2,50,000	
	(Being cancellation of shares bought back)		5,00,000
(c)	Revenue reserve account Dr.		
	To Capital redemption reserve account	2,50,000	
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)		2,50,000

Balance Sheet of Complicated Ltd. as on 1st April, 2016

Particulars	*Note No*	*Amount* ₹
EQUITY AND LIABILITIES		
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) Fixed assets		46,50,000
2 Current assets (40,00,000-5,00,000)		35,00,000
Total		81,50,000

Notes 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)	-	

	Share Option Outstanding Account	4,00,000	
	Capital Reserve	1,00,000	
	Revaluation Reserve	1,00,000	
	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

Working Note:

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

(₹ 32,25,000 – x) – ₹ 24,12,500 = y (1)

$$\left(\frac{y}{20}\times 10\right) = x$$

Or 2x = y (2)

by solving the above equation we get x = ₹ 2,70,833 and y = ₹ 5,41,667

Question 12

The following is the Summarized Balance Sheet of M/s. Vriddhi Infra Ltd. as on 31st March, 2016:

Equity & Liabilities	Amount (₹)	Assets	Amount (₹)
1. Shareholders Fund		1. Non-Current Assets	
(a) Share Capital:		(a) Fixed (Tangible) Assets:	
1,00,000 Equity		Land & Building	21,50,000
Shares of ₹ 10 each fully paid up	10,00,000	Plant & Machinery	15,00,000
(b) Reserve & Surplus:		(b) Non-Current	
		Investments	2,00,000
Securities Premium	3,00,000	2. Current Assets	
General Reserve	2,50,000	(a) Trade Receivables	5,50,000
Profit & Loss		(b) Inventories	1,80,000
Account Surplus	1,50,000	(c) Cash and Cash Equivalents	40,000
2. Non-Current Liabilities			
Long Term Borrowings:			
10% Debentures			
(Secured by floating			
charge on all assets)	20,00,000		
Unsecured Loans	8,00,000		
3. Current Liability & Provisions			
Trade Payables	1,20,000		
Total	**46,20,000**	**Total**	**46,20,000**

On 21st April, 2016 the Company announced the buy back of 25,000 of its equity shares @ ₹ 15 per share. For this purpose, it sold all its investment for ₹ 2.50 lakhs.

On 25th April, 2016, the company achieved the target of buy back.

On 1st May, 2016 the company issued one fully paid up share of ₹ 10 each by way of bonus for every five equity shares held by the equity shareholders.

You are requested to pass necessary Journal Entries for the above transactions.

All necessary workings should form part of your answer.

(*November, 2016, 6 Marks*)

Answer

In the books of Vriddhi Infra Ltd.
Journal Entries

Date 2016	***Particulars***	***Dr.***	***Cr.***
		₹	₹
April 21	Bank A/c Dr. To Investment A/c To Profit on sale of investment (Being investment sold on profit)	2,50,000	 2,00,000 50,000
April 25	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)	2,50,000 1,25,000	 3,75,000
	Equity shares buy back A/c Dr. To Bank A/c* (Being the payment made on account of buy back of 25,000 Equity Shares)	3,75,000	 3,75,000
	General Reserve A/c / P&L 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)	2,50,000	 2,50,000
1st May	Capital redemption reserve A/c Dr. To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	1,50,000	 1,50,000
	Bonus shares A/c Dr. To Equity share capital A/c (Being issue of one bonus equity share for every five equity shares held)	1,50,000	 1,50,000

Working Note:

Amount of bonus shares = $\left[(1,00,000 - 25,000) \times \frac{1}{5}\right] \times 10$

= 15,000 x ₹ 10 = ₹ 1,50,000

Question 13

Following is the summarized 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

* It is assumed that there is bank overdraft amounting ₹ 85,000 [(40,000 + 2,50,000) less ₹ 3,75,000]

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 authorized by its Articles and necessary resolution has been passed by the Company towards this. The buy-back of shares by the Company is also within the provisions of the Companies Act, 2013. The payment for buy back of shares will be made by the Company out of sufficient bank balance available shown as part of Current Assets.

You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet after buy back of shares. (*MTP Oct 2018*) (*RTP May 2018*)

Answer

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 (₹)	Credit (₹)
(a)	Equity shares buy-back account	Dr.	5,00,000	
	To Bank account			5,00,000
	(Being buy back of 25,000 equity shares of ₹10 each @ ₹20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of Complicated Ltd. as on 1st April, 2016

Particulars	Note No	Amount
EQUITY AND LIABILITIES		
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) Fixed assets		46,50,000
2 Current assets (40,00,000 - 5,00,000)		35,00,000
Total		81,50,000

Notes 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)	—	
	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 14

The following was the Balance Sheet of Omega Ltd. as on 31st March, 2016.

Equity & Liabilities	₹Lakhs	Assets	₹Lakhs
Share Capital:		Fixed Assets	14,000
Equity shares of ₹10 each Fully Paid Up	8,000	Investments	3,000
		Cash at Bank	1,650
10% Redeemable Pref. Shares of ₹10 each Fully Paid Up	2,500	Other Current Assets	8,250
Reserves & Surplus			
Capital Redemption Reserve	1,000		
Securities Premium	800		
General Reserve	6,000		
Profit & Loss Account	300		
Secured Loans:			
9% Debentures	5,000		
Current Liabilities:			
Trade payables	2,300		
Sundry Provisions	1,000		
	26,900		26,900

On 1st April, 2016 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 15% of its Equity Shares at ₹20 per Share. In order to make cash available, the Company sold all the Investments for ₹3,150 lakhs and raised a Bank Loan amounting to ₹400 lakh on the Security of the Company's Plant.

You are required to prepare:

(i) Journal entries for the above and

(ii) Company's Balance sheet immediately thereafter.

(*MTP April 2018*) (*15 Marks*)

Answer: (i) Journal Entries in the books of Omega Ltd. (₹ in lakhs)

	Particulars		₹	₹
1	Bank A/c	Dr.	3,150	
	To Investments A/c			3,000
	To Profit and Loss A/c			150
	(Being investment sold on profit for the purpose of buy-back)			
2	10% Redeemable Preference Share Capital A/c	Dr.	2,500	
	Premium on Redemption of Preference Shares A/c	Dr.	250	
	To Preference Shareholders A/c			2,750
	(Being redemption of preference share capital at premium of 10%)			
3	Securities Premium A/c	Dr.	250	
	To Premium on Redemption of Preference Shares A/c			250
	(Being premium on redemption of preference shares adjusted through securities premium)			
4	Equity Share Capital A/c	Dr.	1,200	
	Premium on buyback	Dr.	1,200	
	To Equity buy-back A/c			2,400
	(Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)			
5	Securities Premium A/c (800-250)	Dr.	550	
	General Reserve A/c		650	
	To Premium on Buyback A/c			1,200
	(Being premium on buyback provided first out of securities premium and the balance out of general reserves.)			
6	Bank A/c		400	

	Particulars	₹	₹
	To Bank Loan A/c		400
	(Being loan taken from bank to finance buyback and redemption of shares)		
7	Preference Shareholders A/c	2,750	
	Equity buy-back A/c	2,400	
	To Bank A/c		5,150
	(Being payment made to preference shareholders and equity shareholders)		
8	General Reserve Account	3,700	
	To Capital Redemption Reserve Account		3,700
	(Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)		

* The difference between this figure and guaranteed residual value (₹50,000) is due to rounding off.

(ii) Balance Sheet of Omega Ltd. (after Redemption and Buyback) (₹Lakhs)

	Particulars	Note No	Amount
	EQUITY AND LIABILITIES		₹
(I)	**Shareholders' Funds:**		
	(a) Share Capital	1	6,800
	(b) Reserves and Surplus	2	6,800
(2)	**Non-Current Liabilities:**		
	(a) Long Term Borrowings	3	5,400
(3)	**Current Liabilities:**		
	(a) Trade payables		2,300
	(b) Short Term Provisions		1,000
	Total		22,300
(II)	**ASSETS**		
(1)	**Non-Current Assets**		
	Fixed Assets		14,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		50
	(b) Other Current Assets		8,250
			22,300

Notes to Accounts

				₹ in Lakhs
1.	**Share Capital**			6,800
	680 lakh Equity Shares of ₹10 each Fully Paid up (120 lakh Equity Shares bought back)			
2.	**Reserves and Surplus**	6,000		
	General Reserve	(650)		
	Less: Adjustment for premium paid on buy back			
	Less: Transfer to CRR	(3,700)	1,650	
	Capital Redemption Reserve	1,000		
	Add: Transfer due to buy-back of shares from Gen. res.	3,700	4,700	
	Securities premium	800		
	Less: Adjustment for premium paid on redemption of preference shares	(250)		
	Less: Adjustment for premium paid on buy back	(550)	—	
	Profit & Loss A/c	300		
	Add: Profit on sale of investment	150	450	6,800
3.	**Long-term borrowings**		5,000	
	Secured			
	9 % Debentures			
	Term Loans - From Banks		400	5,400

Working Note

Bank Account

Receipts	Amount (₹Lakhs)	Payments	Amount (₹Lakhs)
To balance b/d	1,650	By Preference Sharesholders A/c	2,750
To Investment A/c (sale Proceeds)	3,150	By Equity Shareholders A/c	2,400
To Bank Loan A/c (Loan received)	400	By Balance c/d (Balancing figure)	50
	5,200		5,200

Income tax on the above will not be included in Revenue A/c of an insurance company.

Question 15

The following summarized 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		
Trade payables	13,00,000	
Other current Liabilities	3.00,000	16,00,000
		1,40,00,000
Assets		
Tangible assets		
Building	25,00,000	
Machinery	31,00,000	
furniture	20,00,000	76,00,000
Non-current Investments		30,00,000
Current assets		
Inventory	12,00,000	
Trade receivables	7,00,000	
cash and bank balance	15,00,000	34,00,000
		1,40,00,000

On 1st April, 2017, the company passed a resolution to buy back 20% of its equity capital @ ₹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) Give necessary journal entries and

(b) Give the Balance Sheet of the company after buy back of shares.

(*RTP November 2018*)

Answer

Journal Entries in the books of Pee Limited

	Particulars	Dr.	Cr.	
(i)	Bank Account	Dr.	25,00,000	
	Profit and Loss Account	Dr.	5,00,000	
	To Investment Account			30,00,000
	(Being the investments sold at loss for the purpose of buy back)			
(ii)	Equity Share capital account	Dr.	4,80,000	

	Particulars	Dr.	Cr.	
	Premium payable on buy back Account	Dr.	24,00,000	
	To Equity shares buy back Account			28,80,000
	(Being the amount due on buy back)			
(iii)	Securities Premium Account	Dr.	24,00,000	
	To Premium payable on buy back Account			24,00,000
	(Being the premium payable on buy back adjusted against securities premium account)			
(iv)	Revenue Reserve Account	Dr.	1,80,000	
	To Capital Redemption Reserve Account			1,80,000
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account (4,80,000-3,00,000)			
(v)	Equity shares buy-back Account	Dr.	28,80,000	
	To Bank Account			28,80,000
	(Being the payment made on buy back)			

Balance Sheet of Pee Limited as on 1st April, 2017
(After buy back of shares)

Particulars	Note No	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	22,20,000
(b) Reserves and Surplus	2	68,00,000
(2) Current Liabilities		16,00,000
Total		1,06,20,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		76,00,000
(2) Current assets		30,20,000
Total		1,06,20,000

Notes to Accounts

			₹	₹
1	**Share Capital**			
	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 share capital			
	Opening no. of shares		2,40,000	
	Buy back of shares during the year		48,000	1,92,000
	During the year the company has buy back of 48,000 shares			
2	**Reserves and Surplus**			
	Capital reserve		10,00,000	
	Capital redemption reserve		1,80,000	
	Securities Premium	27,00,000		
	Less: Premium payable on buy back of shares	24,00,000	3,00,000	
	Revenue reserve	25,00,000		
	Less: Transfer to Capital redemption reserve	1,80,000	23,20,000	
	Profit and loss A/c	35,00,000		
	Less: Loss on investment	5,00,000	30,00.000	68,00,000

Question 16

Alpha Limited furnishes the following summarized 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
Securities premium	350	Investment	148
General reserve	530	Inventory	1,200

Liabilities	***(₹ in lakhs)***	***Assets***	***(₹ in lakhs)***
Capital redemption reserve	400	Trade receivables	500
Profit & loss A/c	340	Cash at bank	1,500
12% Debentures	1,500		
Trade payables	1,400		
Other current liabilities	478		
	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.

(*RTP May, 2019*)

Answer

In the books of Alpha Limited
Journal Entries

Date 2017	***Particulars***		***Dr.***	***Cr. (₹ in lakhs)***
April 1	Bank A/c	Dr.	150	
	To Investment A/c			148
	To Profit on sale of investment			2
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	600	
	Securities premium A/c	Dr.	300	
	To Equity shares buy back A/c			900
	(Being the amount due to equity shareholders on buy back)			
	Equity shares buy back A/c	Dr.	900	
	To Bank A/c			900
	(Being the payment made on account of buy back of 60 Lakh Equity Shares)			
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 from 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) Property, Plants Equipment		
(i) Tangible assets	3	4,050

Particulars	***Note No***	***Amount (₹ in lakhs)***
(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

Notes to Accounts

				(₹ in lakhs)
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 from 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.	**Tangible assets**			
	Machinery		3,600	
	Furniture		450	4,050

Working Note:

Cash at bank 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

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 authorized 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.

(*May 2019*) (*10 Marks*)

Answer

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

* *As per Section 68(2)(d) of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserves after such buy-back. Further under Section 69(1), on buy -back of shares out of free reserves a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). As per section 69 (2) utilization of CRR is restricted to fully paying up unissued shares of the Company which are to be issued as fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buy-back has to be excluded from the present equity.*

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.

Working Note:

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method. Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

$(45,00,000 - x) - 23,25,000 = y$ (1)

$\left(\frac{y}{30} \times 10\right) = x$ Or $3x = y$ (2)

by solving the above equation, we get

x = ₹5,43,750

y = ₹16,31,250

Question 18

Umesh Ltd. resolves to buy back 4 lakhs of its fully paid equity shares of ₹10 each at ₹22 per share. This buyback is in compliance with the provisions of the Companies Act and does not exceed 25% of Company's paid up capital in the financial year. For the purpose, it issues 1 lakh 11% preference shares of ₹10 each at par, the entire amount being payable with applications. 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.

(*RTP November 2022*) (*RTP November 2019*)

Answer

Journal Entries in the books of Umesh Ltd.

			₹	₹
1.	Bank A/c	Dr.	10,00,000	
	To 11% Preference share application & allotment A/c			10,00,000
	(Being receipt of application money on preference shares)			
2.	11% Preference share application & allotment A/c	Dr.	10,00,000	
	To 11% Preference share capital A/c			10,00,000
	(Being allotment of 1 lakh preference shares)			
3.	General reserve A/c	Dr.	30,00,000	
	To Capital redemption reserve A/c			30,00,000
	(Being creation of capital redemption reserve for buy back of shares)			
4.	Equity share capital A/c	Dr.	40,00,000	
	Premium payable on buyback A/c	Dr.	48,00,000	
	To Equity shareholders/Equity shares buy back A/c			88,00,000
	(Amount payable to equity shareholder on buy back)			
5.	Equity shareholders/Equity shares buy back A/c	Dr.	88,00,000	
	To Bank A/c			88,00,000
	(Being payment made for buy back of shares)			
6.	Securities Premium A/c	Dr.	16,00,000	
	General reserve A/c		32,00,000	
	To Premium payable on buyback A/c			48,00,000
	(Being premium on buyback charged from securities premium and general reserve)			

Working Notes:

1. Calculation of amount used from General Reserve Account

		₹
Amount paid for buy back of shares (4,00,000 shares x ₹22)		88,00,000
Less: Proceeds from issue of Preference Shares (1,00,000 shares x ₹10)		(10,00,000)
Less: Utilization of Securities Premium Account		(16,00,000)
Balance used from General Reserve Account		62,00,000
* Used under Section 68 for buy back	32,00,00	
Used under Section 69 for transfer to CRR (W.N 2)	30,00,000	
	62,00,000	

2. Amount to be transferred to Capital Redemption Reserve account

	₹
Nominal value of shares bought back (4,00,000 shares x ₹10)	40,00,000
Less: Nominal value of Preference Shares issued for such buy back (1,00,000 shares x ₹10)	
Amount transferred to Capital Redemption Reserve Account	(10,00,000)
	30,00,000

Question 19

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 Share of ₹100 each fully paid up,	10,00,000	60,00,000
Reserves & Surplus		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	20,00,000	
Dividend Equalization Fund	5,50,000	43,50,000
Non-Current Liabilities		
12% Debenture		12,50,000
Current Liabilities and Provisions		5,50,000
Total		1,21,50,000
Assets		
Fixed Assets		
Tangible Assets		1,00,75,000
Current Assets		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	15,75,000	20,75,000
Total		1,21,50,000

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

(1) Buy back 25% of the paid up capital and 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 share company:

  (a) Issue 3000, 14% debenture of ₹100 each at a premium of 20%.

  (b) Issue 2500, 10% preference share 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 shareholder.

You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back.

(*November 2019, New Course, 15 Marks*)

Answer

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 (Being investment sold on profit)		50,000

	Particulars	**Dr.** ₹	**Cr.** ₹
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		
(a) Long-term borrowings	3	15,50,000
(3) Current Liabilities		
(a) Trade payables		-
(b) current liabilities & Provisions		5,50,000
Total		1,05,60,000
II. Assets		
(1) Non-current assets		
(a) *Property, Plant and Equipment*		1,00,75,000
(2) Current assets		
(a) Investments		2,00,000
(b) Inventory		2,00,000
(c) Cash and cash equivalents (W.N. 2)		85,000
Total		1,05,60,000

Notes to Accounts

				₹
1.	Share Capital			
	Equity share capital (Fully paid up shares of ₹ 20 each)			
	(2,50,000-62,500+37,500 shares)		45,00,000	
	10% preference shares @ ₹ 100 each			
	(10,00,000 + 2,50,000)		12,50,000	57,50,000
2.	Reserves and Surplus			
	Capital Reserve		1,00,000	
	Revenue reserve		2,00,000	
	Securities premium	12,00,000		
	Add: Premium on debenture	60,000		
	Less: Adjustment for premium paid on buy back	(10,00,000)		
	Less: Transfer to CRR	(2,60,000)	Nil	
	Capital Redemption Reserve			
	Transfer due to buy-back of shares from P&L			
	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
3	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 20

The following was the summarized balance sheet of Mukta Ltd. as on 31st March, 2019:

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, 2019 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 utilized to the maximum extents allowed by law.

(*MTP October, 2020*) (*MTP October, 2021*) (*MTP October, 2019, 12 Marks*)

Answer

Journal entries
In the books of Mukta Ltd.

			Dr.	Cr.
				₹ in iakhs
1	Bank A/c	Dr.	25,200	
	To Investments A/c			24,000
	To Profit and Loss A/c			1,200
	(Being Investments sold and, profit being credited to Profit and Loss Account)			
2	10% Redeemable Preference Share Capital A/c	Dr.	20,000	
	Premium payable on Redemption of Preference Shares A/c	Dr.	2,000	
	To Preference Shareholders A/c			22,000
	(Being amount payable on redemption of Preference shares, at a Premium of 10%)			
3	Securities Premium A/c	Dr.	2,000	
	To Premium payable on Redemption of Preference Shares A/c			2,000
	(Being Securities Premium utilised to provide Premium on Redemption of Preference Shares)			
4	Equity Share Capital A/c	Dr.	16,000	
	Premium payable on Buyback A/c	Dr.	16,000	
	To Equity Share buy back A/c			32,000
	(Being the amount due on buy-back)			
5	Securities Premium A/c (6,400 -2,000)	Dr.	4,400	
	General Reserve A/c (balancing figure)	Dr.	11,600	
	To Premium payable on Buyback A/c			16,000
	(Being premium on buyback provided first out of Securities Premium and the balance out of General Reserves.)			
6	Bank A/c	Dr.	16,000	
	To Bank Loan A/c			16,000
	(Being Loan taken from Bank to finance Buyback)			
7	Preference Shareholders A/c	Dr.	22,000	
	Equity Shares buy back A/c	Dr.	32,000	
	To Bank A/c			54,000
	(Being payment made to Preference Shareholders and Equity Shareholders)			
8	General Reserve Account	Dr.	36,000	
	To Capital Redemption Reserve Account			36,000
	(Being amount transferred to Capital Redemption Reserve Account to the extent of face value of preference shares redeemed and equity Shares bought back) (20,000 + 16,000)			

Question 21

The following was the Balance Sheet of C Ltd. as on 31st March, 2019:

Equity & Liabilities	₹ Lakhs	Assets	₹ Lakhs
Share Capital:		Fixed Assets	14,000
Equity shares of ₹ 10 each Fully Paid Up	8,000	Investments	2,350
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	2,500	Cash at Bank	2,300

Equity & Liabilities	₹ Lakhs	Assets	₹ Lakhs
Reserves & Surplus		Other Current Assets	8,250
Capital Redemption Reserve	1,000		
Securities Premium	800		
General Reserve	6,000		
Profit & Loss Account	300		
Secured Loans:			
9% Debentures	5,000		
Current Liabilities:			
Trade payables	2,300		
Sundry Provisions	1,000		
	26,900		26,900

On 1st April, 2019 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 10% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 2,500 lakhs. You are required to pass journal entries for the above and prepare the Company's Balance sheet immediately after buyback of equity shares and redemption of preference shares.

(*May 2020*)

Answer

(i) Journal Entries in the books of C Ltd. **(₹ in lakhs)**

	Particulars			
1	Bank A/c	Dr.	2,500	
	To Investments A/c To			2,350
	Profit and Loss A/c			150
	(Being investment sold on profit for the purpose of buy-back)			
2	10% Redeemable Preference Share Capital A/c	Dr.	2,500	
	Premium on Redemption of Preference Shares A/c To	Dr.	250	
	Preference Shareholders A/c			2,750
	(Being redemption of preference share capital at premium of 10%)			
3	Securities Premium A/c	Dr.	250	
	To Premium on Redemption of Preference Shares A/c			250
	(Being premium on redemption of preference shares adjusted through securities premium)			
4	Equity Share Capital A/c Premium	Dr.	800	
	on buyback	Dr.	800	
	To Equity buy-back A/c			1,600
	(Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)			
5	Securities Premium A/c (800-250)	Dr.	550	
	General Reserve A/c		250	
	To Premium on Buyback A/c			800
	(Being premium on buyback provided first out of securities premium and the balance out of general reserves.)			
6	Preference Shareholders A/c		2,750	
	Equity buy-back A/c		1,600	
	To Bank A/c			4,350
	(Being payment made to preference shareholders and equity shareholders)			
7	General Reserve Account		3,300	
	To Capital Redemption Reserve Account			3,300
	(Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)			

(ii) Balance Sheet of C Ltd. (after Redemption and Buyback)

(₹ Lakhs)

	Particulars	Note No	Amount
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	7,200
	(b) Reserves and Surplus	2	7,200
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	5,000
(3)	Current Liabilities:		
	(a) Trade payables		2,300
	(b) Short Term Provisions		1,000
	Total		22,700
(II)	ASSETS		
(1)	Non-Current Assets		
	PPE		14,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		450
	(b) Other Current Assets		8,250
			22,700

Notes to Accounts

		₹ in Lakhs		
1.	**Share Capital**			
	720 lakh Equity Shares of ₹ 10 each Fully Paid up (80 lakh Equity Shares bought back)			7,200
2.	**Reserves and Surplus**			
	General Reserve	6,000		
	Less: Adjustment for premium paid on buy back	(250)		
	Less: Transfer to CRR	(3,300)	2,450	
	Capital Redemption Reserve	1,000		
	Add: Transfer due to buy-back of shares from Gen. res.	3,300		
			4,300	
	Securities premium	800		
	Less: Adjustment for premium paid on redemption of preference shares	(250)		
	Less: Adjustment for premium paid on buy back	(550)		
	Profit & Loss A/c	300	-	
	Add: Profit on sale of investment	150	450	7,200
3.	**Long-term borrowings**			
	Secured			
	9 % Debentures			5,000

Working Note:

Bank Account

Receipts	Amount	Payments	Amount
	(₹ Lakhs)		(₹ Lakhs)
To balance b/d	2,300	By Preference Shareholders A/c	2,750
To Investment A/c (sale Proceeds)	2,500	By Equity Shareholders A/c	1,600
		By Balance c/d (Balancing figure)	450
	4,800		4,800

Question 22

M/s. Vriddhi Infra Ltd. (a non-listed company) provide the following information as on 31.3.2020:

	(₹)
Land and Building	21,50,000
Plant & Machinery	15,00,000
Non- current Investment	2,00,000
Trade Receivables	5,50,000
Inventories	1,80,000
Cash and Cash Equivalents	40,000
Share capital:1,00,000 Equity Shares of ₹ 10 each fully paid up	10,00,000
Securities Premium	3,00,000
General Reserve	2,50,000
Profit & Loss Account (Surplus)	1,50,000
10% Debentures (Secured by floating charge on all assets)	20,00,000
Unsecured Loans	8,00,000
Trade Payables	1,20,000

On 21st April, 2020 the Company announced the buy back of 15,000 of its equity shares @ ₹ 15 per share. For this purpose, it sold all its investment for ₹ 2.50 lakhs.

On 25th April, 2020, the company achieved the target of buy back. On 1st May, 2020 the company issued one fully paid up share of ₹ 10 each by way of bonus for every eight equity shares held by the equity shareholders.

You are required to pass necessary Journal Entries for the above transactions.

(*RTP, May, 2021*)

Answer

In the books of Vriddhi Infra Ltd.
Journal Entries

Date	*Particulars*		*Dr.*	*Cr.*
2020			₹	₹
April 21	Bank A/c	Dr.	2,50,000	
	To Investment A/c			2,00,000
	To Profit on sale of investment			50,000
	(Being investment sold on profit)			
April 25	Equity share capital A/c	Dr.	1,50,000	
	Securities premium A/c	Dr.	75,000	
	To Equity shares buy back A/c			2,25,000
	(Being the amount due to equity shareholders on buy back)			
	Equity shares buy back A/c	Dr.	2,25,000	
	To Bank A/c			2,25,000
	(Being the payment made on account of buy back of 15,000 Equity Shares)			
	General Reserve A/c OR P&L A/c	Dr.	1,50,000	
	To Capital redemption reserve A/c			1,50,000
	(Being amount equal to nominal value of buy back shares transferred from free reserves to capital redemption reserve account as per the law)			
May 1	Capital redemption reserve A/c	Dr.	1,06,250	
	To Bonus shares A/c (W.N.1)			1,06,250
	(Being the utilization of capital redemption reserve to issue bonus shares)			
	Bonus shares A/c	Dr.	1,06,250	
	To Equity share capital A/c			1,06,250
	(Being issue of one bonus equity share for every ten equity shares held)			

Working Note:

$$\text{Amount of bonus shares} = (1,00,000 - 15,000) \times \frac{1}{8} \times 10 = ₹\ 1,06,250$$

Question 23

The Directors of Umang Ltd. passed a resolution to buyback 5,00,000 of its fully paid equity shares of ₹ 10 each at ₹ 15 per share. This buyback is in compliance with the provisions of the Companies Act, 2013.

For this purpose, the company

(i) Sold its investments of ₹ 30,00,000 for ₹ 25,00,000.

(ii) Issued 20,000, 12% preference shares of ₹ 100 each at par, the entire amount being payable with application.

(iii) Used ₹ 15,00,000 of its Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back.

(iv) The company has necessary cash balance for the payment to shareholders.

You are required to pass necessary Journal Entries (including narration) regarding buy- back of shares in the books of Umang Ltd.

(*Suggested, January, 2021*) (*5 marks*)

Answer

Journal Entries in the books of Umang Ltd.

			Dr. ₹	*Cr.* ₹
1.	Bank A/c	Dr.	25,00,000	
	Profit and Loss A/c	Dr.	5,00,000	
	To Investment A/c			30,00,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2.	Bank A/c	Dr.	20,00,000	
	To 12% Pref. Share capital A/c			20,00,000
	(Being 12% Pref. Shares issued for ₹ 20,00,000)			
3.	Equity share capital A/c Premium payable on buy-back	Dr.	50,00,000	
	To Equity shares buy-back A/c/ Equity shareholders A/c	Dr.	25,00,000	
	(Being the amount due on buy-back of equity shares)			75,00,000
4.	Equity shares buy-back A/c/ Equity shareholders A/c	Dr.	75,00,000	
	To Bank A/c			75,00,000
	(Being payment made for buy-back of equity shares)			
5.	Securities Premium A/c General Reserve A/c	Dr.	15,00,000	
	To Premium payable on buy-back	Dr.	10,00,000	
	(Being premium payable on buy-back charged from Securities premium)			25,00,000
6.	General Reserve A/c	Dr.	30,00,000	
	To Capital Redemption Reserve A/c			30,00,000
	(Being creation of capital redemption reserve to the extent of the equity shares bought back after deducting fresh pref. shares issued)			

Question 24

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.

(*July, 2021 Suggested*) (*15 Marks*)

Answer

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 share buy-back account			12,52,500
	(Being cancellation of shares bought back)			
	Securities Premium account	Dr.	6,00,000	
	General Reserve/Profit & Loss A/c	Dr.	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 (1)
Equation 2: Maximum Permitted Buy-Back *X* Nominal Value Per Share/Offer Price Per Share
y/30 x 10 = x or
3x = y (2)
by solving the above two equations we get
x = ₹9,40,000 and y = ₹28,20,000
In situation 2, first equation will be negative. Buy back not possible in this situation.

Question 25

SM Limited gives the following information as on 31st March, 2020:

		₹
Share capital		
(60,000 Equity Shares of ₹ 10 Each)		6,00,000
Reserve & Surplus:		
Security premium	₹ 70,000	
General reserve	₹ 63,000	
Profit and Loss	₹ 1,40,000	2,73,000
Non-current liability:		
9% debentures (secured)		3,00,000
Current Liabilities:		
Term loan		40,000
Creditors		65,000
Provision for taxation		15,000
Property plant and equipment		6,00,000
Non-current investment		1,50,000
Current assets:		
Stock	₹ 2,00,000	
Debtors	₹ 2,60,000	
Bank	₹ 83,000	5,43,000

The shareholders adopted the resolution on 31st March, 2020 to:
(i) Buy back 25% of the paid up capital @ ₹ 15 each.
(ii) Issue 10% debentures of ₹ 60,000 at a premium of 10% to finance the buyback of shares.
(iii) Maintain a balance of ₹ 20,000 in General Reserve.
(iv) Sell investments worth ₹ 1,00,000 for ₹ 80,000.
(v) Buy back expenses were ₹ 2,000.
You are required to pass necessary journal entries to record the above transactions and prepare Ledger account of Bank.
(*MTP, November, 2021*) (*8 Marks*)

Answer

In the books of SM Limited
Journal Entries

	Particulars		**Dr. ₹**	**Cr. ₹**
1.	Equity share capital A/c(15,000 x ₹10)	Dr.	1,50,000	
	Premium on buyback A/c (15,000 x ₹5)	Dr.	75,000	
	To Equity shares buy back or Equity shareholders A/c (15,000 x ₹15)			2,25,000
	(Being the amount due to equity shareholders on buy back)			
2.	Equity shares buy back/Equity shareholders A/c	Dr.	2,25,000	
	To Bank A/c			2,25,000
	(Being the payment made on account of buy back of 15,000 Equity Shares as per the Companies Act)			
3.	Bank A/c	Dr.	66,000	
	To 10 % Debentures A/c			60,000
	To Securities Premium A/c			6,000
	(Being 14 % debentures issued to finance buy back)			
4.	Buyback Expenses A/c	Dr.	2,000	

	Particulars		**Dr. ₹**	**Cr. ₹**
	To Bank A/c			2,000
	(Buyback expenses paid)			
5.	Bank A/c	Dr.	80,000	
	Profit and Loss A/c (Loss on sale of investment)	Dr.	20,000	
	To Investment A/c			1,00,000
	(Being investment sold at loss)			
6.	General reserve	Dr.	43,000	
	Profit and Loss A/c	Dr.	1,07,000	
	To Capital redemption reserve A/c			1,50,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)			
7.	Securities Premium	Dr.	75,000	
	Profit and Loss A/c	Dr.	2,000	
	To Premium on buyback			75,000
	To Buyback Expenses A/c			2,000
	(Being premium on buyback and buyback expenses charged to securities premium and profit and loss account)			

Bank Account

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To Balance b/d	83,000	By Equity Shareholders A/c	2,25,000
To Investment A/c	80,000	By Expenses on buy back of shares	2,000
To 10% Debentures and Securities premium	66,000	By Balance c/d	2,000
Total	2,29,000	Total	2,29,000

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of ₹ 1,50,000 has been credited to CRR while solving the question.

Question 26

Rohan Ltd. furnishes the following information as at 31-03-2021.

	(in ₹)	**(in ₹)**
Share Capital:		
Equity Share Capital of ₹ 20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹ 100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus:		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	25,50,000	43,50,000
12% Debentures		12,50,000
Current Liabilities and Provisions		5,50,000
Property, Plant and Equipment		1,00,75,000
Current Assets:		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	15,75,000	20,75,000

The shareholders adopted the following resolution on 31st March, 2021:

(1) Buy back 25% of the paid-up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹ 30 per share.

(2) To finance the buy-back of shares, company:
   (a) Issues 3,000, 14% debentures of ₹ 100 each at a premium of 20%.
   (b) Issues 2,500, 10% preference shares of ₹ 100 each.

(3) Sell investment worth ₹ 1,00,000 for ₹ 1,50,000.

(4) Maintain a balance of ₹ 2,00,000 in Revenue Reserve.

(5) Later, the company issue three fully paid up equity shares of ₹ 20 each by way of bonus for every 15 equity shares held by the equity shareholders.

You are required to pass the necessary journal entries to record the above transactions.

(*RTP November 2021*)

Answer

In the books of Rohan Limited
Journal Entries

	Particulars		Dr. ₹	Cr. ₹
1.	Bank A/c	Dr.	3,60,000	
	To 14 % Debenture A/c			3,00,000
	To Securities Premium A/c			60,000
	(Being 14 % debentures issued to finance buy back)			
2.	Bank A/c	Dr.	2,50,000	
	To 10% preference share capital A/c			2,50,000
	(Being 10% preference share issued to finance buy back)			
3.	Bank A/c	Dr.	1,50,000	
	To Investment A/c			1,00,000
	To Profit on sale of investment			50,000
	(Being investment sold on profit)			
4.	Equity share capital A/c (62,500 x ₹20)	Dr.	12,50,000	
	Premium on buyback or Securities premium A/c Dr. (62,500 x ₹16)		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			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)			

Question 27

Complicated Ltd. (an unlisted company) gives the following information as on 31.3.2021:

Particulars	Amount (₹)
Equity shares of ₹ 10 each, fully paid up	13,50,000
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 (Long term - Unsecured)	10,00,000

Particulars	Amount (₹)
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000
Property, plant and equipment	46,50,000
Current assets	40,00,000

The Company wants to buy back 25,000 equity shares of ₹ 10 each, on 1st April, 2021 at ₹ 15 per share. Buy back of shares is duly authorized by its Articles and necessary resolution has been passed by the Company for 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 was made by the Company out of sufficient bank balance available shown as part of Current Assets.

You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet of the company after buy back of shares.

(*RTP May, 2022*)

Answer

As per the information given in the question, buy-back of 25,000 shares @ ₹ 15, as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

			Debit (₹)	*Credit (₹)*
(a)	Equity shares buy-back account	Dr.	3,75,000	
	To Bank account			3,75,000
	(Being buy back of 25,000 equity shares of ₹ 10 each @ ₹ 15 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Premium payable on buyback account	Dr.	1,25,000	
	To Equity shares buy-back account			3,75,000
	(Being cancellation of shares bought back)			
(c)	Securities premium account	Dr.	1,25,000	
	To Premium payable on buyback account			1,25,000
	(Being Premium payable on buyback adjusted against securities premium account)			
(d)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of Complicated Ltd. as at 1st April, 2021

Particulars	*Note No*	*Amount ₹*
EQUITY AND LIABILITIES		
1 **Shareholders' funds**		
(a) Share capital	1	11,00,000
(b) Reserves and Surplus	2	23,50,000
2 **Non-current liabilities**		
(a) Long-term borrowings	3	28,75,000
3 **Current liabilities**		
(a) Short-term borrowings	4	16,50,000
(b) Other current liabilities	5	3,00,000
Total		82,75,000
ASSETS		
1 **Non-current assets**		
(a) Property, Plant and Equipment		46,50,000
2 Current assets (₹ 40,00,000 – ₹ 3,75,000)		36,25,000
Total		82,75,000

Notes to Accounts

		₹	₹
1.	Share Capital		
	Equity share capital		
	1,10,000 Equity shares of ₹10 each		11,00,000
2.	Reserves and Surplus		
	Capital Reserve	2,00,000	
	Capital Redemption Reserve	2,50,000	

			₹	₹
	Securities premium	2,50,000		
	Less: Utilization for share buy-back	(1,25,000)	1,25,000	
	Share Option Outstanding Account		4,00,000	
	Revenue reserves	15,00,000		
	Less: Transfer to CRR	(2,50,000)	12,50,000	
	Surplus i.e. Profit and Loss A/c		1,25,000	23,50,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		10,00,000	28,75,000
4.	Short-term borrowings			
	Current maturities of long-term borrowings			16,50,000
5.	Other Current Liabilities			
	Unpaid dividend		1,00,000	
	Application money received for allotment due for refund		2,00,000	3,00,000

Question 28

Mohan Ltd. furnishes the following summarised Balance Sheet as on 31st March 2021.

(₹ in Lakhs)

	Amount
Equity and Liabilities:	
Shareholder's 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
Security 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 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 on 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 Companies Act, 2013 and

(b) Record the Journal Entries for the above mentioned information.

(*Question Paper of December 2021*) *(10 Marks)*

Answer

(i) Statement determining the maximum number of shares to be bought back

Number of shares (in lakhs)

Particulars	**When loan fund is ₹ 304 lakhs•**
Shares Outstanding Test (W.N.1)	19.5
Resources Test (W.N.2)	11.175
Debt Equity Ratio Test (W.N.3)	29.725
Maximum number of shares that can be bought back [least of the above]	11.175

Thus, the company can buy 11,17,500 Equity shares at ₹ 30 each.

Working Notes:

1. Shares Outstanding Test

Particulars	**(Shares in lakh)**
Number of shares outstanding	78
25% of the shares outstanding	19.5

2. Resources Test

Particulars	
Paid up capital (₹ in lakh)	780
Free reserves (₹ in lakh) (625+52+148-24-240*)	561
Shareholders' funds (₹ in lakh)	1341
25% of Shareholders fund (₹ in lakh)	335.25
Buy-back price per share	30
Number of shares that can be bought back	11.175
**Amount transferred to CRR is excluded from free reserves. Premium on redemption also reduced.*	

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	**₹ In lakh**
(a)	Loan funds (₹)	304
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹) (a/2)	152
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1043.75 (1341-297.25)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	891.75
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	29.725
	As per the provisions of the Companies Act, 2013, company	Qualifies

Alternatively, when current liabilities are considered as part of loan funds, in that case Debt Equity Ratio Test will be done as follows:

	Particulars	**₹ in lakh**
(a)	Loan funds (₹)	699
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (₹) (a/2)	349.5
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1093.125 (1341 - 247.875)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	743.625
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share	24.7875
	As per the provisions of the Companies Act, 2013, company	Qualifies

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR) - Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (1341 – x) – 152 = y

= 1189 – x =y (1)

• *Loan funds have been taken without considering current liabilities. Alternatively, If current liabilities are considered, then the maximum number of shares that can be bought back as per debt equity ratio test will be 24.7875 lakhs.*

Equation 2: Maximum Permitted Buy-Back x Nominal Value Per Share/Offer Price Per Share
y/30 x 10 = x or 3x = y (2)
by solving the above two equations we get
x = ₹ 297.25 and y = ₹ 891.75
Alternatively, when current liabilities are considered as part of loan funds, in that case
Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back
= (1341 – x) – 349.5 = y
= 991.5 – x =y (1)
Equation 2: Maximum Permitted Buy-Back *X* Nominal Value Per Share/Offer Price Per Share
y/30 x 10 = x or 3x = y (2)
by solving the above two equations we get x = 247.875 and y = 743.625

(ii) Journal Entries for Buy Back ***(₹ in lakhs)***

Date	Particulars		Debit	Credit
2021				
1st April	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c	Dr.	24	
	To Preference shareholders A/c			264
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	264	
	To Bank A/c			264
	(Being payment made to shareholders)			
	General Reserve or P&L A/c*	Dr.	24	
	To Premium on redemption of preference shares A/c			24
	(Being premium on redemption of preference shares adjusted through securities premium)			
2nd April	Equity shares buy-back A/c	Dr.	335.25	
	To Bank A/c			335.25
	(Being 11.175 lakhs equity shares of ₹10 each bought back @ ₹30 per share)			
	Equity share capital A/c	Dr.	111.75	
	Securities Premium A/c	Dr.	52	
	General Reserve or P&L A/c	Dr.	171.50	
	To Equity Shares buy-back A/c			335.25
	(Being cancellation of shares bought back)			
	General reserve A/c	Dr.	351.75	
	To Capital redemption reserve A/c			351.75
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law ie. 240+ 111.75 lakhs)			
2nd April	7% Debentures A/c	Dr.	75	
	To Investment (own debentures) A/c			60
	To Profit on cancellation of own debentures A/c			15
	(Being cancellation of own debentures costing ₹ 60 lakhs, face value being ₹ 75 lakhs and the balance being profit on cancellation of debentures)			
4th April	Capital Redemption Reserve	Dr.	133.65	
	To Bonus Shares A/c			133.65
	(Being issue of one bonus equity share for every five equity shares held)			
	Bonus shares A/c	Dr.	133.65	
	To Equity share capital A/c			133.65
	(Being bonus shares issued)			

Working Note: Bonus Share to be issued =66.825 (78 - 11.175) lakh shares divided by 5 = 13.365 lakh shares.

Note: *Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and complies with the Accounting Standards prescribed for them. Alternative entry considering otherwise is also possible by utilizing securities premium amount.

Question 29

VIJ Ltd. has the following capital structure as on 31st March, 2022:

		(₹ In Lakhs)
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 to 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 1akh or ₹ 4500 lakh.

The entire buy-back is completed by 09/12/2022, show the accounting entries withfull narrations in the company's books in each situation.

(*G-II, May, 2023*) (*10 Marks*)

Question 30

Answer the following Questions:

The following is the extract of Balance Sheet of Yellow Limited as on 31.03.2023:

	₹
4,00,000 Equity shares of ₹10 each	*40,00,000*
General Reserve	*48,00,000*
Profit and Loss A/c	*10,00,000*
Security Premium	*18,00,000*
Secured Loans	*60,00,000*
Unsecured Loans	*32,00,000*
Current Liabilities	*28,00,000*
	2,36,00,000
Property, Plant and Equipment	*90,00,000*
Investments	*18,00,000*
Current Assets	*1,28,00,000*
	2,36,00,000

The Company intends to buy back 80,000 equity shares of ₹10 each at a premium of 150%.

You are required to state whether the company can buy back equity shares.

(*Exam. November, 2023*) (*Advance Accounts*) (*5 Marks*)

Question 31

Answer the following Questions:

Pratham Ltd. (*a non-listed company*) *has the following Capital structure as on 31st March, 2023:*

Particulars	*₹*	*₹*
Equity Share Capital (*shares of ₹10 each fully paid*		*30,00,000*
Reserves & Surplus		
General Reserve	*32,50,000*	
Security Premium Account	*6,00,000*	
Profit & Loss Account	*4,30,000*	
Revaluation Reserve	*6,20,000*	*49,00,000*
Loan Funds		*42,00,000*

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy back is ₹ 30 per share.

(*MTP September, 2023*) (*Advance Accounts*) (*10 Marks*)

Answer

Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹ in crores)	21,00,000
(c)	Present equity shareholders fund (₹ in crores)	72,80,000
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
(e)	Maximum permitted buy back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Notes:

1. Shareholders' funds

Particulars	₹
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Equation 1 :(Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity

(72,80,000 –x)-21,00,000 = y (1)

Since 51,80,000 – x = y

$$\text{Equation 2 : } \left(\frac{\text{Maximum buy - back}}{\text{Offer price for buy - back}} \text{ x Nominal Value} \right)$$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10 \right) = x$$

3x = y (2)

x = ₹ 12,95,000 crores and y = ₹ 38,85,000 crores

Question 32

Answer the following Question:

The following information from Balance Sheet of Z Ltd. as on 31st March, 2023:

	₹ Lakhs
Share Capital:	
Equity shares of ₹ 10 each Fully Paid Up	*16,000*
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	*5,000*
Reserves & Surplus	
Capital Redemption Reserve	*2,000*
Securities Premium	*1,600*
General Reserve	*12,000*
Profit & Loss Account	*600*
Secured Loans:	
9% Debentures	*10,000*

	₹ Lakhs
Current Liabilities:	
Trade payables	*4,600*
Sundry Provisions	*2,000*
Fixed Assets	*28,000*
Investments	*4,700*
Cash at Bank	*4,600*
Other Current Assets	*16,500*

On 1st April, 2023 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 10% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 5,000 lakhs.

You are required to pass journal entries for the above and prepare the Company's Balance sheet immediately after buyback of equity shares and redemption of preference shares.

(RTP November, 2023) (Advance Accounts) (10 Marks)

Answer

(i) Journal Entries in the books of Z Ltd. **(₹ in lakhs)**

	Particulars			
1	Bank A/c	Dr.	5,000	
	To Investments A/c To Profit and Loss A/c			4,700
	(Being investment sold on profit for the purpose of buy- back)			300
2	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c	Dr. Dr.	5,000 500	
	To Preference Shareholders A/c			5,500
	(Being redemption of preference share capital at premium of 10%)			
3	Profit and Loss A/c	Dr.	500	
	To Premium on Redemption of Preference Shares A/c			500
	(Being premium on redemption of preference shares adjusted through securities premium)			
4	Equity Share Capital A/c Premium on buyback	Dr.	1,600	
	To Equity buy-back A/c	Dr.	1,600	
	(Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)			3,200
5	Securities Premium A/c (1,600)	Dr.	1,600	
	To Premium on Buyback A/c			
	(Being premium on buyback provided out of securities premium)			1,600
6	Preference Shareholders A/c Equity buy-back A/c		5,500	
	To Bank A/c		3,200	
	(Being payment made to preference shareholders and equity shareholders)			8,700
7	General Reserve Account		6,600	
	To Capital Redemption Reserve Account			6,600
	(Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)			

(ii) Balance Sheet of C Ltd. (after Redemption and Buyback)

(₹ Lakhs)

	Particulars	**Note No**	**Amount**
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	14,400
	(b) Reserves and Surplus	2	14,400
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	10,000

	Particulars	Note No	Amount
(3)	Current Liabilities:		
	(a) Trade payables		4,600
	(b) Short Term Provisions		2,000
	Total		45,400
(II)	ASSETS		
(1)	Non-Current Assets		
	PPE		28,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		900
	(b) Other Current Assets		16,500
			45,400

Notes to Accounts

		₹ in Lakhs		
1.	**Share Capital**			
	1,440 lakh Equity Shares of ₹ 10 each Fully Paid up (160 lakh Equity Shares bought back)			14,400
2.	**Reserves and Surplus**			
	General Reserve	12,000		
	Less: Transfer to CRR	(6,600)	5,400	
	Capital Redemption Reserve	2,000		
	Add: Transfer due to buy-back of shares from Gen. res.	6,600		
			8,600	
	Securities premium	1,600		
	Less: Adjustment for premium paid on buy back	(1,600)		
	Profit & Loss A/c	600		
	Add: Profit on sale of investment	300		
	Less: Adjustment for premium paid on redemption of preference shares	(500)	400	14,400
3.	**Long-term borrowings**			
	Secured			
	9 % Debentures			10,000

Working Note:

Bank Account

	Amount		Amount
	(₹ Lakhs)		(₹ Lakhs)
To balance b/d	4,600	By Preference Shareholders A/c	5,500
To Investment A/c (sale Proceeds)	5,000	By Equity buy back A/c	3,200
		By Balance c/d (Balancing figure)	900
	9,600		9,600

Question 33

Following items appear in the Trail Balance of Star Ltd. as on 31st March, 2023:

Particulars	***₹***
80,000 Equity shares of ₹10 each, ₹ 8 paid-up	*6,40,000*
Capital Reserve (including ₹45,000 being profit on sale of Machinery)	*1,10,000*
Revaluation Reserve	*80,000*
Capital Redemption Reserve	*75,000*
Securities Premium	*60,000*
General Reserve	*2,10,000*
Profit & Loss Account (Cr. Balance)	*1,00,000*

On 1st April, 2023, the Company has made final call on Equity shares @ ₹ 2 per share. The entire money was received in the month of April, 20 23.

On 1st June, 2023, the Company decided to issue to Equity shareholders bonus shares at the rate of 2 shares for every 5 shares held and for this purpose, it was decided that there should be minimum reduction in free reserves. Pass necessary journal entries in the Books of Star Ltd.

(MTP September, 2023) (Accounts) (4 Marks)

Answer

Journal Entries in the books of Star Ltd.

2023			Dr.	Cr.
			₹	₹
April 1	Equity Share Final Call A/c	Dr.	1,60,000	
	To Equity Share Capital A/c			1,60,000
	(Final call of ₹ 2 per share on 80,000 equity shares made due)			
	Bank A/c	Dr.	1,60,000	
	To Equity Share Final Call A/c			1,60,000
	(Final call money on 80,000 equity shares received)			
June 1	Capital Redemption Reserve A/c Capital Reserve	Dr.	75,000	
	Securities Premium A/c General Reserve A/c (b.f.)	Dr.	45,000*	
	To Bonus to Shareholders A/c	Dr.	60,000	
	(Bonus issue of two shares for every five shares held, by utilizing various reserves as per Board's resolution dated…….)	Dr.	1,40,000**	
				3,20,000
	Bonus to Shareholders A/c	Dr.	3,20,000	
	To Equity Share Capital A/c (Capitalization of profit)			3,20,000

* considering it as free reserve as it has been realized.

** Alternatively, different combination of profit and loss balance and general reserve may also be used.

Question 34

Mukti Ltd. (a non-listed company) provide the following information as on 31.3.2023:

	(₹)
Land and Building	21,50,000
Plant & Machinery	15,00,000
Non-current Investment	2,00,000
Trade Receivables	5,50,000
Inventories	1,80,000
Cash and Cash Equivalents	40,000
Share capital:1,00,000 Equity Shares of ₹ 10 each fully paid up	10,00,000
Securities Premium	3,00,000
General Reserve	2,50,000
Profit & Loss Account (Surplus)	1,50,000
10% Debentures (Secured by floating charge on all assets)	20,00,000
Unsecured Loans	8,00,000
Trade Payables	1,20,000

On 21st April, 2023 the Company announced the buy back of 15,000 of its equity shares @ ₹ 15 per share. For this purpose, it sold all its investment for ₹ 2.50 lakhs.

On 25th April, 2023, the company achieved the target of buy back. On 1st May, 2023 the company issued one fully paid up share of ₹ 10 each by way of bonus for every eight equity shares held by the equity shareholders.

You are required to pass necessary Journal Entries for the above transactions.

(*RTP May, 2024*)

Answer

In the books of Mukti Ltd. Journal Entries

Date	Particulars		Dr.	Cr.
2023			₹	₹
April 21	Bank A/c	Dr.	2,50,000	
	To Investment A/c			2,00,000
	To Profit on sale of investment			50,000
	(Being investment sold on profit)			
April 25	Equity share capital A/c	Dr.	1,50,000	

Date	Particulars	Dr.	Cr.
	Securities premium A/c Dr. To Equity shares buy back A/c (Being the amount due to equity shareholders on buy back)	75,000	2,25,000
	Equity shares buy back A/c Dr. To Bank A/c (Being the payment made on account of buy back of 15,000 Equity Shares)	2,25,000	2,25,000
May 1	General Reserve A/c OR P&L A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of buy back shares transferred from free reserves to capital redemption reserve account as per the law)	1,50,000	1,50,000
	Capital redemption reserve A/c Dr. To Bonus to equity shareholder A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	1,06,250	1,06,250
	Bonus to equity shareholder A/c Dr. To Equity share capital A/c (Being issue of one bonus equity share for every ten equity shares held)	1,06,250	1,06,250

Working Note:

Amount of bonus shares = $\left[(1,00,000 - 15,000) \times \frac{1}{8}\right] \times 10$

= ₹ 1,06,250

MCQs

Question - 1: When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to

Answer:

1. *Revenue redemption reserve.*
2. *Capital redemption reserve.*
3. *Buyback reserve*
4. *General reserve.*

Question - 2: When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to

Answer:

1. *Revenue redemption reserve.*
2. *Capital redemption reserve.*
3. *Buy-back reserve*
4. *Special reserve*

Question - 3: State which of the following statements is true?

Answer:

1. *Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.*
2. *Partly paid shares cannot be bought back by a company.*
3. *Buy-back of equity shares in any financial year shall exceed twenty-five per cent of its total paid-up equity capital in that financial year.*
4. *Partly paid shares can be bought back by a company*

Question - 4: Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against

Answer:

1. *(a) Free reserves.*
2. *(b) Securities premium.*
3. *(c) Both (a) and (b).*
4. *(d) Neither (a) nor (b).*

Question - 5: Advantages of Buy-back of shares include to

Answer:

1. *Encourage others to make hostile bid to take over the company.*
2. *Decrease promoters holding as the shares which are bought back are cancelled.*
3. *Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.*
4. *All of the above.*

Question - 6: The companies are permitted to buy-back their own shares out of

Answer:

1. *(a) Free reserves and Securities premium*
2. *(b) Proceeds of the issue of any shares.*
3. *(c) Both (a) and (b)*
4. *(d) Neither (a) nor (b).*

Question - 7: As per section 68(1) of the Companies Act, buy-back of own shares by the company, shall not exceed

Answer:

1. *25% of the total paid-up capital and free reserves of the company.*
2. *20% of the total paid-up capital and free reserves of the company.*
3. *15% of the total paid-up capital and free reserves of the company.*
4. *10% of the total paid-up capital and free reserves of the company.*

Question - 8: As per section 68(1) of the Companies Act, buy-back of own shares by the company, shall not exceed

Answer:

1. *25% of the total paid-up capital and free reserves of the company.*
2. *20% of the total paid-up capital and free reserves of the company.*
3. *15% of the total paid-up capital and free reserves of the company.*
4. *10% of the total paid-up capital and free reserves of the company.*

Question - 9: The companies are permitted to buy-back their own shares out of
Answer:

1. *Free reserves and Securities premium*
2. *Proceeds of the issue of any shares.*
3. *Both (a) and (b)*
4. *Neither (a) nor (b).*

Question - 10: When a company purchases its own shares out of free reserves; a sum equal to nominal value of shares so purchased shall be transferred to
Answer:

1. *Revenue redemption reserve.*
2. *Capital redemption reserve.*
3. *Buy-back reserve*
4. *Special reserve*

Question - 11: State which of the following statements is true?
Answer:

1. *Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.*
2. *Partly paid shares cannot be bought back by a company.*
3. *Buy-back of equity shares in any financial year shall exceed twenty-five per cent of its total paid-up equity capital in that financial year.*
4. *Partly paid shares can be bought back by a company.*

Question - 12: Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against
Answer:

1. *Free reserves.*
2. *Securities premium.*
3. *Both (a) and (b).*
4. *Neither (a) nor (b).*

Question - 13: Advantages of Buy-back of shares include to
Answer:

1. *Encourage others to make hostile bid to take over the company.*
2. *Decrease promoters holding as the shares which are bought back are cancelled.*
3. *Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.*
4. *All of the above.*

Question - 14: Advantages of Buy-back of shares include to

1. *Encourage others to make hostile bid to take over the company.*
2. *Decrease promoters holding as the shares which are bought back are cancelled.*
3. *Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.*
4. *All of the above.*

Question - 15: State which of the following statements is true?

1. *Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.*
2. *Partly paid shares cannot be bought back by a company.*
3. *Buy-back of equity shares in any financial year shall exceed twenty-five per cent of its total paid-up equity capital in that financial year.*
4. *Partly paid shares can be bought back by a company*

Answer

Q1	***2***	***Q2***	***2***	***Q3***	***2***	***Q4***	***3***	***Q5***	***3***	***Q6***	***3***
Q7	***1***	***Q8***	***1***	***Q9***	***3***	***Q10***	***2***	***Q11***	***2***	***Q12***	***3***
Q13	***3***	***Q14***	***3***	***Q15***	***2***						

Amalgamation of Companies
(AS 14: Accounting for Amalgamations)

Question 1

S. Ltd. is absorbed by P. Ltd. S Ltd. gives the following information on the date of absorption:

	₹
Sundry Assets	*13,00,000*
Share capital:	
2,000 7% Preference shares of ₹100 each (fully paid-up)	*2,00,000*
5,000 Equity shares of ₹100 each (fully paid-up)	*5,00,000*
Reserves	*3,00,000*
6% Debentures	*2,00,000*
Trade payables	*1,00,000*

Additional information:

P. Ltd. has agreed:

(i) to issue 9% Preference shares of ₹100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.

(ii) to issue to the debenture-holders in S Ltd. 8% Mortgage Debentures at ₹96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%;

(iii) to pay ₹20 per share in cash and to issue six equity shares of ₹100 each issued at the market value ₹ 125 in lieu of every five shares held in S. Ltd.; and

(iv) to assume the liability to trade payables.

You are required to calculate the purchase consideration.

(*Source: Illustration 1, Study Material*)

Answer:

The purchase consideration will be

	₹	*Form*
Preference shareholders: 2,000 ×3/4 ×100	1,50,000	9% Pref. shares
Equity shareholders: 5,000 ×20	1,00,000	Cash
5,000 × 6/5× 125	7,50,000	Equity shares
	10,00,000	

Note

1. According to AS 14, 'consideration' excludes the any amount payable to debenture-holders. The liability in respect of debentures of S Ltd. will be taken by P Ltd., which will then be settled by issuing new 8% debentures.
2. The issue of the equity shares is done at ₹ 125 (market value) as it has been mentioned in the question. The face value shall not be considered for this purpose.

Question 2

Following is the balance sheet of A Ltd. as on 31st March, 20X1

		Particulars	Notes	₹ (000)
		Equity and Liabilities		
1		**Shareholders' funds**		
		Share capital	1	22,50
	A	Reserves and Surplus	2	9,00
2	B	**Non-current liabilities**		
		Long-term borrowings	3	7,00
3	A	**Current liabilities**		
	A	Trade Payables		5,00
		Total		43,50
	A	**Assets**		
	B			
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	32,50
	B	**Non-current investments**	5	6,00
2	c	**Current assets**		
		Inventories		2,00
		Trade receivables		2,00
		Cash and Cash equivalents		1,00
		Total		43,50

Notes to accounts

1	Share Capital		₹ in ('000)
	Equity share capital		
	1,50,000 Equity Shares of ₹ 10 each		15,00
	7,500 14% Preference Shares of ₹ 100 each		7,50
			22,50
2	**Reserves and Surplus**		
	General reserve		9,00
3	**Long-term borrowings**		
	Secured		
	15% Debentures		7,00
4	**Property, plant and Equipment**		
	Land and Building		32,50
5	**Non-current investments**		
	Investments at cost		6,00

B Ltd agreed to take over the assets and liabilities on the following terms and conditions:

(a) Discharge 15% debentures at a premium of 10% by issuing 15% debentures of X Ltd.

(b) PPE at 10% above the book value and investments at par value.

(c) Current assets at a discount of 10% and Current liabilities at book value.

(d) Preference shareholders are discharged at a premium of 10% by issuing 15% preference shares of Rs.100 each.

(e) Issue 3 equity shares of ₹ 10 each for every 2 equity shares in B Ltd. and pay the balance in cash.

Calculate Purchase consideration.

(*Source: Illustration 2, Study Material*)

Answer:

Calculation of Purchase Consideration (Net Asset value Method)

Particulars	***(₹ in '000's)***
Value of assets taken over:	
Property, Plant and Equipment	35,75
Non-Current Investments	6,00
Current Assets	4,50
Total Assets (A)	46,25
Less: **Liabilities taken over:**	
15% Debentures	7,70
Current Liabilities	5,00
Total Liabilities (B)	12,70
Purchase consideration (A -B)	33,55
Mode of Purchase Consideration	
In the form of 15% Preference shares	8,25
In the form of Equity shares	22,50
In the form of Cash (Balance)	2,80
Total	33,55

Question 3

Let us consider the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	***Notes***	***₹ (000)***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*100,00*
	B	*Reserves and Surplus*	*2*	*12,50*
2		***Non-current liabilities***		
	A	*Long-term borrowings*	*3*	*40,00*
3		***Current liabilities***		
	A	*Trade Payables*		*20,00*
		Total		*172,50*
		Assets		
1		***Non-current assets***		
	A	*Property, Plant and Equipment*	*4*	*105,50*
	B	***Non-current investments***	*5*	*5,00*
2		***Current assets***		
	(a)	*Inventories*		*23,00*
	(b)	*Trade receivables*		*24,00*
	(c)	*Cash and Cash equivalents*		*15,00*
		Total		*172,50*

Notes to accounts

1	***Share Capital***		***₹ in ('000)***
	Equity share capital		
	7,50,000 Equity Shares of ₹ 10 each		*75,00*
	25,000 14% Preference Shares of ₹ 100 each		*25,00*
			100,00
2	***Reserves and Surplus***		
	General reserve		*12,50*
			12,50
3	***Long-term borrowings***		
	Secured		
	14% Debentures		*40,00*
			40,00
4	***Property, plant and Equipment***		
	Land and Building		*50,00*
	Plant and machinery		*45,00*
	Furniture		*10,50*
			105,50
5	***Non-current investments***		
	Investments at cost		*5,00*
			5,00

Other Information:

(i) Y Ltd. takes over X Ltd. on 10th April, 20X1.

(ii) Debenture holders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.

(iii) 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value ₹ 100 each).

(iv) Intrinsic value per share of X Ltd. is ₹ 20 and that of Y Ltd. ₹ 30. Y Ltd. will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, the entry should be made at par value only. The nominal value of each equity share of Y Ltd. is ₹ 10.

Compute the purchase consideration.

(*Source: Illustration 3, Study Material*)

Answer:

Computation of Purchase consideration	*(₹ in '000)*	*Form*
For Preference Shareholders of X Ltd.	3,000	30,000 15% Preference shares in Y Ltd.
For equity shareholders of X Ltd. (20/30 × 7,50,000) × ₹ 10 of ₹ 10 each	5,000	5,00,000 Equity shares of Y Ltd.
Total Purchase consideration	8,000	

Note: According to AS 14, amount paid to the debenture holders should not be included in the purchase consideration calculation. Such debentures will be taken over by Y Ltd. and then discharged by them later.

Question 4

Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04. 20X1. Following is the Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3. 20X1:

		Particulars	Notes	Neel	Gagan
		Equity and Liabilities			
1		**Shareholders' funds**			
	A			7,75,000	8,55,000
2		Share capital		6,23,500	5,57,600
				13,98,500	14,12,600
		Current liabilities			
		Total			
1		**Assets**			
	A	**Non-current assets**	1	12,35,000	12,54,000
2		Property, Plant and Equipment		1,63,500	1,58,600
				13,98,500	14,12,600
		Current assets			
		Total			

***Notes to accounts**:*

1	**Property, plant and Equipment**			
	Land and Building		7,50,000	6,40,000
	Plant and machinery		4,85,000	6,14,000
			12,35,000	12,54,000

Following is the additional information:

(i) The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:

	Neel	Gagan
	₹	₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

(ii) The purchase consideration is to be discharged as under:

(a) Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years.

(b) Profits for the preceding 2 years are given below:

	Neel	Gagan
	₹	₹
Ist year	2,62,800	2,75,125
IInd year	2,12,200	2,49,875
Total	4,75,000	5,25,000

(c) Issue 12% preference shares of ₹ 10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as on 31.3.20X1 after revaluation of assets of Neel Ltd. and Gagan Ltd. respectively.

You are required to compute the

(i) Equity and preference shares issued to Neel Ltd. and Gagan Ltd.,

(ii) Purchase consideration.

(*Source: Illustration 4, Study Material*)

Answer:

(i) Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.

Profits of	***Neel***	***Gagan***
	₹	₹
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

The total profits- ₹ 4,75,000+ ₹ 5,25,000= ₹ 10,00,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profits.

	Neel	***Gagan***
24,000 x 475/1000 24,000 x 525/1000	11,400 equity shares	12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. and Gagan Ltd.

	Neel	***Gagan***
	₹	₹
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued	56,000 shares	
$\left[67,200 \times \frac{100}{12}\right] = 5,60,000$₹@ 10 each		
$\left[73,920 \times \frac{100}{12}\right] = 6,16,000$₹@ 10 each		61,600 shares

(ii) Total Purchase Consideration

	Neel	***Gagan***
	₹	₹
Equity shares @ of ₹ 25 each	2,85,000	3,15,000
12% Preference shares @ of ₹ 10 each	5,60,000	6,16,000
Total	8,45,000	9,31,000

Working Note:

Calculation of Net assets as on 31.3.20X1

	Neel	***Gagan***
	₹	₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	(6,23,500)	(5,57,600)
	8,40,000	9,24,000

Note: Since the income from the preference shares shall be equal to the 8% return on assets, the shares are computed in such way that 12% dividend on them shall be equal to 8% of the return on Net assets.

Question 5

Wye Ltd. acquires the business of Zed Ltd. whose balance sheet as at 31st March, 20X1 is as under:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	12,00,000
	B	Reserves and Surplus	2	1,58,000
2				
	A	**Non-current liabilities**		
		Long-term borrowings	3	2,00,000
3		**Current liabilities**		
	A	Trade Payables		1,20,000
	B	Other current liabilities		
		(Interest payable on debentures)		12,000
		Total		16,90,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	10,00,000
	B	Intangible assets	5	2,90,000
2				
		Current assets		
	A	Inventories		1,50,000
	B			1,80,000
	C	Trade receivables		70,000
		Cash and Cash equivalents		16,90,000
		Total		

Notes to accounts:

		₹
1	**Share Capital**	
	Equity Share capital (₹ 100 each)	8,00,000
	6% Preference Share capital (₹ 100 each)	4,00,000
		12,00,000
2		
	Reserves and Surplus	
	Capital reserve	1,00,000
	Profit and loss A/c	50,000
	Workmen compensation reserve	8,000
	(Expected liability ₹ 5,000)	1,58,000
3	**Long-term borrowings**	
	6% Debentures	2,00,000
		2,00,000
4	**Property, Plant and Equipment**	
	Land and Building	4,00,000
	Plant and machinery	6,00,000
		10,00,000
5	**Intangible assets**	
	Goodwill	2,40,000
	Patents	50,000
		2,90,000

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts:

(i) ₹ 2,00,000 7% Debentures (₹ 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth ₹ 105.

(ii) For each preference share in Zed Ltd. ₹ 10 in cash and one 9% preference share of ₹ 100 each in Wye Ltd.

(iii) For each equity share in Zed Ltd. ₹ 20 in cash and one equity share in Wye Ltd. of ₹ 100 each having the market value of ₹ 140.

(iv) Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of ₹ 10,000. Actual expenses amounted to ₹ 12,500.

Wye Ltd. valued Land and building at ₹ 5,50,000 Plant and Machinery at ₹ 6,50,000 and patents at ₹ 20,000 of Zed Ltd for the purpose of amalgamation.

(*Source: Illustration 5, Study Material*)

Answer:

Purchase Consideration:

			₹	*Form*
(i)	Preference Shares: ₹ 10 per share 40,000			Cash
	Preference shares	4,00,000	4,40,000	Preference shares
(ii)	Equity shares: ₹ 20 per share	1,60,000		Cash
	8,000 equity shares in			
	Wye Ltd. @ ₹ 140	11,20,000	12,80,000	Equity shares
			17,20,000	

Steps to close the Books of the Vendor Company

1. Open Realization Account and transfer all assets at book value.

   Exception: If cash is not taken over by the purchasing company, it should not be transferred.

   Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realization Account.

   The journal entry in the above case is:

		₹	₹
Realization A/c	Dr.	16,20,000	
To Sundries —			
Goodwill			2,40,000
Land & Building			4,00,000
Plant & Machinery			6,00,000
Patents			50,000
Inventory			1,50,000
Trade receivables			1,80,000
(Transfer of assets to Realization Account on sale of business to Wye Ltd.)			

2. Transfer to the Realization Account the liabilities which the purchasing company is to take over. In case of the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is not required (*i.e.,* the reserve portion) should be treated as profit. Accordingly, the following entry will be recorded:

		₹	₹
6% Debentures in Wye Ltd.	Dr.	2,00,000	
Workmen's Compensation Reserve	Dr.	5,000	
Trade payables	Dr.	1,20,000	
To Realization A/c			3,25,000
(Transfer of liabilities taken over by Wye Ltd. to Realization A/c)			

   For liabilities not take over by the purchasing company, the profit or loss on discharge of such liabilities shall be transferred to Realization Account.

3. Debit purchasing company and credit Realization Account with the purchase consideration.

Wye Ltd.-	Dr.		17,20,000
To Realization A/c			17,20,000
(Amount receivable from Wye Ltd. for sale of business)			

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company. Thus —

Cash	Dr.	2,00,000	
9% Preference shares in Wye Ltd.	Dr.	4,00,000	
Equity shares in Wye Ltd.	Dr.	11,20,000	
To Wye Ltd.			17,20,000
(Receipt of purchase consideration from the purchase company)			

5. Expenses of liquidation have to be dealt with according to the circumstances of each case.
   (a) If the vendor company has to bear and pay them:
   Realization Account should be debited and Cash Account credited.
   (b) If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:
   (i) It may be ignored in the books of the vendor company.
   (ii) If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed:
   (a) Debit Purchasing company and credit Cash Account when expenses are paid by the vendor company; and
   (b) Debit Cash Account and credit purchasing company (on the expenses being reimbursed).

   In the above mentioned case Wye Ltd. has to pay maximum of ₹ 10,000 only whereas, the amount spent is ₹ 12,500. Hence ₹ 2,500 is to be borne by Zed Ltd.; the entries required will be :

		₹	₹
Wye Ltd.	Dr.		10,000
Realization A/c	Dr.		2,500
To Cash A/c		12,500	
(Liquidation expenses out of which ₹ 10,000 is payable by Wye Ltd.)			
Cash A/c	Dr.		10,000
To Wye Ltd.		10,000	
(Account reimbursed by Wye Ltd. for expense)			

6. Liabilities not assumed by the purchasing company, have to be paid off. On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realization Account. Zed Ltd. shall pass the following entries in this respect:

		₹	₹
Interest Outstanding	Dr.	12,000	
To Debentureholders A/c			12,000
(Amount due to debenture holders for debentures interest)			
Debentureholders	Dr.	12,000	
To Cash A/c			12,000
(Debentureholders paid cash ₹ 12,000 for outstanding interest)			

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realization Account. Thus —

6% Pref. Share Capital A/c	Dr.	4,00,000	
Realization A/c	Dr.	40,000	
To Preference Shareholders A/c			4,40,000

(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)

Note: In the absence of any indication to the contrary, preference shareholders will be entitled only to the capital contributed by them. But if funds available after paying off creditors are not sufficient to satisfy the claim of preference shareholders fully, they will have to suffer a loss to the extent of the deficit.

8. Pay off preference shareholders by debiting them and crediting whatever is given to them. The entry in the above case is :

		₹	₹
Preference shareholders A/c	Dr.	4,40,000	
To Cash A/c 40,000			
To 9% Preference shares in Wye Ltd.			4,00,000
(Cash and preference shares in Wye Ltd. given to preference shareholders)			

9. Transfer equity share capital and account representing profit or loss (including the balance in Realization Account) to Equity Shareholders Account. This will determine the amount receivable by the equity shareholders. Zed Ltd. shall pass the following entries in this regard :

		₹	₹
Equity Share Capital A/c	Dr.	8,00,000	
Capital Reserve A/c	Dr.	1,00,000	
Profit and Loss A/c	Dr.	50,000	
Workmen's Compensation Reserve A/c	Dr.	3,000	
Realization A/c	Dr.	3,82,500	
To Equity Shareholders A/c			13,35,500
(Various accounts representing capital and profit transferred to Equity Shareholders Account)			

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them. Hence:

Equity Shareholders A/c	Dr.	13,35,500	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c (W.N.2)			2,15,500

Working Notes

1. Realization Account

	₹		₹
To Sundry Assets	16,20,000	By Sundry Liabilities	3,25,000
To Cash (excess expenses of liquidation)	2,500	By Wye Ltd.	17,20,000
To Preference Shareholders	40,000		
To Equity Shareholders A/c - profit transferred	3,82,500		
	20,45,000		20,45,000

2. Cash Account

	₹		₹
To Balance b/d	70,000	By Realization	2,500
To Wye Ltd. (consideration for amalgamation)	2,00,000	By Wye Ltd.	10,000
To Wye Ltd. (liquidation expenses reimbursed)	10,000	By Debenture-holders	12000
		By Preference shareholder	40000
		By Equity Shareholder (B/F)	215500
	280000		280000

Question 6

The following Balance Sheets are given as at 31st March, 20X1:

		Particulars	***₹ Best Ltd. (in lakhs)***	***₹ Better Ltd. (in lakhs)***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital (shares of ₹ 100 each, fully pad)*	*20*	*10*
	B	*Reserves and Surplus*	*10*	*8*
2		***Current liabilities***	*20*	*2*
		Total	*50*	*20*
		Assets		
1		***Non-current assets***		
	A	*Property, Plant and Equipment*	*25*	*15*
	B	*Non-current investments*	*5*	*-*
2		***Current assets***	*20*	*5*
		Total	*50*	*20*

The following further information is given —

(a) Better Limited issued bonus shares on 1st April, 20X1, in the ratio of one share for every two held, out of Reserves and Surplus.

(b) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.

(c) The value of shares in Best Ltd. was considered to be ₹ 150 and the shares in Better Ltd. were valued at ₹ 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.

(d) Liabilities of Better Ltd., included ₹ 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 20X1 after the takeover.

(*Source: Illustration 6, Study Material*)

Answer:

LEDGER OF BETTER LIMITED

Property, Plant and Equipment (PPE) Account

	₹		₹
To Balance b/d	15,00,000	By Realization A/c (transfer)	15,00,000

Current Assets Account

	₹		₹
To Balance b/d	5,00,000	By Realization A/c (transfer)	5,00,000

Liabilities Account

	₹		₹
To Realization A/c	2,00,000	By Balance b/d	2,00,000

Realization Account

	₹		₹
To PPE A/c	15,00,000	By Liabilities A/c	2,00,000
”Current Assets A/c	5,00,000	”Best Limited (Purchase Consideration)	15,00,000
		”Shareholders’ A/c (Loss on Realization)	3,00,000
	20,00,000		20,00,000

Share Capital Account

	₹		₹
To Sundry shareholders A/c - (transfer)	15,00,000	By Balance b/d	10,00,000
		”Reserves & Surplus A/c (Bonus issue)	5,00,000
	15,00,000		15,00,000

Reserves & Surplus Account

	₹		₹
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
” Sundry Shareholders	3,00,000		
	8,00,000		8,00,000

Best Ltd.

	₹		₹
To Realization A/c - Purchase Consideration	15,00,000	By Shares in Best Ltd	15,00,000
	15,00,000		15,00,000

Shares in Best Ltd.

	₹		₹
To Best Ltd.	15,00,000	By Sundry Shareholders A/c	15,00,000

Sundry Shareholders Account

	₹		
To Realization A/c (Loss)	3,00,000	By Share Capital A/c	15,00,000
		” Reserves & Surplus A/c	3,00,000
”Share in Best Ltd.	15,00,000		
	18,00,000		18,00,000

Journal of Best Ltd.

20X1		*Dr.* ₹	*Cr.* ₹
Apr. 1 Property, Plant and Equipment A/c	Dr.	15,00,000	
Current Assets A/c	Dr.	5,00,000	
To Liabilities A/c			2,00,000
To Liquidator of Better Ltd.			15,00,000
To Capital Reserve A/c			3,00,000
(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of ₹ 15,00,000			

as per agreement dated .....)			
Liquidator of Better Ltd.	Dr.	15,00,000	
To Share Capital A/c			10,00,000
To Securities Premium A/c			5,00,000
(Discharge of Purchase consideration by the issue of equity shares of ₹ 10,00,000 at a premium of ₹ 50 per share as per agreement)			
Trade payables A/c	Dr.	1,00,000	
To Trade receivables A/c			1,00,000
(Amount due from Better Ltd., and included in its creditors taken over, cancelled against own Trade receivables)			
Capital Reserve A/c	Dr.	10,000	
To Current Asset (Stock) A/c			10,000
(Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account. 20% on sale value of ₹50,000 shall be eliminated as unrealized profit)			

Working Note :

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at ₹ 100 per share ₹ 15,00,000 Purchase consideration has been discharged by Best Ltd. by the issue of shares for ₹ 10,00,000 at a premium of ₹ 5,00,000. This gives the value of ₹ 150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	30,00,000
	(b)	Reserves and Surplus	2	17,90,000
2		**Current liabilities**		21,00,000
		Total		68,90,000
		Assets		
1		**Non-current assets**		
	(a)	Property, Plant and Equipment	3	40,00,000
	(b)	Non-current investments		5,00,000
2		**Current assets**		23,90,000
		Total		68,90,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	Issued & Subscribed	
	30,000 shares of ₹ 100 (of the above 10,000 shares have been issued for consideration other than cash)	30,00,000
	Total	30,00,000

	Total		
2	**Reserves and Surplus**		
	Capital Reserve (3,00,000 – 10,000)		2,90,000
	Securities Premium		5,00,000
	Other reserves and surplus		10,00,000
	Total		17,90,000
3	**Property, Plant and Equipment**		
	PPE		
	Acquired during the year	25,00,000	
		15,00,000	40,00,000
			40,00,000

Question 7

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies as at the date of amalgamation was as under:

		Particulars	***Notes***	***₹ K Ltd.***	***₹ L Ltd.***
		Equity and Liabilities			
1		***Shareholders' funds***			
	A	*Share capital*	*1*	*12,00,000*	*6,00,000*
	B	*Reserves and Surplus*	*2*	*3,71,375*	*1,97,175*
2		***Non-current liabilities***			
	A	*Long-term borrowings*	*3*	*2,00,000*	*2,00,000*
3		***Current liabilities***			
	A	*Trade Payables*		*1,00,000*	*2,10,000*
		Total		*18,71,375*	*12,07,175*
		Assets			
1		***Non-current assets***			
	A	*Property, Plant and Equipment*	*4*	*11,30,000*	*8,20,000*
	B	*Intangible assets*	*5*	*80,000*	*-*
2		***Current assets***	*6*		
	A	*Inventories*		*2,25,000*	*1,40,000*
	B	*Trade receivables*		*2,75,000*	*1,75,000*
	C	*Cash and Cash equivalents*		*1,61,375*	*72,175*
		Total		*18,71,375*	*12,07,175*

Notes to accounts

	Share Capital		***K Ltd.***	***L Ltd.***
1	*Equity shares of ₹ 100 each*		*8,00,000*	*3,00,000*
	7% Preference Shares of ₹ 100 each		*4,00,000*	*3,00,000*
			12,00,000	*6,00,000*
2	***Reserves and Surplus***			
	General reserve		*-*	*1,00,000*
	Profit and loss account		*3,71,175*	*97,175*
			3,71,175	*1,97,175*

	Share Capital		K Ltd.	L Ltd.
3	**Long-term borrowings**			
	5% Debentures		2,00,000	-
	Secured loan		-	2,00,000
			2,00,000	2,00,000
4	**Property, plant and Equipment**			
	Land and Building		4,50,000	3,00,000
	Plant and machinery		6,20,000	5,00,000
	Furniture and fittings		60,000	20,000
			11,30,000	8,20,000
5	**Intangible assets**			
	Goodwill		80,000	-
			80,000	-
6	**Cash and Cash Equivalents**			
	Cash at Bank		1,20,000	55,000
	Cash in hand		41,375	17,175
			1,61,375	72,175

The terms of amalgamation are as under:

(A) (1) The assumption of liabilities of both the Companies.

(2) Issue of 5 Preference shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at premium of ₹ 4 per share for each preference share held in both the Companies.

(3) Issue of 6 Equity shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at a premium of ₹ 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.

(4) Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd.

(B) (1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively to be raised.

(2) The trade receivables of K Ltd. include ₹ 20,000 due from L Ltd.

(C) The LK Ltd. is to issue 15,000 new equity shares of ₹ 20 each, ₹ 18 paid up at premium of ₹ 4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

(*Source: Illustration 7, Study Material*)

Answer:

Books of K Ltd.

Realization Account

		₹			₹
To	Goodwill	80,000	By	5% Debentures	2,00,000
To	Land & Building	4,50,000	By	Trade payables	1,00,000
To	Plant & Machinery	6,20,000	By	LK Ltd.	15,60,000
To	Furniture & Fitting	60,000		(Purchase consideration)	
To	Trade receivables	2,75,000	By	Equity shareholders A/c (loss)	51,375
To	Stores & inventory	2,25,000			
To	Cash at Bank	1,20,000			
To	Cash in hand	41,375			
To	Preference shareholders (excess payment)	40,000			
		19,11,375			19,11,375

Equity Shareholders Account

	₹		₹
To Realization A/c (loss)	51,375	By Share capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit & Loss A/c	3,71,375
To Cash	64,000		
	11,71,375		11,71,375

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	4,40,000	By Share capital	4,00,000
		By Realization A/c	40,000
	4,40,000		4,40,000

LK Ltd. Account

	₹			₹
To Realization A/c	15,60,000	By Equity Shares in LK Ltd.		
		For Equity	10,56,000	
		Pref.	4,40,000	14,96,000
		By Cash		64,000
	15,60,000			15,60,000

Books of L Ltd.

Realization Account

	₹		₹
To Land & Building	3,00,000	By Trade payables	2,10,000
To Plant & Machinery	5,00,000	By Secured loan	2,00,000
To Furniture & Fittings	20,000	By LK Ltd. (Purchase	
To Trade receivables	1,75,000	consideration)	7,90,000
To Inventory of stores	1,40,000	By Equity shareholders	A/c—
To Cash at bank	55,000	Loss	37,175
To Cash in hand	17,175		
To Pref. shareholders	30,000		
	12,37,175		12,37,175

Equity Shareholders Account

	₹		₹
To Equity shares in LK Ltd.	3,96,000	By Share Capital	3,00,000
To Realization	37,175	By Profit & Loss A/c	97,175
To Cash	64,000	By Reserve	1,00,000
	4,97,175		4,97,175

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	3,30,000	By Share capital	3,00,000
		By Realization A/c	30,000
	3,30,000		3,30,000

LK Ltd. Account

	₹				₹
To Realization A/c	7,90,000	By	Equity shares in LK Ltd.		
			For Equity	3,96,000	
			Preference	3,30,000	7,26,000
		By	Cash		64,000
	7,90,000				7,90,000

Working Notes:

(i) Purchase consideration

	K Ltd. ₹	*L Ltd.* ₹
Payable to preference shareholders:		
Preference shares at ₹ 22 per share	4,40,000	3,30,000
Equity Shares at ₹ 22 per share	10,56,000	3,96,000
Cash [See W.N. (*ii*)]	64,000	64,000
	15,60,000	7,90,000

(ii) Value of Net Assets

		K Ltd. ₹		*L Ltd.* ₹
Goodwill		80,000		
Land & Building		4,50,000		3,00,000
Plant & Machinery		6,20,000		5,00,000
Furniture & Fittings		60,000		20,000
Trade receivables less 2.5%		2,68,125		1,70,625
Inventory less 2%		2,20,500		1,37,200
Cash at Bank		1,20,000		55,000
Cash in hand		41,375		17,175
Less : Debentures	2,00,000	18,60,000	–	12,00,000
Trade payables	1,00,000		2,10,000	
Secured Loans	–	(3,00,000)	2,00,000	(4,10,000)
		15,60,000		7,90,000
Payable in shares		14,96,000		7,26,000
Payable in cash		64,000		64,000

Question 8

Consider the following balance sheets of X Ltd. and Y Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ X Ltd ('000)	₹ Y Ltd. ('000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	72,00	47,00
	B	Reserves and Surplus	2	15,50	10,50
2					
	A	**Non-current liabilities**	3	5,00	3,50
3					
	A	Long-term borrowings		4,50	3,50
	B	**Current liabilities**		2,00	1,50
		Trade Payables		99,00	66,00
1					
	A	Other current liabilities	4	63,25	36,00
	B	Total	5	7,00	5,00
2		**Assets**			
		Non-current assets			
	A	Property, Plant and Equipment		12,50	9,50
	B	Non-current investments		9,00	10,30
	C	**Current assets**		7,25	5,20
		Inventories		99,00	66,00
		Trade receivables			
		Cash and Cash equivalents			
		Total			

Notes to accounts

			X Ltd ('000)	Y Ltd ('000)
1	**Share Capital**			
	Equity share capital (₹ 10 each)		50,00	30,00
	14% Preference Shares capital ₹ 100 each		22,00	17,00
			72,00	47,00
2	**Reserves and Surplus**			
	General reserve		5,00	2,50
	Export profit reserve		3,00	2,00
	Investment allowance reserve		-	1,00
	Profit and loss account		7,50	5,00
			15,50	10,50
3	**Long-term borrowings**			
	13% Debentures of ₹ 100 each		5,00	3,50
4	**Property, Plant and Equipment**			
	Land and Building		25,00	15,50
	Plant and machinery		32,50	17,00
	Furniture		5,75	3,50
			63,25	36,00
5	**Non-current investments**			
	Investments at cost		7,00	5,00
			7.00	5,00

X Ltd. takes over Y Ltd. on 1st April, 20X1. X Ltd. discharges the purchase consideration as below:

(i) Issued 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders of Y Ltd.

(ii) Issued 15% preference shares of ₹ 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the balance sheet of X Ltd. after amalgamation on the assumption that:

(a) the amalgamation is in the nature of merger.

(b) the amalgamation is in the nature of purchase.

(*Source: Illustration 8, Study Material*)

Answer

(a) Amalgamation in the nature of merger:

(i) Journal Entries in the Books of X Ltd.

		Dr. ₹	Cr. ₹
Business Purchase	Dr.	53,70,000	
To Liquidator of Y Ltd.			53,70,000
(Consideration payable for business taken over from Y Ltd)			
Sundry Assets of Y Ltd	Dr.	66,00,000	
General Reserve (Related to X Ltd)		4,20,000	
To Sundry Liabilities of Y Ltd			8,50,000
To Export profit Reserve			2,00,000
To Investment allowance Reserve			1,00,000
To Profit & Loss			5,00,000
To Business Purchase			53,70,000
(Incorporation of various assets and liabilities taken over from Y Ltd. at book values and difference of share capital and purchase consideration being adjusted with free Reserves)			
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000
(Discharge of consideration for Y Ltd.'s business)			
Sundry Liabilities in Y Ltd (13% Debentures in Y Ltd.)	Dr.	3,50,000	
To 13% Debentures			3,50,000
(Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)			

(ii) Balance Sheet of X Ltd.

		Particulars	*Notes*	*₹ in '000*
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570
	b	Reserves and Surplus	2	1,930
2		**Non-current liabilities**		
	a	Long-term borrowings	3	850

		Particulars	Notes	₹ in '000
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		16,500
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	9,925
	b	Non-current investments		1,200
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and cash equivalents		1,245
		Total		16,500

Notes to accounts

				₹ in '000
1	**Share Capital**			
	Equity share capital			
	8,50,000 Equity Shares of ₹ 10 each			8,500
	Preference share capital			
	18,700, 15% Preference Shares of ₹ 100 each			1,870
	22,000, 14% Preference Shares of ₹ 100 each			2,200
	Total			12,570
2	**Reserves and Surplus**			
	General Reserve of X Ltd.	500		
	Add: General reserve of Y Ltd.	250	750	
	Less: Adjustment for amalgamation*		(670)	80
	Export Profit Reserve of X Ltd.		300	
	Add: Export Profit Reserve of Y Ltd.		200	500
	Investment Allowance Reserve			100
	Profit & Loss A/c of X Ltd.		750	
	Add: Profit & Loss A/c of Y Ltd.		500	1,250
	Total			1,930
3	**Long-term borrowings**			
	Secured			
	8,500 13% Debentures of ₹ 100 each			850
	Total			850
4	**Property, Plant and Equipment**			
	Land & Buildings			4,050
	Plant & Machinery			4,950
	Furniture & Fittings			925
	Total			9,925

*The difference between the amount recorded as share capital issued and the amount of share capital of transferor-company should be adjusted in reserves. Thus, Adjustment for amalgamation = ₹ '000 (53,70 – 47,00) = ₹ ('000) 670

(b) ***Amalgamation in the nature of purchase:***

(i) Journal Entries in the Books of X Ltd.

		Dr. ₹	Cr. ₹
Business Purchase	Dr.	53,70,000	
To Liquidator of Y Ltd.			53,70,000
(Consideration payable for business taken over from Y Ltd)			
Sundry Assets of Y Ltd	Dr.	66,00,000	
To Sundry Liabilities of Y Ltd			8,50,000
To Capital Reserve			3,80,000
To Business Purchase			53,70,000
(Incorporation of various assets and liabilities taken over from Y Ltd. at book values and difference of Net assets and purchase consideration being credited to Capital reserve)			
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000
(Discharge of consideration for Y Ltd.'s business)			
13% Debentures in Y Ltd.	Dr.	3,50,000	
To 13% Debentures			3,50,000
(Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)			

Balance Sheet of X Ltd.

		Particulars	*Notes*	*₹ in'000*
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	12,570
	(b)	Reserves and Surplus	2	1,930
2		**Non-current liabilities**		
	(a)	Long-term borrowings	3	850
3		**Current liabilities**		
	(a)	Trade Payables		800
	(b)	Other current liabilities		350
		Total		16,500
		Assets		
1		**Non-current assets**		
	(a)	Property, Plant and Equipment	4	9,925
	(b)	Non-current investments		1,200
2		**Current assets**		
	(a)	Inventories		2,200
	(b)	Trade receivables		1,930
	(c)	Cash and cash equivalents		1,245
		Total		16,500

Notes to accounts

			₹ in'000
1	**Share Capital**		
	Equity share capital		
	8,50,000 Equity Shares of ₹ 10 each		8,500
	Preference share capital		
	18,700, 15% Preference Shares of ₹ 100 each		1,870
	22,000, 14% Preference Shares of ₹ 100 each		2,200
	Total		12,570
2	**Reserves and Surplus**		
	Capital Reserve		380
	General Reserve		500
	Amalgamation adjustment reserve		(300)
	Export Profit Reserve		500
	Investment Allowance Reserve		100
	Surplus (Profit & Loss A/c)		750
	Total		1,930
3	**Long-term borrowings**		
	Secured		
	8,500 13% Debentures of ₹ 100 each		850
	Total		850
4	**Property, Plant and Equipment**		
	Land & Buildings		
	Plant & Machinery		4,050
	Furniture & Fittings		4,950
	Total		925
			9,925

Workings Notes: Capital Reserve arising on Amalgamation:

		₹ ('000)	₹ ('000)
(A)	Net Assets taken over:		
	Sundry Assets		66,00
	Less: 13% Debentures	3,50	
	Trade payables	3,50	
	Other current liabilities	1,50	(8,50)
			57,50
(B)	Purchase consideration:		
	To Equity Shareholders of Y Ltd.		35,00
	To Preference Shareholders of Y Ltd.		18,70
			53,70
(C)	Capital Reserve (A – B)		3,80

Question 9

The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

		Particulars	***Notes***	***₹ P Ltd***	***₹ Q Ltd***
		Equity and Liabilities			
1		***Shareholders' funds***			
	A	*Share capital*	*1*	*8,00,000*	*4,00,000*
	B	*Reserves and Surplus*		*3,00,000*	*2,00,000*

		Particulars	Notes	₹ P Ltd	₹ Q Ltd
2		**Non-current liabilities**			
	A	Long-term borrowings	2	2,00,000	1,50,000
3					
	A	**Current liabilities**		2,50,000	1,50,000
		Trade Payables		15,50,000	9,00,000
		Total			
1					
	A	**Assets**		7,00,000	2,50,000
	B	**Non-current assets**		80,000	80,000
2					
		Property, Plant and Equipment			
	A	Non-current investments		2,40,000	3,20,000
	B			4,20,000	2,10,000
	C	**Current assets**		1,10,000	40,000
		Inventories		15,50,000	9,00,000
		Trade receivables			
		Cash and Cash equivalents			
		Total			

Notes to accounts

			P Ltd.	Q Ltd.
1	**Share Capital**			
	Equity shares of ₹ 10 each		6,00,000	3,00,000
	10% Preference Shares of ₹ 100 each		2,00,000	1,00,000
			8,00,000	4,00,000
2	**Long term borrowings**			
	12% Debentures		2,00,000	1,50,000
			2,00,000	1,50,000

Details of Trade receivables and trade payables are as under:

	P Ltd. (₹)	Q Ltd. (₹)
Trade receivables		
Debtors	3,60,000	1,90,000
Bills Receivable	60,000	20,000
	4,20,000	2,10,000
Trade payables		
Sundry Creditors	2,20,000	1,25,000
Bills Payable	30,000	25,000
	2,50,000	1,50,000

Property, plant and equipment of both the companies are to be revalued at 15% above book value. Both the companies are to pay 10% Equity dividend, but Preference dividend having been already paid.

After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in P Ltd.

(iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include ₹ 10,000 due to P Ltd.

(v) Inventory in Trade and Debtors are taken over at 5% lesser than their book value by P Ltd.

Prepare:

(a) Journal entries in the books of P Ltd.

(b) Statement of consideration payable by P Ltd.

(*Source: Illustration 9, Study Material*)

Answer

(a) Journal Entries in the Books of P Ltd.

		Dr. ₹	Cr. ₹
Property, Plant and Equipment	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of PPE at 15% above book value)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	60,000	
To Bank Account (Payment of equity dividend)			60,000
Business Purchase Account	Dr.	4,90,000	
To Liquidator of Q Ltd.			4,90,000
(Consideration payable for the business taken over from Q Ltd.)			
Property, Plant and Equipment (115% of ₹ 2,50,000)	Dr.	2,87,500	
Inventory (95% of ₹ 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(₹ 40,000 –₹ 30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders of Q Ltd. at a discount of 10%)			

		Dr. ₹	Cr. ₹
Sundry Creditors of Q Ltd.	Dr.	10,000	
To Sundry Debtors of P Ltd. (Cancellation of mutual owing)			10,000
Goodwill	Dr.	30,000	
To Bank			30,000
(Being liquidation expenses reimbursed to Q Ltd.)			
Capital Reserve To Goodwill	Dr.	30,000	
(Being goodwill set off)			30,000

(b) Statement of Consideration payable by P Ltd. for 30,000 shares (payment method)

Shares to be allotted $\frac{30,000}{6} \times 8 = 40,000$ shares of P Ltd.

Issued 40,000 shares of ₹ 10 each i.e. ₹ 4,00,000 (i)

For 10% preference shares, to be paid at 10% discount

$₹\frac{1,00,000 \times 90}{100}$ ₹90,000 (ii)

Consideration amount [(i) + (ii)] ₹ 4,90,000

Question 10

The financial position of two companies Hari Ltd. and Vayu Ltd. as at 31st March, 20X1 was as under:

		Particulars	Notes	Hari Ltd.	Vayu Ltd.
		Equity and Liabilities			
1		***Shareholders' funds***			
	A	*Share capital*	*1*	*11,00,000*	*4,00,000*
	B	*Reserves and Surplus*	*2*	*70,000*	*70,000*
2		***Non-current liabilities***			
	A	*Long term provisions*	*3*	*50,000*	*20,000*
3		***Current liabilities***			
	A	*Trade Payables*		*1,30,000*	*80,000*
		Total		*13,50,000*	*5,70,000*
		Assets			
1		***Non-current assets***			
	A	*Property, Plant and Equipment*	*4*	*8,00,000*	*2,50,000*
	B	*Intangible assets*	*5*	*50,000*	*25,000*
2		***Current assets***			
	A	*Inventories*		*2,50,000*	*1,75,000*
	B	*Trade receivables*		*2,00,000*	*1,00,000*
	C	*Cash and Cash equivalents*		*50,000*	*20,000*
		Total		*13,50,000*	*5,70,000*

Notes to accounts

			Hari Ltd.	Vayu Ltd.
1	***Share Capital***			
	Equity shares of ₹ 10 each		*10,00,000*	*3,00,000*
	9% Preference Shares of ₹ 100 each		*1,00,000*	*--*
	10% Preference Shares of ₹ 100 each		*--*	*1,00,000*
			11,00,000	*4,00,000*

			Hari Ltd.	Vayu Ltd.
2	***Reserves and Surplus***			
	General reserve		70,000	70,000
			70,000	70,000
3	***Long term Provisions***			
	Retirement gratuity fund		50,000	20,000
			50,000	20,000
4	***Property, plant and Equipment***			
	Land and Building		3,00,000	1,00,000
	Plant and machinery		5,00,000	1,50,000
			8,00,000	2,50,000
5	***Intangible assets***			
	Goodwill		50,000	25,000
			50,000	25,000

Hari Ltd. absorbs Vayu Ltd. on the following terms:

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.

(b) Goodwill of Vayu Ltd. is valued at ₹ 50,000, Buildings are valued at ₹ 1,50,000 and the Machinery at ₹1,60,000.

(c) Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.

(d) Equity Shareholders of Vayu Ltd. will be issued Equity Shares @ 5% premium.

Prepare necessary Ledger Accounts to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 20X1.

(*Source: Illustration 10, Study Material*)

Answer:

In the Books of Vayu Ltd.

Realization Account

		₹			₹
To	Sundry Assets	5,70,000	By	Retirement Gratuity Fund	20,000
To	Preference Shareholders (Premium on Redemption)	10,000	By	Trade payables Hari Ltd. (Purchase Consideration)	80,000
To	Equity Shareholders (Profit on Realization)	50,000	By		5,30,000
		6,30,000			6,30,000

Equity Shareholders Account

		₹			₹
To	Equity Shares of Hari Ltd.	4,20,000	By	Share Capital	3,00,000
			By	General Reserve	70,000
			By	Realization Account (Profit on realization)	50,000
		4,20,000			4,20,000

Preference Shareholders Account

		₹			₹
To	9% Preference Shares of Hari Ltd.	1,10,000	By	Preference Capital Share	1,00,000
			By	Realization Account (Premium Redemption on of Preference Shares)	10,000
		1,10,000			1,10,000

Hari Ltd. Account

	₹		₹
To Realization Account	5,30,000	By 9% Preference Shares	1,10,000
		By Equity Shares	4,20,000
	5,30,000		5,30,000

In the Books of Hari Ltd.

Journal Entries

		Dr.	Cr.
		₹	₹
Business Purchase A/c	Dr.	5,30,000	
To Liquidators of Vayu Ltd. Account			5,30,000
(Being business of Vayu Ltd. taken over)			
Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Inventory Account	Dr.	1,57,500	
Trade receivables Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Retirement Gratuity Fund Account			20,000
To Trade payables Account			80,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			5,30,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Vayu Ltd. A/c	Dr.	5,30,000	
To 9% Preference Share Capital A/c			1,10,000
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			20,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Hari Ltd. (after absorption) as at 31st March, 20X1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	16,10,000
	B	Reserves and Surplus	2	90,000
2		**Non-current liabilities**	3	70,000
	A	Long-term provisions		2,10,000
3		**Current liabilities**		7,500
	A	Trade Payables		19,87,500
	B	Short term provision		
		Total		
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	11,10,000
	B	Intangible assets	5	1,00,000
2		**Current assets**		4,07,500
	A	Inventories	6	3,00,000
	B	Trade receivables		70,000
	C	Cash and cash equivalents		
		Total		19,87,500

Notes to accounts

		₹
1 Share Capital		
Equity share capital		
1,40,000 Equity Shares of ₹ 10 each fully paid (Out of above 40,000 Equity Shares were issued in consideration other than for cash)		14,00,000
Preference share capital		
2,100 9% Preference Shares of ₹ 100 each (Out of above 1,100 Preference Shares were issued in consideration other than for cash)		2,10,000
Total		16,10,000
2 Reserves and Surplus		
Securities Premium		20,000
General Reserve		70,000
Total		90,000
3 Long-term provisions		
Retirement Gratuity fund		70,000
Total		70,000
4 Short term Provisions		
Provision for Doubtful Debts		7,500
5 Property, Plant and Equipment		
Buildings		4,50,000
Machinery		6,60,000
Total		11,10,000
6 Intangible assets		
Goodwill		1,00,000
7 Trade receivables		3,00,000

Working Notes:

Purchase Consideration:	₹
Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Inventory	1,57,500
Trade receivables	92,500
Cash at Bank	20,000
	6,30,000
Less: Liabilities:	
Retirement Gratuity Fund	(20,000)
Trade payables	(80,000)
Net Assets/Purchase Consideration	5,30,000
To be satisfied as under:	
10% Preference Shareholders of Vayu Ltd.	1,00,000
Add: 10% Premium	10,000
1,100 9% Preference Shares of Hari Ltd.	1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium	4,20,000
Total	5,30,000

Question 11

The following are the Balance Sheets of A Ltd. and B Ltd. as at 31.3.20X1:

		Particulars	Notes	₹ A Ltd (in'000)	₹ B Ltd (in'000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	2,000	1,000
	B	Reserves and Surplus	2	1,000	(800)
2		**Non-current liabilities**			
	A	Long-term borrowings	3	750	450
3		**Current liabilities**			
	A	Trade Payables		--	50
	B	Short term Borrowings – Bank overdraft		4,050	1,000
		Total			
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		2,700	850
	B	Non-current investments		700	--
2		**Current assets**			
	A	Trade receivables		400	150
	B	Cash and Cash equivalents (cash at bank)		250	--
		Total		4050	1000

Notes to accounts

1	Share capital	A Ltd. ('000)	B Ltd. ('000)
	Equity shares of ₹ 100 each	2000	1000
		2000	1000
2	**Reserves and Surplus**		
	General reserve	1000	--
	Profit and loss A/c (debit balance)	--	(800)
		1000	(800)
3	**Long term borrowings**		
	10% debentures	500	--
	Loan from banks	250	450
		750	450

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

(i) Banks agreed to waive off the loan of ₹ 60 thousands of B Ltd.

(ii) B Ltd. will reduce its shares to ₹ 10 per share and then consolidate 10 such shares into one share of ₹ 100 each (new share).

(iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.

(iv) Trade payables of B Ltd. includes ₹ 100 thousands payable to A Ltd.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger.

(*Source: Illustration 11, Study Material*)

Answer

Calculation of purchase consideration

One share of B Ltd. will be issued in exchange of every share of A Ltd. (i.e. 20,000 equity shares of B Ltd. will be issued against 20,000 equity shares of A Ltd.)	20,000 shares

Journal Entries in the books of B Ltd.

Date			*(₹ in thousands)*	
20X1			*Dr.*	*Cr.*
March,31	Loan from bank A/c	Dr.	60	
	To Capital reduction A/c			60
	(Being loan from bank waived off to the extent of ₹ 60 thousand)			
	Equity share capital A/c (₹ 100)	Dr.	1,000	
	To Equity share capital A/c (₹ 10)			100
	To Capital reduction A/c			900
	(Being equity shares of ₹ 100 each reduced to ₹ 10 each)			
	Equity share capital A/c (₹ 10)	Dr.	100	
	To Equity share capital A/c (₹ 100 each)			100
	(Being 10 equity shares of ₹ 10 each consolidated to one share of ₹ 100 each)			
	Capital reduction A/c	Dr.	960	
	To Profit and loss A/c			800
	To Capital reserve A/c			160
	(Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)			
	Property, plant and equipment A/c	Dr.	2,700	
	Investment A/c	Dr.	700	
	Trade receivables A/c Cash at bank A/c	Dr.	400	
	To Trade payables A/c	Dr.	250	
	To Loans from bank A/c			300
	To 10% Debentures A/c			250
	To Liquidator of A Ltd. A/c			500
	To Reserves A/c			2,000
	(Being assets, liabilities and reserves taken over under pooling of interest method and amount due to Liquidator)			1,000
	Liquidator of A Ltd. A/c	Dr.	2,000	
	To Equity share capital A/c			2,000
	(Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)			
	Trade payables A/c	Dr.	100	
	To Trade receivables A/c (Being mutual owing cancelled)			100

Balance Sheet of B Ltd. after merger as at 31.3.20X1

		Particulars	Notes	₹ in '000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	2,100
	b	Reserves and Surplus	2	1,160

		Particulars	Notes	₹ in '000
2		**Non-current liabilities**		
	a	Long term borrowings	3	1,140
3		**Current liabilities**		
	a	Trade payables		500
	b	Short term borrowings	4	50
		Total		4,950
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment		3,550
	b	Non-current investments		700
2		**Current assets**		
	a	Trade receivables		450
	b	Cash and cash equivalents		250
		Total		4,950

Notes to accounts

			₹ in '000
1	**Share Capital**		
	21,000, Equity shares of ₹ 100 each fully paid		2,100
	(Out of the above, 20,000 shares have been issued for consideration other than cash)		
2	**Reserves and Surplus**		
	Capital reserve	160	
	General reserve	1,000	
	Total		1,160
3	**Long Term Borrowings**		
	10% Debentures	500	
	Loan from Bank (250+450-60)	640	1,140
4	**Short term borrowings**		
	Bank overdraft		50

Question 12

What are the conditions, which, according to AS 14 on Accounting for Amalgamations, must be satisfied for an amalgamation in the nature of merger?

(*Source: Question 7, Study Material*)

Answer

Refer Class notes

Question 13

Distinguish between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation.

(*Source: Question 8, Study Material*)

Answer

Refer Class notes.

Question 14

The following are the Balance Sheets of Yes Ltd. and No Ltd. as at 31st March, 20X1:

		Particulars	*Notes*	*₹ Yes Ltd (in crores)*	*₹ No Ltd (in crores)*
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	12	5
	B	Reserves and Surplus		88	10
2		**Non-current liabilities**			
	A	Long term borrowings	2	--	10
3		**Current liabilities**		33	15
		Total		133	40
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	3	20	6
	B	Non-current investments	4	13	--
2		**Current assets**		100	34
		Total		133	40

Notes of accounts

			Yes Ltd.	No Ltd.
1	**Share Capital**			
	Equity share capital			
	Authorized share capital		25	5
	Issued and subscribed:			
	Equity shares of ₹ 10 each fully paid		12	5
			12	5
2	**Long term borrowings**			
	Unsecured loan from Yes Ltd.		--	10
			--	10
	Property, Plant and Equipment			
	Gross value		70	30
	Depreciation		(50)	(24)
			20	6
4	**Non-current investments**			
	30 lakhs equity shares of ₹ 10 each		3	--
	Long term loan to No Ltd.		10	--
			13	--

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity share of Yes Ltd. issued at a premium of ₹ 2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.

You are asked to pass journal entries in the books of the two companies to give effect to the above.

(*Source: Question 9, Study Material*)

Answer

Journal Entries in the books of No Ltd.

(Rupees in crores)

		Dr.	*Cr.*
Realization Account	Dr.	64.00	
To Property, plant and equipment Account			30.00
To Current Assets Account			34.00
(Being the assets taken over by Yes Ltd. transferred to Realization Account)			
Provision for depreciation Account	Dr.	24.00	
Current Liabilities Account	Dr.	15.00	
Unsecured Loan from Yes Ltd. Account	Dr.	10.00	
To Realization Account			49.00
(Being the transfer of liabilities and provision to Realization Account)			
Yes Ltd.	Dr.	1.2	
To Realization Account			1.2
(Being the amount of consideration due from Yes Ltd. credited to Realization Account)			
Equity Shareholders Account	Dr.	13.80	
To Realization Account			13.80
(Being the loss on Realization transferred to equity share-holders account)			
Equity Share Capital Account	Dr.	5.00	
Reserves and Surplus Account	Dr.	10.00	
To Equity Shareholders Account			15.00
(Being the amount of share capital, reserves and surplus credited to equity shareholders account)			
Equity shares of Yes Ltd.	Dr.	1.20	
To Yes Ltd.			1.20
(Being the receipt of 10 lakhs equity shares of ₹ 10 each at ₹ 12 per share for allotment to shareholders)			
Equity shareholders Account	Dr.	1.20	
To Equity shares of Yes Ltd.			1.20
(Being the distribution of equity shares received from Yes Ltd. to shareholders)			

Journal Entries in the books of Yes Ltd.

(Rupees in crores)

		Dr.	*Cr.*
Business Purchase Account	Dr.	1.2	
To Liquidator of No Ltd. Account			1.2
(Being the amount of purchase consideration agreed under approved scheme of amalgamation- W.N. 1)			
Property, plant and equipment	Dr.	6.00	
Current Assets	Dr.	34.00	
To Current Liabilities			15.00
To Unsecured Loan (from Yes Ltd.)			10.00

To Business Purchase Account			1.20
To Reserve & Surplus A/c			10.00
To Profit & loss A/c*			3.80
(Being the assets and liabilities taken over and the surplus transferred to Profit and loss account)			
Liquidator of No Ltd.	Dr.	1.20	
To Equity Share Capital Account			1.00
To Securities Premium Account			0.20
(Being the allotment to shareholders of No Ltd. 10 lakhs equity shares of ₹ 10 each at a premium of ₹ 2 per share)			
Unsecured Loan (from Yes Ltd.)	Dr.	10.00	
To Loan to No. Ltd.			10.00
(Being the cancellation of unsecured loan given to No Ltd.)			

Working Note:

Purchase Consideration *₹ in crores*

$\frac{50 \text{ lakhs}}{5} \times ₹12$ i.e., 10 lakhs equity shares at `12 per share 1.20

Number of equity shares of ₹ 10 each to be issued $\left[\frac{1.20 \text{ crores}}{12}\right] = 10$ lakhs.

Question 15

The following are the Balance Sheets of X Ltd. and Y Ltd :

		Particulars	Notes	₹ X Ltd.	₹ Y Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	1,00,000	50,000
	B	Reserves and Surplus	2	10,000	(10,000)
2		**Non-current liabilities**			
	A	Long term borrowings	3	--	15,000
3		**Current liabilities**			
	A	Trade Payables		25,000	5,000
		Total		135,000	60,000
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		1,20,000	60,000
	B	Non-current investments	4	15,000	--
		Total		135,000	60,000

* As amalgamation in the nature of merger so balancing figure will be transferred to Profit & Loss account.

Notes to accounts

1	Share Capital		X Ltd.	Y Ltd.
	Equity share capital		1,00,000	50,000
			1,00,000	50,000
2	**Reserves and Surplus**			
	Profit and loss A/c		10,000	--
	Profit and loss A/c (debit balance)		--	(10,000)
			10,000	(10,000)
3	**Long term borrowings**			
	Loan from X Ltd.		--	15,000
4	**Non-current investments**			
	Loan to Y Ltd.		15,000	--
			15,000	--

A new company XY Ltd. is formed to acquire the sundry assets and trade payables of X Ltd. and Y Ltd. and for this purpose, the sundry assets of X Ltd. are revalued at ₹ 1,00,000. The debt due to X Ltd. is also to be discharged in shares of XY Ltd. Show the Ledger Accounts to close the books of X Ltd.

(*Source: Question 10, Study Material*)

Answer

Books of X Ltd.

Realization Account

₹		₹
To Sundry Assets 1,20,000	By Trade payables	25,000
	By XY Ltd. (Purchase consideration)	75,000
———	By Shareholders (Loss on realization)	20,000
1,20,000		1,20,000

Shareholders Account

	₹		₹
To Realization Account (Loss)	20,000	By Equity Share Capital	1,00,000
To Shares in XY Ltd.	90,000	By Profit and Loss Account	10,000
	1,10,000		1,10,000

Loan Y Ltd.

	₹		₹
To Balance b/d	15,000	By Shares in XY Ltd.	15,000

Shares in XY Ltd.

	₹		₹
To XY Ltd.	75,000	By Shareholders	90,000
To Loan Y Ltd.	15,000		
	90,000		90,000

XY Ltd.

	₹		₹
To Realization Account	75,000	By Shares in XY Ltd.	75,000

Question 16

Super Express Ltd. and Fast Express Ltd. were in competing business. They decided to form a new company named Super Fast Express Ltd. The balance sheets of both the companies were as under:

		Particulars	*Notes*	*Super Express Ltd.* ₹	*Fast Express Ltd.* ₹
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	20,00,000	10,00,000
	B	Reserves and Surplus	2	1,00,000	2,60,000
2		**Non-current liabilities**			
	A	Long term provisions	3	1,00,000	--
3		**Current liabilities**			
	A	Trade Payables		60,000	40,000
		Total		22,60,000	13,00,000
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	14,00,000	11,00,000
	B	Intangible assets	5	--	1,00,000
2		**Current assets**			
	A	Inventories		3,00,000	40,000
	B	Trade receivables		2,40,000	40,000
	C	Cash and Cash equivalents	6	3,20,000	20,000
		Total		22,60,000	13,00,000

Notes to accounts

		Super Express Ltd. ₹	*Fast Express Ltd.* ₹
1	**Share Capital**		
	Equity shares of ₹ 100 each	20,00,000	10,00,000
2	**Reserves and Surplus**		
	Insurance reserve	1,00,000	--
	Employee profit sharing reserve	--	60,000
	Reserve account	--	1,00,000
	Surplus	--	1,00,000
		1,00,000	2,60,000
3	**Long term provisions**		
	Provident fund	1,00,000	--
	Total	1,00,000	--
4	**Property, Plant and Equipment**		
	Land and Building	10,00,000	6,00,000
	Plant and machinery	4,00,000	5,00,000
		14,00,000	11,00,000

		Super Express Ltd. ₹	*Fast Express Ltd.₹*
5	**Intangible assets**		
	Goodwill	--	1,00,000
		--	1,00,000
6.	**Cash and Cash Equivalents**		
	Cash at Bank	2,20,000	10,000
	Cash in hand	1,00,000	10,000
		3,20,000	20,000

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of ₹ 100 each in lieu of purchase consideration amounting to 30,000 (20,000 for Super-Fast Express Ltd and 10,000 for Fast Express Ltd.).

Prepare opening balance sheet of Super Fast Express Ltd. considering pooling method.

(*Source: Question 11, Study Material*)

Answer

Balance Sheet of Super Fast Express Ltd

	Particulars	Notes	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
	(a) Share capital	1	30,00,000
	(b) Reserves and Surplus	2	3,60,000
2	**Non-current liabilities**		
	(a) Long-term provisions	3	1,00,000
3	**Current liabilities**		
	(a) Trade Payables		1,00,000
	Total		35,60,000
	Assets		
1	Non-current assets		
	(a) Property, Plant and Equipment	4	25,00,000
	(b) Intangible assets	5	1,00,000
2	**Current assets**		
	Inventories		3,40,000
	Trade receivables		2,80,000
	Cash and cash equivalents	6	3,40,000
	Total		35,60,000

Notes to Accounts

		₹
1	**Share Capital**	
	Equity share capital	
	Issued, subscribed and paid up	
	30,000 Equity shares of ₹ 100 each	30,00,000
	Total	30,00,000
2	**Reserves and Surplus**	
	Reserve account	1,00,000
	Surplus	1,00,000

		₹
	Insurance reserve	1,00,000
	Employees profit sharing account	60,000
	Total	3,60,000
3	**Long-term provisions**	
	Provident fund	1,00,000
	Total	1,00,000
4	**Property, Plant and Equipment**	
	Buildings	16,00,000
	Machinery	9,00,000
	Total	25,00,000
5	**Intangible assets**	
	Goodwill	1,00,000
	Total	1,00,000
6	**Cash and cash equivalents**	
	Balances with banks	2,30,000
	Cash on hand	1,10,000
	Total	3,40,000

Question 17

The following were the Balance Sheets of P Ltd. and V Ltd. as at 31st March, 20X1:

		Particulars	***Notes***	***₹ P Ltd (₹ in Lakhs)***	***₹ V Ltd (₹ in Lakhs)***
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	15,000	6,000
	B	Reserves and Surplus	2	15,370	4,335
2		**Non-current liabilities**			
		Long term borrowings	3	--	1,000
3		**Current liabilities**			
	A	Trade Payables		1,200	463
	B	Short term provisions		1,830	702
		Total		33,400	12,500
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	22,304	6,750
2		**Current assets**			
	A	Inventories		7,862	4,041
	B	Trade receivables		2,120	1,100
	C	Cash and Cash equivalents		1,114	609
		Total		33,400	12,500

Notes to accounts

			₹ P Ltd (₹ in Lakhs)	***₹ V Ltd (₹ in Lakhs)***
1	**Share Capital**		15,000	6,000
2	**Reserves and Surplus**			
	Securities premium		3,000	--
	Foreign project reserve		--	310
	General reserve		9,500	3,200
	Profit and loss account		2,870	825
			15,370	4,335
3	**Long term borrowings**			
	12% debentures		--	1,000
			--	1,000
4	**Property, Plant and Equipment**			
	Land and Building		6,000	--
	Plant and machinery		14,000	5,000
	Furniture and fixtures		2,304	1,750
			22,304	6,750

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.

On 1st April 20X1, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P Ltd. would allot three fully paid equity shares of ₹ 10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Details of trade receivables and trade payables as under:

	P Ltd. (₹ in lakhs)	**V Ltd. (₹ in lakhs)**
Trade payables		
Bills Payable	120	-
Trade Creditors	1,080	463
	1,200	463
Trade receivables		
Debtors	2,120	1,020
Bills Receivable	—	80
	2,120	1,100

Expenses of amalgamation amounting to ₹ 1 lakh were borne by P Ltd. You are required to :

(i) Pass journal entries in the books of P Ltd. and

(ii) Prepare P Ltd.'s Balance Sheet immediately after the merger.

(*Source: Question 12, Study Material*)

Answer

Books of P Ltd. Journal Entries

		Dr. (₹ in Lacs)	*Cr. (₹ in Lacs)*
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd.			9,000
(Being business of V Ltd. taken over for Consideration settled as per agreement)			

Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1750	
Inventory	Dr.	4,041	
Debtors	Dr.	1,020	
Cash at Bank	Dr.	609	
Bills Receivable	Dr.	80	
To Foreign Project Reserve			310
To General Reserve (3,200 - 3,000)			200
To Profit and Loss A/c (825)			825
To Liability for 12% Debentures			1,000
To Creditors			463
To Provisions			702
To Business Purchase			9,000
(Being assets & liabilities taken over from V Ltd.)			
Liquidator of V Ltd. A/c	Dr.	9,000	
To Equity Share Capital A/c			9,000
(Purchase consideration discharged in the form of equity shares)			
Goodwill A/c	Dr.	1	
To Bank A/c			1
(Liquidation expenses paid by P Ltd debited to Goodwill Ac)			
Profit and loss A/c Dr		1	
To Goodwill A/c			1
(being the Goodwill charged to Profit and loss account)			
Liability for 12% Debentures A/c	Dr.	1,000	
To 13% Debentures A/c			1,000
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	80	
To Bills Receivable A/c			80
(Cancellation of mutual owing on account of bills)			

Balance Sheet of P Ltd. as at 1st April, 20X1 (after merger)

		Particulars	Notes	₹ (in lakhs)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	24,000
	B	Reserves and Surplus	2	16,654
2		**Non-current liabilities**	3	1,000
	A	Long-term borrowings		
3		**Current liabilities**		
	A	Trade Payables (1,543 + 40)		1,583
	B	Short-term provisions		2,532
		Total		45,769
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	29,004
2		**Current assets**		
	A	Inventories		11,903
	B	Trade receivables		3,140
	C	Cash and cash equivalents		1,722
		Total		45,769

Notes to accounts

	₹
1. Share Capital	
Equity share capital	
Authorized, issued, subscribed and paid up	
24 crores equity shares of ₹ 10 each	24,000
(Of the above shares, 9 crores shares have been issued for consideration other than cash)	
Total	24,000
2. Reserves and Surplus	
General Reserve	9,700
Securities Premium	3,000
Foreign Project Reserve	310
Profit and Loss Account	3,644
Total	16,654
3. Long-term borrowings	
Secured	———
13% Debentures	1,000
4. Property, Plant and Equipment	
Land & Buildings	6,000
Plant & Machinery	19,000
Furniture & Fittings	4,004
Total	29,004

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration= $₹6,000\text{ lacs} \times \frac{3}{2} = ₹9,000\text{ lacs}$

Question 18

Sun and Neptune had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of ₹ 4,00,000 divided into 80,000 equity shares of ₹ 5 each. On 31st March, 20X3 the respective information of Sun and Neptune were as follows:

	Sun (₹)	Neptune (₹)
Share capital	3,65,000	3,52,500
Current liabilities	5,97,000	1,80,250
Property, Plant and Equipment	6,35,000	3,65,000
Current assets	3,27,000	1,67,750

Additional Information:

(a) Revalued figures of non-current and Current assets were as follows:

	Sun (₹)	Neptune (₹)
Property, Plant and Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

(b) The debtors and creditors include ₹ 43,350 owed by Sun to Neptune.

The purchase consideration is satisfied by issue of the following shares and debentures.

(i) 60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

	Sun (₹)	Neptune (₹)
20X1 Profit	4,49,576	2,73,900
20X2 (Loss)/Profit	(2,500)	3,42,100
20X3 Profit	3,77,924	3,59,000

(ii) 15% debenture in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31st March, 20X3 after revaluation of assets.

You are required to:

(1) Compute the amount of debentures and shares to be issued to Sun and Neptune.

(2) A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.

(*Source: Question 13, Study Material*)

Answer

(1) Computation of Amount of Debentures and Shares to be issued:

	Sun	*Neptune*
(i) *Average Net Profit*		
₹ (4,49,576-2,500+3,77,924)/3	= 2,75,000	
₹ (2,73,900+,3,42,100+3,59,000)/3		= 3,25,000

(ii) *Equity Shares Issued*

(a) Ratio of distribution

Sun: Neptune

275 325

(b) Number

Sun : 27,500

Neptune: 32,500

60,000

(c) Amount

27,500 shares of ₹ 5 each	=	1,37,500
32,500 shares of ₹ 5 each	=	1,62,500

(iii) *Capital Employed (after revaluation of assets)*	₹	₹
Property, plant and equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750
	10,09,500	5,47,750
Less: Current Liabilities	(5,97,000)	(1,80,250)
	4,12,500	3,67,500
(iv) *Debentures Issued*		
8% Return on capital employed	33,000	29,400

15% Debentures to be issued to provide equivalent income:

$$\text{Sun}: 33,000 \times \frac{100}{15}. = 2,20,000$$

$$\text{Neptune}: 29,400 \times \frac{100}{15}. = 1,96,000$$

(2) ***Balance Sheet of Jupiter Ltd.***

As at 31st March 20X3 (after amalgamation)

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
	3	4,16,000

Particulars	Note No	₹
(2) Non-Current Liabilities		
(a) Long-term borrowings		7,33,900
(3) Current Liabilities Total		15,13,900
(a) Other current liabilities		
II. Assets		
(1) Non-current assets		
(a) PPE		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		15,13,900

Notes to Accounts

		₹
1	Share Capital	
	Authorized	
	80,000 Equity Shares of ₹ 5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of ₹ 5 each	3,00,000
	(all the above shares are allotted as fully paid-up	
	pursuant to a contract without payment being received in cash)	
2	Reserve and Surplus	
	Capital Reserve	64,000
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	4,16,000

Working Notes:

	Sun ₹	***Neptune*** ₹	***Total*** ₹
(1) *Purchase Consideration*			
Equity Shares Issued	1,37,500	1,62,500	3,00,000
15% Debentures Issued	2,20,000	1,96,000	4,16,000
	3,57,500	3,58,500	7,16,000
(2) *Capital Reserve*			
(a) Net Assets taken over Property, plant & equipment	7,10,000	3,90,000	11,00,000
Current Assets	2,99,500	1,14,400*	4,13,900
	10,09,500	5,04,400	15,13,900
Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
	4,55,850	3,24,150	7,80,000
(b) Purchase Consideration	3,57,500	3,58,500	7,16,000
(c) Capital Reserve [(a) - (b)]	98,350		
(d) Goodwill [(b) - (a)]		34,350	
(e) Capital Reserve [Final Figure(c) -(d)]			64,000

* 1,57,750–43,350= 1,14,400

** 5,97,000–43,350= 5,53,650

Question 19

A Ltd. take over B Ltd. on April 01, 20X1 and discharges consideration for the business as follows:

(i) Issued 42,000 fully paid equity shares of ₹10 each at par to the equity shareholders of B Ltd.

(ii) Issued fully paid up 15% preference shares of ₹100 each to discharge the preference shareholders (₹1,70,000) of B Ltd. at a premium of 10%.

(iii) It is agreed that the debentures of B Ltd. (₹50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Determine the amount of purchase consideration as per AS 14.

(*Source: Illustration 1, Study Material*)

Answer

Particulars	₹
Equity Shares (42,000 x 10)	4,20,000
15% Preference Share Capital	1,70,000
Add: Premium on Redemption	17,000
Purchase Consideration	6,07,000

Note: As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Question 20

A Ltd. and B Ltd. were amalgamated on and from 1st April, 20X1. A new company C Ltd. was formed to take over the business of the existing companies. A Ltd. and B Ltd. have the following ledger balances as on 31st March, 20X1:

	***A Ltd.* (₹ *in lakhs*)**	***B Ltd.* (₹ *in lakhs*)**
Land and Building	*550*	*400*
Plant and Machinery	*350*	*250*
Investments (Non-current)	*150*	*50*
Inventory	*350*	*250*
Trade Receivables	*300*	*350*
Cash and Bank	*300*	*200*
Share Capital:		
Equity Shares of ₹100 each	*800*	*750*
12% Preference shares of ₹100 each	*300*	*200*
Reserves and Surplus:		
Revaluation Reserve	*150*	*100*
General Reserve	*170*	*150*
Investment Allowance Reserve	*50*	*50*
Profit and Loss Account	*50*	*30*
Secured Loans:		
10% Debentures (₹100 each)	*60*	*30*
Trade Payables	*420*	*190*

Additional Information:

(1) 10% Debenture holders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of ₹100 each so as to maintain the same amount of interest.

(2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of ₹150 per share (face value of ₹100).

(3) C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ ₹30 each, having a face value of ₹10 per share.

(4) Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd. as on 1st April, 20X1 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

(*Source: Illustration 2, Study Material*)

Answer

Balance Sheet of C Ltd. as at 1st April, 20X1

Particulars	Note No.	(₹ in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,200
(b) Reserves and Surplus	2	1,650
(2) Non-Current Liabilities Long-term borrowings	3	60
(3) Current Liabilities Trade payables	8	610
Total		3,520
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	1,550
(b) Intangible assets	5	20
(c) Non-current investments	6	200
(2) Current assets		600
(a) Inventory (350 + 250)	7	650
(b) Trade receivables		500
(c) Cash and bank balances (300 + 200)		3,520
Total		

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	Equity share capital (W.N.1)		
	70,00,000[1] Equity shares of ₹ 10 each	700	
	5,00,000[2] Preference shares of ₹ 100 each	500	
	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		1,200
2.	Reserves and surplus		
	Securities Premium Account (W.N.3) (950 + 700)	1,650	
	Investment Allowance Reserve (50 + 50)	100	
	Amalgamation Adjustment Reserve (50 + 50)	*(100)*	*1,650*
3.	Long-term borrowings		
	15% Debentures		60
4.	Property, Plant and Equipment		
	Land and Building (550 + 400)	950	
	Plant and Machinery (350 + 250)	600	1,550
5.	Intangible assets		
	Goodwill [W.N. 2] (110 – 90)		20
6.	Non-current Investments		
	Investments (150 + 50)		200
7.	Trade receivables (300 + 350)		650
8.	Trade payables (420 + 190)		610

[1] 40,00,000 + 30,00,000
[2] 3,00,000 + 2,00,000

Working Notes:

			(₹ in lakhs)	
	(a) Preference shareholders:		*A Ltd.*	*B Ltd.*
(1)	Computation of Purchase consideration			
	$\left(\frac{3,00,00,000}{100} \text{ i.e. } 3,00,000 \text{ shares}\right) \times \text{Rs.}150 \text{ each}$		450	
	$\left(\frac{2,00,00,000}{100} \text{ i.e. } 2,00,000 \text{ shares}\right) \times \text{Rs.}150 \text{ each}$			300
	(b) Equity shareholders:			
	$\left(\frac{8,00,00,000 \times 5}{100} \text{ i.e. } 40,00,000 \text{ shares}\right) \times \text{Rs.}30 \text{ each}$		1,200	
	$\left(\frac{7,50,00,000 \times 5}{100} \text{ i.e. } 30,00,000 \text{ shares}\right) \times \text{Rs.}30 \text{ each}$			900
	Amount of Purchase Consideration		1,650	1,200
(2)	Net Assets Taken Over			
	Assets taken over:			
	Land and Building		550	400
	Plant and Machinery		350	250
	Investments		150	50
	Inventory		350	250
	Trade receivables		300	350
	Cash and bank		300	200
			2,000	1,500
	Less: Liabilities taken over:			
	Debentures	40		20
	Trade payables	420		190
			460	210
	Net assets taken over		1,540	1,290
	Purchase consideration		1,650	1,200
	Goodwill		110	
	Capital reserve			90
(3)	Computation of securities premium			
	On preference share capital			
	A Ltd.- 3,00,000 x 50		150	
	B Ltd.- 2,00,000 x 50			100
	On equity share capital			
	A Ltd.- 40,00,000 x 20		800	
	B Ltd.- 30,00,000 x 20			600
	Total		950	700

Question 21

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14 (Revised).

(*Source: Theory Question 6, Study Material*)

Answer

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 (Revised) on Accounting for Amalgamation. Refer Para 2.5 for details.

Question 22

List the conditions to be fulfilled as per AS 14 (Revised) for an amalgamation to be in the nature of merger, in the case of companies.

(*Source: Theory Question 7, Study Material*)

Answer

According to AS 14 "Accounting for Amalgamations", Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Question 23

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

(*Source: Theory Question 8, Study Material*)

Answer

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

The Pooling of Interest Method

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Question 24

X Co. Ltd. having share capital of ₹ 50 lakhs divided into equity shares of ₹ 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of ₹ 10 each for every 10 shares of X Co. Ltd.

Explain how the difference will be adjusted in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interests method' of amalgamation as per AS 14.

(*Source: Practical Question 9, Study Material*)

Answer

Particulars	₹
Purchase consideration = 5,00,000 x 11/10 = 55,000	55,00,000
shares of ₹ 10 each	50,00,000
Less: Share capital of X Co. Ltd.	
Difference Adjusted through General Reserve	5,00,000

Question 25

On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(i) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.

(ii) Cash payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.

(iv) Debentures of Rina Ltd. 20,000) will he converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

(*Source: Practical Question 10, Study Material*)

Answer

A per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase Consideration

Particulars	₹
Equity Shares (50,000x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

Note: Payment to debenture holders are not covered by the term 'consideration'.

Journal entry

Particulars	₹	₹
Liquidation of Rina Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c To Securities		2,00,000
premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Being payment of cash and issue of shares for discharge of purchase consideration)		

QUESTION BANK

Question 26

The Balance Sheet of Mars Limited as on 31st March, 2011 was as follows:

Liabilities	₹	Assets		₹
Share Capital:		**Fixed Assets**		
1,00,000 Equity Shares of ₹ 10 each fully paid up	10,00,000	Land and building		7,64,000
Reserve and Surplus		**Current Assets**		
Capital Reserve	42,000	Stock		7,75,000
Contingency Reserve	2,70,000	Sundry Debtors	1,60,000	
Profit and Loss A/c	2,52,000	Less: Provision for Doubtful debts	8,000	1,52,000
Current Liabilities & Provisions		Bills receivable		30,000
Bills payable	40,000	Cash at Bank		3,29,000
Sundry Creditors	2,26,000			
Provision for Income-tax	2,20,000			
	20,50,000			20,50,000

On 1st April, 2011 Jupiter Limited agreed to absorb Mars Limited on the following terms and conditions:

(1) Jupiter Limited will takeover the assets at the following values:
Land and building ₹ 10,80,000
Stock ₹ 7,70,000
Bills receivable ₹ 30,000

(2) Purchase consideration will be settled by Jupiter Ltd. as under:
4,100 fully paid 10% preference share of ₹ 100 will be issued and the balance will be settled by issuing equity shares of ₹ 10 each at ₹ 8 paid up.

(3) Liquidation expenses are to be reimbursed by Jupiter Ltd. to the extent of ₹ 5,000

(4) Sundry debtors realised ₹ 1,50,000. Bills payable were settled for ₹ 38,000. Income-tax authorities fixed the taxation liability at ₹ 2,22,000 and the same was paid.

(5) Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹ 8,000.

You are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Jupiter Limited in discharge of purchase consideration.

(ii) Prepare the Realisation A/c, Bank Account, Equity Shareholders Account and Jupiter Limited's Account in the books of Mars Ltd.

(*Group I-May 2011, 16 Marks*)

Answer

(i) Calculation of number of shares to be allotted

Particulars	*Amount (₹)*
Land and building	10,80,000
Inventory	7,70,000
Bills receivable	30,000
Total	18,80,000
Amount discharged by issue of preference shares	4,10,000
Number of preference shares to be issued (4,10,000/100)	4,100 shares
Amount discharged by issue of equity shares (₹ 18,80,000 - ₹ 4,10,000)	14,70,000
Number of equity shares to be issued (₹ 14,70,000/8)	1,83,750 Shares

(ii) Ledger Accounts in the books of Mars Limited

Realization Account

Particulars	*₹*	*Particulars*	*₹*
To Land and building	7,64,000	By Provision for doubtful debts	8,000
To Inventory	7,75,000	By Bills payable	40,000
To debtors	1,60,000	By creditors	2,26,000
To Bills receivable	30,000	By Provision for taxation	2,20,000

Particulars	₹	*Particulars*	₹
To Bank A/c -liquidation expenses	3,000	By Jupiter Ltd. (purchase consideration)	18,80,000
To Bank A/c- bills payable	38,000	By Bank A/c- debtors	1,50,000
To Bank A/c -income tax	2,22,000		
To Bank A/c - creditors	2,16,000		
To Profit transferred to equity shareholders A/c	3,16,000		
	25,24,000		25,24,000

Bank Account

Particulars	₹	*Particulars*	₹
To Balance b/d	3,29,000	By Realisation A/c	3,000
To Realisation A/c (payment received		(liquidation expenses)	
from debtors)	1,50,000	By Jupiter Ltd.	5,000
To Jupiter Ltd. (liquidation expenses)	5,000	By Bills payable	38,000
		By Income tax	2,22,000
		By creditors	
		(Bal.fig.)	2,16,000
	4,84,000		4,84,000

Equity Shareholders Account

Particulars	₹	*Particulars*	₹
To 10% Preference shares in		By Equity share capital A/c	10,00,000
Jupiter Limited	4,10,000	By Capital reserve	42,000
To Equity shares in Jupiter		By Contingency reserve	2,70,000
Limited	14,70,000	By Profit and loss A/c	2,52,000
		By Realisation A/c (profit)	3,16,000
	18,80,000		18,80,000

Jupiter Limited Account

Particulars	₹	*Particulars*	₹
To Realisation A/c	18,80,000	By 10% Preference shares in	4,10,000
To Bank A/c (Reimbursement exp.)	5,000	Jupiter Limited	
		By Bank A/c (Liquidation exp.)	5,000
		By Equity shares in Jupiter Limited	14,70,000
	18,85,000		18,85,000

Question 27

The following was the Balance Sheet of V Ltd. as on 31st March, 2012:

Particulars	Note No.	Amount ₹ (in lakhs)
Equity and Liabilities		
(1) Shareholder's funds		
(a) Share Capital	1	1,150
(b) Reserves and Surplus	2	(87)
(2) Non-current Liabilities		
(a) Long-term Borrowings	3	630
(3) Current Liabilities		
Trade Payables		170
Total		1,863
Assets		
(1) Non-current Assets		
Tangible Assets	4	1,152
(2) Current Assets		
Inventories		380
Trade Receivables		256
Cash and Cash equivalents	5	75
Total		1,863

Notes:

(1)	Share Capital	
	Authorised:	?
	Issued, Subscribed and Paid up:	
	80 lakh, Equity Shares of ₹10 each, Fully paid up	800
	35 lakh 12% Cumulative Preference Shares Of ₹10 each, fully paid up	350
	Total	**1,150**
(2)	Reserves and Surplus	
	Debit Balance of Profit & Loss Account	(87)
	Total	**(87)**
(3)	Long-Term Borrowings	
	10% Secured Cumulative Debentures of ₹100 each, fully paid up	600
	Outstanding Debenture Interest	30
	Total	**630**
(4)	Tangible Assets	
	Land and Buildings	445
	Plant and Machinery	593
	Furniture, Fixtures and Fittings	114
	Total	**1,152**
(5)	Cash and Cash Equivalents	
	Balance at Bank	69
	Cash in hand	6
	Total	**75**

On 1st April, 2012 P Ltd. took over the entire business of V Ltd. on the following terms:

V Ltd.'s equity shareholders would receive 4 fully paid equity shares of P Ltd. of ₹10 each issued at a premium of ₹2.50 each for every five shares held by them in V Ltd.

Preference shareholders of V Ltd. would get 35 lakh 13% Cumulative Preference Shares of ₹10 each fully paid up in P Ltd., in lieu of their present holding.

All the debentures of V Ltd. would be converted into equal number of 10.5% Secured Cumulative Debentures of ₹100 each, fully paid up after the takeover by P Ltd., which would also pay outstanding debenture interest in cash.

Expenses of amalgamation would be borne by P Ltd. Expenses came to be ₹2 lakh P Ltd. discovered that its creditors included ₹7 lakh due to V Ltd. for goods purchased.

Also P Ltd.'s stock included goods of the invoice price of ₹5 lakh earlier purchased from V Ltd., which had charged profit @ 20% of the invoice price.

You are required to:

(i) Prepare Realisation A/c in the books of V Ltd.

(ii) Pass journal entries in the books of P Ltd. assuming it to be an amalgamation in the nature of merger.

(*Group I-November 2012, 16 Marks*)

Answer

(i) In the books of V Ltd.

Realisation Account

		₹ in lakhs			*₹ in lakhs*
To	Land and Buildings A/c	445	By	10% Secured Cumulative Debentures A/c	600
To	Plant and Machinery A/c	593	By	Outstanding Debenture interest A/c	30
To	Furniture, Fixtures & Fittings A/c	114	By	Trade payables A/c	170
To	Inventories A/c	380	By	P Ltd. A/c (purchase consideration - Refer working note)	1,150
To	Trade Receivables A/c	256			
To	Bank A/c	69			
To	Cash in Hand A/c	6			
To	Equity Shareholders' A/c (Profit on Realisation)	87			
		1,950			1,950

(ii) In the books of P Ltd.

Journal Entries

			Dr. ₹ *in lakhs*	*Cr* ₹ *in lakhs*
1.	Business Purchase A/c To Liquidator of V Ltd. A/c (Being purchase consideration due)	Dr.	1,150	1,150
2.	Land and Buildings A/c	Dr.	445	
	Plant and Machinery A/c	Dr.	593	
	Furniture, Fixtures & Fittings A/c	Dr.	114	
	Inventories A/c	Dr.	380	
	Trade Receivables A/c	Dr.	256	
	Bank A/c	Dr.	69	
	Cash in Hand A/c	Dr.	6	
	Profit and Loss A/c	Dr.	87	
	To 10% Debentures A/c			600
	To Outstanding Debenture interest A/c			30
	To Trade payables A/c			170
	To Business Purchase A/c			1,150
	(Being assets and liabilities taken over from V Ltd. under the scheme of amalgamation in the nature of merger)			
3.	Liquidators of V Ltd. A/c	Dr.	1,150	640 350
	To Equity Share Capital A/c			160
	To 13% Cumulative Preference Shares A/c			
	To Securities Premium A/c			
	(Being discharge of consideration, by allotment of 64 lakhs equity shares of ₹ 10 each at a premium of ₹ 2.50 per share and 35 lakhs 13% cumulative preference shares of ₹ 10 each at par)			
4.	10% Secured Cumulative Debentures A/c To 10.5% Secured Cumulative Debentures A/c (Being 10% Secured Cumulative Debentures of V Ltd. converted into 10.5% Secured Cumulative Debentures of P Ltd.)	Dr.	600	600
5.	Outstanding Debenture interest A/c To Bank A/c (Being outstanding debenture interest paid in cash by P Ltd.)	Dr.	30	30
6.	Profit and Loss A/c To Bank A/c (Being amalgamation expenses met by P Ltd.)	Dr.	2	2
7.	Trade Payables A/c To Trade Receivables A/c (Being settlement of mutual liability)	Dr.	7	7
8.	Profit and Loss A/c To Inventories A/c (5 x 20%) (Being unrealized profit on Inventory eliminated from the inventories of P Ltd.)	Dr.	1	1

Working Note:

Calculation of Purchase Consideration payable by P Ltd.

	₹ *in lakhs*	
Payment to preference shareholders:		
13% Cumulative Preference Shares of ₹ 10 each (35 lakhs shares ´ ₹ 10)	350	
Payment to equity shareholders:		
(80 lakhs shares x 4/5) = 64 lakhs equity shares @ ₹ 10		640
Securities Premium (64 lakhs equity shares @ ₹ 2.5)		160
Total purchase consideration		1,150

Question 28

Given below are the Balance Sheet of two companies as on 31st December, 2015.

A Limited

Liabilities	₹	Assets	₹
Share Capital:		Patent	1,00,000
Issued and fully paid up		Building	5,40,000
50,000 8% Cumulative	5,00,000	Plant and Machinery	15,10,000
Preference Shares of ₹ 10 each			
1,50,000 Equity shares of ₹ 10 each	15,00,000	Furniture	75,000
		Investment	1,55,000
General Reserve	7,65,000	Stock	3,58,000
Profit and Loss account	1,25,000	Sundry Debtors	72,000
Sundry Creditors	60,000	Cash and Bank	1,40,000
	29,50,000		**29,50,000**

B Limited

Liabilities	₹	Assets	₹
Share Capital:		Goodwill	62,000
Issued and fully paid		Motor Car	1,26,000
50,000 Shares of ₹ 10 each	5,00,000	Furniture	58,000
Profit and Loss Account	45,000	Stock	2,40,000
Sundry Creditors	31,000	Sundry Debtors	70,000
		Cash at Bank	20,000
	5,76,000		**5,76,000**

It has been agreed that both these companies should be wound up and a new company AB Ltd. should be formed to acquire the assets of both the companies on the following terms and conditions:

(i) AB Ltd. is to have an authorized capital of ₹ 36,00,000 divided into 60,000, 8% cumulative preference shares of ₹ 10 each and 3,00,000 equity shares of ₹ 10 each.

(ii) AB Ltd. is to purchase the whole of the assets of A Ltd. (except cash and Bank Balances) for ₹ 28,25,000 to be settled as to ₹ 5,75,000 in cash and as to the balance by issue of 1,80,000 equity shares, credited as fully paid, to be treated as valued at ₹ 12.50 each.

(iii) AB Ltd. is to purchase the whole of the assets of B Ltd. (except cash and Bank balances) for ₹ 4,91,000 to be settled as to ₹ 16,000 in cash and as to the balance by issue of 38,000 equity shares, credited as fully paid, to be treated as valued at ₹ 12.50 each.

(iv) A Ltd. and B Ltd. both are to be wound up, the two liquidators distributing the shares in AB Ltd. in kind among the equity shareholders of the respective companies.

(v) The liquidator of A Ltd. is to pay the preference shareholders ₹ 12 in cash for every share held in full satisfaction of their claims.

(vi) AB Ltd. is to make a public issue of 60,000, 5% cumulative preference shares at a premium of 10% and 30,000 equity shares at the issue price of ₹ 12.50 per share, all amount payable in full on application.

It is estimated that the cost of liquidation (including the liquidators' remuneration) will be ₹ 10,000 in case of A Ltd. and ₹ 5,000 in case of B Ltd. and that the preliminary expenses of AB Ltd. will amount to ₹ 24,000 exclusive of the underwriting commission of ₹ 38,900 payable on the public issue.

You are required to prepare the initial Balance Sheet of AB Ltd. on the basis that all assets other than goodwill are taken over at the book value. (*Group-I, May 2016, 16 Marks*)

Answer

Balance Sheet of AB Ltd.

Particulars	Notes	₹
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	30,80,000
(b) Reserves and Surplus	2	6,17,100
2 Current liabilities		
(a) Other liabilities		38,900
Total		37,36,000

Assets		
1 Non-current assets	3	23,09,000
(a) Fixed assets	4	1,12,000
Tangible assets		1,55,000
Intangible assets		
(b) Non-current investments		
2 Current assets		5,98,000
(a) Inventories (3,58,000 + 2,40,000)		1,42,000
(b) Trade receivables (72,000 +70,000)		4,20,000
(c) Cash and cash equivalents		
Total		37,36,000

Notes to accounts

		₹
1 Share Capital		
Authorized share capital		
3,00,000 equity shares of ₹ 10 each	30,00,000	
60,000, 8% cumulative Preference Shares of ₹10 each	6,00,000	36,00,000
Equity share capital		
2,48,000 equity shares of ₹ 10 each (Of the above shares, 2,18,000 shares have been issued for consideration other than cash)		24,80,000
Preference share capital		
60,000, 8% cumulative Preference Shares of ₹10 each		6,00,000
Total		30,80,000
2 Reserves and Surplus		
Debit balance of Profit and Loss Account		
Underwriting commission	38,900	
Preliminary expenses	24,000	(62,900)
Securities Premium A/c		
(2,48,000 equity shares x 2.50)	6,20,000	
(60,000 Preference shares x ₹ 1)	60,000	6,80,000
		6,17,100
3 Tangible assets		
Building	5,40,000	
Motor car	1,26,000	
Plant & machinery	15,10,000	
Furniture	1,33,000	23,09,000
4 Intangible assets		
Goodwill (W.N. 4) (15,000 +62,000-65,000)	12,000	
Patents	1,00,000	1,12,000

Working Notes:

1. Mode of discharge of Purchase Consideration of A Ltd.

	₹
Cash payment	5,75,000
Equity shares (1,80,000 Shares x ₹ 12.5)	22,50,000
Total Purchase consideration	28,25,000

2. Mode of discharge of Purchase Consideration of B Ltd.

	₹
Cash payment	16,000
Equity shares (38,000 shares x ₹ 12.5)	4,75,000
Total Purchase consideration	4,91,000

3. Cash at bank balance in the initial balance sheet of AB Ltd.

Cash and Bank Account

	₹		₹
To Issue of preference shares		By Payment to A ltd.	5,75,000
(60,000 x 11)	6,60,000	By Payment to B ltd.	16,000
To Equity shares		By Preliminary expenses	24,000
(30,000 x 12.50)	3,75,000	By Balance c/d	4,20,000
	10,35,000		10,35,000

4. Calculation of goodwill/ capital reserve of A Ltd. & B Ltd.

Particulars		A Ltd.		B Ltd.
Business Purchase A/c		28,25,000		4,91,000
Less: Goodwill			62,000	
Patent A/c	1,00,000		-	
Building A/c	5,40,000		-	
Plant & Mach. A/c	15,10,000		-	
Motor car A/c	-		1,26,000	
Furniture A/c	75,000		58,000	
Investment A/c	1,55,000		-	
Stocks A/c	3,58,000		2,40,000	
Debtors A/c	72,000	(28,10,000)	70,000	(5,56,000)
Goodwill / Capital reserve (Bal. fig.)		15,000		(65,000)
Net goodwill (15,000 +62,000 -65,000) = 12,000				

Note:

1. As per the information given in the question, only the assets of A Ltd. and B Ltd. are taken over by AB Ltd. Thus the creditors are considered to be paid by the liquidators of the respective companies and hence being not taken over by AB Ltd.
2. As per the information given in the second last para of the question, it is stated that the preliminary expenses of AB Ltd. will amount to ₹ 24,000 exclusive of the underwriting commission of ₹ 38,900 payable on the public issue. It has been assumed that ₹ 24,000 has been paid and underwriting commission is still payable in the balance sheet of the amalgamated company. Alternatively, any other reasonable assumption about this may be considered.
3. Preliminary expenses and underwriting commission have been written off as per the provisions of Accounting standards.

Question 29

Anjana Ltd. is absorbed by Sanjana Ltd., the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000) the payment of the 9% debentures of ₹ 50,000 at a premium of 20% in 8% debentures issued at a premium of 25% at face value and the payment of ₹ 15 per share in cash and allotment of three 11% preference share of ₹ 10 each at a discount of 10% and four equity share of ₹ 10 each at a premium of 20% fully paid for every five shares in Anjana Ltd.. The number of share of the vendor company are 1,50,000 of ₹ 10 each fully paid.

Calculate purchase consideration as per Accounting Standard-14.

(*Group-I, May 2016, 4 Marks*)

Answer

As per AS 14 on Accounting for Amalgamations, the term 'consideration' has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company

The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration

Computation of Purchase Consideration

	₹
Cash payment [₹15 x 1,50,000]	22,50,000
11% Preference Shares of ₹ 10 each @ 10% discount	8,10,000
[(1,50,000 x 3/5) x ₹ 9]	
Equity shares of ₹ 10 each @ 20% premium	
[(1,50,000 x 4/5) x ₹ 12]	14,40,000
Total Purchase consideration	45,00,000

For every 5 shares Anjana Ltd. will receive (i) 4 equity shares @ ₹ 12 per share and (ii) 3 11% Preference Shares shares @ ₹ 9 per share.

Question 30

Exe Limited was wound up on 31.3.2004 and its Balance Sheet as on that date was given below:

Equity and Liabilities		₹
Shareholders Funds		
Share Capital: 1,20,000 Equity		
Share of ₹10 each		12,00,000
Reserves and Surplus		
Profit prior to Incorporation		42,000
Contingency Reserve		2,70,000
Profit and Loss Accounts		2,52,000
Current Liabilities		
Bills payable		40,000
Sundry creditors		2,26,000
Provisions:		
Provision for Income tax		2,20,000
		22,50,000
Non Current Assets		₹
Fixed assets		9,64,000
Current Assets		
Stock	7,75,000	
Sundry Debtors	1,60,000	
Less: Provision for bad and doubtful debts	8,000	
Bills Receivable	30,000	
Cash at bank	3,29,000	12,86,000
		22,50,000

Wye Limited took over the following assets at values shown as under:
Fixed assets ₹12,80,000, Stock ₹7,70,000 and Bills Receivable ₹30,000.
Purchase consideration was settled by Wye Limited as under:
₹5,10,000 of the consideration was satisfied by the allotment of fully paid 10 % preference shares of ₹100 each. The balance was settled by issuing equity shares of ₹10 each at ₹8 per share paid up.
Sundry debtors realized ₹1,50,000. Bills payable was settled for ₹38000. Income tax authorities fixed the taxation liability at ₹2,22,000.
Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹8,000.
You are required to:

(1) Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.
(2) Prepare the Realizations account, Cash/bank account, Equity Shareholders account and Wye Limited account in the books of Exe Limited.
(3) Pass journal entries in the books of Wye Limited.

(*Group II-November 2004, 16 Marks*)

Answer

(i) Purchase consideration

	₹
Fixed assets	12,80,000
Stock	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares = ₹ 5,10,000
No. of preference shares to be allotted = 5,10,000 × 100 = 5,100 shares
Amount discharged by allotment of equity shares = ₹ 20,80,000 – ₹ 5,10,000
= ₹ 15,70,000
Paid up value of equity share = ₹ 8
Hence, number of equity shares to be issued = 15,70,000/8 = 1,96,250 shares

(ii) **Realisation Account**

In the books of Exe Ltd.

	₹		₹
To Fixed assets	9,64,000	By Provision for bad and doubtful debts	8,000
To Stock		By Bills payable	40,000
To Sundry debtors	7,75,000	By Sundry creditors	2,26,000
To Bills receivable	1,60,000	By Provision for taxation	2,20,000
To Bank account:	30,000	By Wye Ltd. account	
Liquidation expenses	8,000	(Purchase consideration)	20,80,000
Bills payable Tax liability	38,000	By Bank account: Sundry debtors	1,50,000
Sundry creditors	2,22,000		
To Equity shareholders	2,11,000		
(profit transferred)			
	3,16,000		
	27,24,000		27,24,000

Cash/Bank Account

	₹		₹
To Balance b/d	3,29,000	By Realisation account:	
To Realisation account:		Liquidation expenses	8,000
Sundry debtors	1,50,000	Bills payable	38,000
		Tax liability	2,22,000
		Sundry creditors (Bal.fig.)	2,11,000
			4,79,000
	4,79,000		

Equity Shareholders Account

		₹		₹
To	10% Preference shares in Wye Ltd.	5,10,000	By Equity share capital account	12,00,000
To	Equity shares in Wye Ltd.	15,70,000	By Profit prior to incorporation By Contingency reserve	42,000
			By Profit and loss account	2,70,000
			By Realisation account (Profit)	2,52,000
				3,16,000
		20,80,000		20,80,000

Wye Limited Account

	₹		₹
To Realisation account	20,80,000	By 10% Preference shares in Wye Ltd. By Equity shares in Wye Ltd.	5,10,000
			15,70,000
	20,80,000		20,80,000

(iii) **Journal Entries**

in the books of Wye Ltd.

Particulars		*Dr.* *Amount* ₹	*Cr.* *Amount* ₹
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			
Fixed assets account	Dr.	12,80,000	
Stock account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account		20,80,000	
To 10% Preference share capital account	Dr.		5,10,000
To Equity share capital account			15,70,000
(Being the allotment of 10% fully paid up preference shares and equity shares of ₹ 10 each, ₹ 8 each paid up as per agreement for discharge of purchase consideration)			

Question 31

Given below balance sheet of Vasudha Ltd and Vaishali Ltd as at 31st March, 2012.

Liabilities	Vasudha Ltd.	Vaishali Ltd.	Assets	Vasudha Ltd.	Vaishali Ltd.
Issued Share Capital:			Factory Building	2,10,000	1,60,000
Equity Shares of ₹10 each	5,40,000	4,03,300	Debtors Stock	2,86,900 91,500	1,72,900 82,500
General Reserves	1,01,000	65,000	Goodwill	50,000	35,000
Profit & Loss A/c	66,000	43,500	Cash at Bank	98,000	1,09,590
Sundry Creditors	44,400	58,200	Preliminary Expenses	15,000	10,010
Total	**7,51,400**	**5,70,000**	**Total**	**7,51,400**	**5,70,000**

Goodwill of the Companies Vasudha Ltd. and Vaishali Ltd. is to be valued at ₹75,000 and ₹50,000 respectively. Factory Building of Vasudha Ltd is worth ₹1,95,000 and of Vaishali Ltd. ₹1,75,000. Stock of Vaishali Ltd. has been shown at 10% above of its cost.

It is decided that Vasudha Ltd. will absorb Vaishali Ltd. by taking over its entire business by issue of shares at the Intrinsic Value.

You are required to draft the balance sheet of the new company after putting through the schemes.

(*Group II-May 2012, 16 Marks*)

Answer

Balance Sheet of Vasudha Ltd. as on 31st March, 2012 (After absorption)

		Particulars	*Note No*	*Amount*
				₹
		EQUITY AND LIABILITIES		
1		**Shareholders' funds**		
	(a)	Share capital	1	9,43,300
	(b)	Reserves and Surplus	2	2,72,990
2		**Current liabilities**		
	(a)	Trade payables (44,400+58,200)		1,02,600
		Total		13,18,890
		ASSETS		
1		**Non-current assets**		
	(a)	Fixed assets		
	(i)	Tangible assets	3	3,85,000
	(ii)	Intangible assets	4	1,00,000
2		**Current assets**		
	(a)	Inventories(91,500 + 75,000)		1,66,500
	(b)	Trade receivables(2,86,900 + 1,72,900)		4,59,800
	(c)	Cash and cash equivalents(98,000 + 1,09,590)		2,07,590
		Total		13,18,890

Notes to accounts

		₹	₹
1.	**Share Capital**		
	Equity share capital		
	(54,000 + 40,330) Equity shares of ₹10 each		9,43,300
2.	**Reserves and Surplus**		
	Profit and Loss A/c	66,000	
	General reserves	1,01,000	
	Less: Preliminary expenses*	(15,000)	
	Securities Premium A/c (Refer W.N.)	1,20,990	2,72,990
3	**Tangible assets**		
	Factory building (2,10,000 + 1,75,000)		3,85,000
4.	**Intangible assets**		
	Goodwill (50,000+50,000)		1,00,000

NOTE: As the assets of Vasudha Ltd are shown in the Books after absorption at carrying value only, no adjustment for revaluation of the same has been done in the Balance Sheet. However, assets of Vaishali Ltd have been taken at the fair value as indicated.

Working Note:

1. Computation of shares issued on the basis of intrinsic values

	Vasudha Ltd.	Vaishali Ltd.
	₹	₹
Goodwill	75,000	50,000
Factory building	1,95,000	1,75,000
Debtors	2,86,900	1,72,900
Stock	91,500	(82,500/110%)= 75,000
Cash at Bank	98,000	1,09,590
	7,46,400	5,82,490
Less: Sundry Creditors	(44,400)	(58,200)
Net assets	7,02,000	5,24,290
Number of shares	54,000	40,330
Intrinsic value	₹ 13	₹ 13

Hence, Vasudha Ltd. will give its 40,330 shares of ₹ 10 each @ ₹ 13 each to Vaishali Ltd.

Discharge of Purchase consideration by Vasudha Ltd to the Liquidators of Vaishali Ltd.

	Share Capital	Securities Premium
	₹	₹
40,330 Shares @ ₹ 10 each	4,03,300	
40,330 shares @ ₹ 3 each		1,20,990

Note: If Vaishali Ltd. Company is not liquidated then above question will be solved on the basis of business acquisition.

Question 32

P Ltd. and Q Ltd. were carrying on the business of manufacturing of auto components. Both the companies decided to amalgamate and a new company PQ Ltd. is to be formed with an Authorized Capital of ₹10,00,000 divided into ₹1,00,000 equity shares of ₹ 10.each. The Balance Sheet of the companies as on 31.03.2014 were as under:

P Limited

Balance Sheet as at 31.03.2014

Particulars	**Amount ₹**
I. Equity and Liabilities	
1. Shareholder's Fund	
(a) Share Capital	
(b) Reserve & Surplus	1,40,000
Profit & Loss A/c	30,000
2. Non Current Liabilities	
8% Secured Debentures	1,10,000
3. Current Liabilities	
Trade Payables	54,000
Total Liabilities	**3,34,000**
II. Assets	
1. Noncurrent assets	
(a) Fixed Assets	
Building at cost less Depreciation	1,00,000
Plant & Machinery at cost less Depreciation.	25,000
2. Current Assets	
(a) Inventories	1,35,000
(b) Trade Receivables	44,000
(c) Cash at Bank	30,000
Total Assets	3,34,000

Q Limited
Balance Sheet as at 31.03.2014

Particulars	Amount ₹
I. Equity and Liabilities	
1. Shareholder's Fund	
(a) Share Capital	2,50,000
(b) Reserve & Surplus	
General Reserve	1,20,000
Profit & Loss A/c	35,000
2. Current Liabilities	
Trade Payable	1,40,000
Total	**5,45,000**
II. Assets	
1. Noncurrent assets	
(a) Fixed Assets	
Building at cost less Depreciation	1,90,000
Plant & Machinery at cost less Depreciation.	80,000
Furniture & Fixture at cost less Depreciation	25,000
2. Current Assets	
(a) Inventories	50,000
(b) Trade Receivables	1,42,000
(c) Cash at Bank	58,000
Total	**5,45,000**

The assets and liabilities of the existing companies are to be transferred at book value with the exception of some items detailed below:

(i) Goodwill of P Ltd. was worth ₹ 50,000 and of Q Ltd. was worth ₹ 1,50,000.
(ii) Furniture & Fixture of Q Ltd. was valued at ₹ 35,000.
(iii) The debtors of P Ltd. are realized fully and bank balance of P Ltd. are to be retained by the liquidator and the sundry creditors are to be paid out of the proceeds thereof.
(iv) The debentures of P Ltd. are to be discharged by issue of 8% debentures of PQ Ltd. at a premium of 10%.

You are required to:

(i) Compute the basis on which shares in PQ Ltd. will be issued at par to the shareholders of the existing companies.
(ii) Draw up a Balance Sheet of PQ Ltd. as at 1st April, 2014, the date of completion of amalgamation,
(iii) Write up journal entries including bank entries for closing the books of P Ltd.

(G*roup II-May 2014, 16 Marks*)

Answer

Calculation of Purchase Consideration

	P Ltd. (₹)	*Q Ltd. (₹)*
Assets taken over:		
Goodwill	50,000	1,50,000
Building	1,00,000	1,90,000
Plant & Machinery	25,000	80,000
Furniture & Fixtures	-	35,000
Inventories	1,35,000	50,000
Trade Receivables	-	1,42,000
Cash at Bank	-	58,000
	3,10,000	7,05,000
Less :Liabilities taken over	(1,21,000)	-
8% Debentures	-	(1,40,000)
Trade Payables	1,89,000	5,65,000
Net Assets taken over	18,900	56,500
To be satisfied by issue of shares of PQ Ltd. of ₹ 10 each at par		

PQ Limited
Balance Sheet as at 1st April, 2014

Particulars	*Note No.*	*Amount (₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	7,54,000
(b) Reserve & Surplus	2	11,000
(2) Non-current Liabilities		
(a) Long term borrowings	3	1,10,000
(3) Current Liabilities		
(a) Trade Payables		1,40,000
Total		10,15,000
II. Assets		
(1) Non-current assets		
(a) Fixed Assets		
Tangible	4	4,30,000
Intangible	5	2,00,000
(2) Current Assets		
(a) Inventories		1,85,000
(b) Trade Receivables		1,42,000
(c) Cash at Bank		58,000
Total		10,15,000

Notes to Accounts:

			₹
1	**Share Capital**		
	Authorized		
	1,00,000 shares of ₹ 10 each		10,00,000
	Issued, Subscribed and Paid up		
	75,400 shares of ₹ 10 each		7,54,000
	(All the above shares are allotted as fully paid up pursuant to scheme of amalgamation without payments being received in cash)		
2	**Reserve & Surplus**		
	Securities Premium Account		11,000
3	**Long term borrowings -**		
	8 % Debentures		1,10,000
4	**Tangible Fixed Assets**		
	Building		
	P Ltd.	1,00,000	
	Q Ltd.	1,90,000	2,90,000
	Plant & Machinery		
	P Ltd.	25,000	
	Q Ltd.	80,000	1,05,000
	Furniture & Fixture		
	Q Ltd.		35,000
			4,30,000
5			
	Intangible Asset		
	Goodwill		
	P Ltd.	50,000	2,00,000
	Q. Ltd.	1,50,000	

Working Note:

Computation of Securities Premium

Debentures issued by PQ Ltd. to the existing debenture holders of P Ltd. at 10% premium. Securities Premium = ₹ 1,10,000 x 10% = ₹ 11,000.

In the books of P Ltd. (Journal Entries)

			₹	₹
1	Realization Account	Dr.	3,04,000	
	To Building			1,00,000
	To Plant & Machinery			25,000
	To Inventories			1,35,000
	To Trade Receivables			44,000
	(Being all assets except cash transferred to Realization Account)			
2	8% Debentures Account	Dr.	1,10,000	
	Trade Payables	Dr.	54,000	
	To Realization Account			1,64,000
	(Being all liabilities transferred to Realization Account)			
3	Equity Share Capital	Dr.	1,40,000	
	Profit & Loss Account	Dr.	30,000	
	To Equity Shareholder's Account			1,70,000
	(Being Equity transferred to Equity Shareholders' Account)			
4	PQ Ltd	Dr.	1,89,000	
	To Realization Account			1,89,000
	(Being Purchase consideration due)			
5	Bank Account	Dr.	44,000	
	To Realization Account			44,000
	(Being Cash received from trade receivables in full)			
6	Realization Account	Dr.	54,000	
	To Bank Account			54,000
	(Being payment made to Trade Payables)			
7	Shares in PQ Ltd.			
	To PQ Ltd.	Dr.	1,89,000	1,89,000
	(Being purchase consideration received in the form of Equity Shares of PQ Ltd.)			
8	Realization Account (balancing figure) To Equity Shareholders' Account	Dr.	39,000	39,000
	(Being profit on realization transferred to Equity Shareholders' Account)			
9	Equity Shareholders' Account			
	To Shares in PQ Ltd.	Dr.	2,09,000	1,89,000
	To Bank Account			20,000
	(Being final payment made to shareholders)			

Question 33

Distinguish between Amalgamation Absorption and External Reconstruction of Company.

(*May 2019*) (*5 Marks*)

Answer

Difference between Amalgamation, Absorption and External Reconstruction

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and a new company is formed to take over their business.	In this case, an existing company takes over the business of one or more existing companies.	In this case, a newly formed company takes over the business of an existing company.
Minimum number of Companies involved	At least three companies are involved.	At least two companies are involved.	Only two companies are involved.
Number of new resultant companies	Only one resultant company is formed. Two companies are wound up to form a single resultant company.	No new resultant company is formed.	Only one resultant company is formed. Under this case a newly formed company takes over the business of an existing company.
Objective	Amalgamation is done to cut competition and reap the economies in large scale.	Absorption is done to cut competition and reap the economies in large scale.	External reconstruction is done to reorganise the financial structure of the company.
Example	A Ltd. and B Ltd. amalgamate to form C Ltd.	A Ltd. takes over the business of another existing company B Ltd.	B Ltd. is formed to take over the business of an existing company A Ltd.

Question 34

The financial position of X Ltd. and Y Ltd. as on 31st March, 2018 was as under:

	X Ltd. (₹)	Y Ltd. (₹)
Equity and Liabilities		
Equity Shares of ₹10 each	30,00,000	9,00,000
9% Preference Shares of ₹100 each	3,00,000	-
10% Preference Shares of ₹100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	3,90,000	2,40,000
Total	40,50,000	17,10,000
Assets		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	1,50,000	60,000
Total	40,50,000	17,10,000

X Ltd. absorbs Y Ltd. on the following terms:

(i) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.

(ii) Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of preceding three financial years (2016-17: ₹90,000; 2015-16: ₹78,000 and 2014-15: ₹72,000). The profits of 2014 -15 included credit of an insurance claim of ₹25,000 (fire occurred in 2013-14 and loss by fire ₹30,000 was booked in Profit and Loss Account of that year). In the year 2015 -16, there was an embezzlement of cash by an employee amounting to ₹10,000.

(iii) Land & Buildings are valued at ₹5,00,000 and the Plant & Machinery at ₹4,00,000.

(iv) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.

(v) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to ₹15,000 and such asset was also taken over by X Ltd.

(vi) The trade payables of Y Ltd. included ₹20,000 payable to X Ltd.

(vii) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium.

You are required to

(i) Prepare Realisation A/c in the books of Y Ltd.

(ii) Show journal entries in the books of X Ltd.

(iii) Prepare the Balance Sheet of X Ltd. after absorption as at 31st March, 2018.

(RTP November 2020) (May 2018) (20 Marks)

Answer

In the Books of Y Ltd.
Realisation Account

	₹			₹
To Sundry Assets:			By Retirement Gratuity	60,000
Goodwill	75,000		Fund	
Land & Building	3,00,000		By Trade payables	2,40,000
Plant & Machinery	4,50,000		By X Ltd. (Purchase	15,90,000
Inventory	5,25,000		Consideration)	
Trade receivables	3,00,000			
Bank	60,000	17,10,000		
To Preference		30,000		
Shareholders				
(Premium on				
Redemption)				
To Equity Shareholders				
(Profit on Realisation)		1,50,000		
		18,90,000		18,90,000

In the Books of X Ltd.
Journal Entries

		Dr.	Cr.
		₹	₹
Business Purchase A/c	Dr.	15,90,000	
To Liquidators of Y Ltd. Account			15,90,000
(Being business of Y Ltd. taken over)			
Goodwill Account	Dr.	1,50,000	
Land & Building Account	Dr.	5,00,000	
Plant & Machinery Account	Dr.	4,00,000	
Inventory Account	Dr.	4,72,500	
Trade receivables Account	Dr.	3,00,000	
Bank Account	Dr.	60,000	
Unrecorded assets Account	Dr.	15,000	
To Retirement Gratuity Fund Account			60,000
To Trade payables Account			2,40,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			15,90,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Y Ltd. A/c	Dr.	15,90,000	
To 9% Preference Share Capital A/c			3,30,000
To Equity Share Capital A/c			12,00,000
To Securities Premium A/c			60,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of X Ltd. (after absorption)
as at 31st March, 2018

Particulars			Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	48,30,000
	B	Reserves and Surplus	2	2,70,000

Particulars			Notes	₹
2		**Non-current liabilities**		
	A	Long-term provisions	3	2,10,000
3		**Current liabilities**		
	A	Trade Payables	4	6,10,000
	B	Short term provision	5	7,500
		Total		59,27,500
		Assets		
1		**Non-current assets**		
	A	Fixed assets		
		Tangible assets	6	33,00,000
		Intangible assets	7	3,00,000
2		**Current assets**		
	A	Inventories	8	12,22,500
	B	Trade receivables	9	8,80,000
	C	Other current Assets	10	15,000
	D	Cash and cash equivalents	11	2,10,000
		Total		59,27,500

Notes to accounts

	₹
1 Share Capital	
Equity share capital	
4,20,000 Equity Shares of ₹10 each fully paid (Out of above 1,20,000 Equity Shares were issued in consideration other than for cash)	42,00,000
Preference share capital	
6,300 9% Preference Shares of ₹100 each (Out of above 3,300 Preference Shares were issued in consideration other than for cash)	6,30,000
Total	48,30,000
2. Reserves and Surplus	
Securities Premium	60,000
General Reserve	2,10,000
Total	2,70,000
3. Long-term provisions	
Retirement Gratuity fund	2,10,000
4. Trade payables	
(3,90,000 + 2,40,000-20,000*)	6,10,000
* Mutual Owings eliminated.	
5. Short term Provisions	
Provision for Doubtful Debts	7,500
6. Tangible assets	
Land & Buildings	14,00,000
Plant & Machinery	19,00,000
Total	33,00,000
7. Intangible assets	
Goodwill (1,50,000 + 1,50,000)	3,00,000
8. Inventories (7,50,000 + 4,72,500)	12,22,500
9. Trade receivables (6,00,000 + 3,00,000 - 20,000)	8,80,000
10. Other current Assets	15,000
11. Cash and cash equivalents (1,50,000 + 60,000)	2,10,000

Working Notes:

1. Computation of goodwill

	₹
Profit of 2016-17	90,000
Profit of 2015-16 adjusted ₹78,000 + 10,000)	88,000
Profit of 2014-15 adjusted (₹72,000 - 25,000)	47,000
	2,25,000
Average profit	75,000

Goodwill to be valued at 2 times of average profits = ₹75,000 x 2 = ₹1,50,000

2.

Purchase Consideration:		₹
Goodwill		1,50,000
Land & Building		5,00,000
Plant & Machinery		4,00,000
Inventory		4,72,500
Trade receivables		3,00,000
Unrecorded assets		15,000
Cash at Bank		60,000
		18,97,500
Less: Liabilities:		
Retirement Gratuity	60,000	
Trade payables	2,40,000	
Provision for doubtful debts	7,500	(3,07,500)
Net Assets/Purchase Consideration		15,90,000
To be satisfied as under:		
10% Preference Shareholders of Y Ltd.		3,00,000
Add: 10% Premium		30,000
9% Preference Shares of X Ltd.		3,30,000
Equity Shareholders of Y Ltd. to be satisfied by issue of 1,20,000		
equity Shares of X Ltd. at 5% Premium		12,60,000
Total		15,90,000

Question 35

P Ltd. and Q Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of P Ltd. and Q Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in PQ Ltd.

The Summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March, 2017 (the date of amalgamation) are given below:

Summarized balance sheets as at 31-03-2017

Liabilities	P Ltd. ₹	Q Ltd. ₹	Assets	P Ltd. ₹	Q Ltd. ₹
Equity & liabilities:			*Assets:*		
Shareholders Fund			*Non-current Assets:*		
(a) Share Capital	6,00,000	8,40,000	Fixed Assets (excluding Goodwill)	7,20,000	10,80,000
(b) Reserves	10,20,000	6,00,000	*Current Assets*		
Current Liabilities			(a) Inventories	3,60,000	6,60,000
Bank Overdraft	—	5,40,000	(b) Trade receivables	4,80,000	7,80,000
Trade payables	2,40,000	5,40,000	(c) Cash at Bank	3,00,000	—
	18,60,000	25,20,000		18,60,000	25,20,000

The consideration was to be based on the net assets of the companies as shown in the above Balance Sheets, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March, 2017. The weights for this purpose for the years 2014-15, 2015-16 and 2016-17 were agreed as 1, 2 and 3 respectively.

The profit had been:

2014-15 ₹3,00,000; 2015-16 ₹5,25,000 and 2016-17 ₹6,30,000.

The shares of PQ Ltd. were to be issued to P Ltd. and Q Ltd. at a premium and in proportion to the agreed net assets value of these companies.

In order to raise working capital, PQ Ltd proceeded to issue 72,000 shares of ₹10 each at the same rate of premium as issued for discharging purchase consideration to P Ltd. and Q Ltd.

You are required to:

(i) Calculate the number of shares issued to P Ltd. and Q Ltd; and

(ii) Prepare required journal entries in the books of PQ Ltd.; and

(iii) Prepare the Balance Sheet of PQ Ltd. as per Schedule III after recording the necessary journal entries.

(*RTP May 2018*)

Answer:

(i) Calculation of number of shares issued to P Ltd. and Q Ltd.:

Amount of Share Capital as per balance sheet		₹
P Ltd.		6,00,000
Q Ltd.		8,40,000
		14,40,000
Share of P Ltd.	= ₹14,40,000 x [21,60,000/(21,60,000 + 14,40,000)]	
	= ₹8,64,000 or 86,400 shares	
Securities premium	= ₹21,60,000 - ₹8,64,000 = ₹12,96,000	
Premium per share	= ₹12,96,000/₹86,400 = ₹15	
Issued 86,400 shares	@ ₹10 each at a premium of ₹15 per share	
Share of Q Ltd.	= ₹14,40,000 x [14,40,000/(21,60,000 + 14,40,000)]	
	= ₹5,76,000 or 57,600 shares	
Securities premium	= ₹14,40,000 - ₹5,76,000 = ₹8,64,000	
Premium per share	= ₹8,64,000/₹57,600 = ₹15	
Issued 57,600 shares	@ ₹10 each at a premium of ₹15 per share	

(ii) Journal Entries in the books of PQ Ltd.

		Dr.	Cr.
Particulars		**Amount (₹)**	**Amount (₹)**
Business purchase account	Dr.	36,00,000	
To Liquidator of P Ltd. account			21,60,000
To Liquidator of Q Ltd. account			14,40,000
(Being the amount of purchase consideration payable to liquidator of P Ltd. and Q Ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	
Fixed assets account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	
Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of P Ltd. taken over)			
Fixed assets account	Dr.	10,80,000	
Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Q Ltd. taken over)			
Liquidator of P Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 x ₹10)			8,64,000
To Securities premium (86,400 x ₹15)			12,96,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Liquidator of Q Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 x ₹10)			5,76,000
To Securities premium (57,600 x ₹15)			8,64,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			

		Dr.	Cr.
Particulars		**Amount (₹)**	**Amount (₹)**
Bank A/c	Dr.	18,00,000	
To Equity share capital account			7,20,000
To Securities premium			10,80,000
(Equity share capital issued to raise working capital)			

(iii) Balance Sheet of PQ Ltd. on 31st March, 2017 after amalgamation

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	(a)	Share capital	1	21,60,000
	(b)	Reserves and Surplus	2	32,40,000
2		Current liabilities		
	(a)	Trade payables (2,40,000 + 5,40,000)		7,80,000
		Total		61,80,000
		Assets		
1	(a)	Non-current assets Fixed assets		
		Tangible assets (7,20,000 + 10,80,000)		18,00,000
		Intangible assets (goodwill)	4	5,40,000
2		Current assets		
	(a)	Inventories (3,60,000 + 6,60,000)		10,20,000
	(b)	Trade receivables (4,80,000 +7,80,000)		12,60,000
	c	Cash and cash equivalents	3	15,60,000
		Total		61,80,000

Notes to accounts

		₹
1	**Share Capital**	
	Issued, subscribed and paid up share capital	
	2,16,000 Equity shares of ₹10 each	21,60,000
	(Out of the above 1,44,000 shares issued for non-cash consideration under scheme of amalgamation)	
2	**Reserves and Surplus**	
	Securities premium (@ ₹15 for 2,16,000 shares)	32,40,000
3	**Cash and cash equivalents**	
	Cash at Bank	15,60,000
4	**Intangible Assets**	
	Goodwill	5,40,000

Working Notes:

1. Calculation of goodwill of P Ltd.

Particulars	Amount ₹	Weight	Weighted amount ₹
2014-15	3,00,000	1	3,00,000
2015-16	5,25,000	2	10,50,000
2016-17	6,30,000	3	18,90,000
Total (a + b + c)	14,55,000	6	32,40,000
weighted Average = [Total weighted amount/Total of weight]			
[₹32,40,000/6]			
Goodwill			5,40,000

2. Calculation of Net assets

	P Ltd. ₹	Q Ltd. ₹
Assets		
Goodwill	5,40,000	
Fixed assets	7,20,000	10,80,000
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft		5,40,000
Trade payables	2,40,000	5,40,000
Net assets or Purchase consideration	21,60,000	14,40,000

3. New authorized capital

= ₹14,40,000 + ₹12,00 000 = ₹26,40,000

4. Cash and Cash equivalents

P Ltd. Balance	3,00,000
Cash received from Fresh issue (72,000 X ₹25)	18,00,000
Less: Bank Overdraft	21,00,000
	5,40,000
	15,60,000*

* The balance of cash and cash equivalents has been shown after setting off overdraft amount.

Question 36

The following is the summarized Balance Sheet of 'A' Ltd. as on 31.3.2017:

Liabilities	₹	Assets	₹
14,000 Equity shares of ₹100 each, fully paid up	14,00,000	Sundry assets	18,00,000
General reserve	10,000		
10% Debentures	2,00,000		
Trade payables	1,40,000		
Bank overdraft	50,000		
	18,00,000		18,00,000

B Ltd. agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis: Market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value. The liabilities are taken over at book values. There is an unrecorded liability of ₹25,000.

(*MTP October 2019*) (*MTP April 2018*) (*4 Marks*)

Answer:

Calculation of Purchase Consideration under Net Assets Method

	₹	₹
Sundry assets		
$18,00,000 \times \frac{75}{100} \times \frac{112}{100}] =$	15,12,000	
$18,00,000 \times \frac{25}{100} \times \frac{92}{100} =$	4,14,000	19,26,000
Less: Liabilities:		
10% Debentures	2,00,000	
Trade payables	1,40,000	
Bank overdraft	50,000	
Unrecorded liability	25,000	(4,15,000)
Purchase consideration		15,11,000

Question 37

On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(i) Issued 50,000 fully paid Equity shares of ₹10 each at a premium of ₹5 per share to the equity shareholders of Rina Ltd.

(ii) Cash payment of ₹50,000 was made to equity shareholders of Rina Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹100 each at par to discharge the preference shareholders of Rina Ltd.

(iv) Debentures of Rina Ltd. 20,000) will he converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

(November 2018) (5 marks)

Answer

Particulars	**₹**
Equity Shares (50,000x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Journal entry relating to discharge of consideration in the books of Tina Ltd.

	₹	₹
Liquidation of Rina Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Discharge of purchase consideration)		

Question 38

The financial position of two companies Alex Ltd. and Beta Ltd. as on 31st March, 2017 was as under:

Assets	**A/ex Ltd. (₹)**	**Beta Ltd. (₹)**
Goodwill	1,40,000	70,000
Building	8,40,000	2,80,000
Machinery	14,00,000	4,20,000
Inventory	7,00,000	4,90,000
Trade receivables	5,60,000	2,80,000
Cash at Bank	1,40.000	56,000
	37,80,000	15,96,000
Liabilities	**Alex Ltd.(₹)**	**Beta Ltd.(₹)**
Share Capital:		
Equity Shares of ₹10 each	28,00,000	8,40,000
8% Preference Shares of ₹100 each	2,80,000	-
10% Preference Shares of ₹100 each	-	2,80,000
General Reserve	1,96,000	1,96,000
Retirement Gratuity fund	1,40,000	56,000
Trade payables	3,64,000	2,24,000
	37,80,000	15,96,000

Beta Ltd. is absorbed by Alex Ltd. on the following terms:

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 8% Preference Shares of Alex Ltd.

(b) Goodwill of Beta Ltd. is valued at ₹1,40,000, Buildings are valued at ₹4,20,000 and the Machinery at ₹4,48,000.

(c) Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.

(d) Equity Shareholders of Beta Ltd. will be issued Equity Shares of Alex Ltd. @ 5% premium.

You are required to:

(a) Prepare necessary Ledger Accounts to close the books of Beta Ltd.

(b) Prepare the acquisition entries in the books of Alex Ltd.

(c) Also prepare the Balance Sheet after absorption as at 31st March, 2017.

(*MTP October 2020*) (*RTP November 2018*)

Answer

(a) In the Books of Beta Ltd.

Realisation Account

	₹		₹
To Sundry Assets	15,96,000	By Retirement Gratuity Fund	56,000
To Preference Shareholders (Premium on Redemption)	28,000	By Trade payables (Purchase Consideration)	2,24,000
To Equity Shareholders (Profit on Realisation)	1,40,000	By Alex Ltd.	14,84,000
	17,64,000		17,64.000

Equity Shareholders Account

	₹		₹
To Equity Shares of Alex Ltd.	11,76,000	By Share Capital	8,40,000
		By General Reserve	1,96,000
		By Realisation Account (Profit on Realisation)	1,40,000
	11,76,000		11,76,000

Preference Share Account

	₹		₹
To 8% Preference Shares of Alex Ltd.	3,08,000	By Preference Share Capital	2,80,000
		By Realisation Account (Premium on Redemption of Preference Shares)	28,000
	3,08,000		3,08,000

Alex Ltd. Account

	₹		₹
To Realisation Account	14,84,000	By 8% Preference Shares	3,08,000
		By Equity Shares	11,76,000
	14,84,000		14,84,000

(b) In the Books of Alex Ltd.

Journal Entries

		Dr.	Cr.
		₹	₹
Business Purchase A/c	Dr.	14,84,000	
To Liquidators of Beta Ltd. Account			14,84,000
(Being business of Beta Ltd. taken over)			
Goodwill Account	Dr.	1,40,000	
Building Account	Dr.	4,20,000	
Machinery Account	Dr.	4,48,000	
Inventory Account	Dr.	4,41,000	
Trade receivables Account	Dr.	2,80,000	
Bank Account	Dr.	56,000	
To Retirement Gratuity Fund Account			56,000
To Trade payables Account			2,24,000
To Provision for Doubtful Debts Account			21,000
To Business Purchase A/c			14,84,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Beta Ltd. A/c	Dr.	14,84,000	
To 8% Preference Share Capital A/c			3,08,000
To Equity Share Capital A/c			11,20,000
To Securities Premium A/c			56,000
(Being Purchase Consideration satisfied as above).			

(c) Balance Sheet of Alex Ltd. (after absorption) as at 31st March, 2017

Particulars			Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	45,08,000
	B	Reserves and Surplus	2	2,52,000
2		**Non-current liabilities**		
	A	Long-term provisions		1,96,000
3		**Current liabilities**		
	A	Trade Payables		5,88,000
	B	Short term provision		21,000
		Total		55,65,000
		Assets		
1		**Non-current assets**		
	A	Fixed assets		
		Tangible assets	3	31,08,000
		Intangible assets		2,80,000
2		**Current assets**		
	A	Inventories		11,41,000
	B	Trade receivables		8,40,000
	C	Cash and cash equivalents		1,96,000
		Total		55,65,000

Notes to accounts:

	₹
1 Share Capital	
Equity share capital	
3,92,000 Equity Shares of ₹10 each fully paid (Out of above 1,12,000 Equity Shares were issued in consideration other than for cash)	39,20,000
Preference share capital	5,88,000
5,880 8% Preference Shares of ₹100 each (Out of above 3,080 Preference Shares were issued in consideration other than for cash)	
Total	45,08,000
2 Reserves and Surplus	
Securities Premium	56,000
General Reserve	1,96,000
Total	2,52,000
3 Tangible assets	
Buildings	12,60,000
Machinery	18,48,000
Total	31,08,000

Working Notes:

Purchase Consideration:	₹
Goodwill	1,40,000
Building	4,20,000
Machinery	4,48,000
Inventory	4,41,000
Trade receivables	2,59,000
Cash at Bank	56,000
Less: Liabilities:	
Retirement Gratuity	(56,000)
Trade payables	(2,24,000)
Net Assets/Purchase Consideration	14,84,000
To be satisfied as under:	
Preference Shareholders of Beta Ltd.	2,80,000

Purchase Consideration:	₹
Add: 10% Premium	28,000
Satisfied by issue of 3,080 no. of 8% Preference Shares of Alex Ltd.	3,08,000
Equity Shareholders of Beta Ltd. to be satisfied by issue of 1,12,000 Equity Shares of Alex Ltd. at 5% Premium	11,76,000
Total	14,84,000

Question 39

The following were the summarized Balance Sheets of P Ltd. and V Ltd. as at 31 -3-20X1:

Liabilities	**P Ltd. (₹ in lakhs)**	**V Ltd. (₹ in lakhs)**
Equity Share Capital (Fully paid shares of ₹10 each)	15,000	6,000
Securities Premium	3,000	–
Foreign Project Reserve	–	310
General Reserve	9,500	3,200
Profit and Loss Account	2,870	825
12% Debentures	–	1,000
Trade payables	1,200	463
Provisions	1,830	702
	33,400	12,500
Land and Buildings	6,000	–
Plant and Machinery	14,000	5,000
Furniture, Fixtures and Fittings	2,304	1,700
Inventory	7,862	4,041
Trade receivables	2,120	1,100
Cash at Bank	1,114	609
Cost of Issue of Debentures	—	50
	33,400	12,500

All the bills receivable held by V Ltd. were P Ltd.'s acceptances.

On 1st April 20X1, P Ltd. took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P Ltd. would allot three fully paid equity shares of ₹10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Details of trade receivables and trade payables as under:

Assets	**P Ltd. (₹ in lakhs)**	**V Ltd. (₹ in lakhs)**
Trade payables		
Bills Payable	120	-
Creditors	1,080	463
	1,200	463
Trade receivables		
Debtors	2,120	1,020
Bills Receivable	—	80
	2,120	1,100

Expenses of amalgamation amounting to ₹1 lakh were borne by P Ltd.

You are required to:

(i) Prepare journal entries in the books of P Ltd. and

(ii) Prepare P Ltd.'s Balance Sheet immediately after the merger considering that the cost of issue of debentures shown in the balance sheet of the V Ltd. company is not transferred to the P Ltd. company.

(*MTP April 2019*) (*MTP August 2018*) (*15 Marks*)

Answer: Books of P Ltd.

Journal Entries

		Dr. (₹ in Lacs)	*Cr. (₹ in Lacs)*
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd.			9,000
(Being business of V Ltd. taken over for consideration settled as per agreement)			

Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1,700	
Inventory	Dr.	4,041	
Debtors	Dr.	,020	
Cash at Bank	Dr.	609	
Bills Receivable	Dr.	80	
To Foreign Project Reserve			310
To General Reserve (3,200 - 3,000)			200
To Profit and Loss A/c (825 – 50*)			775
To Liability for 12% Debentures			1,000
To Creditors			463
To Provisions			702
To Business Purchase			9,000
(Being assets & liabilities taken over from V Ltd.)			
Liquidator of V Ltd. A/c	Dr.	9,000	
To Equity Share Capital A/c			9,000
(Purchase consideration discharged in the form of equity shares)			
Profit & loss A/c	Dr.	1	
To Bank A/c			1
(Liquidation expenses paid by P Ltd.)			
Liability for 12% Debentures A/c	Dr.	1,000	
To 13% Debentures A/c			1,000
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	80	
To Bills Receivable A/c			80
(Cancellation of mutual owing on account of bills)			

Balance Sheet of P Ltd. as at 1st April, 20X1 (after merger)

		Particulars	Notes	₹(in lakhs)
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	24,000
	B	Reserves and Surplus	2	16,654
2		**Non-current liabilities**		
	A	Long-term borrowings	3	1,000
3		**Current liabilities**		
	A	Trade Payables (1,543 + 40)		1,583
	B	Short-term provisions		2,532
		Total		**45,769**
		Assets		
1		**Non-current assets**		
	A	Fixed assets		
		Tangible assets	4	29,004
2		**Current assets**		
	A	Inventories		11,903
	B	Trade receivables		3,140
	C	Cash and cash equivalents		1,722
		Total		**45,769**

Notes to accounts

		₹
1.	**Share Capital**	
	Equity share capital	
	Authorised, issued, subscribed and paid up	
	24 crores equity shares of ₹10 each (Of the above shares, 9 crores shares have been issued for consideration other than cash)	24,000
	Total	**24,000**

		₹
2.	**Reserves and Surplus**	
	General Reserve	9,700
	Securities Premium	3,000
	Foreign Project Reserve	310
	Profit and Loss Account	3,644
	Total	**16,654**
3.	**Long-term borrowings**	
	Secured	
	13% Debentures	1,000
4.	**Tangible assets**	
	Land & Buildings	6,000
	Plant & Machinery	19,000
	Furniture & Fittings	4,004
	Total	**29,004**

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = ₹6,000 lacs × $\frac{3}{2}$ = ₹9,000 lacs.

* Cost of issue of debenture adjusted against P & L Account of V Ltd.

Question 40

P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2016. Their summarized Balance Sheets as on 31.03.2016 were as follows:

(₹ in '000)

Particulars	P Ltd.	Q Ltd.
Source of Funds:		
Equity share capital (₹10 each)	300	280
9% preference share Capital (₹100 each)	60	40
Investment allowance Reserve	70	60
Profit and Loss Account	8	12
10% Debentures	100	60
Trade Payables	50	30
Tax provision	14	8
Total	602	490
Application of Funds:		
Building	120	100
Plant and Machinery	160	140
Investments	80	50
Trade receivables	90	70
Inventories	72	80
Cash and Bank	80	50
Total	602	490

From the following information, you are required to prepare the Balance Sheet as on 01.04.2016 of a new company, R Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

(i) 50% Debenture are to be converted into Equity Shares of the New Company.
(ii) Investments are non- current in nature.
(iii) Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.
(iv) 10% of trade receivables were doubtful for both the companies. Inventories to be carried at cost.
(v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.
(vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of ₹10 each of the new company at a premium of ₹5 per share.

Give your answer on the basis that amalgamation is in the nature of purchase.

(*MTP October 2018*) (*15 Marks*)

Answer

M/s R Ltd.
Balance Sheet as at 1.4.2016

		Particulars	Notes	₹ in'000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	6,55,980
	b	Reserves and Surplus	2	2,77,990
2		**Non-current liabilities**		
	a	Long-term borrowings	3	80,000
3		**Current liabilities**		
	a	Trade Payables	4	80,000
	b	Short term provision	5	22,000
		Total		11,15,970
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	6	5,60,000
	b	Non-current investments	7	1,30,000
2		**Current assets**		
	a	Inventory	8	1,52,000
	b	Trade receivables	9	1,44,000
	c	Cash and cash equivalents	10	1,29,970
		Total		11,15,970

Notes to accounts

		₹ in'000
1.	**Share Capital**	
	Equity share capital	
	55,598 Equity shares of ₹10 each, fully paid up (W.N.2)	5,55,980
	Preference share capital	
	9% Preference share capital (Share of ₹100 each) (W.N.2)	1,00,000
		6,55,980
2.	**Reserves and Surplus**	
	Securities premium (W.N.2)	2,77,990
	Investment allowance reserve	
	(₹70,000+ ₹60,000)	1,30,000
	Amalgamation adjustment reserve	(1,30,000)
		2,77,990
3.	**Long-term borrowings**	
	Secured	
	10% Debentures (50% of ₹1,60,000)	80,000
4.	**Trade Payables** (₹50,000+ ₹30,000)	80,000
5.	**Short term provisions**	
	Provision for tax (₹14,000+ ₹8,000)	22,000
6.	**Tangible assets**	
	Building (₹1,32,000+₹1,05,000)	2,37,000
	Plant and machinery (₹1,76,000+₹1,47,000)	3,23,000
		5,60,000
7.	Non-current Investments (₹80,000+ ₹50,000)	1,30,000
8.	**Inventory**	
	Stock (₹72,000+ ₹80,000)	1,52,000
9.	**Trade receivables**	
	Trade receivables (90% of (₹90,000+ ₹70,000)	1,44,000
10.	**Cash and cash equivalents**	
	Cash and Bank (₹80,000+ ₹50,000 – ₹30)	1,29,970

Working Notes:

1. Calculation of value of equity shares issued to transferor companies

		P Ltd.		*Q Ltd.*
		(₹)		*(₹)*
Assets taken over:				
Building		1,32,000		1,05,000
Plant and machinery		1,76,000		1,47,000
Investments		80,000		50,000
Inventories		72,000		80,000
Trade receivables		81,000		63,000
Cash & Bank		80,000		50,000
		6,21,000		4,95,000
Less: Liabilities:				
10% Debentures	1,00,000		60,000	
Trade payables	50,000		30,000	
Tax Provision	14,000	1,64,000	8,000	98,000
		4,57,000		3,97,000
Less: Preference Share Capital		60,000		40,000
		3,97,000		3,57,000

2. Number of shares issued to equity shareholders, debenture holders and preference shareholders

	P Ltd.	*Q Ltd.*	*Total*
Equity shares issued @ ₹15 per share (including ₹5 premium)			
₹3,97,000/15	26,466 shares1		
₹3,57,000/15		23,800shares	50,266 shares
Equity share capital @ ₹10	₹2,64,660	₹2,38,000	₹5,02,660
Securities premium @ ₹5	₹1,32,330	₹1,19,000	₹2,51,330
	₹3,96,990	₹3,57,000	₹7,53,990
50% of Debentures are converted into equity shares @ ₹15 per share			
1,00,000/2 = 50,000/15	3,332 shares2		
60,000/2 = 30,000/15		2,000 shares	5,332 shares
Equity share capital @ ₹10	₹33,320	₹20,000	₹53,320
Security premium@ ₹5	₹16,660	₹10,000	₹26,660
	₹49,980	₹30,000	₹79,980
9% Preference share capital issued	₹60,000	₹40,000	₹1,00,000

Question 41

The following are the summarized Balance Sheet of VT Ltd. and MG Ltd. as on 31st March, 2018:

Particulars	VT Ltd. (₹)	MG Ltd. (₹)
Equity and Liabilities		
Equity Shares of ₹10 each	12,00,000	6,00,000
10% pref. Shares of ₹100 each	4,00,000	2,00,000
Reserve and Surplus	6,00,000	4,00,000
12% Debentures	4,00,000	3,00,000
Trade Payables	5,00,000	3,00,000
Total	**31,00,000**	**18,00,000**
Assets		
Fixed Assets	14,00,000	5,00,000
Investment	1,60,000	1,60,000
Inventory	4,80,000	6,40,000
Trade Receivables	8,40,000	4,,20,000
Cash at Bank	2,20,000	80,000
Total	**31,00,000**	**18,00,000**

1 Cash paid for fraction of shares = ₹3,97,000 less ₹3,96,990 = ₹10

2 Cash paid for fraction of shares = ₹50,000 less ₹49,980 = ₹20

Details of Trade receivables and trade payables are as under:

	VT Ltd. (₹)	MG Ltd. (₹)
Trade Receivable		
Debtors	7,20,000	3,80,000
Bills Receivable	1,20,000	40,000
	8,40,000	**4,20,000**
Trade Payables		
Sundry Creditors	4,40,000	2,50,000
Bill Payable	60,000	50,000
	5,00,000	**3,00,000**

- Fixed Assets of both the companies are to be revalued at 15% above book value.
- Inventory in Trade and Debtors are taken over 5% lesser than their book value.
- Both the companies are to pay 10% equity dividend, Preference divided having been already paid.

After the above transactions are given effect to, VT Ltd. will absorb MG Ltd. on the following terms:

(i) VT Ltd. will issue 16 Equity Shares of ₹10 each at par against 12 Shares of MG Ltd.

(ii) 10% Preference Shareholders of MG Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹100 each at par in VT Ltd.

(iii) 12% Debenture holders of MG Ltd. are to be paid at 8% premium by 12% Debentures in VT Ltd. issued at a discount of 10%.

(iv) ₹60,000 is to be paid by VT Ltd. to MG Ltd. for Liquidation expenses.

(v) Sundry Debtors of MG Ltd. includes ₹20,000 due from VT Ltd.

You are required to prepare:

(1) Journal entries in the books of VT Ltd.

(2) Statement of consideration payable by VT Ltd.

(*May 2019*) (*10 Marks*)

Answer:

(i) Journal Entries in the Books of VT Ltd.

		Dr. ₹	*Cr.* ₹
Fixed Assets	Dr.	2,10,000	
To Revaluation Reserve			2,10,000
(Revaluation of fixed assets at 15% above book value)			
Reserve and Surplus	Dr.	1,20,000	
To Equity Dividend			1,20,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	1,20,000	
To Bank Account			1,20,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	9,80,000	
To Liquidator of MG Ltd.			9,80,000
(Consideration payable for the business taken over from MG Ltd.)			
Fixed Assets (115% of ₹5,00,000)	Dr.	5,75,000	
Inventory (95% of ₹6,40,000)	Dr.	6,08,000	
Debtors	Dr.	3,80,000	
Bills Receivable	Dr.	40,000	
Investment	Dr.	1,60,000	
Cash at Bank	Dr.	20,000	
(₹80,000 –₹60,000 dividend paid)			
To Provision for Bad Debts (5% of ₹3,60,000)			18,000
To Sundry Creditors			2,50,000
To 12% Debentures in MG Ltd.			3,24,000
To Bills Payable			50,000
To Business Purchase Account			9,80,000

		Dr. ₹	Cr. ₹
To Capital Reserve (Balancing figure)			1,61,000
(Incorporation of various assets and liabilities taken over from MG Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of MG Ltd.	Dr.	9,80,000	
To Equity Share Capital			8,00,000
To 10% Preference Share Capital			1,80,000
(Discharge of consideration for MG Ltd.'s business)			
12% Debentures in MG Ltd. (₹3,00,000 × 108%)	Dr.	3,24,000	
Discount on Issue of Debentures	Dr.	36,000	
To 12% Debentures			3,60,000
(Allotment of 12% Debentures to debenture holders of MG Ltd. at a discount of 10%)			
Sundry Creditors	Dr.	20,000	
To Sundry Debtors			20,000
(Cancellation of mutual owing)			
Goodwill	Dr.	60,000	
To Bank			60,000
(Being liquidation expenses reimbursed to MG Ltd.)			
Capital Reserve/P&L A/c	Dr.	60,000	
To Goodwill			60,000
(Being goodwill set off)			

(ii) Statement of Consideration payable by VT Ltd. for 60,000 shares (payment method)

Shares to be allotted 60,000/12 × 16 = 80,000 shares of VT Ltd.

Issued 80,000 shares of ₹10 each i.e. ₹8,00,000 (i)

For 10% preference shares, to be paid at 10% discount

₹2,00,000x 90/100 ₹1,80,000(ii)

Consideration amount [(i) + (ii)] ₹9,80,000

Question 42

The following is the summarized Balance Sheet of A Ltd. as at 31st March, 2019:

Liabilities	₹	Assets	₹
8,000 Equity shares of ₹100 each	8,00,000	Building	3,40,000
10% Debentures	4,00,000	Machinery	6,40,000
Loans	1,60,000	Inventory	2,20,000
Trade payables	3,20,000	Trade receivables	2,60,000
General Reserve	80,000	Bank	1,36,000
		Patent	1,30,000
		Share issue Expenses	34,000
	17,60,000		17,60,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹6,00,000 and the balance in fully paid equity shares of ₹100 each at ₹125 per share.

The average profit is ₹1,24,400. The liquidation expenses amounted to ₹16,000. B Ltd. sold prior to 31st March, 2018 goods costing ₹1,20,000 to A Ltd. for ₹1,60,000.

₹1,00,000 worth of goods are still in Inventory of A Ltd. on 31st March, 2019. Trade payables of A Ltd. include ₹40,000 still due to B Ltd.

Show the necessary Ledger Accounts to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2019 after the takeover.

(*RTP November 2019*)

Answer

Books of A Limited Realization Account

		₹			₹
To	Building	3,40,000	By	Trade payables	3,20,000
To	Machinery	6,40,000	By	B Ltd.	12,10,000
To	Inventory	2,20,000	By	Equity Shareholders (Loss)	76,000
To	Trade receivables	2,60,000			
To	Patent	1,30,000			
To	Bank (Exp.)	16,000			
		16,06,000			16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realization (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% Debentures	4,00,000
			By	Loan	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

10% Debentures Account

To	Bank	4,00,000	By	Balance b/d	4,00,000
		4,00,000			4,00,000

Loan Account

To	Bank	1,60,000	By	Balance b/d	1,60,000
		1,60,000			1,60,000

Share Issue Expenses Account

To	Balance b/d	34,000	By	Equity shareholders	34,000
		34,000			34,000

General Reserve Account

To	Equity shareholders	80,000	By	Balance b/d	80,000
		80,000			80,000

B Ltd. Account

To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd. (4,880 shares at ₹125 each)	6,10,000
		12,10,000			12,10,000

Equity Shares in B Ltd. Account

To	B Ltd.	6,10,000	By	Equity shareholders	6,10,000
		6,10,000			6,10,000

Equity Share Holders Account

To	Realization Account	76,000	By	Equity share capital	8,00,000
To	Share issue Expenses	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd

Balance Sheet as on 1st April, 2019 (An extract)*

	Particulars	*Notes*	*₹*
	Equity and Liabilities		
1	**Shareholders' funds**		
(a)	Share capital	1	4,88,000
(b)	Reserves and Surplus	2	1,07,000
2	**Current liabilities**		

* *In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the complete Balance Sheet of B Ltd. after takeover cannot be prepared.*

	Particulars	***Notes***	₹
(a)	Trade Payables	3	2,80,000
(b)	Bank overdraft		6,00,000
	Total		14,75,000
	Assets		
1	**Non-current assets**		
(a)	Property, Plant and Equipment		
	Tangible assets	4	8,82,000
	Intangible assets	5	2,16,000
2	**Current assets**		
(a)	Inventories	6	1,83,000
(b)	Trade receivables	7	1,94,000
			14,75,000

Notes to Accounts

			₹
1	**Share Capital**		
	Equity share capital		
	4,880 Equity shares of ₹100 each (Shares have been issued for consideration other than cash)		4,88,000
	Total		4,88,000
2	**Reserves and Surplus (an extract)**		
	Securities Premium		1,22,000
	Profit and loss account	…..	
	Less: Unrealized profit	(15,000)	(15,000)
	Total		1,07,000
3	**Trade payables**		
	Opening balance	3,20,000	
	Less: Inter-company transaction cancelled upon amalgamation	(40,000)	2,80,000
4	**Tangible assets**		
	Buildings		3,06,000
	Machinery		5,76,000
	Total		8,82,000
5	**Intangible assets**		
	Goodwill		2,16,000
6	**Inventories**		
	Opening balance	1,98,000	
	Less: Cancellation of profit upon amalgamation	(15,000)	1,83,000
7	**Trade receivables**		
	Opening balance	2,34,000	
	Less: Intercompany transaction cancelled upon amalgamation	(40,000)	1,94,000

Working Notes:

1. Valuation of Goodwill	₹
Average profit	1,24,400
Less: 8% of ₹8,80,000	(70,400)
Super profit	54,000
Value of Goodwill = 54,000 x 4	2,16,000
2. Net Assets for purchase consideration	
Goodwill as valued in W.N.1	2,16,000
Building	3,06,000
Machinery	5,76,000
Inventory	1,98,000
Trade receivables (2,60,000-26,000)	2,34,000
Total Assets	15,30,000
Less: Trade payables	(3,20,000)
Net Assets	12,10,000

Out of this ₹6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) ₹6,10,000 in shares of ₹125. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. Unrealized Profit on Inventory	₹
The Inventory of A Ltd. includes goods worth ₹1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this Inventory will be	25,000
$\frac{40,000}{1,60,000} \times 1,00,000$	
As B Ltd purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹1,00,000.	(10,000)
Amount of unrealized profit	15,000

Question 43

P Ltd. and Q Ltd. agreed to amalgamate and form a new company called PQ Ltd. The summarized balance sheets of both the companies on the date of amalgamation stood as below:

Liabilities	P Ltd. ₹	Q Ltd. ₹	Assets	P Ltd. ₹	Q Ltd. ₹
Equity Shares (₹ 100 each)	8,20,000	3,20,000	Land & Building	4,50,000	3,40,000
9% Pref. Shares (₹ 100 each)	3,80,000	2,80,000	Furniture & Fittings	1,00,000	50,000
8% Debentures	2,00,000	1,00,000	Plant & Machinery	6,20,000	4,50,000
General Reserve	1,50,000	50,000	Trade receivables	3,25,000	1,50,000
Profit & Loss A/c	3,52,000	2,05,000	Inventory	2,33,000	1,05,000
Unsecured Loan	-	1,75,000	Cash at bank	2,08,000	1,75,000
Trade payables	88,000	1,60,000	Cash in hand	54,000	20,000
	19,90,000	12,90,000		19,90,000	12,90,000

PQ Ltd. took over the assets and liabilities of both the companies at book value after creating provision @ 5% on inventory and trade receivables respectively and depreciating Furniture & Fittings by @ 10%, Plant and Machinery by @ 10%. The trade receivables of P Ltd. include ₹ 25,000 due from Q Ltd.

PQ Ltd. will issue:

(i) 5 Preference shares of ₹ 20 each @ ₹ 18 paid up at a premium of ₹ 4 per share for each pref. share held in both the companies.

(ii) 6 Equity shares of ₹ 20 each @ ₹ 18 paid up a premium of ₹ 4 per share for each equity share held in both the companies.

(iii) 6% Debentures to discharge the 8% debentures of both the companies.

(iv) 20,000 new equity shares of ₹ 20 each for cash @ ₹ 18 paid up at a premium of ₹ 4 per share.

PQ Ltd. will pay cash to equity shareholders of both the companies in order to adjust their rights as per the intrinsic value of the shares of both the companies.

You are required to prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books.

(*May 2020*)

Answer

In the Books of P Ltd.
Realization Account

		₹			₹
To	Land & Building	4,50,000	By	8% Debentures	2,00,000
To	Plant & Machinery	6,20,000	By	Trade Payables	88,000
To	Furniture & Fitting	1,00,000	By	PQ Ltd.	16,02,100
To	Trade receivables	3,25,000		(Purchase consideration)	
To	Inventory/Stock	2,33,000	By	Equity Shareholders A/c	1,37,900
To	Cash at Bank	2,08,000		(loss)	
To	Cash in Hand	54,000			
To	Preference shareholders (excess payment)	38,000			
		20,28,000			20,28,000

Equity Shareholders Account

		₹			₹
To	Realization A/c (loss)	1,37,900	By	Share capital	8,20,000
To	Equity Shares in PQ Ltd.	10,82,400	By	Profit & Loss A/c	3,52,000
To	Cash	1,01,700	By	General Reserve	1,50,000
		13,22,000			13,22,000

9% Preference Shareholders Account

To	Preference Shares in PQ Ltd.	4,18,000	By	Pref. Share capital	3,80,000
			By	Realization A/c	38,000
		4,18,000			4,18,000

PQ Ltd. Account

To	Realization A/c	16,02,100	By Shares in PQ Ltd.		
			For Equity	10,82,400	15,00,400
			For Pref.	4,18,000	
			By Cash		1,01,700
		16,02,100			16,02,100

8% Debentures holders Account

	₹		₹
To 6% Debentures	2,00,000	By 8% Debentures	2,00,000

Books of Q Ltd.

Realization Account

		₹			₹
To	Land & Building	3,40,000	By	8% Debentures	1,00,000
To	Plant & Machinery	4,50,000	By	Trade payables	1,60,000
To	Furniture & Fittings	50,000	By	Unsecured loan	1,75,000
To	Trade receivables	1,50,000	By	PQ Ltd. (Purchase	
To	Inventory	1,05,000		consideration)	7,92,250
To	Cash at bank	1,75,000	By	Equity Shareholders A/c	90,750
To	Cash in hand	20,000		Loss	
To	Pref. shareholders	28,000			
		13,18,000			13,18,000

Equity Shareholders Account

		₹		₹
To	Equity shares in PQ Ltd.	4,22,400	By Share Capital	3,20,000
To	Realization	90,750	By Profit & Loss A/c	2,05,000
To	Cash	61,850	By General Reserve	50,000
		5,75,000		5,75,000

9% Preference Shareholders Account

	₹		₹
To Preference Shares in PQ Ltd.	3,08,000	By Share capital	2,80,000
	———	By Realization A/c	28,000
	3,08,000		3,08,000

PQ Ltd. Account

	₹			₹
To Realization A/c	7,92,250	By Equity shares in PQ Ltd.		
		For Equity	4,22,400	
		Preference	3,08,000	7,30,400
	———	By Cash		61,850
	7,92,250			7,92,250

8% Debentures holders Account

	₹		₹
To 6% Debentures	1,00,000	By 8% Debentures	1,00,000

Working Notes:

(i) Purchase consideration

	P Ltd. ₹	*P Ltd.* ₹
Payable to preference shareholders:		
Preference shares at ₹ 22 per share	4,18,000	3,08,000
Equity Shares at ₹ 22 per share	10,82,400	4,22,400
Cash [See W.N. (ii)]	1,01,700	61,850
	16,02,100	7,92,250

(ii) Value of Net Assets

		P Ltd. ₹		*P Ltd.* ₹
Land & Building		4,50,000		3,40,000
Plant & Machinery less 10% Depreciation		5,58,000		4,05,000
Furniture & Fittings less 10% Depreciation		90,000		45,000
Trade receivables less 5%		3,08,750		1,42,500
Inventory less 5%		2,21,350		99,750
Cash at Bank		2,08,000		1,75,000
Cash in hand		54,000		20,000
		18,90,100		12,27,250
Less: Debentures	2,00,000		1,00,000	
Trade payables	88,000		1,60,000	
Secured Loans	———	(2,88,000)	1,75,000	(4,35,000)
		16,02,100		7,92,250
Payable in shares		15,00,400		7,30,400
Payable in cash*		1,01,700		(61,850)

(iii)

	P	**Q**
Plant &Machinery	6,20,000	4,50,000
Less: Depreciation 10%	62,000	45,000
	5,58,000	4,05,000
Furniture & Fixtures	1,00,000	50,000
Less: Depreciation 10%	10,000	5,000
	90,000	45,000

**This cash is paid to equity shareholders of both the companies for adjustment of their rights as per intrinsic value of both companies*

Question 44

The following were summarized Balance sheets of Robert Ltd. and Diamond Ltd. as at 31.03.2020

	Robert Ltd. (₹ in lakhs)	**Diamond Ltd. (₹ in lakhs)**
Liabilities		
Equity Share Capital (Fully paid shares of ₹ 10 each)	22,500	9,000
Securities Premium	4,500	-
Foreign Project Reserve	-	465
General Reserve	14,250	4,800
Profit and Loss Account	4,305	1,237.5
12% Debentures	-	1,500
Trade payables	1,800	694.5
Provisions	2,745	1,053
	50,100	18,750
Assets		
Land and Buildings	9,000	-
Plant and Machinery	21,000	7,500
Furniture, Fixtures and Fittings	3,456	2,550
Inventory	11,793	6,061.5

	Robert Ltd. (₹ in lakhs)	Diamond Ltd. (₹ in lakhs)
Trade receivables	3,180	1,650
Cash at Bank	1,671	913.5
Cost of Issue of Debentures	-	75
.	50,100	18,750

All the bills receivable held by Diamond Ltd. were Robert Ltd.'s acceptances.

On 1st April 2020, Robert Ltd. took over Diamond Ltd. in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business, Robert Ltd. would allot three fully paid equity shares of ₹ 10 each at par for every two shares held in Diamond Ltd. It was also agreed that 12% debentures in Diamond Ltd. would be converted into 13% debentures in Robert Ltd. of the same amount and denomination.

Details of trade receivables and trade payables are as under:

Particulars	Robert Ltd.	Diamond Ltd.
	(₹ in lakhs)	
Trade Payables		
Creditors	1,620	694.5
Bills Payable	180	-
	1,800	694.5
Trade receivables		
Debtors	3,180	1,530
Bills Receivables	-	120
	3,180	1,650

Expenses of amalgamation amounting to ₹ 1.5 lakhs were borne by Robert Ltd. You are required to:

(i) Pass journal entries in the books of Robert Ltd. and

(ii) Prepare Robert Ltd.'s Balance Sheet immediately after the merger considering that the cost of issue of debentures shown in the balance sheet of Diamond Ltd. is not transferred to Robert Ltd

(*MTP March 2021*) (*MTP, May, 2020*) (*20 marks*)

Answer

Books of Robert Ltd.
Journal Entries

		(₹ *in Lacs*)	(₹ *in Lacs*)
Business Purchase A/c	Dr.	13,500	
To Liquidator of Diamond Ltd.			13,500
(Being business of Diamond Ltd. Taken over for consideration settled as per agreement)			
Plant and Machinery	Dr.	7,500	
Furniture & Fittings	Dr.	2,550	
Inventory	Dr.	6,061.5	
Debtors	Dr.	1,530	
Cash at Bank	Dr.	913.5	
Bills Receivable	Dr.	120	
To Foreign Project Reserve			465
To General Reserve ₹ (4,800 - 4,500)			300
To Profit and Loss A/c ₹ (1,237.5 – 75*)			1,162.5
To Liability for 12% Debentures			1,500
To Creditors			694.5
To Provisions			1,053
To Business Purchase A/c			13,500
(Being assets & liabilities taken over from Diamond Ltd.)			
Liquidator of Diamond Ltd. A/c	Dr.	13,500	
To Equity Share Capital A/c			13,500
(Purchase consideration discharged in the form of equity shares)			

* Cost of issue of debentures adjusted against P & L A/c of Diamond Ltd.

		(₹ *in Lacs*)	(₹ *in Lacs*)
Profit & Loss A/c	Dr.	1.5	
To Bank A/c			1.5
(Liquidation expenses paid and charged to P& L A/c)			
Liability for 12% Debentures A/c	Dr.	1,500	
To 13% Debentures A/c			1500
(12% debentures discharged by issue of 13% debentures)			
Bills Payable A/c	Dr.	120	
To Bills Receivable A/c			120
(Cancellation of mutual owing on account of bills)			

Balance Sheet of Robert Ltd. as at 1st April, 2020 (after merger)

		Particulars	Notes	₹ (in lakhs)
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	36,000
	B	Reserves and Surplus	2	24,981
2		Non-current liabilities		
	A	Long-term borrowings	3	1,500
3		Current liabilities		
	A	Trade Payables (1,800+694.5-120)		2,374.5
	B	Short-term provisions (2,745+1,053)		3,798
		Total		68,653.5
		Assets		
1		Non-current assets		
	A	Property, Plant & Equipment	4	43,506
2		Current assets		
	A	Inventories (11,793+6,061.5)		17,854.5
	B	Trade receivables (3,180+1,650-120)		4,710
	C	Cash and cash equivalents (1,671+913.5-1.5)		2,583
		Total		68,653.5

Notes to Accounts

		₹
1.	Share Capital	
	Equity share capital	
	Authorized, issued, subscribed and paid-up: 36 crores equity shares of ₹ 10 each (out of these shares, 13.5 crores shares have been issued for consideration other than cash)	36,000
2.	Reserves and Surplus	
	General Reserve	14,550
	Securities Premium	4,500
	Foreign Project Reserve	465
	Profit and Loss Account ₹ (4,305 +1,162.5-1.5)	5,466
	Total	24,981
3.	Long-term borrowings	
	Secured	
	13% Debentures	1,500
4.	PPE	
	Land & Buildings	9,000
	Plant & Machinery	28,500
	Furniture & Fittings	6,006
	Total	43,506

Working Note:

Computation of purchase consideration

Purchase consideration was discharged in the form of three equity shares of *Robert* Ltd. for every two equity shares held in *Diamond* Ltd.

Purchase consideration = ₹ 9,000 lacs $\times \frac{3}{2}$ = Rs. 13,500 lacs

Question 45

The Paid-up capital of S Limited amounted to ₹ 5,00,000 Equity Shares of ₹ 10 each. Due to continuous loss incurred by the company, the following scheme of Reconstruction has been approved for S Limited on 1st April, 2020.

(i) In lieu of present holding the Equity Shareholders are to receive:
  (a) Fully Paid Equity Shares equal to 3/5th of their holding.
  (b) 8% Preference Shares fully paid to the extent of 20% of the above new Equity Shares.
  (c) 10% Second Debentures of ₹ 40,000.

(ii) An issue of 8% Debentures First Debentures of ₹ 1,00,000 was made and fully subscribed for cash,

(iii) The Assets were reduced as follows:-
  (a) Building from ₹ 2,00,000 to ₹ 1,50,000
  (b) Plant & Machinery from ₹ 1,50,000 to ₹ 1,30,000
  (c) Goodwill from ₹ 30,000 to Nil.

Show the Journal Entries in the books of S Limited to give effect of the scheme of Reconstruction.

(*MTP, May, 2020*) (*5 marks*)

Answer

Journal Entries in the books of S Ltd.

2020			Dr. ₹	Cr. ₹
April 1	Equity Share Capital A/c (₹ 10)	Dr.	5,00,000	
	To Equity Share Capital A/c			3,00,000
	To 8% Preference Equity Share Capital A/c			60,000
	To 10% Second Debentures A/c			40,000
	To Capital Reduction /Reconstruction A/c			1,00,000
	(Being reduction of equity shares to 3/5 shares, issue of preference shares and debentures as per Reconstruction Scheme dated...)			
	Capital Reduction/Reconstruction A/c	Dr.	1,00,000	
	To Building A/c			50,000
	To Plant and Machinery A/c			20,000
	To Goodwill A/c			30,000
	(Being value of building and plant and machinery reduced and goodwill written off completely.)			
	Bank A/c	Dr.	1,00,000	
	To 8% First Debentures A/c			1,00,000
	(Being ₹ 1,00,000 debentures issued)			

Question 46

On 1st April, 2021, Bimal Ltd. take over the business of Vimal Ltd. and discharged purchase consideration as follows:

(i) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Vimal Ltd.

(ii) Cash payment of ₹ 50,000 was made to equity shareholders of Vimal Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Vimal Ltd.

(iv) Debentures of Vimal Ltd. (₹1,20,000) will be converted into equal number and amount of 10% debentures of Bimal Ltd.

Calculate the amount of Purchase consideration as per AS 14 and pass Journal Entry relating to discharge of purchase consideration in the books of Bimal Ltd.

(*MTP, April, 2021*) (*5 marks*)

Answer

Particulars	***₹***
Equity Shares (50,000 x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Journal entry relating to discharge of consideration in the books of Bimal Ltd.

Liquidation of Vimal Ltd.A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Discharge of purchase consideration)		

Question 47

Mohan Ltd. gives you the following information as on 31st March, 2020:

	₹
Share capital:	
Equity shares of ₹ 10 each	3,00,000
6,000, 9% cumulative preference shares of ₹ 10 each	60,000
Profit and Loss Account (Dr. balance)	1,70,000
10% Debentures of ₹ 100 each	2,00,000
Interest payable on Debentures	20,000
Trade Payables	1,50,000
Property, Plant and Equipment	3,40,000
Goodwill	10,000
Inventory	80,000
Trade Receivables	1,10,000
Bank Balance	20,000

A new company Ravi Ltd. is formed with authorised share capital of ₹ 4,00,000 divided into 40,000 Equity Shares of ₹ 10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following terms:

(i) (a) Mohan Ltd.'s debentures are paid by similar debentures in new company and for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.

(b) The trade payables are paid by issue of 12,000 equity shares at par in full and final settlement of their claims.

(c) Preference shareholders are to get equal number of equity shares issued at par. Dividend on preference shares is in arrears for three years. Preference shareholders to forgo dividend for two years. For balance dividend, equity shares of equal amount are issued at par.

(d) Equity shareholders are issued one share at par for every three shares held in Mohan Ltd.

(ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%). Goodwill is to be eliminated. The Property, plant and equipment is taken over at ₹ 3,08,400.

(iii) Remaining equity shares of the new company are issued to public at par fully paid up.

(iv) Expenses of ₹ 5,000 to be met from bank balance of Mohan Ltd. This is to be adjusted from the bank balance of Mohan Ltd. before acquisition by Ravi Ltd.

You are required to prepare:

(a) Realisation account and Equity Shareholders' account in the books of Mohan Ltd.

(b) Bank Account and Balance Sheet with notes to accounts in the books of Ravi Ltd.

(*RTP, May, 2021*)

Answer

In the books of Mohan Ltd.

(i) Realisation Account

		₹			₹
To	Goodwill	10,000	By	10% Debentures	2,00,000
To	Property, plant and equipment	3,40,000	By	Interest accrued on debentures	20,000
To	Inventory	80,000	By	Trade payables	1,50,000
To	Trade receivables	1,10,000	By	Ravi Ltd. (Purchase consideration) (W.N. 1)	1,65,400
To	Bank (20,000 - 5,000)	15,000	By	Equity shareholders A/c (loss on realization) (Bal. fig.)	25,000
To	Preference share holders A/c (W.N.2)	5,400			
		5,60,400			5,60,400

(ii) **Equity shareholders' Account**

		₹			₹
To	Profit & loss A/c	1,70,000	By	Equity Share capital	3,00,000
To	Expenses*	5,000			
To	Equity shares in Ravi Ltd.	1,00,000			
To	Realization A/c	25,000			
		3,00,000			3,00,000

*****Alternatively, expenses may be routed through Realization account.

In the books of Ravi Ltd.

(i) **Bank Account**

		₹			₹
To	Business Purchase	15,000	By	Balance c/d (Bal. fig.)	1,09,600
To	Equity shares application & allotment A/c (W.N. 3)	94,600			
		1,09,600			1,09,600

(ii) **Balance Sheet as at 31st March, 2020**

Particulars	***Note No.***	***₹***
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital		
(2) Non-Current Liabilities	1	4,00,000
Long-term borrowings	2	2,00,000
Total		6,00,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		3,08,400
(2) Current assets		
(a) Inventories		72,000
(b) Trade receivables		1,10,000
(c) Cash and cash equivalents		1,09,600
Total		6,00,000

Notes to Accounts

		₹
1.	Share Capital	
	Authorised share capital	
	40,000 equity shares of ₹ 10 each	4,00,000
	Issued and Subscribed	
	40,000 shares of ₹ 10 each fully paid up	4,00,000
	(out of the above, 30,540 (W.N.3) shares have been allotted as fully paid-up pursuant to contract without payment being received in cash)	
2.	**Long Term Borrowings**	
	10% Debentures	2,00,000

Working Notes:

1. Calculation of Purchase consideration

	₹
Payment to preference shareholders	
6,000 equity shares @ ₹ 10	60,000
For arrears of dividend: (6,000 x ₹ 10) x 9%	5,400
Payment to equity shareholders	
(30,000 shares x 1/3) @ ₹ 10	1,00,000
Total purchase consideration	1,65,400

2. Preference shareholders' Account in books of Mohan Ltd.

	₹		₹
To Equity Shares in Ravi Ltd.	65,400	By Preference Share capital	60,000
		By Realization A/c (Bal. fig.)	5,400
	65,400		65,400

3. Calculation of number of Equity shares issued to public

	Number of shares	
Authorized equity shares		40,000
Less: Equity shares issued for		
Interest accrued on debentures	2,000	
Trade payables of Mohan Ltd.	12,000	
Preference shareholders of Mohan Ltd.	6,000	
Arrears of preference dividend	540	
Equity shareholders of Mohan Ltd.	10,000	(30,540)
Number of equity shares issued to public at par for cash		9,460

Question 48

High Ltd. and Low Ltd. were amalgamated on and from, 1st April, 2020. A new company Little Ltd. was formed to take over the business of the existing Companies. The summarized Balance sheets of High Ltd. and Low Ltd. as on 31st March, 2020 are as under:

(₹ in Lakhs)

Liabilities	*High Ltd.*	*Low Ltd.*	*Assets*	*High Ltd.*	*Low Ltd.*
Share Capital:			*Property, Plant and Equipment:*		
Equity Shares of ₹100 each	*1000*	*850*	*Land & Building*	*670*	*385*
14% Pref Shares of ₹100 each	*320*	*175*	*Plant & Machinery*	*475*	*355*
Reserves & Surplus:			*Investments*	*95*	*80*
Revaluation Reserve	*225*	*110*	*Current Assets:*		
General Reserve	*360*	*240*	*Stock*	*415*	*389*
Investment Allowance Reserve	*80*	*40*	*Sundry Debtors*	*322*	*213*
P & L Account	*85*	*82*	*Bills Receivables*	*35*	*-*
Non-Current Liabilities:			*Cash & Bank*	*303*	*166*
Secured Loans:					
13% Debentures (₹100 each)	*100*	*56*			
Unsecured Loans (Public Deposits)	*50*	*-*			
Current Liabilities & Provisions:		*-*			
Sundry Creditors	*65*	*35*			
Bills Payable	*30*	*-*			
TOTAL	*2315*	*1588*	*TOTAL*	*2315*	*1588*

Other Information:

(1) *13% Debenture holders of High Ltd. & Low Ltd. are discharged by Little Ltd. by issuing such number of its 15% Debentures of ₹100 each so as to maintain the same amount of interest.*

(2) *Preference Shareholders of the two companies are issued equivalent number of 15% Preference shares of Little Ltd. at a price of ₹125 per share (Face Value ₹100)*

(3) *Little Ltd. will issue 4 Equity Shares for each Equity Share of High Ltd. & 3 equity shares for each Equity Share of Low Ltd. The shares are to be issued at ₹35 each having a face value of ₹10 per share.*

(4) *Investment Allowance Reserve is to be maintained for two more years.*

Prepare the Balance sheet of Little Ltd. as on 1st April, 2020 after the amalgamation has been carried out in basis of in the nature of Purchase.

(*Suggested, November, 2020) (15 marks*)

Answer

Balance Sheet of Little Ltd. as at 1st April, 2020

Particulars	Note No.	(₹ in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,150.0
(b) Reserves and Surplus	2	2,437.8
(2) Non-Current Liabilities		
Long-term borrowings	3	135.2

Particulars	Note No.	(₹ in lakhs)
Other Borrowings- Unsecured Loans		50
(3) Current Liabilities		
Trade payables	4	130.0
Total		3,903
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	1,885
(b) Non-current investment (95 + 80)		175
(2) Current assets		
(a) Inventory (415+389)		804
(b) Trade receivables	6	570
(c) Cash and bank balances (303 + 166)		469
Total		3,903

Notes to Accounts

			(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital			
	Equity share capital (W.N.1)			
	65,50,0001 Equity shares of 10 each		655	
	4,95,0002 Preference shares of ₹ 100 each		495	
	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)			1,150
2.	Reserves and surplus			
	Securities Premium Account (W.N.3) (1080+ 681.25)		1,761.25	
	Capital Reserve (W.N. 2)(283.33 + 393.22)		676.55	
	Investment Allowance Reserve (80 + 40)		120	
	Amalgamation Adjustment Reserve (80 + 40)		(120)	2,437.8
3.	Long-term borrowings			
	15% Debentures			135.2
4.	Trade payables			
	Sundry Creditors: High Ltd.		65	
	Low Ltd.		35	
	Bills Payable: High Ltd.		30	130
5.	Property, Plant and Equipment			
	Land and Building : High Ltd	670		
	Low Ltd	385	1055	
	Plant and Machinery: High Ltd.	475		
	Low Ltd.	355	830	1,885
6.	Trade receivables			
	Sundry Debtors: High Ltd.		322	
	Low Ltd.		213	
	Bills Receivables: High Ltd.		35	570

Working Notes:

		(₹ in lakhs)	
		High Ltd.	Low Ltd.
(1)	Computation of Purchase consideration		
	(a) Preference shareholders:		
	$\left(\frac{3,20,00,000}{100} \text{ i.e. } 3,20,000 \text{ shares}\right) \times ₹125 \text{ each}$	400	
			218.75
	$\left(\frac{1,75,00,000}{100} \text{ i.e. } 1,75,000 \text{ shares}\right) \times ₹125 \text{ each}$	1,400	

1 40,00,000 + 25,50,000
2 3,20,000 + 1,75,000

			(₹ in lakhs)	
			High Ltd.	**Low Ltd.**
(2)	(b) Equity shareholders:		____	892.50
	$\left(\frac{10,00,00,000 \times 4}{100} \text{ i.e. } 40,00,000 \text{ shares}\right) \times ₹\,35 \text{ each}$			
	$\left(\frac{8,50,00,000 \times 3}{100} \text{ i.e. } 25,50,000 \text{ shares}\right) \times ₹35 \text{ each}$		1,800	1,111.25
	Amount of Purchase Consideration		670	385
	Computation of Capital Reserve		475	355
	Assets taken over:		95	80
	Land and Building		415	389
	Plant and Machinery		322	213
	Investments		35	
	Inventory			
	Trade receivables			
	Bills Receivables			
	Cash and bank		303	166
	Less: Liabilities taken over:		2,315	1,588
	Debentures	86.67		48.53
	Unsecured Loan	50		
	Creditors Bills Payable	65		35
		30		
			231.67	83.53
(3)	Net assets taken over		2083.33	1,504.47
	Purchase consideration		1,800	1,111.25
	Capital reserve		283.33	393.22
	Computation of securities premium			
	On preference share capital			
	High Ltd.- 3,20,000 x 25		80	
	Low Ltd.- 1,75,000 x 25			43.75
	On equity share capital		1000	
	High Ltd.- 40,00,000 x 25			637.5
	Low Ltd.- 25,50,000 x 25			
	Total		1080	681.25

(4) Issue of Debentures (₹ In Lakhs)
High Ltd.- 15% fresh issue of debenture for 13% old debentures = 100 X 13% /15% = 86.67 (rounded off)
Low Ltd.- 15% fresh issue of debenture for 13% old debentures = 56 X 13% /15% = 48.53 (rounded off)
Total number of debentures issued = 86.67 + 48.53 = 135.20 Lakhs

Question 49

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigate competition, a new company Glorious Ltd, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. The summarized Balance Sheet of Galaxy Ltd. and Glory Ltd. as at 31st March, 2020 are as follows:

				Galaxy Ltd.	***Glory Ltd.***
				₹	₹
(I)		***Equity & Liabilities***			
	(1)	***Shareholders' fund***			
		Share Capital			
		Equity shares of ₹ 10 each		*8,40,000*	*4,55,000*
	(2)	***Reserves & Surplus***	.		
		General Reserve		*4,48,000*	*40,000*
		Profit & Loss A/c		*1,12,000*	*72,000*
	(3)	***Non-current Liabilities***			
		Secured Loan		-	*3,30,000*
		6% Debentures			
		Current Liabilities		*4,20,000*	*1,83,000*
		Trade Payables	*Total*	*18,20,000*	*10,80,000*

				Galaxy Ltd.	Glory Ltd.
				₹	₹
(ii)		***Assets***			
	(1)	***Non-current assets***			
		Property, Plant & Equipment			
		Freehold property, at cost		*5,88,000*	*3,36,000*
		Plant & Machinery, at cost less depreciation		*1,40,000*	*84,000*
		Motor vehicles, at cost less depreciation		*56,000*	*-*
	(2)	***Current Assets***			
		Inventories		*3,36,000*	*4,38,000*
		Trade Receivables		*4,62,000*	*1,18,000*
		Cash at Bank		*2,38,000*	*1,04,000*
			Total	*18,20,000*	*10,80,000*

Assets and Liabilities are to be taken at book value, with the following exceptions:

(i) The Debentures of Glory Ltd. are to be discharged, by the issue of 8% Debentures of Glorious Ltd. at a premium of 10%.

(ii) Plant and Machinery of Galaxy Ltd. are to be valued at ₹2,52,000.

(iii) Goodwill is to be valued at : Galaxy Ltd. ₹4,48,000 Glory Ltd. ₹1,68,000

(iv) Liquidator of Glory Ltd. is appointed for collection from trade debtors and payment to trade creditors. He retained the cash balance and collected ₹1,10,000 from debtors and paid ₹ 1,80,000 to trade creditors. Liquidator is entitled to receive 5% commission for collection and 2.5% for payments. The balance cash will be taken over by new company.

You are required to:

(1) Compute the number of shares to be issued to the shareholders of Galaxy Ltd. and Glory Ltd, assuming the nominal value of each share in Glorious Ltd. is ₹10.

(2) Prepare Balance Sheet of Glorious Ltd., as on 1st April, 2020 and also prepare notes to the accounts as per Schedule III of the Companies Act, 2013. (*Suggested, January, 2021*) (*20 marks*)

Answer

(i) Calculation of Purchase consideration (or basis for issue of shares of Glorious Ltd.

	Galaxy Ltd.	Glory Ltd.
Purchase Consideration:	₹	₹
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36,000
Plant and Machinery	2,52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000
Less: Liabilities:		
6% Debentures (3,00,000 x 110%)		(3,30,000)
Trade payables	- (4,20,000)	
Net Assets taken over	19,60,000	7,20,000
To be satisfied by issue of shares of Glorious. Ltd. @ ₹ 10 each	1,96,000	72,000

(ii) Balance Sheet of Glorious Ltd. as at 1st April, 2020

		Particulars		Note No	Amount
					₹
		EQUITY AND LIABILITIES			
1		Shareholders' funds			
	(a)	Share capital		1	26,80,000
	(b)	Reserves and surplus		2	30,000
2					
		Non-current liabilities			
	(a)	Long-term borrowings		3	3,00,000
3					
	(a)	Current liabilities			4,20,000
		Trade payables			34,30,000
			Total		
1		**ASSETS**			

			Particulars	***Note No***	***Amount***
					₹
2			Non-current assets		
	(a)	(i)		4	13,16,000
		(ii)	Property, plant and equipment	5	6,16,000
			Intangible assets		
				6	7,74,000
	(a)		Current assets		
	(b)		Inventories		4,62,000
	(c)		Trade receivables	7	2,62,000
			Cash and cash equivalents		
			Total		34,30,000

Notes to accounts:

		₹	₹
1.	Share Capital		
	Equity share capital		26,80,000
	2,68,000 shares of ₹ 10 each		
	(All the above shares are issued for consideration other than cash)		
2.	Reserves and surplus		
	Securities Premium		30,000
	(10% premium on debentures of ₹3,00,000)		
3.	Long-term borrowings		
	Secured		
	8% 3,000 Debentures of ₹100 each		3,00,000
4.	Property Plant and Equipment		
	Freehold property		
	Galaxy Ltd.		
	Glory Ltd.	5,88,000	
	Plant and Machinery	3,36,000	9,24,000
	Galaxy Ltd.		
	Glory Ltd.	2,52,000	
	Motor vehicles -Galaxy Ltd.	84,000	3,36,000
			56,000
			13,16,000
5	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	4,38,000	7,74,000
7	Cash and cash equivalents		
	Galaxy Ltd.	2,38,000	
	Glory Ltd.(As per working note)	24,000	2,62,000

Working note:

Calculation of cash balance of Glory Limited to be taken over by Glorious Limited

		₹
Cash balance as at 31st March,2020		1,04,000
Add: Received from debtors		1,10,000
		2,14,000
Less: paid to creditors		(1,80,000)
		34,000
Less: Commission to liquidators		
On Debtors @ 5%	5,500	
On Creditors @ 2.5%	4,500	
		(10,000)
		24,000

Note:

1. It is assumed that the nominal value of debentures of Glory Ltd. is ₹ 100 each.
2. As per the information given in the question, debentures of Glory Ltd. are to be discharged by the issue of debentures of Glorious Ltd. at premium of 10%. It is assumed in the above solution that the debentures are issued at premium of ₹ 10 for discharge of debentures of ₹ 3,30,000. Alternative answer considering other reasonable assumption is also possible.

Question 50

The summarized Balance Sheets of Black Limited and White Limited as on 31st March, 2020 is as follows:

Particulars	Notes	Black Limited (₹ In 000)	White Limited (₹ In 000)
Equity and Liabilities			
Shareholders' Funds			
(a) Share Capital	1	6,000	3,600
(b) Reserves and Surplus	2	1,080	660
Current Liabilities			
Trade payables		600	360
Total		7,680	4,620
Assets			
Non-current assets			
Property, Plant and Equipment		3,600	2,400
Current assets			
(a) Inventories		960	720
(b) Trade receivables		1,680	1,080
(c) Cash and Cash Equivalents		1,440	420
Total		7,680	4,620

Note No.	Particulars	Black Limited (₹ in 000)	White Limited (₹ in 000)
1.	Share Capital	6,000	3,600
	Equity Shares of ₹ 100 each		
	Reserves and Surplus		
2.	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

Black Limited takes over White Limited on 1st July, 2020.

No Balance Sheet of White Limited is available as on that date. It is, however estimated that White Limited earned profit of ₹ 2,40,000 after charging proportionate depreciation @ 10% p.a. on Property Plant and Equipment, during April-June, 2020.

Estimated profit of Black Limited during these 3 months was ₹ 4,80,000 after charging proportionate deprecation @ 10% p.a. on Property Plant and Equipment

Both the companies have declared and paid 10% dividend within this 3 months' period.

Goodwill of White Limited is valued at ₹ 2,40,000 and Property Plant and Equipment are valued at ₹ 1,20,000 above the depreciated book value on the date of takeover.

Purchase consideration is to be satisfied by Black Limited by issuing shares at par. Ignore income tax. You are required to:

(i) Compute No. of shares to be issued by Black Limited to White Limited against purchase consideration.

(ii) Calculate the balance of Net Current Assets of Black Limited and White Limited as on 1st July, 2020.

(iii) Give balance of Profit or Loss of Black Limited as on 1st July, 2020

(iv) Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover.

(*July, 2021 Suggested*) (*10 Marks*)

Answer

(i) No. of shares issued by Black Ltd. to White Ltd. against purchase consideration

White Ltd.	₹	₹
Goodwill		2,40,000
Property, plant and equipment	24,00,000	
Less: Depreciation [24,00,000 × 10 % × 3/12]	(60,000)	
	23,40,000	

White Ltd.		₹	₹
Add: Appreciation		1,20,000	24,60,000
Inventory			7,20,000
Trade receivables			10,80,000
Cash and Bank balances		4,20,000	
Add: Profit after depreciation	2,40,000		
Add: Depreciation (non-cash)	60,000	3,00,000	
Less: Dividend [36,00,000 × 10%]		(3,60,000)	3,60,000
			48,60,000
Less: Trade payables			(3,60,000)
Purchase Consideration			45,00,000
Number of shares to be issued by Black Ltd. @ ₹ 100 each			45,000 shares

(ii) Calculation of Net Current Assets as on 01.07.2020

	₹	Black Ltd. ₹		White Ltd. ₹
Current assets:				
Inventory		9,60,000		7,20,000
Trade receivables		16,80,000		10,80,000
Cash and Bank	14,40,000		4,20,000	
Less: Dividend	(6,00,000)		(3,60,000)	
Add: Profit after depreciation	4,80,000		2,40,000	
Add: Depreciation being non cash	90,000	14,10,000	60,000	3,60,000
		40,50,000		21,60,000
Less: Trade payables		(6,00,000)		(3,60,000)
		34,50,000		18,00,000

(iii) Profit and Loss Account balance of Black Ltd. as on 1.07.2020

	₹
P & L A/c balance as on 31.03.2020	7,20,000
Less: Dividend paid	(6,00,000)
	1,20,000
Add: Estimated profit for 3 months after charging depreciation	4,80,000
	6,00,000

(iv) Property, plant and equipment as on 01.07.2020

Property, plant and equipment of Black Ltd. as on 31.03.2020		36,00,000
Less: Depreciation for 3 months [36,00,000 x 10% x 3/12]		(90,000)
Property, plant and equipment of White Ltd. Taken over as on 31.03.2020	24,00,000	35,10,000
Less: Proportionate depreciation for 3 months on fixed assets	(60,000)	
	23,40,000	
Add: Appreciation above the estimated book value	1,20,000	24,60,000
Total Property, plant and equipment as on 1.7.2020		59,70,000

Question 51

Sun and Neptune (both companies) had been carrying on business independently. They agreed to amalgamate and form a new company Jupiter Ltd. with an authorised share capital of ₹ 4,00,000 divided into 80,000 equity shares of ₹ 5 each. On 31st March, 2021 Sun and Neptune provide the following information:

	Sun (₹)	Neptune (₹)
Fixed Assets	6,35,000	3,65,000
Current Assets	3,27,000	1,67,750
	9,62,000	5,32,750
Less: Current Liabilities	(5,97,000)	(1,80,250)
Representing Capital	3,65,000	3,52,500

Additional Information:

(a) Revalued figures of Fixed and Current assets were as follows:

	Sun (₹)	Neptune (₹)
Fixed Assets	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

(b) The debtors and creditors include ₹ 43,350 owed by Sun to Neptune.

The purchase consideration is satisfied by issue of the following shares and debentures.

(i) 60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

	Sun (₹)	Neptune (₹)
2019 Profit	4,49,576	2,73,900
2020 (Loss)/Profit	(2,500)	3,42,100
2021 Profit	3,77,924	3,59,000

(ii) 15% debentures in Jupiter Ltd. at par to provide an income equivalent to 8% return business as on capital employed in their respective business as on 31st March, 2021 after revaluation of assets.

You are required to:

(1) Compute the amount of debentures and shares to be issued to Sun and Neptune.

(2) A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.

(*MTP, October 2021*) (*16 Marks*)

Answer

(1) Computation of Amount of Debentures and Shares to be issued:

	Sun ₹	Neptune ₹
(i) Average Net Profit		
₹ (4,49,576-2,500+3,77,924)/3	= 2,75,000	
₹ (2,73,900+,3,42,100+3,59,000)/3		= 3,25,000

(ii) Equity Shares Issued

(a) Ratio of distribution

Sun	:	Neptune
275	:	325

(b) Number

Sun	:	27,500
Neptune	:	32,500
		60,000

(c) Amount

		Sun ₹	Neptune ₹
	27,500 shares of ₹ 5 each	1,37,500	
	32,500 shares of ₹ 5 each		1,62,500
(iii)	**Capital Employed (after revaluation of assets)**	**₹**	**₹**
	Fixed Assets	7,10,000	3,90,000
	Current Assets	2,99,500	1,57,750
		10,09,500	5,47,750
	Less: Current Liabilities	-5,97,000	-1,80,250
		4,12,500	3,67,500
(iv)	**Debentures Issued**		
	8% Return on capital employed	33,000	29,400
	15% Debentures to be issued to provide equivalent income:		
	Sun: 33,000 × 100/15	2,20,000	
	Neptune: 29,400 × 100/15		1,96,000

(2) Balance Sheet of Jupiter Ltd.

As at 31st March 2021 (after amalgamation)

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		

Particulars	Note No	₹
(a) Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
(1) Non-current assets		
(a) Fixed assets		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		15,13,900

Notes to Accounts

		₹
1	Share Capital	
	Authorized	
	80,000 Equity Shares of ₹ 5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of ₹ 5 each	3,00,000
	(all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash)	
2	Reserve and Surplus	
	Capital Reserve	64,000
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	4,16,000

Working Notes:

		Sun ₹	Neptune ₹	Total ₹
(1)	Purchase Consideration			
	Equity Shares Issued	1,37,500	1,62,500	3,00,000
	15% Debentures Issued	2,20,000	1,96,000	4,16,000
		3,57,500	3,58,500	7,16,000
(2)	Capital Reserve			
(a)	Net Assets taken over			
	Fixed Assets	7,10,000	3,90,000	11,00,000
	Current Assets	2,99,500	1,14,400*	4,13,900
		10,09,500	5,04,400	15,13,900
	Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
		4,55,850	3,24,150	7,80,000
(b)	Purchase Consideration	3,57,500	3,58,500	7,16,000
(c)	Capital Reserve [(a) - (b)]	98,350		
(d)	Goodwill [(b) - (a)]		34,350	
(e)	Capital Reserve [Final Figure(c) -(d)]			64,000

* 1,57,750–43,350= 1,14,400

** 5,97,000–43,350= 5,53,650

Question 52

A Ltd. gives the following information on 31st March, 2021:

	₹
8,000 Equity shares of ₹ 100 each	8,00,000
10% Debentures	4,00,000
Loans	1,60,000
Trade payables	3,20,000
General Reserve	80,000
Building	3,40,000
Machinery	6,40,000
Inventory	2,20,000

	₹
Trade receivables	2,60,000
Bank	1,36,000
Patent	1,30,000
Profit & Loss account (Dr. balance)	34,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹ 6,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 1,24,400. The liquidation expenses amounted to ₹ 16,000. B Ltd. sold prior to 31st March, 2021 goods costing ₹ 1,20,000 to A Ltd. for ₹ 1,60,000. ₹ 1,00,000 worth of goods are still in Inventory of A Ltd. on 31st March, 2021. Trade payables of A Ltd. include ₹ 40,000 still due to B Ltd.

Show the Realisation A/c, Bank A/c, B Ltd. A/c and Equity shareholders A/c to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2021 after the takeover from the available information.

(*MTP, November, 2021*) (16 Marks)

Answer

Books of A Limited

Realization Account

		₹			₹
To	Building	3,40,000	By	Trade payables	3,20,000
To	Machinery	6,40,000	By	B Ltd.	12,10,000
To	Inventory	2,20,000	By	Equity Shareholders (Loss)	76,000
To	Trade receivables	2,60,000			
To	Patent	1,30,000			
To	Bank (Exp.)	16,000			
		16,06,000			16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realization (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% Debentures	4,00,000
			By	Loans	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

B Ltd. Account

To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd. (4,880 shares at ₹ 125 each)	6,10,000
		12,10,000			12,10,000

Equity Share Holders Account

To	Realization Account	76,000	By	Equity share capital	8,00,000
To	Profit & Loss A/c (Dr.)	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd
Balance Sheet as on 1st April, 2021 (An extract)1

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	4,88,000
	(b)	Reserves and Surplus	2	1,07,000
2		**Current liabilities**		
	(a)	Trade Payables	3	2,80,000
	(b)	Bank overdraft		6,00,000
		Total		14,75,000
		Assets		
1		**Non-current assets**		
		Property, Plant and Equipment	4	8,82,000
		Intangible assets	5	2,16,000
2		**Current assets**		
	(a)	Inventories	6	1,83,000
	(b)	Trade receivables	7	1,94,000
				14,75,000

Notes to Accounts

			₹
1	**Share Capital**		
	Equity share capital		
	4,880 Equity shares of ₹ 100 each (Shares have been issued for consideration other than cash)		4,88,000
	Total		4,88,000
2	**Reserves and Surplus (an extract)**		
	Securities Premium		1,22,000
	Profit and loss account	…..	
	Less: Unrealized profit	(15,000)	(15,000)
	Total		1,07,000
3	**Trade payables**		
	Opening balance	3,20,000	
	Less: Inter-company transaction cancelled upon amalgamation	(40,000)	2,80,000
4	**Property, Plant and Equipment**		
	Buildings		3,06,000
	Machinery		5,76,000
	Total		8,82,000
5	**Intangible assets**		
	Goodwill		2,16,000
6	**Inventories**		
	Opening balance	1,98,000	
	Less: Cancellation of profit upon amalgamation	(15,000)	1,83,000
7	**Trade receivables**		
	Opening balance	2,34,000	
	Less: Intercompany transaction cancelled upon amalgamation	(40,000)	1,94,000

Working Notes:

		₹
1.	**Valuation of Goodwill**	
	Average profit	1,24,400
	Less: 8% of ₹ 8,80,000	(70,400)
	Super profit	54,000
	Value of Goodwill = 54,000 x 4	2,16,000

1 In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the complete Balance Sheet of B Ltd. after takeover cannot be prepared.

2. Net Assets for purchase consideration	
Goodwill as valued in W.N.1	2,16,000
Building	3,06,000
Machinery	5,76,000
Inventory	1,98,000
Trade receivables	2,34,000
Total Assets	15,30,000
Less: Trade payables	(3,20,000)
Net Assets	12,10,000

Out of this ₹ 6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) ₹ 6,10,000 in shares of ₹ 125. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. Unrealized Profit on Inventory	₹
The Inventory of A Ltd. includes goods worth ₹ 1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this Inventory will be	
$\frac{40,000}{1,60,000} \times 1,00,000$	25,000
As B Ltd. purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 1,00,000.	(10,000)
Amount of unrealized profit	15,000

Question 53

Heera Ltd. and Rita Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of Heera Ltd. and Rita Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in HR Ltd.

Heera Ltd. and Rita Ltd. make available the following information as on 31st March, 2021 (the date of amalgamation):

	Heera Ltd. ₹	Rita Ltd. ₹
Property, plant and Equipment	7,20,000	10,80,000
Inventories	3,60,000	6,60,000
Trade receivables	4,80,000	7,80,000
Cash at Bank	3,00,000	-
Share Capital	6,00,000	8,40,000
Reserves	10,20,000	6,00,000
Bank Overdraft	-	5,40,000
Trade payables	2,40,000	5,40,000

The consideration was to be based on the net assets of the companies as shown above but subject to an additional payment to Heera Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March, 2021. The weights for this purpose for the years 2018-19, 2019-20 and 2020-21 were agreed as 1, 2 and 3 respectively.

The profit had been:

2018-19 ₹ 3,00,000; 2019-20 ₹ 5,25,000 and 2020-21 ₹ 6,30,000.

The shares of HR Ltd. were to be issued to Heera Ltd. and Rita Ltd.at a premium and in proportion to the agreed net assets value of these companies.

In order to raise working capital, HR Ltd. proceeded to issue 72,000 shares of ₹ 10 each at the same rate of premium as issued for discharging purchase consideration to Heera Ltd. and Rita Ltd.

You are required to calculate the number of shares issued to Heera Ltd. and Rita Ltd. and prepare necessary journal entries in the books of HR Ltd.

(*RTP November 2021*)

Answer

Calculation of number of shares issued to Heera Ltd. and Rita Ltd.

Amount of Share Capital as per balance sheet		₹
Heera Ltd.		6,00,000
Rita Ltd.		8,40,000
		14,40,000
Share of Heera Ltd.	= ₹ 14,40,000 x [21,60,000/ (21,60,000 + 14,40,000)]	
	= ₹ 8,64,000 or 86,400 shares	
Securities premium	= ₹ 21,60,000 – ₹ 8,64,000 = ₹ 12,96,000	

Premium per share	= ₹ 12,96,000 / ₹ 86,400 = ₹ 15
Issued 86,400 shares	@ ₹ 10 each at a premium of ₹ 15 per share
Share of Rita Ltd.	= ₹ 14,40,000 x [14,40,000/ (21,60,000 + 14,40,000)]
	= ₹ 5,76,000 or 57,600 shares
Securities premium	= ₹ 14,40,000 – ₹ 5,76,000 = ₹ 8,64,000
Premium per share	= ₹ 8,64,000 / ₹ 57,600 = ₹ 15
Issued 57,600 shares	@ ₹ 10 each at a premium of ₹ 15 per share

Journal Entries in the books of HR Ltd.

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Business purchase account	Dr.	36,00,000	
To Liquidator of Heera Ltd. account			21,60,000
To Liquidator of Rita Ltd. account			14,40,000
(Being the amount of purchase consideration payable to liquidator of Heera Ltd. and Rita ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	
PPE account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	
Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of Heera Ltd. taken over)			
PPE account	Dr.	10,80,000	
Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Rita Ltd. taken over)			
Liquidator of Heera Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 x ₹ 10)			8,64,000
To Securities premium (86,400 x ₹ 15)			12,96,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Liquidator of Rita Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 x ₹ 10)			5,76,000
To Securities premium (57,600 x ₹ 15)			8,64,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Bank A/c		18,00,000	
To Equity share capital account (72,000 x ₹10)			7,20,000
To Securities premium (72,000 x ₹ 15)			10,80,000
(Equity share capital issued to raise working capital)			

Working Notes:

1. Calculation of goodwill of Heera Ltd.

Particulars	Amount ₹	Weight	Weighted amount ₹
2018-19	3,00,000	1	3,00,000
2019-20	5,25,000	2	10,50,000
2020-21	6,30,000	3	18,90,000
Total (a+b+c)	14,55,000	6	32,40,000
Weighted Average = [Total weighted amount/Total of weight] [₹ 32,40,000/6] Goodwill			5,40,000

2. Calculation of Net assets

	Heera Ltd. ₹	Rita Ltd. ₹
Assets		
Goodwill	5,40,000	
PPE	7,20,000	10,80,000
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft		5,40,000
Trade payables	2,40,000	5,40,000
Net assets or Purchase consideration	21,60,000	14,40,000

Question 54

The following are the Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

Particulars	Note No.	Aakash Limited (₹)	Ganga Limited (₹)
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	1	80,00,000	20,00,000
(b) Reserves and Surplus	2	(3,24,00,000)	56,00,000
(2) Non-Current Liabilities:			
(a) Secured Loans	3	3,20,00,000	1,60,00,000
(b) Unsecured Loans	4	1,72,00,000	-
(3) Current Liabilities:			
(a) Trade Payables		56,00,000	36,00,000
(b) Other Current Liabilities	5	2,04,00,000	56,00,000
Total		5,08,00,000	3,28,00,000
II. Assets:			
(1) Non-Current Assets:			1,36,00,000
Property, Plant & Equipment		68,00,000	
(2) Current Assets:			
(a) Inventories		3,68,00,000	-
(b) Other Current Assets		72,00,000	1,92,00,000
Total		5,08,00,000	3,28,00,000

Notes to Accounts:

		Aakash Limited (₹)	Ganga Limited (₹)
1.	Share Capital		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of ₹10 each	60,00,000	-
	20,000 Preference Shares of ₹ 100 each	20,00,000	-
	2,00,000 Equity Shares of ₹ 10 each	-	20,00,000
		80,00,000	20,00,000
2.	Reserves and Surplus		
	General Reserve	8,00,000	56,00,000
	Surplus	(3,32,00,000)	-
		(3,24,00,000)	56,00,000
3.	Secured Loans		
	(Secured Loans of Aakash Limited are secured against pledge of Inventories)	3,20,00,000	1,60,00,000
4.	Unsecured Loans	1,72,00,000	-
5.	Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000
	Liability to Employees	60,00,000	36,00,000
		2,04,00,000	56,00,000

Both the companies go into liquidation and a new company 'Aakash Ganga Limited' is formed to take over their business. The following information is given:

(i) All Current Assets of two companies, except pledged inventory are taken over by Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.

(ii) Property, Plant and Equipment of both the companies are taken over at book value by Aakash Ganga Limited.

(iii) Secured Loans include ₹ 32,00,000 accrued interest in case of Ganga Limited.

(iv) 4,00,000 Equity Shares of ₹ 10 each are allotted by Aakash Ganga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.

(v) Preference Shareholders in Aakash Limited are issued Equity Shares in Aakash Ganga Ltd. worth ₹ 4,00,000 in lieu of their present holdings.

(vi) Secured Loan agree to continue the balance amount of their loans to Aakash Ganga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.

(vii) Unsecured Loans are taken over by Aakash Ganga Limited at 25% of loan amounts.

(viii) Employees are issued fully paid Equity Shares in Aakash Ganga Limited in full settlement of their dues.

(ix) Statutory Liabilities are taken over by Aakash Ganga Limited at full value and Trade Payables are taken over at 80% of the book value.

You are required to prepare the opening Balance Sheet of Aakash Ganga Limited as at 1.4.2021.

(*RTP May, 2022*)

Answer

Balance sheet of Aakash Ganga Ltd. as at 1st April, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) **Shareholders' Funds**		
(a) Share Capital	1	1,40,00,000
(2) **Non-Current Liabilities**		
(a) Long term borrowings	2	2,12,60,000
(3) **Current Liabilities**		
(a) Trade Payables	3	73,60,000
(b) Other current liabilities	4	1,64,00,000
Total		5,90,20,000
II. Assets		
(1) **Non-current assets**		
(a) Property, Plant & Equipment	5	2,04,00,000
(b) Intangible assets	6	1,54,20,000
(2) **Current assets**		
(a) Cash and cash equivalents		40,00,000
(b) Other current assets	7	1,92,00,000
Total		5,90,20,000

Notes to Accounts

				(₹)
1.	Share Capital			
	Issued, subscribed & Paid up:			
	14,00,000 equity shares of ₹ 10 each, fully paid up (W.N.4)			1,40,00,000
	(of the above 10,00,000 shares have been issued for consideration other than cash)			
2.	Long Term borrowings			
	Secured Loans			
	Aakash Limited	25,60,000		
	Ganga Limited	1,44,00,000	1,69,60,000	
	Unsecured Loans		43,00,000	2,12,60,000
3.	Trade Payables (W.N.1)			
	Aakash Limited		44,80,000	
	Ganga Limited		28,80,000	73,60,000
4.	Other current liabilities			
	Statutory Liabilities			

			(₹)
	Aakash Limited	1,44,00,000	
	Ganga Limited	20,00,000	1,64,00,000
5.	Property, Plant & Equipment		
	Aakash Limited	68,00,000	
	Ganga Limited	1,36,00,000	2,04,00,000
6.	Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7.	Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

1. Value of total liabilities taken over by Aakash Ganga Ltd. **(₹)**

	Aakash Limited		Ganga Limited	
Current liabilities				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	44,80,000	2,48,80,000	28,80,000	84,80,000
Secured loans				
Given in Balance Sheet	3,20,00,000		1,60,00,000	
Interest waived	-		16,00,000	1,44,00,000
Value of Inventory (80% of ₹ 3,68,00,000)	2,94,40,000	25,60,000		
Unsecured Loans (25% of ₹1,72,00,000)		43,00,000		-
		3,17,40,000		2,28,80,000

2. Assets taken over by Aakash Ganga Ltd. (₹)

	Aakash Limited	Ganga Limited
	₹	₹
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets		
(80% and 70% respectively of book value)	57,60,000	1,34,40,000
	1,25,60,000	2,70,40,000

3. Goodwill/Capital Reserve on amalgamation (₹)

Liabilities taken over (W.N. 1)		3,17,40,000	2,28,80,000
Equity shares to be issued to Preference Shareholders		4,00,000	-
	A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N. 2)	B	(1,25,60,000)	(2,70,40,000)
	A-B	1,95,80,000	(41,60,000)
		Goodwill	Capital Reserve
Net Goodwill (1,95,80,000- 41,60,000)		1,54,20,000	

4. Equity shares issued by Aakash Ganga Ltd.

(i)	For Cash		40,00,000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	96,00,000	
(iii)	To Preference shareholders	4,00,000	1,00,00,000
			1,40,00,000
	No. of shares @ ₹ 10		14,00,000

Question 55

Moon Limited is absorbed by Sun Limited; the consideration, being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000); the payment of 9% Debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value; the payment of ₹ 18 per share in cash; allotment of two 11% preference shares of ₹ 10/- each and one equity share of ₹ 10/- each at a premium of 30% fully paid for every three shares in Moon Limited respectively.

The number of shares of the vendor company is 1,50,000 of ₹ 10/- each fully paid. Calculate purchase consideration as per AS-14. (*Question Paper of December 2021*) (*5 Marks*)

Answer

As per AS 14 "Accounting for Amalgamations", the term consideration has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Purchase consideration will be:

	₹	Form
Equity shareholders:		
1,50,000 × ₹ 18	27,00,000	Cash
1,50,000 × 2/3 × ₹ 10	10,00,000	11% Pref. shares
1,50,000 × 1/3 × ₹ 13	6,50,000	Equity shares
	43,50,000	

Note:

1. According to AS 14, 'consideration' excludes the any amount payable to debenture- holders. The liability in respect of debentures of vendor company will be taken by transferee company, which will then be settled by issuing new debentures.
2. Liquidation expenses will also not form part of purchase consideration.

Question 56

Dark Ltd. and Fair Ltd. were amalgamated on and from 1st April, 2021. A new company Bright Ltd. was formed to take over the business of the existing companies. The Balance Sheets of Dark Ltd. and Fair Ltd. as at 31st March, 2021 are given below:

(₹ In Lakhs)

	Particulars	Note No.	Dark Ltd.	Fair Ltd.
I	Equity and Liabilities			
	(1) Shareholders' Funds			
	(a) Share Capital	1	1,650	1,425
	(b) Reserves and Surplus	2	630	495
	(2) Non-Current Liabilities			
	Long Term Borrowings			
	10% Debentures of 1100 each		90	45
	(3) Current Liabilities			
	Trade Payables		630	285
	Total		**3,000**	**2,250**
II	Assets			
	(1) Non Current Assets			
	(a) Property, Plant and Equipment		1,350	975
	(b) Non Current Investments		225	75
	(2) Current Assets			
	(a) Inventories		525	375
	(b) Trade Receivables		450	525
	(c) Cash and Cash Equivalents		450	300
	Total		**3,000**	**2.250**

Notes to Accounts

		Dark Ltd. (₹ in lakhs)	Fair Ltd (₹ in lakhs)
1	Share Capital		
	Equity Shares of ₹ 100 each	1,200	1,125
	14% Preference Shares of ₹ 100 each	450	300
		1,650	1,425
2	Reserves and Surplus		
	Revaluation Reserve	225	150
	General Reserve	255	225
	Investment Allowance Reserve	75	75
	Profit and Loss Account		45
		630	495

Additional Information:

(i) Bright Limited will issue 5 equity shares for each equity share of Dark Limited and 4 equity shares for each equity share of Fair Limited. The shares are to be issued @ ₹ 35 each having a face value of ₹ 10 per share.

(ii) Preference Shareholders of the two companies are issued equivalent number of 16% preference shares of Bright Limited at a price of ₹ 160 per share (face value ₹ 100).

(iii) 10% Debenture holders of Dark Limited and Fair Limited are discharged by Bright Limited, issuing such number of its 16% Debentures of ₹ 100 each so as to maintain the same amount of interest.

(iv) Investment allowance reserve is to be maintained for 4 more years.

(v) Liquidation expenses are for Dark Limited ₹ 6,00,000 and for Fair Limited ₹ 3,00,000. It is decided that these expenses would be borne by Bright Limited.

(vi) All the assets and liabilities of Dark Limited and Fair Limited are taken over at book value.

(vii) Authorised equity share capital of Bright Limited is ₹ 15,00,00,000 divided into equity shares of ₹ 10 each. After issuing required number of shares to the liquidators of Dark Limited and Fair Limited, Bright Limited issued balance shares to public. The issue was fully subscribed.

You are required to prepare Balance Sheet of Bright Limited as at 1st April, 2021 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

(*Question Paper of December 2021*) (*15 Marks*)

Answer:

Balance Sheet of Bright Ltd. as at 1st April, 2021

Particulars	***Note No.***	***(₹ in lakhs)***
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	2,250
(b) Reserves and Surplus	2	4,200
(2) **Non-Current Liabilities**		
Long-term borrowings	3	84.375
(3) **Current Liabilities**		
Trade payables	4	915
Total		7449.375
II. **Assets**		
(1) **Non-current assets**		
(a) (i) Property, plant and equipment	5	2,325
(ii) Intangible assets	6	633.375
(b) Non-current investments	7	300
(2) **Current assets**		
(a) Inventories	8	900
(b) Trade receivables	9	975
(c) Cash and cash equivalents	10	2316
Total		7449.375

Notes to Accounts

			(₹ in lakhs)	**(₹ in lakhs)**
1.	Share Capital			
	Authorized Share Capital			
	1,50,00,000 Equity shares of ₹10 each		1500	
	7,50,000 16% Preference Share of 100 each		750	
	Issued: 1,50,00,000 Equity shares of ₹ 10 each (Out of which 1,05,00,000 Shares were Issued for consideration other than cash)		1500	
	7,50,000 16% Preference Shares of 100 each (Issued for consideration other than cash)		750	2,250
2.	Reserves and surplus			
	Securities Premium Account			
	(1,50,00,000 shares ×₹ 25)	3750		
	(7,50,000 shares × ₹ 60)	450	4,200	
	Investment Allowance Reserve		150	
	Amalgamation Adjustment Reserve		(150)	4,200
3.	Long-term borrowings			
	16% Debentures (56,25,000+28,12,500) (W.N. 3)			84.375

			(₹ in lakhs)	(₹ in lakhs)
4.	Trade payables			
	Dark Ltd.		630	
	Fair Ltd.		285	915
5.	Property, plant & equipment			
	Land and Building		1350	
	Plant and Machinery		975	2,325
6.	Intangible assets			
	Goodwill [W.N. 2]	624.375		
	Add: liquidation exp. (6+3)	9.00		633.375
7.	Non-current Investments			
	Investments (225+75)			300
8.	Inventories			
	Dark Ltd.		525	
	Fair Ltd.		375	900
9	Trade receivables			
	Dark Ltd.		450	
	Fair Ltd.		525	975
10	Cash & cash equivalents			
	Dark Ltd.		450	
	Fair Ltd.		300	
	Liquidation Expenses (6+3)		(9)	
	Shares issued for cash (45 lakh shares x ₹35)		1575	2316

Working Notes:

		(₹ in lakhs)	
		Dark Ltd.	**Fair Ltd.**
(1)	Computation of Purchase consideration		
	(a) Preference shareholders:		
	$\left(\frac{4,50,00,000}{100}\right)$	720	
	i.e. 4,50,000 shares × ₹ 160 each		
	$\left(\frac{3,00,00,000}{100}\right)$		480
	i.e. 3,00,000 shares × ₹ 160 each		
	(b) Equity shareholders:		
	$\left(\frac{12,00,00,000 \times 5}{100}\right)$	2,100	
	i.e. 60,00,000 shares x ₹ 35 each		
	$\left(\frac{11,25,00,000 \times 4}{100}\right)$		
	i.e. 45,00,000 shares × ₹ 35 each		1,575
	Amount of Purchase Consideration	2,820	2,055
(2)	Net Assets Taken Over		
	Assets taken over:		
	Property Plant & Equity	1,350	975
	Non-Current Investments	225	75
	Inventory	525	375
	Trade receivables	450	525
	Cash and bank	450	300
		3,000	2,250

			(₹ in lakhs)		
			Dark Ltd.		Fair Ltd.
	Less: Liabilities taken over:				
	10% Debentures	56.25		28.125	
	Trade payables	630	(686.25)	285	(313.125)
	Net assets taken over		2,313.75		1936.875
	Purchase consideration		2,820		2055.00
	Goodwill		506.25		118.125
	Total goodwill				624.375

(3) Issue of Debentures

Debentures	₹ 90,00,000	₹ 45,00,000
Interest 10%	₹ 9,00,000	₹ 4,50,000
	$\left(\frac{9,00,000 \times 100}{16}\right) = 56,25,000$	$\left(\frac{4,50,000 \times 100}{16}\right) = 28,12,500$

NOTE: In the above solution ₹ 35 has been considered as the issue price of Equity shares for public issue also. Alternative considering this as ₹ 10 also possible. In that case, the balance of cash and cash equivalents will be ₹ 1,191 lakhs and securities premium will be ₹ 3,075 lakhs in place of the balances given in the balance sheet in the above solution.

Question 57

Amalgamation of Companies

The balance sheets of Truth Limited and Myth Limited as at 31.03.2021 is given below. Myth Limited is to be amalgamated with Truth Limited from 1.04.2021. The amalgamation is to be carried out in the nature of purchase.

Particulars	Note No.	Truth Ltd. (₹)	Myth Ltd. (₹)
(1) Equity and Liabilities			
1. Shareholders' Funds			
(a) Share Capital	1	10,00,000	4,00,000
(b) Reserves and Surplus	2	11,35,000	4,13,000
2. Non -Current Liabilities	3	-	1,50,000
3. Current Liabilities	4	1,40,000	1,82,000
Total		22,75,000	11,45,000
(2) Assets			
1. Non -Current Assets			
(a) Property, Plant & Equipment		15,75,000	6,80,000
(b) Investments		1,87,500	1,00,000
2. Current Assets	5	5,12,500	3,65,000
Total		22,75,000	11,45,000

Note No.	Particulars	Truth Limited (₹)	Myth Limited (₹)
1	Share Capital		
	Equity shares of ₹ 10 each	10,00,000	4,00,000
2	Reserves & Surplus		
	General Reserve	5,05,000	2,30,000
	Profit & Loss A/c	4,45,000	1,58,000
	Export Profit Reserve	1,85,000	25,000
		11,35,000	4,13,000
3	Non-Current Liabilities		
	14% Debentures	---	1,50,000
4	Current Liabilities		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
		1,40,000	1,82,000
5	Current Assets		
	Inventory	2,15,000	85,000
	Trade Receivables	2,02,500	1,75,000
	Cash and Cash equivalents	95,000	1,05,000
		5,12,500	3,65,000

Truth Limited would issue 12% debentures to discharge the claim of the debenture holders of Myth Limited so as to maintain their present annual interest income. Non-trade investment, which constitute 80% of their respective total investments yielded income of 20% to Truth Limited and 15% to Myth Limited. This income is to be deducted from profits while computing average profit for the purpose of calculating goodwill. Profit before tax of both the companies during the last 3 years were as follows:

	Truth Limited (₹)	Myth Limited (₹)
2018-2019	8,20,000	2,55,000
2019-2020	7,45,000	2,15,000
2020-2021	6,04,000	2,14,000

Goodwill is to be calculated on the basis of simple average of three years profit by using Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the amalgamation.

(*RTP November, 2022*)

Balance Sheet of Truth Ltd. (after amalgamated with Myth Ltd.) as at 1.4.2021

Particulars	***Note No.***	***(₹)***
I. Equity and liabilities		
(1) Shareholder's funds		
(a) Share capital	1	13,13,750
(b) Reserves and surplus	2	20,76,250
(2) Non-current liabilities		
12% Debentures	3	1,75,000
(3) Current liabilities		
(a) Trade payables	4	2,32,000
(b) Other current liabilities	5	90,000
Total		38,87,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	22,55,000
(b) Intangible assets (Goodwill) [WN 1]		4,67,000
(c) Non-current investments	7	2,87,500
(2) Current assets		
(a) Inventories (2,15,000 + 85,000)		3,00,000
(b) Trade receivables (2,02,500 + 1,75,000)		3,77,500
(c) Cash & cash equivalents (95,000 + 1,05,000)		2,00,000
Total		38,87,000

Notes to Accounts

			(₹)	**(₹)**
1.	Share Capital			
	1,31,375 Equity Shares of ₹ 10 each [1,00,000 + 31,375]			13,13,750
	(of the above shares, 31,375 shares were issued to the vendors otherwise than for cash)			
2.	Reserves and surplus			
	General Reserve		5,05,000	
	Profit and Loss A/c		4,45,000	
	Securities Premium [31,375 x 30]		9,41,250	
	Export profit reserve	1,85,000		
	Add: Balance of Myth Ltd.	25,000	2,10,000	
	Amalgamation Adjustment Reserve		(25,000)	20,76,250
3.	Long Term Borrowings			
	12% Debentures issued to Myth Ltd.			1,75,000
4.	Trade payables			
	Trade payables		90,000	
	Add: Taken over		1,42,000	2,32,000
5	Other Current Liabilities			
	Truth Ltd.		50,000	
	Myth Ltd.		40,000	90,000

		(₹)	(₹)
6.	Property, Plant & Equipment		
	Truth Ltd.	15,75,000	
	Myth Ltd.	6,80,000	22,55,000
7.	Investment		
	Truth Ltd.	1,87,500	
	Myth Ltd.	1,00,000	2,87,500

Working Notes:

(1) Valuation of Goodwill

(i) Capital Employed

	Truth Ltd.		Myth Ltd.	
	₹	₹	₹	₹
Assets as per Balance Sheet		22,75,000		11,45,000
Less: Non-trade Investment		(1,50,000)		(80,000)
		21,25,000		10,65,000
Less: Liabilities:				
14% Debentures	-		1,50,000	
Trade payables	90,000		1,42,000	
Other current liabilities	50,000	(1,40,000)	40,000	(3,32,000)
Capital Employed		19,85,000		7,33,000

(ii) Average Profit before Tax

	Truth Ltd.		Myth Ltd.	
2018-2019		8,20,000		2,55,000
2019-2020		7,45,000		2,15,000
2020- 2021		6,04,000		2,14,000
Total profit of 3 years (a)		21,69,000		6,84,000
Simple Average [(a)/3]		7,23,000		2,28,000
Less: Non-trading income*		(30,000)		(12,000)
		6,93,000		2,16,000
(iii) Goodwill				
Capitalised value of average profit	[(6,93,000 / 18) x 100]	38,50,000		12,00,000
Less: Capital Employed [From (i) above]		(19,85,000)	[(2,16,000 / 18) x 100]	(7,33,000)
Goodwill		18,65,000		4,67,000

* For Truth Ltd. = 1,87,500 x 80% x 20% = 30,000; and
Myth Ltd. = 1,00,000 x 80% x 15% = 12,000

(2) Intrinsic Value per Share

	Truth Ltd.		Myth Ltd.	
		₹		₹
Goodwill [W.N. 1]	18,65,000		4,67,000	
Other Assets	22,75,000	41,40,000	11,45,000	16,12,000
Less: Liabilities				
12% Debentures	-		1,75,000**	
Trade payables	90,000		1,42,000	
Provision for Tax	50,000	(1,40,000)	40,000	(3,57,000)
Net Assets		40,00,000		12,55,000
Intrinsic value per share [Net Assets / No. of Shares]		40,00,000 / 1,00,000 = ₹ 40		12,55,000 / 40,000 = ₹ 31.375

$$**1,50,000 \times \frac{14\%}{12\%} = 1,75,000$$

(3) Purchase Consideration & manner of its discharge

Intrinsic Value of Myth Ltd. [a]	₹ 31.375 per share
No. of shares [b]	40,000 shares
Purchase Consideration c= [a x b]	₹ 12,55,000
Intrinsic Value of Truth Ltd. [d]	₹ 40 per share
No. of shares to be issued [c / d]	31,375 shares

Question 58

Amalgamation of Companies

The following information is being provided by VT Ltd. and MG Ltd. as on 31st March, 2022:

Particulars	VT Ltd. (₹)	MG Ltd. (₹)
Equity Shares of ₹ 10 each	12,00,000	6,00,000
10% Pref. Shares of ₹ 100 each	4,00,000	2,00,000
Reserve and Surplus	6,00,000	4,00,000
12% Debentures	4,00,000	3,00,000
Trade Payables	5,00,000	3,00,000
Fixed Assets	14,00,000	5,00,000
Investment	1,60,000	1,60,000
Inventory	4,80,000	6,40,000
Trade Receivables	8,40,000	4,20,000
Cash at Bank	2,20,000	80,000

Details of Trade receivables and trade payables are as under:

	VT Ltd. (₹)	MG Ltd. (₹)
Trade Receivable		
Debtors	7,20,000	3,80,000
Bills Receivable	1,20,000	40,000
	8,40,000	4,20,000
Trade Payables		
Sundry Creditors	4,40,000	2,50,000
Bills Payable	60,000	50,000
	5,00,000	3,00,000

Fixed Assets of both the companies are to be revalued at 15% above book value. Inventory in Trade and Debtors are taken over at 5% lesser than their book value.

Both the companies are to pay 10% equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, VT Ltd. will absorb MG Ltd. on the following terms:

(i) VT Ltd. will issue 16 Equity Shares of ₹ 10 each at par against 12 Shares of MG Ltd.

(ii) 10% Preference Shareholders of MG Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each, at par, in VT. Ltd.

(iii) 12% Debenture holders of MG Ltd. are to be paid at 8% premium, by 12% Debentures in VT Ltd., issued at a discount of 10%.

(iv) ₹ 60,000 is to be paid by VT Ltd. to MG Ltd. for Liquidation expenses.

(v) Sundry Debtors of MG Ltd. includes ₹ 20,000 due from VT Ltd.

You are required to prepare :

(1) Journal entries in the books of VT Ltd.

(2) Statement of consideration payable by VT Ltd.

(*RTP May, 2023*)

Answer

(i) Journal Entries in the Books of VT Ltd.

		Dr. ₹	*Cr.* ₹
Fixed Assets	Dr.	2,10,000	
To Revaluation Reserve			2,10,000
(Revaluation of fixed assets at 15% above book value)			
Reserve and Surplus	Dr.	1,20,000	
To Equity Dividend			1,20,000
(Declaration of equity dividend @ 10%)			

		Dr. ₹	Cr. ₹
Equity Dividend	Dr.	1,20,000	
To Bank Account			1,20,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	9,80,000	
To Liquidator of MG Ltd.			9,80,000
(Consideration payable for the business taken over from MG Ltd.)			
Fixed Assets (115% of ₹ 5,00,000)	Dr.	5,75,000	
Inventory (95% of ₹ 6,40,000)	Dr.	6,08,000	
Debtors	Dr.	3,80,000	
Bills Receivable	Dr.	40,000	
Investment	Dr.	1,60,000	
Cash at Bank	Dr.	20,000	
(₹ 80,000 –₹ 60,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 3,60,000)			18,000
To Sundry Creditors			2,50,000
To 12% Debentures in MG Ltd.			3,24,000
To Bills Payable			50,000
To Business Purchase Account			9,80,000
To Capital Reserve (Balancing figure)			1,61,000
(Incorporation of various assets and liabilities taken over from MG Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of MG Ltd.	Dr.	9,80,000	
To Equity Share Capital			8,00,000
To 10% Preference Share Capital			1,80,000
(Discharge of consideration for MG Ltd.'s business)			
12% Debentures in MG Ltd. (₹ 3,00,000 × 108%)	Dr.	3,24,000	
Discount on Issue of Debentures	Dr.	36,000	
To 12% Debentures			3,60,000
(Allotment of 12% Debentures to debenture holders of MG Ltd. at a discount of 10%)			
Sundry Creditors	Dr.	20,000	
To Sundry Debtors			20,000
(Cancellation of mutual owing)			
Goodwill	Dr.	60,000	
To Bank			60,000
(Being liquidation expenses reimbursed to MG Ltd.)			
Capital Reserve/P&L A/c	Dr.	60,000	
To Goodwill			60,000
(Being goodwill set off)			

(ii) Statement of Consideration payable by VT Ltd. for 60,000 shares (payment method) Shares to be allotted 60,000/12 × 16 = 80,000 shares of VT Ltd.

Issued 80,000 shares of ₹ 10 each i.e.	₹ 8,00,000	(i)
For 10% preference shares, to be paid at 10% discount		
₹ 2,00,000x 90/100	₹ 1,80,000	(ii)
Consideration amount [(i) + (ii)]	₹ 9,80,000	

Question 59

X Ltd. and Y Ltd. had been carrying on business independently. They agreed to amalgamate and form a new company XY Ltd. with an authorized share capital of ₹40,00,000 divided into. ₹8,00,000 equity shares of ₹5 each. On 31st March, 2023 the respective information of X Ltd. and Y Ltd. were as follows:

		X Ltd. (₹)	Y Ltd. (₹)
Share Capital		34,25,000	36,10,000
Trade Payable		59,70,000	18,02,500
Property, Plant and Equipment		58,25,000	37,40,000
Current Assets		31,45,000	15,99,500

Additional Information:

The following revalued figures of non-current and current assets are :

	X Ltd. (₹)	Y Ltd. (₹)
Property, Plant and Equipment	71,00,000	39,00,000
Current Assets	29,95,000	15,77,500

The debtors and creditors include ₹1,37,250 owed by X Ltd. to Y Ltd.

The purchase consideration is satisfied by issue of the following shares, and debentures.

6,20,000 equity shares of XY Ltd. to X Ltd and Y Ltd. in the proportion to the profitability of their respective business based on the average net profit during the last four years which were as follows :

	X Ltd. (₹)	Y Ltd. (₹)
2020 Profit	42,50,000	26,50,000
2021 Profit	44,45,760	27,d0,000
2022 (Loss)/Profit	(75,000)	34,00,000
2023 Profit	37,79,240	35,90,000

7.5% debenture in XY Ltd. at par to provide en income equivalent to 4% refund business as on capital employed in their respective bus@ as on 31st March, 2023 after revaluation of assets.

You are required to :

(1) Compute the amount of debenture and shares to be issued to 'X' Ltd. and 'Y' Ltd.

(2) A Balance Sheet of XY Ltd. showing the position immediately after amalgamation.

(*G-II, May, 2023*) (*20 Marks*)

Question 60

Som Ltd. agreed to takeover Dove Ltd. on 1st April, 2020. The terms and conditions of takeover were as follows:

(i) Som Ltd. issued 56,000 equity shares of ₹100 each at a premium of ₹10 per share to the equity shareholders of Dove Ltd.

(ii) Cash payment of ₹ 1,00,000 was made to equity shareholders of Dove Ltd.

(iii) 20,000 fully paid preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Dove Ltd.

You are required to calculate the amount of purchase consideration as per the provisions of AS 14

(*RTP, November, 2020*)

Answer

As per AS 14, 'Accounting for Amalgamations' consideration for the amalgamation means the aggregate of shares and other securities issued and payment made in form of cash or other assets by the transferee company to the shareholders of the transferor company.

(i) Computation of Purchase Consideration:

		₹
(a)	Preference Shares:	
	20,000 Preference shares in Som Ltd. @ ₹ 70 per share	14,00,000
(b)	Cash	1,00,000
(c)	Equity shares: 56,000 equity shares in Som Ltd. @ ₹ 110 per share	61,60,000
		76,60,000

Question 61

Astha Ltd. is absorbed by Nistha Ltd.; the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000); the payment of the 9% debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value and the payment of ₹15 per share in cash and allotment of three 11% preference shares of ₹ 10 each and four equity shares of ₹10 each at a premium of 20% fully paid for every five shares in Astha Ltd.

The number of shares of the vendor company are 1,50,000 of ₹ 10 each fully paid. Calculate purchase consideration as per AS 14.

(*RTP, May, 2021*)

Answer

As per AS 14 'Accounting for Amalgamations', the term 'consideration' has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration.

Computation of Purchase Consideration

	₹
Cash payment ₹15 x 1,50,000	22,50,000
11% Preference Shares of ₹ 10 each [(1,50,000 x 3/5) x ₹ 10]	9,00,000
Equity shares of ₹ 10 each @ 20% premium [(1,50,000 x 4/5) x ₹ 12]	14,40,000
Total Purchase consideration	45,90,000

Question 62

Naresh Ltd. had the following transactions during the financial year 2019 -2020:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2019 to operate a restaurant from Sankalp Ltd. for ₹1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during the financial year 2019-2020.

(iii) On 20th August, 2019, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2020.

(*RTP, May, 2021*)

Answer

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2020

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 i.e. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

Question 63

List the conditions to be fulfilled as per AS-14 (Revised) for an amalgamation to be in the nature of merger.

(*Suggested, January, 2021) (5 marks)*

Answer

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Question 64

Star Limited agreed to take over Moon Limited on 1st April, 2022. The terms and conditions of takeover were as follows:

(i) Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Moon Limited.

(ii) Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.

(iii) 25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Moon Limited.

You are required:

(i) to give the meaning of "consideration for the amalgamation' as per AS-14, and

(ii) Calculate the amount of purchase consideration.

(*Suggested November, 2022*) (*4 Marks*)

Answer

Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase consideration	***(₹)***	***Form***
For Preference Shareholders of Moon Ltd. (25,000 × ₹ 70)	17,50,000	25,000 Preference
For equity shareholders of Moon Ltd. (70,000 × ₹ 110)	77,00,000	70,000 Equity shares of Star Ltd.
	1,25,000	Cash
Total Purchase consideration	95,75,000	

Question 65

Explain the difference between pooling of interest and purchase method of accounting for amalgamations.

(*MTP October, 2023*) (*Advance Accounts*) (*4 Marks*)

Answer

Pooling of Interest Method

Under pooling of interests method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies. As a result the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in reserves.

Purchase Method

The assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. No reserves, other than statutory reserves, of the transferor company should be incorporated in the financial statements of transferee company.

Question 66

High Ltd. and Low Ltd. were amalgamated on and from, 1st April, 2023. A new company Little Ltd. was formed to take over the business of the existing Companies. High Ltd. and Low Ltd. give the following information as on 31st March, 2023:

(₹ *in Lakhs*)

	High Ltd.	***Low Ltd.***		***High Ltd.***	***Low Ltd.***
Share Capital:			*Property, Plant and Equipment:*		
Equity Shares of ₹100 each	*1000*	*850*	*Land & Building*	*670*	*385*
14% Pref Shares of ₹100 each	*320*	*175*	*Plant & Machinery*	*475*	*355*
Reserves & Surplus:			*Investments*	*95*	*80*
Revaluation Reserve	*225*	*110*	*Current Assets:*		
General Reserve	*360*	*240*	*Stock*	*415*	*389*
Investment Allowance Reserve	*80*	*40*	*Sundry Debtors*	*322*	*213*
P & L Account	*85*	*82*	*Bills Receivables*	*35*	*-*
Non-Current Liabilities:			*Cash & Bank*	*303*	*166*
Secured Loans:					
13% Debentures (₹100 each)	*100*	*56*			
Unsecured Loans (Public Deposits)	*50*	*-*			
Current Liabilities & Provisions:		*-*			
Sundry Creditors	*65*	*35*			
Bills Payable	*30*	*-*			

Other Information:

(1) 13% Debenture holders of High Ltd. & Low Ltd. are discharged by Little Ltd. by issuing such number of its 15% Debentures of ₹100 each so as to maintain the same amount of interest.

(2) Preference Shareholders of the two companies are issued equivalent number of 15% Preference shares of Little Ltd. at a price of ₹125 per share (Face Value ₹100)

(3) Little Ltd. will issue 4 Equity Shares for each Equity Share of High Ltd. & 3 equity shares for each Equity Share of Low Ltd. The shares are to be issued at ₹35 each having a face value of ₹10 per share.

(4) Investment Allowance Reserve is to be maintained for two more years.

Prepare the Balance sheet of Little Ltd. as on 1st April, 2023 after the amalgamation, has been carried out, in the nature of Purchase.

(*MTP September, 2023*) (*Advance Accounts*) (*14 Marks*)

Answer

Balance Sheet of Little Ltd. as at 1st April, 2023

Particulars	**Note No.**	**(₹ in lakhs)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,150.0
(b) Reserves and Surplus	2	2,437.8
(2) Non-Current Liabilities		
Long-term borrowings	3	135.2
Other Borrowings- Unsecured Loans		50
(3) Current Liabilities		
Trade payables	4	130.0
Total		**3,903**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	1,885
(b) Non-current investment (95 + 80)		175
(2) Current assets		
(a) Inventory (415+389)		804
(b) Trade receivables	6	570
(c) Cash and bank balances (303 + 166)		469
Total		3,903

Notes to Accounts

			(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital			
	Equity share capital (W.N.1)			
	65,50,000[1] Equity shares of 10 each		655	
	4,95,000[2] Preference shares of ₹ 100 each		495	
	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)			
2.	Reserves and surplus			1,150
	Securities Premium Account (W.N.3) (1080+ 681.25)		1,761.25	
	Capital Reserve (W.N. 2)(283.33 + 393.22)		676.55	
	Investment Allowance Reserve (80 + 40)		120	
	Amalgamation Adjustment Reserve (80 + 40)		(120)	2,437.8
3.	Long-term borrowings			
	15% Debentures			135.2
4.	Trade payables			
	Sundry Creditors: High Ltd.		65	
	Low Ltd. Bills Payable: High Ltd.		35	
			30	130
5.	Property, Plant and Equipment			
	Land and Building : High Ltd	670		
	Low Ltd	385	1055	
	Plant and Machinery: High Ltd.	475		
	Low Ltd.	355	830	1,885
6.	Trade receivables			
	Sundry Debtors: High Ltd.		322	
	Low Ltd. Bills Receivables: High Ltd.		213	
			35	570

Working Notes:

			(₹ in lakhs)	
			High Ltd.	**Low Ltd.**
(1)	Computation of Purchase consideration			
	(a)	Preference shareholders:	400	
		$\left(\frac{3,20,00,000}{100} \text{ i.e. } 3,20,000 \text{ shares}\right) \times ₹125 \text{ each}$		
		$\left(\frac{1,75,00,000}{100} \text{ i.e. } 1,75,000 \text{ shares}\right) \times ₹125 \text{ each}$		218.75
	(b)	Equity shareholders:	1,400	
		$\left(\frac{10,00,00,000 \times 4}{100} \text{ i.e. } 40,00,000 \text{ shares}\right) \times ₹35 \text{ each}$		
		$\left(\frac{8,50,00,000 \times 3}{100} \text{ i.e. } 25,50,000 \text{ shares}\right) \times ₹35 \text{ each}$		892.50
	Amount of Purchase Consideration		1,800	1,111.25
(2)	Computation of Capital Reserve			
	Assets taken over:			
	Land and Building		670	385
	Plant and Machinery		475	355
	Investments		95	80

1 40,00,000 + 25,50,000.

2 3,20,000 + 1,75,000.

			(₹ in lakhs)	
			High Ltd.	**Low Ltd.**
	Inventory		415	389
	Trade receivables		322	213
	Bills Receivables		35	
	Cash and bank		303	166
			2,315	1,588
	Less: Liabilities taken over:			
	Debentures	86.67		48.53
	Unsecured Loan	50		
	Creditors	65		35
	Bills Payable	30		
			231.67	83.53
	Net assets taken over		2083.33	1,504.47
	Purchase consideration		1,800	1,111.25
	Capital reserve		283.33	393.22
(3)	Computation of securities premium			
	On preference share capital			
	High Ltd.- 3,20,000 x 25			
	Low Ltd.- 1,75,000 x 25		80	
	On equity share capital			43.75
	High Ltd.- 40,00,000 x 25		1000	
	Low Ltd.- 25,50,000 x 25			637.5
	Total		1080	681.25
(4)	Issue of Debentures (₹ In Lakhs)			
	High Ltd.- 15% fresh issue of debenture for 13% old debentures = 100 X 13% /15% = 86.67(rounded off)			
	Low Ltd.- 15% fresh issue of debenture for 13% old debentures = 56 X 13% /15% = 48.53 (rounded off)			
	Total number of debentures issued = 86.67 + 48.53 = 135.20 Lakhs			

Question 67

The following information from Balance Sheet of X Ltd. as at 31st March, 2023:

	₹
4,000 Equity shares of ₹100 each	*4,00,000*
10% Debentures	*2,00,000*
Loans	*80,000*
Trade payables	*1,60,000*
General Reserve	*40,000*
Building	*1,70,000*
Machinery	*3,20,000*
Inventory	*1,10,000*
Trade receivables	*1,30,000*
Bank	*68,000*
Patent	*65,000*
Share issue Expenses	*17,000*

Y Ltd. agreed to absorb X Ltd. on the following terms and conditions:

(1) Y Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 years purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) Y Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹ 3,00,000 and the balance in fully paid equity shares of ₹100 each at ₹125 per share.

The average profit is ₹62,200. The liquidation expenses amounted to ₹8,000. Y Ltd. sold prior to 31st March, 2023 goods costing ₹60,000 to X Ltd. for ₹80,000. ₹50,000 worth of goods are still in Inventory of X Ltd. on 31st March, 2023. Trade payables of X Ltd. include ₹20,000 still due to Y Ltd.

Show the necessary Ledger Accounts to close the books of X Ltd. and prepare the Balance Sheet of Y Ltd. as at 1st April, 2023 after the takeover.

(RTP November, 2023) (Advance Accounts) (14 Marks)

Answer

Books of X Limited
Realisation Account

		₹			₹
To	Building	1,70,000	By	Trade payables	1,60,000
To	Machinery	3,20,000	By	Y Ltd.	6,05,000
To	Inventory	1,10,000	By	Equity Shareholders (Loss)	38,000
To	Trade receivables	1,30,000			
To	Patent	65,000			
To	Bank (Exp.)	8,000			
		8,03,000			8,03,000

Bank Account

To	Balance b/d	68,000	By	Realisation (Exp.)	8,000
To	Y Ltd.	3,00,000	By	10% Debentures	2,00,000
			By	Loan	80,000
			By	Equity shareholders	80,000
		3,68,000			3,68,000

10% Debentures Account

To	Bank	2,00,000	By	Balance b/d	2,00,000
		2,00,000			2,00,000

Loan Account

To	Bank	80,000	By	Balance b/d	80,000
		80,000			80,000

Share Issue Expenses Account

To	Balance b/d	17,000	By	Equity shareholders	17,000
		17,000			17,000

General Reserve Account

To	Equity shareholders	40,000	By	Balance b/d	40,000
		40,000			40,000

Y Ltd. Account

To	Realisation A/c	6,05,000	By Bank		3,00,000
			By Equity share in Y Ltd. (2,440 shares at ₹ 125 each)		3,05,000
		6,05,000			6,05,000

Equity Shares in Y Ltd. Account

To	Y Ltd.	3,05,000	By	Equity shareholders	3,05,000
		3,05,000			3,05,000

Equity Share Holders Account

To	Realisation	38,000	By	Equity share capital	4,00,000
To	Share issue Expenses	17,000	By	General reserve	40,000
To	Equity shares in B Ltd.	3,05,000			
To	Bank	80,000			
		4,40,000			4,40,000

Y Ltd

Balance Sheet as on 1st April, 2023 (An extract)*

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	2,44,000
	b	Reserves and Surplus	2	53,500
2		**Current liabilities**		
	a	Trade Payables	3	1,40,000
	b	Bank overdraft		3,00,000
		Total		7,37,500
		Assets		
1		**Non-current assets**		
	a	Property, Plant and Equipment	4	4,41,000
		Intangible assets	5	1,08,000
2		**Current assets**		
	a	Inventories	6	91,500
	b	Trade receivables	7	97,000
				7,37,500

Notes to Accounts

			₹
1	**Share Capital**		
	Equity share capital		
	2,440 Equity shares of ₹ 100 each (Shares have been issued for consideration other than cash)		2,44,000
	Total		2,44,000
2	**Reserves and Surplus (an extract)**		
	Securities Premium		61,000
	Profit and loss account	…..	
	Less: Unrealised profit	(7,500)	(7,500)
	Total		53,500
3	**Trade payables**		
	Opening balance	1,60,000	
	Less: Inter-company transaction cancelled upon amalgamation	(20,000)	1,40,000
4	**Property, Plant and Equipments**		
	Buildings		1,53,000
	Machinery		2,88,000
	Total		4,41,000
5	**Intangible assets**		
	Goodwill		1,08,000
6	**Inventories**		
	Opening balance	99,000	
	Less: Cancellation of profit upon amalgamation	(7,500)	91,500
7	**Trade receivables**		
	Opening balance	1,17,000	
	Less: Intercompany transaction cancelled upon amalgamation	(20,000)	97,000

* In the absence of the particulars of assets and liabilities (other than those of X Ltd.), the complete Balance Sheet of Y Ltd. after takeover cannot be prepared

Working Notes:

1. Valuation of Goodwill	₹
Average profit	62,200
Less: 8% of ₹ 4,40,000	(35,200)
Super profit	27,000
Value of Goodwill = 27,000 x 4	1,08,000
2. Net Assets for purchase consideration	
Goodwill as valued in W.N.1	1,08,000
Building	1,53,000
Machinery	2,88,000
Inventory	99,000
Trade receivables (1,30,000-13,000)	1,17,000
Total Assets	7,65,000
Less: Trade payables	(1,60,000)
Net Assets	6,05,000

Out of this ₹ 3,00,000 is to be paid in cash and remaining i.e., (6,05,000 – 3,00,000) ₹ 3,05,000 in shares of ₹ 125. Thus, the number of shares to be allotted 3,05,000/125 = 2,440 shares.

3. Unrealised Profit on Inventory	₹
The Inventory of X Ltd. includes goods worth ₹ 50,000 which was sold by Y Ltd. on profit. Unrealized profit on this Inventory will be [20,000/80,000 x 50,000]	12,500
As Y Ltd purchased assets of X Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 50,000.	(5,000)
Amount of unrealized profit	7,500

Question 68

Naresh Ltd. had the following transactions during the financial year 2022-2023:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2022. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2022 to operate a restaurant from Sankalp Ltd. for ₹ 1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during the financial year 2022-2023.

(iii) On 20th August, 2022, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition.

Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2023.

(*RTP May, 2024*)

Answer

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2023

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000

		₹
	Less: Amortisation as per AS 14 ie. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

Question 69

Following is the information of Anu Ltd. and Banu Ltd. as on 31.03.2023 were as under:

	Anu Ltd. (₹)	**Banu Ltd. (₹)**
Share Capital:		
50,000 Equity Shares of ₹10 each, Fully Paid	5,00,000	
37,500 Equity Shares of ₹10 each, Fully Paid		3,75,000
General Reserve	3,00,000	-
Profit and Loss Account	62,500	62,500
Trade Payables	2,62,500	1,62,500
5% Debentures	-	1,50,000
Freehold Property	3,75,000	3,00,000
Plant and Machinery	75,000	50,000
Motor Vehicle	37,500	25,000
Trade Receivables	2,50,000	1,00,000
Inventory	2,87,500	2,25,000
Cash at Bank	1,00,000	50,000

Anu Ltd. and Banu Ltd. carry on business of similar nature and they agreed to amalgamate.

A new Company, Anban Ltd. is formed to take over the Assets and Liabilities of Anu Ltd. and Banu Ltd. on the following basis:

Assets and Liabilities are to be taken at Book Value, with the following exceptions:

(a) Goodwill of Anu Ltd. and Banu Ltd. is to be valued at ₹1,75,000 and ₹50,000 respectively.

(b) Plant and Machinery of Anu Ltd. are to be valued at ₹1,25,000.

(c) The Debentures of Banu Ltd. are to be discharged by the issue of 6% Debentures of Anan Ltd. at a premium of 5%.

You are required to:

1. Compute the basis on which shares in Anban Ltd. will be issued to Shareholders of the existing Companies assuming nominal value of each share of Anban Ltd. is ₹10.
2. Draw up a Balance Sheet of Anban Ltd. as on 1st April, 2023, when Amalgamation is completed.

(*MTP Advanced Accounting April, 2024*) (*14 Marks*)

Answer

Calculation of Net Assets

Particulars	**Anu Ltd. (₹)**	**Banu Ltd. (₹)**
Goodwill	1,75,000	50,000
Freehold property	3,75,000	3,00,000
Plant & Machinery	1,25,000	50,000
Motor vehicle	37,500	25,000
Trade receivable	2,50,000	1,00,000
Inventory	2,87,500	2,25,000
Cash at Bank	1,00,000	50,000
Total	13,50,000	8,00,000
Less : Trade payable	(2,62,500)	(1,62,500)
6% debentures	-	(1,57,500)
Net Assets	10,87,500	4,80,000

Calculation of Purchase Consideration

Sr. No.	Particulars	Computation	Anu Ltd	Banu Ltd
1	Amount payable to Equity Share Holder in the form of			
	1,08,750 Equity shares of ₹10 each	(1,08,750 × 10)	10,87,500	
	48,000 Equity shares of ₹10 each	(48,000 × 10)		4,80,000
	Purchase Consideration		10,87,500	4,80,000

Balance Sheet of Anban Ltd. as on 1st April, 2023

	Particulars	Note No.	₹
	Equity and Liabilities		
(1)	Shareholders' Funds		
(a)	Share Capital	1	15,67,500
(2)	Non-current Liabilities		
(a)	Long term borrowings	2	1,57,500
(3)	Current Liabilities		
(a)	Trade Payables (2,62,500 + 1,62,500)		4,25,000
	Total		21,50,000
	Assets		
(1)	Non-current Assets		
(a)	Property Plant and Equipment	3	9,12,500
(b)	Intangible assets	4	2,25,000
(2)	Current Assets		
(a)	Inventories (2,87,500 + 2,25,000)		5,12,500
(b)	Trade Receivables (2,50,000 + 1,00,000)		3,50,000
(c)	Cash and cash equivalents (1,00,000 + 50,000)		1,50,000
	Total		21,50,000

Notes to Accounts:

Note No.	Particulars	₹
1	Share Capital	
	Equity share capital	
	1,56,750 equity shares of ₹10 each	15,67,500
	(out of above shares are issued for consideration other than cash)	
2	Long term borrowings	
	6% Debentures	1,57,500
3	Property, Plant & Equipment's	
	Freehold property (3,75,000 + 3,00,000)	6,75,000
	Plant & Machinery (1,25,000 + 50,000)	1,75,000
	Motor Vehicle (37,500+25,000)	62,500
		9,12,500
4	Intangible assets	
	Goodwill (1,75,000 + 50,000)	2,25,000

Question 70

The financial position of two companies Hari Ltd. and Vayu Ltd. as at 31 st March, 2023 was as under:

		Particulars	Notes	Hari Ltd.	Vayu Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	11,00,000	4,00,000
	B	Reserves and Surplus	2	70,000	70,000
2		**Non-current liabilities**			
	A	Long term provisions	3	50,000	20,000
3		**Current liabilities**			
	A	Trade Payables		1,30,000	80,000
		Total		13,50,000	5,70,000
		Assets			

		Particulars	Notes	Hari Ltd.	Vayu Ltd.
1		**Non-current assets**			
	A	Property, Plant and Equipment	4	8,00,000	2,50,000
	B	Intangible assets	5	50,000	25,000
2		**Current assets**			
	A	Inventories		2,50,000	1,75,000
	B	Trade receivables		2,00,000	1,00,000
	C	Cash and Cash equivalents		50,000	20,000
		Total		13,50,000	5,70,000

Notes to accounts

			Hari Ltd.	Vayu Ltd.
1	**Share Capital**			
	Equity shares of ₹ 10 each		10,00,000	3,00,000
	9% Preference Shares of ₹ 100 each		1,00,000	--
	10% Preference Shares of ₹ 100 each		--	1,00,000
			11,00,000	4,00,000
2	**Reserves and Surplus**			
	General reserve		70,000	70,000
			70,000	70,000
3	**Long term Provisions**			
	Retirement gratuity fund		50,000	20,000
			50,000	20,000
4	**Property, plant and Equipment**			
	Land and Building		3,00,000	1,00,000
	Plant and machinery		5,00,000	1,50,000
			8,00,000	2,50,000
5	**Intangible assets**			
	Goodwill		50,000	25,000
			50,000	25,000

Hari Ltd. absorbs Vayu Ltd. on the following terms:

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.

(b) Goodwill of Vayu Ltd. is valued at ₹ 50,000, Buildings are valued at ₹ 1,50,000 and the Machinery at ₹ 1,60,000.

(c) Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.

(d) Equity Shareholders of Vayu Ltd. will be issued necessary Equity Shares @ 5% premium.

Prepare necessary the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 2023. (*MTP Advanced Accounting March, 2024*) (*14 Marks*)

Answer

In the Books of Hari Ltd.
Journal Entries

		₹	₹
Business Purchase A/c	Dr.	5,30,000	
To Liquidators of Vayu Ltd. Account			5,30,000
(Being business of Vayu Ltd. taken over)			
Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Inventory Account	Dr.	1,57,500	
Trade receivables Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Retirement Gratuity Fund Account			20,000
To Trade payables Account			80,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			5,30,000
(Being Assets and Liabilities taken over as per agreed valuation).			

		₹	₹
Liquidators of Vayu Ltd. A/c	Dr.	5,30,000	
To 9% Preference Share Capital A/c			1,10,000
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			20,000
(Being Purchase Consideration satisfied as above).			

Balance Sheet of Hari Ltd. (after absorption) as at 31st March, 2023

Particulars			Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	16,10,000
	B	Reserves and Surplus	2	90,000
2		**Non-current liabilities**		
	A	Long-term provisions	3	70,000
3		**Current liabilities**		
	A	Trade Payables		2,10,000
		Total		19,80,000
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	4	11,10,000
	B	Intangible assets	5	1,00,000
2		**Current assets**		
	A	Inventories		4,07,500
	B	Trade receivables	6	2,92,500
	C	Cash and cash equivalents		70,000
		Total		19,80,000

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	1,40,000 Equity Shares of ₹ 10 each fully paid (Out of above 40,000 Equity Shares were issued in consideration other than for cash)		14,00,000
	Preference share capital		
	2,100 9% Preference Shares of ₹ 100 each (Out of above 1,100 Preference Shares were issued in consideration other than for cash)		2,10,000
	Total		16,10,000
2	**Reserves and Surplus**		
	Securities Premium		20,000
	General Reserve		70,000
	Total		90,000
3	**Long-term provisions**		
	Retirement Gratuity fund		70,000
	Total		70,000
4	**Property, Plant and Equipment**		
	Buildings		4,50,000
	Machinery		6,60,000
	Total		11,10,000
5	**Intangible assets**		
	Goodwill		1,00,000
6	**Trade receivables**		3,00,000
	Less: Provision for Doubtful Debts		7,500
			2,92,500

Working Notes:

Purchase Consideration:	**₹**
Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Inventory	1,57,500
Trade receivables	92,500
Cash at Bank	20,000
Less: Liabilities:	6,30,000
Retirement Gratuity Fund	(20,000)
Trade payables	(80,000)
Net Assets/ Purchase Consideration	5,30,000
To be satisfied as under:	
10% Preference Shareholders of Vayu Ltd.	1,00,000
Add: 10% Premium	10,000
1,100 9% Preference Shares of Hari Ltd.	1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium	4,20,000
Total	5,30,000

Question 71

Intelligent Limited and Diligent Limited are carrying their business independently for last two years. Following financial information in respect of both the companies as at 31st March, 2024 has been given to you:

Particulars	**Intelligent Limited (₹)**	**Diligent Limited (₹)**
Equity Share Capital of ₹ 100 each	12,00,000	10,00,000
8% Preference shares of ₹ 100 each	3,00,000	2,00,000
Trade Payables	12,00,000	4,00,000
Retirement Gratuity Fund (Long Term)	3,00,000	2,00,000
Profit and Loss Account		
Opening balance	4,50,000	2,50,000
Profit for the current year	2,50,000	1,50,000
Land and Buildings	10,00,000	8,00,000
Plant and Machinery	10,00,000	6,00,000
Inventories	7,00,000	4,00,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	4,00,000	1,00,000

On 1st April, 2024, both the companies agreed to amalgamate and form a new company 'Genius Limited' with an authorized capital of ₹40,00,000 divided into 30,000 equity shares of ₹100 each and 10,000 8% preference shares of ₹100 each.

The amalgamation has to be carried out on the basis of following agreement:

(1) Assets of both the companies were to be revalued as follows:

Particulars	**Intelligent Limited (₹)**	**Diligent Limited (₹)**
Land and Buildings	11,00,000	8,50,000
Plant and Machinery	9,00,000	4,00,000
Inventories	6,00,000	3,00,000

(2) Trade payables of Intelligent Limited includes ₹1,00,000 due to Diligent Ltd. and the Trade receivables of Diligent Limited shows ₹1,00,000 receivables from Intelligent Limited.

(3) The purchase consideration is to be discharged in the following manner:

(i) Issue 22,000 Equity Shares of ₹100 each fully paid up in the proportion of the sum of their profitability in the preceding two financial years.

(ii) Preference shareholders of both companies are issued equivalent number of 10% Preference Shares of ₹100 each of Genius Limited at a price of ₹125 per share.

(iii) 12% debentures of ₹100 each in Genius Limited at par to provide an income equivalent to 10% return on the basis of net assets in their respective business as on 1st April, 2024 after revaluation of assets.

You are required to:

(a) Compute the amount of Shares & Debentures to be issued to Intelligent Limited and Diligent Limited.

(b) Prepare a Balance Sheet of Genius Limited showing the position immediately after amalgamation.

(*Question Paper May, 2024) (14 Marks*)

MCQs

Question - 1: Amalgamation adjustment reserve is opened in the books of the amalgamated company to incorporate

Answer:

1. *Assets of the amalgamating company.*
2. *Non- Statutory reserves of the amalgamating company.*
3. *Statutory reserves of the amalgamating company.*
4. General reserve of the amalgamating company.

Question - 2: A company into which the vendor company is merged is called

Answer:

1. *Transferee company.*
2. *Transferor company.*
3. *Selling company.*
4. *Acquiree company.*

Question - 3: Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as

Answer:

1. *Other current asset.*
2. *Separate line item with a negative sign under the head Reserves and Surplus.*
3. *Other non-current assets.*
4. *Investment of the company*

Question - 4: If expenses of liquidation of the vendor company are paid by the purchasing company then, in purchasing company's book, the account debited is

Answer:

1. *Goodwill account.*
2. *Liquidation expense account.*
3. *Vendor company account.*
4. *General reserve.*

Question - 5: In case of amalgamation, the entry for elimination of unrealized profit or loss on stock is made

Answer:

1. *By the vendor company*
2. *By the purchasing company*
3. *By the third party*
4. *By the court*

Question - 6: If the purchase consideration is more than net assets (at agreed values) of the transferor company, difference shall be recorded as _____ in the books of the transferee company.

Answer:

1. *Goodwill.*
2. *Capital Reserve.*
3. *Profit.*
4. *Loss.*

Question - 7: In case of amalgamation, the entry for elimination of unrealized profit or loss on stock is made

Answer:

1. *By the vendor company*
2. *By the purchasing company*
3. *By the third party*
4. *By the court*

Question - 8: If expenses of liquidation of the vendor company are paid by the purchasing company then, in purchasing company's book, the account debited is

Answer:

1. *Goodwill account.*
2. *Liquidation expense account.*
3. *Vendor company account.*
4. *General reserve.*

Question - 9: Amalgamation adjustment reserve is opened in the books of the amalgamated company to incorporate

Answer:

1. *Assets of the amalgamating company.*
2. *Non- Statutory reserves of the amalgamating company.*
3. *Statutory reserves of the amalgamating company.*
4. *General reserve of the amalgamating company.*

Question - 10: Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as

Answer:

1. *Other current asset.*
2. *Separate line item with a negative sign under the head 'Reserves and Surplus'.*
3. *Other non-current assets.*
4. *Investment of the company*

Question - 11: A company into which the vendor company is merged is called

Answer:

1. *Transferee company.*
2. *Transferor company.*
3. *Selling company.*
4. *Acquiree company.*

Question - 12: If the purchase consideration is more than net assets (at agreed values) of the transferor company, difference shall be recorded as _____ in the books of the transferee company.

Answer:

1. *Goodwill.*
2. *Capital Reserve.*
3. *Profit.*
4. *Loss.*

Question - 13: Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as

Answer:

1. *Other current asset.*
2. *Separate line item with a negative sign under the head 'Reserves and Surplus'.*
3. *Other non-current assets.*
4. *Investment of the company*

Question - 14: For amalgamation in the nature of merger, the shareholders holding at least _____ or more of the equity shares of the transferor company becomes the equity shareholders of the transferee company.

Answer:

1. *51%*
2. *90%*
3. *99%*
4. *100%*

Question - 15: X Ltd. goes into liquidation and a new company Z Ltd. is formed to take over the business of X Ltd. It is a case of:

Answer:

1. *Absorption*
2. *External reconstruction*
3. *Amalgamation*
4. *Commencement.*

Question - 16: Under purchase method the difference between the purchase consideration and net assets acquired should be adjusted to

Answer:

1. *General reserve*
2. *Amalgamation adjustment account*
3. *Goodwill or capital reserve*
4. *General Reserve or Capital Reserve.*

Question - 17: As per AS 14 purchase consideration is what is payable to

Answer:

1. *Shareholders*
2. *Creditors*
3. *Debenture holders*
4. *Shareholders and Debenture holders*

Question - 18: Which of the following statement is correct:

Answer:

1. *In case of merger – ESH can be issued only equity shares as a part of Purchase consideration.*
2. *In case of purchase – ESH can be issued Preference shares also as a part of Purchase consideration.*
3. *Both (a) and (b) are correct.*
4. *Both (a) and (b) are incorrect.*

Question - 19: State which statement is correct:

Answer:

1. *In case of merger – assets and liabilities can only be taken over at book values.*
2. *In case of purchase – assets and liabilities can be taken over at book values or agreed values.*
3. *Both (a) and (b) are correct.*
4. *Both (a) and (b) are incorrect.*

Question - 20: State which statement is correct:

Answer:

1. *In case of merger – All Reserves and surplus of vendor company are taken over by Purchasing company.*
2. *In case of Purchase – None of the Reserves and surplus of vendor company are taken over by Purchasing company.*
3. *Both (a) and (b) are correct.*
4. *Only (a) is correct.*

Question - 21: State which statement is correct:

Answer:

1. *In case of merger – We use pooling of interest method for accounting.*
2. *In case of Purchase We use purchase method or pooling of interest method depending upon whether it is take over at agreed values or book values.*
3. *Both (a) and (b) are correct.*
4. *Only (a) is correct.*

Question - 22: State which statement is incorrect:

Answer:

1. *In case of merger – We can issue either preference shares or equity shares to PSH.*
2. *In case of Purchase – We can issue either preference shares or equity shares to PSH.*
3. *In case of merger – We can issue only preference shares to PSH.*
4. *none of the above*

Answer

Q1	**3**	**Q2**	**1**	**Q3**	**2**	**Q4**	**1**	**Q5**	**2**	**Q6**	**1**
Q7	**2**	**Q8**	**1**	**Q9**	**3**	**Q10**	**2**	**Q11**	**1**	**Q12**	**1**
Q13	**2**	**Q14**	**2**	**Q15**	**2**	**Q16**	**3**	**Q17**	**1**	**Q18**	**2**
Q19	**3**	**Q20**	**4**	**Q21**	**4**	**Q22**	**3**				

Accounting for Reconstruction of Companies

Question 1

On 31-12-20X1, B Ltd. had 20,000, ₹ 10 Equity Shares as authorized 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 two 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.

(*Source: Illustration 1, Study Material*)

Solution

Journal Entries

20X2			₹	₹
June	Equity Share Capital (₹ 10) A/c	Dr.	1,60,000	
	To Equity Share Capital (₹ 5) A/c			1,60,000
	(Being the sub-division of 20,000 shares of ₹ 10 each with ₹ 8 paid up into 40,000 shares ₹ 5 each with ₹ 4 paid up by resolution in general meeting dated)			
20X3 June	Equity Share Capital (₹ 5) A/c	Dr.	1,60,000	
	To Equity Share Capital (₹ 100) A/c			1,60,000
	(Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shares with ₹ 80 paid up)			

Notes to Balance Sheet

Liabilities:	₹
As on 31-12-20X1	
1. Share Capital	
Authorized:	
20,000 Equity Shares of ₹ 10 each	2,00,000
Issued, Subscribed and Paid up:	
20,000 Equity Shares of ₹ 10 each ₹ 8 per share paid up	1,60,000
As on 31-12-20X2	
1. Share Capital	
Authorized:	
40,000 Equity Shares of ₹ 5 each	2,00,000
Issued, Subscribed and Paid up:	
40,000 Equity Shares of ₹ 5 each ₹ 4 per share paid up	1,60,000

Liabilities:	***₹***
As on 31-12-20X3	₹
1. Share Capital	
Authorized:	
2,000 Equity Shares of ₹ 100 each	2,00,000
Issued, Subscribed and Paid up:	
2,000 Equity Shares of ₹ 100 each ₹ 80 per share paid up	1,60,000

Note: Some accountants prefer not to make any entry as the amount remains same. Even when an entry is passed it applies only to the called-up portion, and not to uncalled or unissued portion of share capital.

Question 2

C Ltd. had ₹ 5,00,000 authorized capital on 31-12-20X1 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully paid up. In June 20X2 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.

(*Source: Illustration 2, Study Material*)

Solution

Journal Entries

			₹	₹
20X2				
June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c			4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated…)			
20X3				
June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Notes to Balance Sheet

	₹
As on 31-12-20X1	
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	5,00,000
Issued and Subscribed	
4,000 Equity Shares of ₹ 100 each fully called up	4,00,000
As on 31-12-20X2	₹
Share Capital	
Authorized	
5,000 Equity Shares of ₹ 100 each	5,00,000
Issued and Subscribed	
Equity Stock- 4,000 Equity Shares of ₹ 100 converted into Stock	4,00,000

	₹
As on 31-12-20X3	₹
Share Capital	
Authorized	
50,000 Equity Shares of ₹ 10 each	5,00,000
Issued and Subscribed	
40,000 Equity Shares of ₹ 10 each fully called up	4,00,000

Question 3

The Balance Sheet of A & Co. Ltd. as at 31-12-20X1 is as follows:

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*11,50,000*
	B	*Reserves and Surplus*	*2*	(*5,35,000*)
2		***Non-current liabilities***		
	A	*Long-term borrowings*	*3*	*3,75,000*
3		***Current liabilities***		
	A	*Trade Payables*		*3,00,000*
	B	*Short term borrowings - Bank Overdraft*		*1,95,000*
	C	*Other current liabilities*	*4*	*1,22,500*
		Total		*16,07,500*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and equipment*	*5*	*4,75,000*
	B	*Intangible assets*	*6*	*1,67,500*
	C	*Non-current investments*	*7*	*55,000*
2		***Current assets***		
	A	*Inventories*		*4,25,000*
	B	*Trade receivables*		*4,85,000*
		Total		*16,07,500*

Notes to accounts

		₹
1	***Share Capital***	
	Equity share capital:	
	75,000 Equity Shares of ₹ 10 each	*7,50,000*
	Preference share capital:	
	4,000 6% Cumulative Preference Shares of ₹ 100 each	*4,00,000*
		11,50,000
2	***Reserves and Surplus***	
	Debit balance of Profit and loss Account	(*5,35,000*)
		(*5,35,000*)
3	***Long-term borrowings***	
	Secured	
	6% Debentures (*secured on the freehold property*)	*3,75,000*
		3,75,000
4	***Other current liabilities***	
	Loan from directors	*1,00,000*
	Interest payable on 6% debentures	*22,500*

		₹
		1,22,500
5	***Property plant and Equipment***	
	Freehold property	*4,25,000*
	Plant	*50,000*
		4,75,000
6	***Intangible assets***	
	Goodwill	*1,30,000*
	Patents	*37,500*
		1,67,500
7	***Non-current investments***	
	Investments at cost	*55,000*
		55,000

The Court approved a Scheme of re-organization to take effect on 1-1-20X2, 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) Interest payable 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% p.a.

(v) Patents and Goodwill to be written off.

(vi) Inventory to be written off by ₹ 65,000.

(vii) Amount of ₹ 68,500 to be provided for bad debts.

(viii) Remaining freehold property after giving to debenture holders, to be re-valued at ₹ 3,87,500.

(ix) 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 totalling ₹ 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.

(*Source: Illustration 3, Study Material*)

Solution

Journal of A & Co. Ltd.

			Dr. ₹	***Cr.*** ₹
20X2	Equity Share Capital A/c (₹ 10)	Dr.	7,50,000	
Jan. 1	To Capital Reduction A/c			6,00,000
	To Equity Share Capital A/c (₹ 2)			1,50,000
	(Reduction of equity shares of ₹ 10 each to shares of ₹ 2 each as per Reconstruction Scheme dated...)			
	6% Cum. Preference Share Capital A/c (₹ 100)	Dr.	4,00,000	
	To Capital Reduction A/c			1,00,000
	To Pref. Share Capital A/c (₹ 75)			3,00,000
	(Reduction of preference shares of ₹ 100 each to shares of ₹ 75 each as per reconstruction scheme)			

			Dr. ₹	Cr. ₹
Jan. 1	Capital Reduction Account	Dr.	24,000	
	To Equity Share Capital Account			24,000
	(Arrears of preference dividends satisfied by the issue of equity shares, 25% of the amount due, ₹ 96,000)			
20X2 Jan. 1	Freehold Property A/c	Dr.	82,500	
	To Capital Reduction A/c			82,500
	(Appreciation in the value of property:			
	Book value: ₹ 1,00,000; ₹ 3,25,000; Total ₹ 4,25,000 — Revalued Figure: ₹ 1,20,000; ₹ 3,87,500; ₹ 5,07,500			
	Profit on revaluation: ₹ 82,500)			
”	6% Debentures A/c	Dr.	1,20,000	
	To Freehold Property A/c			1,20,000
	(Claims of debenture-holders, in part, in respect of principal discharged by transfer of freehold property vide Scheme of Reconstruction)			
	Interest payable A/c	Dr.	22,500	
	To Bank A/c			22,500
	(Debenture interest paid)			
”	Bank A/c	Dr.	1,30,000	
	To 8% Debentures A/c			1,30,000
	(8% Debentures issued for cash)			
”	Bank A/c	Dr.	1,40,000	
	To Investment A/c			55,000
	To Capital Reduction A/c			85,000
	(Sale of Investment for ₹ 1,40,000 cost being ₹ 55,000; profit credited to Capital Reduction Account)			
”	Directors’ Loan A/c	Dr.	1,00,000	
	To Equity Share Capital A/c			90,000
	To Bank A/c			5,000
	To Capital Reduction A/c			5,000
	(Directors’ loan discharged by issue of equity shares of ₹ 90,000, cash payments of ₹ 5,000 and surrender of ₹ 5,000, vide Scheme of Reconstruction)			
”	Capital Reduction A/c	Dr.	8,48,500	
	To Patents			37,500
	To Goodwill			1,30,000
	To Inventory			65,000
	To Provision for Doubtful Debts			68,500
	To Bank			12,500
	To Profit & Loss Account			5,35,000

		Dr. ₹	Cr. ₹
	(Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtful debts and payment for cancellation of capital commitments)		

Note: Penalty charges for cancellation of the contract amounts to ₹ 12,500 (2,50,000X5%) being paid in cash.

Balance Sheet of A & Co. Ltd. (And Reduced) as at 1st January, 20X2

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	5,64,000
2		**Non-current liabilities**		
	A	Long-term borrowings	2	3,85,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
		Total		12,49,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	4,37,500
	B	Intangible assets	4	-
2		**Current assets**		
	A	Inventories		3,60,000
	B	Trade receivables	5	4,16,500
	C	Cash and cash equivalents		35,000
		Total		12,49,000

Notes to accounts

1	**Share Capital**		
	Equity share capital		
	1,32,000 Equity shares of ₹ 2 each (of the above 57,000 shares have been issued for consideration other than cash)		2,64,000
	Preference share capital		
	4,000 6% Preference shares of ₹ 75 each		3,00,000
	Total		5,64,000
	Long-term borrowings		
2	Secured		
	6% Debentures		2,55,000
	8% Debentures		1,30,000
	Total		3,85,000
3	**Property, plant and equipment**		
	Freehold property	4,25,000	
	Add: Appreciation under scheme of Reconstruction	82,500	
	Less: Disposed of	(1,20,000)	3,87,500
	Plant		50,000
	Net carrying value		4,37,500

4	**Intangible assets**		
	Goodwill	1,30,000	
	Less: Written off under scheme of Reconstruction	(1,30,000)	
	Net carrying value		NIL
	Patents	37,500	
	Less: Written off under scheme of Reconstruction	(37,500)	-
	Net carrying value	-	NIL
5	**Trade Receivables**	4,85,000	
	Less: Provision for doubtful debts	68,500	
			4,16,500

Question 4

Given below is the Balance sheet of Rebuilt Ltd. as at 31.3.20X1:

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*13,50,000*
	B	*Reserves and Surplus*	*2*	(*4,51,000*)
2		***Non-current liabilities***		
	A	*Long-term borrowings* (*Loan*)	*3*	*5,73,000*
3		***Current liabilities***		
	A	*Trade Payables*		*2,07,000*
	B	*Other current liabilities*		*35,000*
		Total		*17,14,000*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and equipment*	*4*	*6,68,000*
	B	*Intangible assets*	*5*	*3,18,000*
2		***Current assets***		
	A	*Inventories*		*4,00,000*
	B	*Trade receivables*		*3,28,000*
		Total		*17,14,000*

Notes to accounts

		₹
1	***Share Capital***	
	Equity share capital	*7,50,000*
	15,000 Equity Shares of ₹50 each	
	Preference share capital	
	12,000, 7% Cumulative Preference Shares of ₹50 each	
	(*Preference dividend is in arrears for five years*)	*6,00,000*
	Total	*13,50,000*
2	***Reserves and Surplus***	
	Debit balance of Profit and loss Account	*(4,51,000)*
		(4,51,000)

		₹
3	***Long-term borrowings***	
	Loan	*5,73,000*
		5,73,000
4	***Property, plant and Equipment***	
	Building at cost less depreciation	*4,00,000*
	Plant at cost less depreciation	*2,68,000*
		6,68,000
5	***Intangible assets***	
	Trademarks and Goodwill at cost	*3,18,000*
		3,18,000

The Company is not earning profits, short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

(a) The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.

(b) The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.

(c) Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

(d) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (a) above.

(e) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the company.

(f) The equity share capital cancelled is to be applied:

(i) to write off the debit balance in the profit and loss A/c; and

(ii) to write off ₹ 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

(*Source: Illustration 4, Study Material*)

Solution

In the books of Rebuilt Ltd.

Journal Entries

	Particulars		***Debit*** (₹)	***Credit*** (₹)
1.	Equity share capital A/c (₹ 50)	Dr.	7,50,000	
	To Equity share capital A/c (₹ 2.50)			37,500
	To Capital reduction A/c			7,12,500
	(Being equity capital reduced to nominal value of ₹ 2.50 each)			
2.	Bank A/c	Dr.	1,12,500	
	To Equity share capital			1,12,500
	(Being 3 right shares against each share was issued and subscribed)			

	Particulars		***Debit*** (₹)	***Credit*** (₹)
3.	7% Preference share capital A/c (₹ 50)	Dr.	6,00,000	
	Capital reduction A/c	Dr.	60,000	
	To 5% Preference share capital (₹ 10)			4,80,000
	To equity share capital (₹ 50)			1,80,000
	(Being 7% preference shares of ₹ 50 each converted to 5% preference shares of ₹ 10 each and also given to them 6 equity shares for every share held)			
4.	Loan A/c	Dr.	1,50,000	
	To 5% Preference share capital A/c			1,20,000
	To Equity share capital A/c			30,000
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c			1,00,000
	(Being shares subscribed by the directors)			
6.	Equity share application money A/c	Dr.	1,00,000	
	To Equity share capital A/c			1,00,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being loan repaid)			
8.	Capital reduction A/c	Dr.	6,52,500	
	To Profit and loss A/c			4,51,000
	To Plant A/c			35,000
	To Trademarks and Goodwill A/c (Bal.fig.)			1,66,500
	(Being losses and assets written off to the extent required)			

Balance sheet of Rebuilt Ltd. (and reduced) as at 31.3.20X1

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	10,60,000
2		**Non-current liabilities**		
	(a)	Long-term borrowings		2,23,000
3		**Current liabilities**		
	(a)	Trade Payables		2,07,000
	(b)	Other current liabilities		35,000
		Assets Total		15,25,000
1		**Non-current assets**		
	(a)	Property, plant and equipment	2	6,33,000
	(b)	Intangible assets	3	1,51,500
2		**Current assets**		
	(a)	Inventories		4,00,000
	(b)	Trade receivables		3,28,000
	(c)	Cash and cash equivalents	4	12,500
		Total		15,25,000

Notes to accounts

			₹
1.	**Share Capital**		
	Authorized capital:		
	65,000 Preference shares of ₹ 10 each	6,50,000	
	3,00,000 Equity shares of ₹ 2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:		
	1,80,000 equity shares of ₹ 2.5 each	4,60,000	
	60,000, 5% Preference shares of ₹ 10 each	6,00,000	10,60,000
2.	**Property plant and equipment**		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3.	**Intangible assets**		
	Trademarks and goodwill		1,51,500
4.	**Cash and cash equivalents**		
	Bank (1,12,500+1,00,000-2,00,000)		12,500

Question 5

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

	₹
Property, Plant and Equipment	*2,50,00,000*
Investments (*Market-value ₹19,00,000*)	*20,00,000*
Current Assets	*2,00,00,000*
P & L A/c (*Dr. balance*)	*12,00,000*
Share Capital: Equity Shares of ₹100 each	*2,00,00,000*
6%, Cumulative Preference Shares of ₹100 each	*1,00,00,000*
5% Debentures of ₹100 each	*80,00,000*
Creditors	*1,00,00,000*
Provision for taxation	*2,00,000*

The following scheme of Internal Reconstruction is sanctioned:

(i) All the existing equity shares are reduced to ₹40 each.

(ii) All preference shares are reduced to ₹60 each.

(iii) The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹100 each and exchange the same for fresh debentures of ₹70 each for every debenture held by them.

(iv) Property, Plant and Equipment is to be written down by 20%.

(v) Current assets are to be revalued at ₹90,00,000.

(vi) Investments are to be brought to their market value.

(vii) One of the creditors of the company to whom the company owes ₹40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹40 each in full and final settlement of his claim.

(viii) The taxation liability is to be settled at ₹3,00,000.

(ix) It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries and show the Balance Sheet of the company after giving effect to the above.

(*Source: Illustration 5, Study Material*)

Solution

Journal Entries in the books of Vaibhav Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr.	2,00,00,000	
	To Equity Share Capital (₹ 40) A/c		80,00,000
	To Capital Reduction A/c		1,20,00,000
	(Being conversion of equity share capital of ₹ 100 each into ₹40 each as per reconstruction scheme)		
(ii)	6% Cumulative Preference Share capital (₹ 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference Share Capital (₹ 60)A/c		60,00,000
	To Capital Reduction A/c		40,00,000
	(Being conversion of 6% cumulative preference shares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		
(iii)	5% Debentures (₹ 100) A/c Dr.	80,00,000	
	To 6% Debentures (₹ 70) A/c		56,00,000
	To Capital Reduction A/c		24,00,000
	(Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Sundry Creditors A/c Dr.	40,00,000	
	To Equity Share Capital (₹ 40) A/c		24,00,000
	To Capital Reduction A/c		16,00,000
	(Being a creditor of ₹ 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	2,00,000	
	Capital Reduction A/c Dr.	1,00,000	
	To Liability for Taxation A/c		3,00,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)		
(vi)	Capital Reduction A/c Dr.	199,00,000	
	To P & L A/c		12,00,000
	To Property, Plant and Equipment A/c		50,00,000
	To Current Assets A/c		110,00,000
	To Investments A/c		1,00,000
	To Capital Reserve A/c (Bal. fig.)		26,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)		
(vii)	Liability for Taxation A/c Dr.	3,00,000	
	To Current Assets (Bank A/c)		3,00,000
	(Being the payment of tax liability)		

Balance Sheet of Vaibhav Ltd. (and reduced) as at 31st March, 20X1

	Particulars	*Notes*	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
(a)	Share capital	1	164,00,000
(b)	Reserves and Surplus	2	26,00,000
2	**Non-current liabilities**		
	Long-term borrowings	3	56,00,000
3	**Current liabilities**		
	Trade Payables (1,00,00,000 less 40,00,000)		60,00,000
	Total		3,06,00,000
	Assets		
1	**Non-current assets**		
(a)	Property, plant and equipment	4	2,00,00,000
(b)	Investments	5	19,00,000
2	**Current assets**	6	87,00,000
	Total		3,06,00,000

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	2,60,000 equity shares of ₹ 40 each (of the above 60,000 shares have been issued for consideration other than cash)		1,04,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	1,00,000 6% Cumulative Preference shares of ₹ 60 each		60,00,000
	Total		1,64,00,000
2.	**Reserves and Surplus**		
	Capital Reserve		26,00,000
3.	**Long-term borrowings**		
	Secured		
	6% Debentures		56,00,000
4.	**Property, Plant and Equipment**		
	Carrying value	2,50,00,000	
	Adjustment under scheme of reconstruction	(50,00,000)	2,00,00,000
5.	**Investments**		
		20,00,000	
	Adjustment under scheme of reconstruction	(1,00,000)	19,00,000
6.	**Current assets**		
	Adjustment under scheme of reconstruction	2,00,00,000	
		(1,10,00,000)	
	Taxation liability paid	90,00,000	87,00,000
		(3,00,000)	

Working Note:

Capital Reduction Account

To	Liability for taxation A/c	1,00,000	By	Equity share capital	1,20,00,000
To	P & L A/c	12,00,000	By	6% Cumulative preferences	
To	Property, and plant equipment	50,00,000			
To	Current assets	1,10,00,000	Share capital		40,00,000
To	Investment	1,00,000	By	5% Debentures	24,00,000
To	Capital Reserve (Bal. fig.)	26,00,000	By	Sundry creditors	16,00,000
		2,00,00,000			2,00,00,000

Question 6

Following is the Balance Sheet of ABC Ltd. as at 31st March, 20X1:

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	*Share capital*	*1*	*26,00,000*
	B	*Reserves and Surplus*	*2*	*(4,05,000)*
2		***Non-current liabilities***		
	A	*Long-term borrowings*	*3*	*12,00,000*
3		***Current liabilities***		
	A	*Trade Payables*		*5,92,000*
	B	*Short term borrowings - Bank overdraft*		*1,50,000*
		Total		*41,37,000*
		Assets		
1		***Non-current assets***		
	A	*Property, plant and equipment*	*4*	*11,50,000*
	B	*Intangible assets*	*5*	*70,000*
	C	*Non-current investment*	*6*	*68,000*
2		***Current assets***		
	A	*Inventory*		*14,00,000*
	B	*Trade receivables*		*14,39,000*
	C	*Cash and cash equivalents*		*10,000*
		Total		*41,37,000*

Notes to accounts:

		₹
1	***Share Capital***	
	Equity share capital:	
	2,00,000 Equity Shares of ₹10 each	*20,00,000*
	6,000, 8% Preference shares of ₹100 each	*6,00,000*
		26,00,000
2	***Reserves and Surplus***	
	Debit balance of Profit and loss A/c	*(4,05,000)*
		(4,05,000)
3	***Long-term borrowings***	
	9% debentures	*12,00,000*
		12,00,000

		₹
4	***Property, Plant and Equipment***	
	Plant and machinery	*9,00,000*
	Furniture and fixtures	*2,50,000*
		11,50,000
5	***Intangible assets***	
	Patents and copyrights	*70,000*
		70,000
6	***Non-current investments***	
	Investments (market value of ₹ 55,000)	*68,000*
		68,000

The following scheme of reconstruction was finalized:

(i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.

(ii) Debenture holders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.

(iii) Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.

(iv) Investment value to be reduced to market price.

(v) 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.

(*Source: Illustration 6, Study Material*)

Solution

In the Books of ABC Ltd.

Journal Entries

Particulars		₹	₹
8% Preference share capital A/c	Dr.	6,00,000	
To 11% Debentures A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital and issue of 11% debentures]			
9% Debentures A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment of plant & machinery]			
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving Inventories]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			

Particulars		₹	₹
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

Capital Reduction Account

		₹			₹
To	Investments A/c	13,000	By	Preference share capital A/c	1,80,000
To	Profit and loss A/c	4,05,000	By	9% Debenture holders A/c	3,00,000
To	Capital reserve A/c	1,54,000	By	Trade payables A/c	92,000
		5,72,000			5,72,000

Balance Sheet of ABC Ltd. (And Reduced) As at 31st March 20X1

Particulars	***Note No***	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000
Total		28,74,000
II. Assets		
(1) Non-current assets		
(a) *Property, plant and equipment*	4	2,50,000
(b) Intangible assets	5	70,000
(c) Non-current investments	6	55,000
(2) Current assets		
(a) Inventories (₹ 14,00,000 – ₹ 5,00,000)		9,00,000
(b) Trade receivables		14,39,000
(c) Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

			₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹ 10 each fully paid-up		20,00,000
2.	**Reserve and Surplus**		
	Capital Reserve		1,54,000
3.	**Long Term Borrowings**		
	11% Debentures (₹ 4,20,000 + ₹ 3,00,000)		7,20,000
4.		9,00,000	
	Property, Plant and Equipment		
			-

			₹
	Plant & machinery	9,00,000	2,50,000
	Less: Adjustment on scheme of reconstruction		
5	Furniture & fixtures		
	Intangible assets		70,000
	Patents & copyrights		3,20,000
6.	**Non-Current Investments**		
	Investments (₹ 68,000 – ₹ 13,000)		55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid

= ₹ 10,000 + ₹ 3,00,000 – ₹ 1,50,000 = ₹ 1,60,000

Question 7

The Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows :

		Particulars		***Notes***	***₹***
		Equity and Liabilities			
1		***Shareholders' funds***			
	A	*Share capital*		*1*	*10,00,000*
	B	*Reserves and surplus*		*2*	*(6,00,000)*
2		***Non-current liabilities***			
	A	*Long-term borrowings*		*3*	*2,00,000*
3					
	A	***Current liabilities***			*72,000*
	B	*Trade Payables*		*4*	*24,000*
	C	*Other current liabilities*		*5*	*24,000*
		Short term provisions	*Total*		*7,20,000*
1					
	A	***Assets***		*6*	*1,00,000*
2		***Non-current assets***			
	A	*Property, Plant and Equipment*			*3,20,000*
	B	***Current assets***			*2,70,000*
	C	*Inventory*			*30,000*
		Trade receivables	*Total*		*7,20,000*
		Cash and cash equivalents			

Notes to accounts

			₹
1	***Share Capital***		
	Equity share capital		
	10,000 Equity Shares of ₹ 100 each		*10,00,000*
			10,00,000
2	***Reserves and Surplus***		
	Debit balance of Profit and loss Account		*(6,00,000)*
			(6,00,000)
3	***Long-term borrowings***		
	12% debentures		*2,00,000*
			2,00,000

			₹
4	***Other current liabilities***		
	Interest payable on debentures		*24,000*
			24,000
5	***Short term provisions***		
	Provision for taxation		*24,000*
			24,000
6	***Property, Plant and Equipment***		
	Machinery		*1,00,000*
			1,00,000

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 is sub-divided into ten fully paid up equity shares of ₹ 10 each.

(b) After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables 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) Trade payables claim shall be reduced to 50 per cent, it is 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

(*Source: Illustration 7, Study Material*)

Solution

		Dr. ₹	***Cr.*** ₹
Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000
To Equity Share Capital (₹ 10) A/c			5,00,000
(Subdivision of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			
12% Debentures A/c	Dr.	1,50,000	
Interest payable A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debenture holders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000
(Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c			3,64,000

	Dr. ₹	Cr. ₹
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)		
Reconstruction A/c Dr.	6,04,000	
To Profit and Loss A/c		6,00,000
To Capital Reserve A/c		4,000
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)		

Balance Sheet of Revise Limited (and reduced) as at...

Particulars	*Note No.*	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities		
(a) Other current liabilities	4	6,000
(b) Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,00,000
(2) Current assets		
(a) Inventories		3,20,000
(b) Trade receivables		2,70,000
(c) Cash and cash equivalents		30,000
Total		7,20,000

Notes to Accounts

		₹
1.	**Share Capital**	
	Equity Share Capital	
	Issued Capital: 53,600 Equity Shares of ₹ 10 each	5,36,000
	Preference Share Capital	
	Preference Shares	1,00,000
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	
		6,36,000
2.	**Reserve and Surplus**	
	Capital Reserve	4,000
3.	**Long-term borrowings**	
	Unsecured Loans	
	12% Debentures	50,000

		₹
4.	**Other current liabilities**	
	Interest payable on debentures	6,000
5.	**Short-term provisions**	
	Provision for Income-tax	24,000
6.	**Property, plant and Equipment**	
	Machinery	1,00,000

Question 8

Recover Ltd. decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 20X1 is as follows-

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		***Shareholders' funds***		
	A	Share capital	*1*	*3,50,000*
	B	Reserves and surplus	*2*	*(70,000)*
2		***Non-current liabilities***		
	A	*Long-term borrowings*	*3*	*50,000*
3		***Current liabilities***		
	A	Trade Payables		*80,000*
	B	*Short term Borrowings – Bank overdraft*		*90,000*
	C	*Other Current Liabilities (Interest payable on Debentures)*		*5,000*
				5,05,000
		Assets		
1		***Non-current assets***		
	A	Property, Plant Equipment	*4*	*3,35,000*
	B	*Intangible assets*	*5*	*50,000*
	C	*Non-current investments*	*6*	*40,000*
2		***Current assets***		
	A	*Inventories*		*30,000*
	B	*Trade receivables*		*50,000*
				5,05,000

Notes to accounts:

1	***Share Capital***		₹
	Equity share capital:		
	20,000 Equity Shares of ₹ 10 each		*2,00,000*
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of ₹ 10 each (preference dividend has been in arrears for 4 years)		*1,50,000*
			3,50,000
2	***Reserves and surplus***		
	Profit and loss account (debit balance)		*(70,000)*
			(70,000)
3	***Long-term borrowings***		
	Secured		
	10% Debentures (secured on the free hold property)		*50,000*
			50,000

4	***Property, Plant and Equipment***		
	Freehold property		*1,20,000*
	Leasehold property		*85,000*
	Plant and machinery		*1,30,000*
			3,35,000
5	***Intangible assets***		
	Goodwill		*50,000*
			50,000
6	***Non-current investments***		
	Non-Trade investments at cost		*40,000*
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

(i) The preference shares were reduced to ₹ 2.5 per share, and the equity shares to ₹ 1 per share.

(ii) One new equity share of ₹ 1 was issued for the arrears of preferred dividend for past 4 years.

(iii) The debenture holders took over the freehold property at an agreed figure of ₹ 75,000 and paid the balance to the company after deducting the amount due to them.

(iv) Plant and Machinery was written down to ₹ 1,00,000.

(v) Non-trade Investments were sold for ₹ 32,000.

(vi) Goodwill and obsolete stock (included in the value of inventories) of ₹ 10,000 were written off.

(vii) A contingent liability of which no provision had been made was settled at ₹ 7,000 and of this amount, ₹ 6,300 was recovered from the insurance.

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

(*Source: Illustration 8, Study Material*)

Solution

Journal entries in the books of Recover Ltd

Particulars		**Dr.** ₹	**Cr.** ₹
8% Cumulative Preference share capital (₹ 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (₹2.5) A/c			37,500
To Reconstruction (₹ 7.5) A/c			1,12,500
(Preference shares being reduced to shares of ₹ 2.5 per share and remaining transferred to reconstruction account as per internal reconstruction scheme)			
Equity share capital A/c (₹10)	Dr.	2,00,000	
To Equity Share capital A/c (₹ 1)			20,000
To Reconstruction A/c (₹ 9)			1,80,000
(Equity shares reduced to ₹ 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
10% Debentures A/c	Dr.	50,000	
Interest payable on debentures A/c	Dr.	5,000	

Particulars		Dr. ₹	Cr. ₹
Bank A/c	Dr.	20,000	
Reconstruction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the reconstruction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Reconstruction A/c	Dr.	8,000	
To Investments A/c			40,000
(Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Reconstruction A/c	Dr.	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingency payment amount)			
Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c			70,000
(Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in reconstruction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 20X1 (and reduced)

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		**Non-current liabilities**		
	A	Long-term borrowings		-

		Particulars	*Notes*	₹
3		**Current liabilities**		
	A	Trade Payables		80,000
	B	Short term borrowings - Bank Overdraft		90,000
		Total		**3,06,300**
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	1,85,000
2		**Current assets**		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	51,300
		Total		**3,06,300**

Notes to accounts:

1	**Share Capital**	₹
	Equity share capital	
	68,000 Equity Shares of ₹ 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of ₹ 2.5 each	37,500
		1,05,500
2	**Reserves and surplus**	
	Capital reserve	30,800
3	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
		1,85,000
4	**Cash and cash equivalents**	
	Bank A/c (20,000+32,000-7000+6,300)	51,300

Question 9

What are the methods of internal reconstruction generally followed by companies?

(*Source: Question 7, Study Material*)

Answer

Methods of Internal reconstruction:

- Sub-division or consolidation of shares into smaller or higher Denomination and Conversion of share into stock or vice-versa
- Variation of shareholders' rights
- Reduction of share capital
- Compromise, arrangements etc.
- Surrender of Shares.

Question 10

Parth Ltd, had laid down the following terms upon the sanction of the reconstruction plan by the court-

1. Furniture and Fixtures which stood at the books at ₹ 1,50,000 to be written down to ₹ 95,000. The freehold premises which was valued at ₹ 7,00,000 showed an appreciation of ₹ 55,000.
2. Plant and machinery showed fall in value of ₹ 89,000, to be recorded in the books. Investment at ₹2,00,000 was brought down to the existing market value at ₹ 1,05,000.

3. Debenture holders accepted to receive the following in lieu of their present 9% debentures of ₹ 2,50,000-
   (a) 1/5th of the total to be paid in cash to them.
   (b) To take over the land and buildings of value ₹ 72,000.
   (c) To forgo the remaining unpaid portion as a policy of reconstruction.

Write off the profit and loss A/c debit balance at ₹ 70,000 which had been accumulated over the years. In case of any shortfall, the balance of the General reserve of ₹ 1,50,000 can be utilized to write off the losses under reconstruction scheme.

Show the necessary journal entries as part of the reconstruction process considering that balance in general reserve utilized to write off the losses as per reconstruction scheme.

(*Source: Question 8, Study Material*)

Answer

Journal entries in the books of Parth Ltd.

		Dr.	Cr.
		₹	₹
Reconstruction A/c	Dr.	2,39,000	
To Furniture and Fixtures A/c			55,000
To Plant and machinery A/c			89,000
To Investment A/c			95,000
(Writing off overvalued assets as per Reconstruction Scheme dated.)			
Freehold premises A/c	Dr.	55,000	
To Reconstruction A/c			55,000
(Being the increase in the premises credited to reconstruction account as per reconstruction scheme)			
9% Debentures A/c	Dr.	2,50,000	
To Bank A/c			50,000
To Land and building A/c To Reconstruction A/c			72,000
(Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)			1,28,000
Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c			70,000
(Being the loss written off as per reconstruction scheme)			
General reserve A/c	Dr.	1,26,000	
To Reconstruction A/c			1,26,000
(Being the balance in general reserve utilized to write off the losses as per reconstruction scheme)			

Question 11

The following scheme of reconstruction has been approved for Win Limited:

(i) The shareholders to receive in lieu of their present holding at 1,00,000 shares of ₹ 10 each, the following:
   (a) New fully paid ₹ 10 Equity shares equal to 3/5th of their holding.
   (b) 10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.
   (c) ₹ 40,000, 8% Debentures.

(ii) An issue of ₹ 1 lakh 10% first debentures was made and allotted, payment for the same being received in cash forthwith.

(iii) Goodwill which stood at ₹ 1,40,000 was completely written off.

(iv) Plant and machinery which stood at ₹ 2,00,000 was written down to ₹ 1,50,000.

(v) Freehold property which stood at ₹ 1,50,000 was written down by ₹ 50,000.

You are required to draw up the necessary Journal entries in the Books of Win Limited for the above reconstruction. Suitable narrations to Journal entries should form part of your answer.

(*Source: Question 8, Study Material*)

Answer

Journal Entries

		₹	₹
Equity Share Capital (old) A/c	Dr.	10,00,000	
To Equity Share Capital (₹ 10) A/c			6,00,000
To 10% Preference Share Capital A/c			1,20,000
To 8% Debentures A/c			40,000
To Capital Reduction A/c			2,40,000
(Being new equity shares, 10% Preference Shares, 8% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
Bank A/c	Dr.	1,00,000	
To 10% First Debentures A/c			1,00,000
(Being allotment of 10% first Debentures)			
Capital Reduction A/c	Dr.	2,40,000	
To Goodwill Account			1,40,000
To Plant and Machinery Account			50,000
To Freehold Property Account			50,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery and Freehold property as per the scheme)			

Question 12

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the Company as at 31.3.20X1 before reconstruction:

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	65,00,000
	B	Reserves and Surplus	2	(20,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	15,00,000
3		**Current liabilities**		
	A	Trade Payables		5,00,000
		Total		65,00,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	45,00,000
	B	Intangible assets	5	20,00,000
2		**Current assets**		Nil
		Total		65,00,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	Authorized share capital	
	1,50,000 Equity shares of ₹ 50 each	75,00,000
	Issued, subscribed and paid up capital	
	50,000 Equity Shares of ₹ 50 each	25,00,000
	1,00,000 Equity shares of ₹ 50 each, ₹ 40 paid up	40,00,000
		65,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(20,00,000)
		(20,00,000)
3	**Long-term borrowings**	
	Secured: 12% First debentures	5,00,000
	12% Second debentures	10,00,000
		15,00,000
4	**Property, Plant and Equipment**	
	Building	10,00,000
	Plant	10,00,000
	Computers	25,00,000
		45,00,000
5	**Intangible assets**	
	Goodwill	20,00,000
		20,00,000

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
Trade payables	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 (₹ 40 paid up)	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 lakhs 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 utilised in writing off of Goodwill, Profit and Loss A/c Loss 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.

(*Source: Question 10, Study Material*)

Answer

Journal Entries in books of Green Limited

		Dr. ₹	Cr. ₹
Bank Account	Dr.	10,00,000	
To Equity Share Capital Account			10,00,000
(Balance of ₹ 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)			
Equity Share Capital Account (₹ 50)	Dr.	75,00,000	
To Equity Share Capital Account (₹ 20)			30,00,000
To Capital Reduction Account			45,00,000
(Reduction of equity shares of ₹ 50 each to shares of ₹ 20 each as per reconstruction scheme)			
12% First Debentures Account	Dr.	3,00,000	
12% Second Debentures Account	Dr.	7,00,000	
Trade payables Account	Dr.	2,00,000	
To X			12,00,000
(The total amount due to X, transferred to his account)			
Bank Account	Dr.	2,00,000	
To X			2,00,000
(The amount paid by X under the reconstruction scheme)			
12% First Debentures Account	Dr.	2,00,000	
12% Second Debentures Account	Dr.	3,00,000	
Trade payables Account	Dr.	1,00,000	
To Y			6,00,000
(The total amount due to Y, transferred to his account)			
Y	Dr.	6,00,000	
To 14% First Debentures Account			3,00,000
To Capital Reduction Account			3,00,000
(The amount due to Y discharged by issue of 14% first debentures)			
X	Dr.	14,00,000	
To 14% First Debentures Account			7,00,000
To Capital Reduction Account			7,00,000
(The cancellation of ₹ 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)			
Capital Reduction Account	Dr.	55,00,000	
To Goodwill Account			20,00,000
To Profit and Loss Account			20,00,000
To Computers Account			15,00,000

(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss account, and computers—

Working Note:

Balance Sheet of Green Limited (and reduced) as at 31st March, 20X1

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	30,00,000
2		**Non-current liabilities**		
	(a)	Long-term borrowings	2	10,00,000
3		**Current liabilities**		
	(a)	Trade Payables		2,00,000
		Total		42,00,000
		Assets		
1		**Non-current assets**		
	(a)	Property, plant and equipment	3	30,00,000
2		**Current assets**		
		Cash and cash equivalents		12,00,000
		Total		42,00,000

Notes to accounts

		₹
1.	**Share Capital**	
	Equity share capital	
	Issued, subscribed and paid up	
	1,50,000 equity shares of ₹ 20 each	30,00,000
	Total	30,00,000
2.	**Long-term borrowings**	
	Secured	
	14% First Debentures	10,00,000
	Total	10,00,000
3.	**Property, Plant and Equipment**	
	Building	10,00,000
	Plant	10,00,000
	Computers	10,00,000
	Total	30,00,000

Working Note:

Capital Reduction Account

	₹		₹
To Goodwill A/c	20,00,000	By Equity Share Capital A/c	45,00,000
To P & L A/c	20,00,000	By X	7,00,000
To Computers (Bal. Fig.)	15,00,000	By Y	3,00,000
	55,00,000		55,00,000

Question 13

The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,50,00,000
	B	Reserves and Surplus	2	(6,00,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	40,00,000
3		**Current liabilities**		
	A	Trade Payables		50,00,000
	B	Short term provisions	4	1,00,000
		Total		2,35,00,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment		1,25,00,000
	B	Non-current investment	5	10,00,000
2		**Current assets**		1,00,00,000
		Total		2,35,00,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	1,00,000 Equity Shares of ₹ 100 each	1,00,00,000
	50,000, 12% Cumulative Preference shares of ₹ 100 each	50,00,000
		1,50,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(6,00,000)
		(6,00,000)
3	**Long-term borrowings**	
	40,000, 10% debentures of ₹100 each	40,00,000
		40,00,000
4	**Short term provisions**	
	Provision for taxation	1,00,000
		1,00,000
5	**Non-current investments**	
	Investments (market value of ₹ 9,50,000)	10,00,000
		10,00,000

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to ₹ 40 each.

(ii) All preference shares are reduced to ₹ 60 each.

(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 debenture held by them.

(iv) One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.

(v) Property, plant and equipment are to be written down by 30%.

(vi) Current assets are to be revalued at ₹ 45,00,000.

(vii) The taxation liability of the company is settled at ₹ 1,50,000.

(viii) Investments to be brought to their market value.

(ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

(*Source: Question 11, Study Material*)

Answer

Journal Entries in the books of Weak Ltd.

		₹	₹
(i)	Equity share capital (₹ 100) A/c Dr.	1,00,00,000	
	To Equity Share Capital (₹ 40) A/c		40,00,000
	To Capital Reduction A/c		60,00,000
	(Being conversion of equity share capital of ₹ 100 each into ₹ 40 each as per reconstruction scheme)		
(ii)	12% Cumulative Preference Share capital (₹ 100) A/c Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (₹ 60) A/c		30,00,000
	To Capital Reduction A/c		20,00,000
	(Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		
(iii)	10% Debentures A/c Dr.	40,00,000	
	To 12% Debentures A/c		28,00,000
	To Capital Reduction A/c		12,00,000
	(Being 12% debentures issued to 10% debenture- holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Trade payables A/c Dr.	20,00,000	
	To Equity Share Capital A/c		12,00,000
	To Capital Reduction A/c		8,00,000
	(Being a creditor of ₹ 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	1,00,000	
	Capital Reduction A/c Dr.	50,000	
	To current assets(bank A/c) A/c		1,50,000
	(Being liability for taxation settled)		
(vi)	Capital Reduction A/c Dr.	99,00,000	
	To P & L A/c		6,00,000
	To Property, plant and equipment A/c		37,50,000
	To Current Assets A/c		55,00,000
	To Investments A/c		50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, plant and equipment, Current Assets, Investments through capital reduction account)		

		₹	₹
(vii)	Capital Reduction A/c Dr	50,000	
	To capital Reserve A/c		50,000
	(Being balance in capital reduction account transferred to capital reserve account)		

Balance Sheet of Weak Ltd. (and reduced) as at 31.3.20X1

		Particulars	***Notes***	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	82,00,000
	(b)	Reserves and Surplus	2	50,000
2		**Non-current liabilities**		
	(a)	Long-term borrowings	3	28,00,000
3		**Current liabilities**		
	(a)	Trade Payables		30,00,000
		Total		1,40,50,000
		Assets		
1		**Non-current assets**		
	(a)	Property, plant and equipment	4	87,50,000
	(b)	Investments	5	9,50,000
2		**Current assets**	6	43,50,000
		Total		1,40,50,000

Notes to accounts

		₹	₹
1.	**Share Capital**		
	Equity share capital		
	Issued, subscribed and paid up		
	1,30,000 equity shares of ₹ 40 each		52,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	50,000 12% Cumulative Preference shares of ₹ 60 each		30,00,000
	Total		82,00,000
2.	**Reserves and Surplus**		
	Capital Reserve		50,000
3.	**Long-term borrowings**		
	Secured		
	12% Debentures		28,00,000
4.	**Property, plant and Equipment**		
	Total PPE	1,25,00,000	
	Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5.	**Investments**	10,00,000	
	Adjustment under scheme of reconstruction	(50,000)	9,50,000
6.	**Current assets**	45,00,000	
	Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:

Capital Reduction Account

	₹		₹
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative preference share capital	20,00,000
To Property, plant and equipment	37,50,000	By 10% Debentures	12,00,000
To Current assets	55,00,000	By Trade payables	8,00,000
To Investment	50,000		
To Capital Reserve (bal. fig.)	50,000		
	1,00,00,000		1,00,00,000

Question 14

The following is the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	***Notes***	***₹***
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	36,00,000
	B	Reserves and Surplus	2	(14,40,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	6,00,000
3		**Current liabilities**		
	A	Trade Payables		3,00,000
	B	Short term borrowings - Bank overdraft		6,00,000
		Total		36,60,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	30,00,000
	B	Intangible assets	5	90,000
2		**Current assets**		
	(a)	Inventories		2,60,000
	(b)	Trade receivables		2,80,000
	(c)	Cash and cash equivalents		30,000
		Total		36,60,000

Notes to accounts

		₹
1	**Share capital**	
	24,000 Equity Shares of ₹ 100 each	24,00,000
	12,000, 10% Preference Shares of ₹ 100 each	12,00,000
	Total	36,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss Account	(14,40,000)
		(14,40,000)

		₹
3	**Long-term borrowings**	
	10% debentures	6,00,000
		6,00,000
4.	**Property, plant and Equipment**	
	Land and Building	12,00,000
	Plant and Machinery	18,00,000
		30,00,000
5	**Intangible assets**	
	Goodwill	90,000
		90,000

On the above date, the company adopted the following scheme of reconstruction:

(i) The equity shares are to be reduced to shares of ₹ 40 each fully paid and the preference shares to be reduced to fully paid shares of ₹ 75 each.

(ii) The debenture holders took over Inventories and Trade receivables in full satisfaction of their claims.

(iii) The Land and Building to be appreciated by 30% and Plant and machinery to be depreciated by 30%.

(iv) The debit balance of profit and loss account and intangible assets are to be eliminated.

(v) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above scheme of reconstruction and prepare the reconstructed Balance Sheet

(*Source: Question 12, Study Material*)

Answer

In the books of X Ltd.

Journal Entries

	31st March, 20X1		₹	₹
(i)	Equity Share Capital A/c (₹ 100)	Dr.	24,00,000	
	To Equity Share Capital A/c (₹ 40)			9,60,000
	To Capital Reduction A/c			14,40,000
	(Being 24,000 equity shares of ₹ 100 each reduced to ₹ 40 each fully paid up)			
(ii)	10% Preference Share Capital A/c (₹ 100)	Dr.	12,00,000	
	To 10% Preference Share Capital A/c (₹ 75)			9,00,000
	To Capital Reduction A/c			3,00,000
	(Being 12,000 Preference shares of ₹ 100 each reduced to ₹ 75 each fully paid up)			
(iii)	10% Debentures A/c	Dr.	6,00,000	
	To Inventories A/c			2,60,000
	To Trade receivables A/c			2,80,000
	To Capital Reduction A/c			60,000
	(Being debenture holders given Inventories and Trade receivables in full settlement of their claims)			
(iv)	Land & Building A/c	Dr.	3,60,000	
	To Capital Reduction A/c			3,60,000
	(Being Land & Building appreciated by 30%)			

	31st March, 20X1		₹	₹
(v)	Capital reduction A/c	Dr.	5,000	
	To Cash A/c			5,000
	(Being expenses of reconstruction paid)			
(vi)	Capital Reduction A/c	Dr.	20,70,000	
	To Goodwill A/c			90,000
	To Profit and Loss A/c			14,40,000
	To Plant & Machinery A/c			5,40,000
	(Being various losses written off, assets written down through Capital Reserve A/c)			
(vii)	Capital Reduction	Dr.	85,000	
	To Capital Reserve A/c (Bal. Fig.)			85,000
	(Being balance in Capital Reduction A/c transferred to Capital Reserve A/c)			

Balance Sheet (And Reduced) of X Ltd. as at 31st March, 20X1

		Particulars	Notes No.	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	18,60,000
	(b)	Reserves and Surplus	2	85,000
2		**Current liabilities**		
	(a)	Trade Payables		3,00,000
	(b)	Short term borrowings		6,00,000
		Total		28,45,000
		Assets		
1		**Non-current assets**		
	(a)	Property, plant and equipment	3	28,20,000
2		**Current assets**		
		Cash and cash equivalents (30,000 -5,000)		25,000
		Total		28,45,000

Notes to accounts

1.	**Share Capital**		₹
	Equity share capital		
	24,000 equity shares of ₹ 40 each fully paid up		9,60,000
	Preference share capital		
	12,000, 10% Preference shares of ₹ 75 each fully paid up		9,00,000
	Total		18,60,000
2.	**Reserves and Surplus**		
	Capital Reserve		85,000
3.	**Property, plant and Equipment**		
	Land and Building	15,60,000	
	Plant and Machinery	12,60,000	
	Total		28,20,000

QUESTION BANK

Question 15

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.

(*Group I-November 2013, 4 Marks*)

Answer

Journal Entries

			₹	₹
(i)	Equity share Capital A/c.	Dr.	20,00,000	
	To Equity Stock			1,00,000
	To 12% Fully Convertible Debentures			19,00,000
	(Being conversion of 2 lakh equity shares of ₹ 10 each into stock of ₹ 1,00,000 and balance as fully convertible debentures as per resolution)			
(ii)	Equity Share Capital A/c (₹ 2.50)	Dr.	100,00,000	
	To Equity Share Capital A/c (₹ 10)			100,00,000
	(Being consolidation of 40 lakh shares of ₹ 2.50 each into 10 lakh shares of ₹ 10 each as per resolution)			
(iii)	11% Preference Shares Capital A/c (₹ 50)	Dr.	500,00,000	
	To 11% Preference Share Capital A/c (₹ 10)			500,00,000
	(Being subdivision of 10 lakh preference shares of ₹ 50 each into 50 lakh shares of ₹ 10 each as per resolution)			
(iv)	12% Preference Share Capital A/c	Dr.	5,00,000	
	To 14% Preference Share Capital			3,00,000
	To 12% Non-cumulative Preference Share Capital			2,00,000
	(Being conversion of preference shares as per resolution)			

Question 16

The Balance Sheet of X Ltd. as on 31st March 2014 was as follows:

X Limited

Balance Sheet as at 31.03.2014

	Particulars	Amount (₹)
I	**Equity and Liabilities**	
1	Shareholder's Fund	
	Share Capital	
	(a) 40,000 equity shares of ₹ 100 each fully paid	40,00,000
	(b) 20,000 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)
2	Non-Current Liabilities	
	Long Term Borrowings	
	7% Debentures of ₹ 100 each	4,00,000
3	Current Liabilities	
	Other Current Liabilities	

	Particulars		Amount (₹)
	(a) Creditors		10,00,000
	(b) Loan from Director		2,00,000
	Total Liabilities		**54,50,000**
II	**Assets**		
	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 reorganisation 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 of 4%. 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 transaction.

(*Group II-November 2014, 16 Marks*)

Answer

In the books of X Ltd.
Journal Entries

Particulars		Amount (₹)	Amount (₹)
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)			
10% Preference Share Capital (₹ 100) A/c	Dr.	20,00,000	
To 10% Preference Share Capital (₹ 75) A/c			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)			
10% Preference Share Capital (₹ 75) A/c	Dr.	15,00,000	
To 13% Preference Share Capital (₹ 50) A/c			10,00,000
To Equity Share Capital A/c			5,00,000
(Being one new 13% Preference Share of ₹ 50 each and one Equity Share of ₹ 25 each issued against 10% Preference Share of ₹ 75 each)			

Particulars		Amount (₹)	Amount (₹)
Capital Reduction A/c	Dr.	2,00,000	
To Preference Share Dividend Payable A/c (Being arrear of Preference Share Dividend payable for one year)			2,00,000
Preference Share Dividend Payable A/c	Dr.		
To Equity Share Capital A/c (₹ 25)		2,00,000	
(Being Equity Shares of ₹ 25 each issued for arrears of Preference Share Dividend)			2,00,000
7% Debenture A/c			
To Debenture Holders A/c	Dr.	4,00,000	
(Being balance of 7% Debentures transferred to Debenture Holders A/c)			4,00,000
	Dr.		
Debenture Holders A/c	Dr.	4,00,000	
To 13% Preference Share Capital A/c			1,00,000
To Bank A/c			2,70,000
To Capital Reduction A/c			30,000
(Being 25% of Debenture Holders opted to take 13% Preference Shares at par and remaining took 90% cash payment for their claims)			
Loan from Director	Dr.	2,00,000	
To Provision for Contingent Liability A/c			2,00,000
(Being contingent liability of ₹ 2,00,000 is payable and adjusted against loan from Director A/c)			
Bank A/c	Dr.	12,50,000	
To Equity Share Application & Allotment A/c (Being application money received on 50,000 Equity Shares @ ₹ 25 each)			12,50,000
Equity Share Application & Allotment A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being application money transferred to Capital A/c on allotment)			
Underwriting Commission A/c	Dr.	50,000	
To Bank A/c			50,000
(Being underwriting commission paid)			
Land & Building A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being value of land & Building appreciated)			
Expenses on Reconstruction A/c	Dr.	20,000	
To Bank A/c			20,000
(Being payment of expenses on reconstruction)			
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 17

The following is the Balance Sheet of Star Ltd. as on 31st March, 2015:

A. Equity & Liabilities:	**₹**
1. Shareholder's 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 & 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 to 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 ₹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 Worksmen'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 to 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.

(*Group II-November 2015, 16 Marks*)

Answer

In the books of Star Ltd.
Journal Entries

	Particulars		Amount ₹	Amount ₹
(i)	7% Preference share capital (₹ 100)	Dr.	9,00,000	
	To 9% Preference share capital (₹ 80)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being preference shares reduced to ₹ 80 and 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.	50,000	
	To Capital reduction A/c			50,000
	(Being directors refunded the fee amount)			
(iv)	Trade payables A/c (Interest on debentures)	Dr.	26,000	
	To Capital reduction A/c			26,000
	(Being interest forgone by the debenture holders)			
(v)	No entry required			
(vi) (a)	'B' 6% Debentures A/c	Dr.	3,50,000	
	To Debentures holders A/c			3,50,000
	(Being amount due to Debentures holders)			
(b)	Debentures holders A/c	Dr.	4,40,000	
	To Chennai Works A/c			4,25,000
	To Equity share capital A/c			15,000
	(Being Chennai works taken over and equity shares issued to 'B' 6% Debenture holders)			
(c)	Equity share of Zia ltd. A/c	Dr.	90,000	
	To Debentures holders A/c			90,000
	(Being 9,000 equity shares of Zia Ltd. issued by Debentures holders)			
(vii) (a)	Chennai Works – Workmen Compensation Fund	Dr.	4,000	
	To Capital reduction A/c			4,000
	(Being difference due to reduced amount of actual liability transferred to capital reduction account)			
(b)	Bank A/c	Dr.	15,400	
	To Investment for Workmen Compensation Fund			14,000
	To Capital reduction A/c			1,400
	(Being investment for Workmen Compensation Fund sold @ 10% profit)			
(c)	Trade Payables A/c	Dr.	15,400	
	To Bank A/c			15,400
	(Being part payment made to trade payables)			
(viii)	Capital reduction A/c	Dr.	2,10,000	
	To Provision for Doubtful Debts A/c			20,000
	To Inventory A/c			1,90,000
	(Being assets revalued)			
(ix)	Capital reduction A/c	Dr	5,50,000	2,00,000
	To Profit & Loss A/c			3,50,000*
	To Tangible Assets – Chennai Works			
	(Being assets revalued and losses written off)			

	Particulars		Amount ₹	Amount ₹
(x)	Capital reduction A/c	Dr		
	To Tangible Assets – Bombay Works		4,01,400	
	To Capital reserve A/c			2,67,600
	(Being assets revalued and remaining amount transferred to capital reserve account)			1,33,800

* ₹ 7,75,000 less ₹ 4,25,000

Question 18

Proficient Infosoft Ltd. is in the hands of a Receiver for Debenture Holders who holds a charge on all asset except uncalled capital. The following statement shows the position as regards creditors as on 30th June, 2016:

Liabilities	₹	Assets	₹
8000 shares of ₹ 100 each ₹ 60 paid up	-	Property (cost is ₹ 3,80,800) estimated at	1,08,000
First Debentures	3,60,000	Plant & Machinery	
Second Debentures	7,80,000	(Cost is ₹ 2,87,200)	
Unsecured trade payables	5,40,000	estimated at	72,000
		Cash in hand of the receiver	3,24,000
			5,04,000
		Uncalled Capital	3,20,000
			8,24,000
		Deficiency	8,56,000
	16,80,000		**16,80,000**

A holds the first debentures for ₹ 3,60,000 and second debentures for ₹ 3,60,000. He is also an unsecured trade payable for ₹ 1,08,000. B holds second debentures for ₹ 3,60,000 and is an unsecured trade payable for ₹ 72,000.

The following scheme of reconstruction is proposed.

(i) A is to cancel ₹ 2,52,000 of the total debt owing to him; to bring ₹ 36,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 6,12,000 in satisfaction of all his claims.

(ii) B to accept ₹ 1,08,000 in cash in satisfaction of all claims by him.

(iii) In full settlement of 60% of the claim, unsecured trade payable (other than A and B) agreed to accept three shares of ₹ 25 each, fully paid against their claim for each ₹ 100.
The balance of 40% 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.

(iv) Uncalled capital is to be called up in full and ₹ 75 per share cancelled, thus making the shares of ₹ 25 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

(*Group I, November 2016, 16 Marks*)

Answer

Journal Entries

Particulars		*Debit (₹)*	*Credit (₹)*
First debentures A/c	Dr.	3,60,000	
Second debentures A/c	Dr.	3,60,000	
Unsecured trade payables A/c	Dr.	1,08,000	
To A			8,28,000
(Being A's total liability ascertained)			
A	Dr.	2,52,000	
To Capital reduction A/c			2,52,000
(Being cancellation of debt up to ₹2,52,000)			
Bank A/c	Dr.		
To A		36,000	
(Being cash received in course of settlement)			36,000
A	Dr.		
To First debentures A/c		6,12,000	
(Being liability of A, discharged against first debentures)			6,12,000
Second debentures A/c	Dr.	3,60,000	
Unsecured trade payables A/c	Dr.	72,000	
To B			4,32,000
(Being B's liability ascertained)			

Particulars		***Debit (₹)***	***Credit (₹)***
B	Dr.	4,32,000	
To Bank A/c			1,08,000
To Capital reduction A/c			3,24,000
(Being B's liability discharged in satisfaction of all claims)			
Unsecured trade payables A/c	Dr.		
To Equity share capital A/c		3,60,000	
To Loan (Unsecured) A/c			1,62,000
To Capital reduction A/c			1,44,000
(Being settlement of unsecured Trade payables)			54,000
Share call A/c	Dr.		
To Share capital A/c		3,20,000	
(Being final call money due)			3,20,000
Bank A/c	Dr.		
To Share call A/c			
(Being final call money received)		3,20,000	3,20,000
Share capital A/c (Face value ₹100)	Dr.		
To Share capital (Face value ₹25)			2,00,000
To Capital reduction A/c		8,00,000	6,00,000
(Being share capital reduced to ₹25 each)			
Capital reduction A/c	Dr.		
To Profit and loss A/c			11,68,000
(Being reconstruction surplus used to write off losses – W.N. 2)		11,68,000	
Capital Reduction A/c	Dr.		
To Capital Reserve A/c			
(Being balance in capital reduction account transferred to capital reserve account)			62,000
		62,000	

Working Notes:

1.	**Settlement of claim of remaining unsecured Trade payables**	₹
	60% of ₹3,60,000	2,16,000
	Considering their claim for share of ₹100 each	
	2,16,000/100 =2,160 shares	
	Less: Number of shares to be issued	
	2,160 x 3= 6,480 shares of ₹25 each	
		(1,62,000)
	Transferred to Capital reduction A/c	54,000

2. Ascertainment of profit and loss account's debit balance at the time of reconstruction.

	₹	₹
Assets		
Fixed assets (3,80,800 + 2,87,200)	6,68,000	
Cash	3,24,000	9,92,000
Less: Capital & Liabilities:		
Share capital		
1st Debentures	4,80,000	
2nd Debentures	3,60,000	
Unsecured trade payables	7,80,000	
Profit and loss A/c (Debit balance)	5,40,000	(21,60,000)
		(11,68,000)

Question 19

M/s Xylem Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the company as on 31st March, 2017 before reconstruction:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital		Land & Building	42,70,000
50,000 shares of ₹50		Machinery	8,50,000
each fully paid up	25,00,000	Computers	5,20,000
1,00,000 shares of ₹50		Inventories	3,20,000
each ₹40 paid up	40,00,000	Trade receivables	10,90,000
Capital Reserve	5,00,000	Cash at Bank	2,68,000
8% Debentures of ₹100 each	4,00,000	Profit & Loss Account	29,82,000
12% Debentures of ₹100 each	6,00,000		
Trade creditors	12,40,000		
Outstanding Expenses	10,60,000		
	1,03,00,000		1,03,00,000

Following is the interest of Mr. A and Mr. B in M/s Xylem Limited:

	Mr. A	Mr. B
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹40 each.
(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for ₹12,50,000.
(3) Trade creditors are given option of either to accept fully paid equity shares of ₹40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade creditors for ₹7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
(4) Mr. A agrees to cancel debentures amounting to ₹2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to ₹1,00,000.
(5) Mr. B 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, Inventories at ₹3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.
(7) Outstanding Expenses are fully paid in cash.
(8) Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to prepare necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

(*RTP May 2018*)

Answer:

Journal Entries

		₹	₹
Bank A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Being money on final call received)			
Equity share capital (₹50) A/c	Dr.	75,00,000	
To Equity share capital (₹40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of ₹50 each into ₹40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at ₹40 each)			
Trade payables A/c	Dr.	12,40,000	
To Equity share capital A/c			7,50,000

		₹	₹
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to creditors in shares or cash to the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To A A/c			7,00,000
(Being cancellation of 8% and 12% debentures of A)			
A A/c	Dr.	7,00,000	
To 15% Debentures A/c			5,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To 15% Debentures A/c			1,00,000
(Being new debentures subscribed by A)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c	Dr.	2,00,000	
To B A/c			3,00,000
(Being cancellation of 8% and 12% debentures of B)			
B A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Land and Building (51,84,000 - 42,70,000)	Dr.	9,14,000	
Inventories	Dr.	30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000
(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Profit and Loss A/c			29,82,000
(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance and downfall in value of other assets)			
Capital Reserve A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being debit balance of capital reduction account adjusted against capital reserve)			

Balance Sheet of Xylem Ltd. (as reduced) as on 31.3.2017

Particulars	Notes	₹
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	80,00,000
2 Non-current liabilities		
(a) Long-term borrowings	2	8,50,000
Total		88,50,000
Assets		
1 Non-current assets		
(a) Fixed assets		
Tangible assets	3	63,04,000

Particulars	Notes	₹
2 Current assets		
(a) Inventories		3,50,000
(b) Trade receivables		9,81,000
(c) Cash and cash equivalents		12,15,000
Total		88,50,000

Notes to accounts

		₹	₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹40		80,00,000
2.	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3.	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. Cash at Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	2,68,000	By Trade Creditors A/c	3,43,000
To Equity Share capital A/c	10,00,000	By Outstanding expenses A/c	10,60,000
To Equity Share Capital A/c	12,50,000	By Balance c/d (bal. fig.)	12,15,000
To 15% Debentures A/c	1,00,000		
	26,18,000		26,18,000

Capital Reduction Account

Particulars	₹	Particulars	₹
To Machinery A/c	1,30,000	By Equity Share Capital A/c	15,00,000
To Computers A/c	1,20,000	By Trade payables A/c	1,47,000
To Trade receivables A/c	1,09,000	By A A/c	2,00,000
To Profit and Loss A/c	29,82,000	By BA/c	50,000
		By Land & Building	9,14,000
		By Inventories	30,000
		By Capital Reserve A/c	5,00,000
	33,41,000		33,41,000

Question 20

The Balance Sheet of Lion Limited as on 31-03-2016 is given below:

Particulars	Note No.	Amount (₹ in lakh)
Equity & Liabilities		
Shareholders' Funds		
Shares' Capital	1	1.400
Reserves & Surplus	2	(522)
Non-Current Liabilities		
Long term Borrowings	3	700
Current Liabilities		
Trade Payables	4	102
Other Liabilities	5	24
Total		1704
Assets		
Non-Current Assets		
Fixed Assets		
Tangible Assets	6	750
Current Assets		
Current Investments	7	200

Particulars	Note No.	Amount (₹ in lakh)
Inventories	8	300
Trade Receivables	9	450
Cash & Cash Equivalents	10	4
Total		1704

Notes to Accounts:

		₹ in Lakhs
(1)	Share Capital	
	Authorised:	
	200 lakh shares of ₹10 each	2,000
	8 lakh, 8% Preference Shares of ₹100 each	800
		2,800
	Issued, Subscribed and paid up:	
	100 lakh Equity Shares of ₹10 each, full paid up	1,000
	4 lakh 8% Preference Shares of ₹100 each, fully paid up	400
	Total	1400
(2)	Reserves and Surplus	
	Debit balance of Profit & Loss A/c	(522)
(3)	Long Term Borrowings	
	6% Debentures (Secured by Freehold Property)	400
	Directors' Loan	300
		700
(4)	Trade Payables	
	Trade payables for Goods	102
(5)	Other Current Liabilities	
	Interest Accrued and Due on 6% Debentures	24
(6)	Tangible Assets	
	Freehold Property	550
	Plant & Machinery	200
		750
(7)	Current Investment	
	Investment in Equity Instruments	200
(8)	Inventories	
	Finished Goods	300
(9)	Trade Receivables	
	Trade receivables for Goods	450
(10)	Cash and Cash Equivalents	
	Balance with Bank	4

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹80 each and Equity Shares to ₹2 each.
(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹2 each to be allotted.
(3) Debenture holders agreed to take one Freehold Property at its book value of ₹300 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
(4) Interest accrued and due on Debentures to be paid in cash.
(5) Remaining Freehold Property to be valued at ₹400 lakh.
(6) All investments sold out for ₹250 lakh.
(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹2 each to be allowed.
(8) 40% of Trade receivables and 80% of Inventories to be written off.
(9) Company's contractual commitments amounting to ₹600 lakh have been settled by paying 5% penalty of contract value.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;
(b) Prepare Capital Reduction Account; and
(c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction.

(*MTP March 2018*) (*15 Marks*)

Answer

(a) Journal Entries in the books of Lion Ltd.

	Particulars		Debit (₹ in lakhs)	Credit (₹ in lakhs)
(i)	8% Preference share capital A/c (₹100 each)	Dr.	400	
	To 8% Preference share capital A/c (₹80 each)			320
	To Capital Reduction A/c			80
	(Being the preference shares of ₹100 each reduced to ₹80 each as per the approved scheme)			
(ii)	Equity share capital A/c (₹10 each)	Dr.	1,000	
	To Equity share capital A/c (₹2 each)			200
	To Capital Reduction A/c			800
	(Being the equity shares of ₹10 each reduced to ₹2each)			
(iii)	Capital Reduction A/c	Dr.	32	
	To Equity share capital A/c (₹2 each)			32
	(Being 1/3rd arrears of preference share dividend of 3 years to be satisfied by issue of 8 lakhs equity shares of ₹2 each)			
(iv)	6% Debentures A/c	Dr.	300	
	To Freehold property A/c			300
	(Being claim of Debenture holders settled in part by transfer of freehold property)			
(v)	Accrued debenture interest A/c	Dr.	24	
	To Bank A/c			24
	(Being accrued debenture interest paid)			
(vi)	Freehold property A/c	Dr.	150	
	To Capital Reduction A/c			150
	(Being appreciation in the value of freehold property)			
(vii)	Bank A/c	Dr.	250	
	To Investments A/c			200
	To Capital Reduction A/c			50
	(Being investment sold at profit)			
(viii)	Director's loan A/c	Dr.	300	
	To Equity share capital A/c (₹2 each)			90
	To Capital Reduction A/c			210
	(Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of ₹2 each)			
(ix)	Capital Reduction A/c	Dr.	972	
	To Profit and Loss A/c			522
	To Trade receivables A/c (450 x 40%)			180
	To Inventories-in-trade A/c (300 x 80%)			240
	To Bank A/c (600 x 5%)			30
	(Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account)			
(x)	Capital Reduction A/c		286	
	To Capital reserve A/c			286
	(Being balance transferred to capital reserve account as per the scheme)			

Capital Reduction Account

Dr. **Cr.**

	(₹ in lakhs)		(₹ in lakhs)
To Equity Share Capital	32	By Preference Share Capital	80
To Trade receivables	180	By Equity Share Capital	800
To Finished Goods	240	By Freehold Property	150
To Profit & Loss A/c	522	By Bank	50
To Bank A/c	30	By Director's Loan	210
To Capital Reserve	286		
	1,290		1,290

Notes to Balance Sheet

		(₹ in lakhs)	(₹ in lakhs)
1.	*Share Capital*		
	Authorised:		
	200 lakhs Equity shares of ₹2 each		400
	8 lakhs 8% Preference shares of ₹80 each		640
			1,040
	Issued:		
	161 lakhs equity shares of ₹2 each		322
	4 lakhs Preference Shares of ₹80 each		320
			642
2.	**Tangible Assets**		
	Freehold Property	550	
	Less: Utilized to pay Debenture holders	(300)	
		250	
	Add: Appreciation	150	400
	Plant and Machinery		200
			600

Question 21

The shareholders of Lili Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2017 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Lili Ltd.

Summarised Balance Sheet of Lili Ltd. as on 31.3.2017

Liabilities		₹	Assets		₹
Share Capital			*Fixed Assets*		
30,000 Equity shares of ₹10 each		3,00,000	Trademarks and Patents		1,10,000
40,000 8% Cumulative Preference			Goodwill at cost		36,100
shares ₹10 each		4,00,000	Freehold Land		1,20,000
			Freehold Premises		2,44,000
Reserves and Surplus			Plant and Equipment		3,20,000
Securities Premium Account		10,000	*Investment*		
			(marked to market)		
Profit and Loss Account		(1,38,400)			
Secured Borrowings					64,000
9% Debentures (₹100)	1,20,000		*Current Assets*		
Accrued Interest	5,400	1,25,400	Inventories:		
Current liabilities			Raw materials and packing		
Trade payables		1,20,000	materials	60,000	
Tax payable		50,000	Finished goods	16,000	76,000
Temporary bank overdraft		2,23,100	Trade receivables		1,20,000
		10,90,100			10,90,100

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

(1) The authorized capital of the Company to be re-fixed at ₹10 lakhs (preference capital of ₹3 lakhs and equity capital of ₹7 lakhs). Both classes of shares are of ₹10 each.

(2) The preference shares are to be reduced to ₹5 each and equity shares reduced by ₹3 per share. Post reduction, both classes of shares to be re-consolidated into ₹10 shares.

(3) Trade Investments are to be liquidated in open market.

(4) One fresh equity shares of ₹10 to be issued for every ₹40 of preference dividends in arrears (ignore taxation).

(5) Expenses for the scheme were ₹10,000.

(6) The debenture holders took over freehold land at ₹2,10,000 and settled the balance after adjusting their dues.

(7) Unprovided contingent liabilities were settled at ₹54,000 and a pending insurance claim receivable settled at ₹12,500.

(8) The intangible assets were all to be written off along with ₹10,000 worth obsolete packing material and 10% of the receivables.

(9) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.

(10) The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.

(*MTP April 2018*) (*16 Marks*)

Answer:

In the books of Lili Ltd.
Journal Entries

				Dr.	Cr.
	2017			₹	₹
1	March 31	Equity Share Capital A/c (₹10)	Dr.	3,00,000	
		To Capital Reduction A/c			90,000
		To Equity Share Capital A/c (₹7)			2,10,000
		(Being reduction of equity shares of ₹10 each to shares of ₹7 each as per Reconstruction Scheme dated...)			
2.		8% Cum. Preference Share Capital A/c (₹10)	Dr.	4,00,000	
		To Capital Reduction A/c			2,00,000
		To Preference Share Capital A/c (₹5)			2,00,000
		(Being reduction of preference shares of ₹10 each to shares of ₹5 each as per reconstruction scheme)			
3.		Equity Share Capital A/c (30,000 x ₹7)	Dr.	2,10,000	
		Preference Share Capital Ac (40,000 x ₹5)	Dr.	2,00,000	
		To Equity Share Capital A/c			
		(21,000 x ₹10)			2,10,000
		To Preference Share Capital A/c			
		(20,000 x ₹10)			2,00,000
		(Being post reduction, both classes of shares reconsolidated into ₹10 each)			
4.		Cash Account	Dr.	64,000	
		To Trade Investments			64,000
		(Being trade investments liquidated in the open market)			
5.		Capital Reduction Account	Dr.	32,000	
		To Equity Share Capital Account			32,000
		(Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of ₹10 each)			
6.		Capital Reduction Account	Dr.	10,000	
		To Cash Account			10,000
		(Being expenses of reconstruction scheme paid in cash)			
7.		9% Debentures Account	Dr.	1,20,000	
		Accrued Interest Account	Dr.	5,400	
		To Debenture holders Account			1,25,400
		(Being amount due to debenture holders)			
8.		Debenture holders Account	Dr.	1,25,400	
		Cash Account (2,10,000 - 1,25,400)	Dr.	84,600	
		To Freehold Land			1,20,000
		To Capital Reduction Account (2,10,000 - 1,20,000)			90,000
		(Being Debenture holders took over freehold land at ₹2,10,000 and settled the balance)			
9.		Capital Reduction Account	Dr.	54,000	
		To Cash Account			54,000
		(Being contingent liability of ₹54,000 paid)			
10.		Cash Account	Dr.	12,500	
		To Capital Reduction Account			12,500
		(Being pending insurance claim received)			
11.		Capital Reduction Account	Dr.	1,68,100	
		To Trademarks and Patents			1,10,000
		To Goodwill			36,100

				Dr.	Cr.
	2017			₹	₹
		To Raw materials & Packing materials			10,000
		To Trade receivables			12,000
		(Being intangible assets written off along with raw materials and packing materials worth ₹10,000 and 10% of trade receivables)			
12.		Cash Account	Dr.	1,26,000	
		To Equity Share Capital Account			1,26,000
		(Being 12,600 shares issued to existing shareholders)			
13.		Bank Overdraft Account	Dr.	2,23,100	
		To Cash Account			2,23,100
		(Being cash balance utilized to pay off bank overdraft)			
14.		Capital Reduction Account	Dr.	1,28,400	
		To Capital reserve Account			1,28,400
		(Being balance of capital reduction account transferred to capital reserve account)			

(ii) Capital Reduction Account

Particulars	₹	Particulars	₹
To Equity share capital	32,000	By Preference share capital	2,00,000
To Cash (contingent liability settled)	54,000	By Equity share capital	90,000
To Trademarks and Patents	1,10,000	By Freehold land	90,000
To Goodwill	36,100	By Cash (insurance claim)	12,500
To Raw material and Packing materials	10,000		
To Trade receivables	12,000		
To Cash account	10,000		
To Capital reserve account	1,28,400		
	3,92,500		3,92,500

(iii) Cash Account

Particulars	₹	Particulars		₹
To Investment	64,000	By Capital reduction (Contingent liability)		54,000
To 9% Debenture holders (2,10,000-1,25,400)	84,600	By Expenses		10,000
To Capital reduction (insurance claim)	12,500	By Temporary bank overdraft - From available cash (64,000 + 84,600 + 12,500 - 54,000 - 10,000)	97,100	
To Equity share capital 12,600 shares @ ₹10 each	1,26,000	- From proceeds of equity share capital (2,23,100-97,100)	1,26,000	
				2,23,100
	2,87,100			2,87,100

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft = ₹2,23,100 - ₹97,100 = ₹1,26,000

Question 22

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

	(₹ in 000)
	Amount
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) Ail 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.

(November 2018) (10 marks)

Answer*:*

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 share capital 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

		₹'000	₹'000
	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&LA/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 23

The summarized balance sheet of Z Limited as on 31st March, 2017 is as under:

Liabilities	Amount in ₹
Share Capital:	
5,00,000 Equity shares of ₹10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account	(14,60,000)
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1.00,000
Total	81,00,000
Assets:	
Non-Current Assets:	
Fixed Assets:	
(a) Tangible Assets:	
Land & Buildings	30,00,000
Plants Machinery	12,50,000
Furnitures Fixtures	2,50,000
(b) Intangible Assets:	
Goodwill	10,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000
Discount on issue of debentures	1,00,000
Total	81,00,000

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹1,00,000 and ₹60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares to be converted into fully paid equity shares of ₹5.00 each.

(ii) The Preference shares be reduced to ₹50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹1,00,000 and ₹60,000 respectively in cash and to receive new 12% debentures for the balance amount.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of ₹3.00 lacs were cancelled on payment of ₹15,000 as penalty.

(vii) Directors refunded ₹1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid ₹15,000.

(ix) The taxation liability of the company was settled for ₹75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to prepare necessary journal entries for all the above-mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit and Loss account arid Discount on issue of debentures. And also, prepare Bank Account and Reconstruction Account.

(*RTP November 2018*)

Answer

Journal Entries in the Books of Z Ltd.

			Dr.	Cr.
			₹	₹
(i)	Equity Share Capital (₹10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹10 each fully paid into same number of fully paid equity shares of ₹5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (₹100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹100 each into same number of 10% preference share of ₹50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables	Dr.	60,000	
	Interest on debentures outstanding A/c	Dr.	64,000	
	Bank A/c	Dr.	60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			

			Dr.	Cr.
			₹	₹
(v)	Trade payables A/c To Reconstruction A/c (Being remaining trade payables sacrificed 50% of their claim.)	Dr.	1,70,000	 1,70,000
(vi)	Directors' Loan A/c To Equity Share Capital 5) A/c To Reconstruction A/c (Being Directors' loan claim settled by issuing 12,000 equity shares of ₹5 each as per scheme of reconstruction.)	Dr.	1,00,000	 40,000 60,000
(vii)	Reconstruction A/c To Bank A/c (Being payment made towards penalty of 5% for cancellation of capital commitments of ₹3 Lakhs.)	Dr.	15,000	15,000
(viii)	Bank A/c To Reconstruction A/c (Being refund of fees by directors credited to reconstruction A/c)	Dr.	1,00,000	1,00,000
(ix)	Reconstruction A/c To Bank A/c (Being payment of reconstruction expenses)	Dr.	15,000	15,000
(x)	Provision for Tax A/c To Bank A/c To Reconstruction A/c (Being payment of tax liability in full settlement against provision for tax)	Dr.	1,00,000	75,000 25,000
(xi)	Land and Building A/c To Reconstruction A/c (Being appreciation in value of Land & Building recorded)	Dr.	2,00,000	2,00,000
(xii)	Reconstruction A/c To Goodwill A/c To Patent A/c To Profit and Loss A/c To Discount on issue of Debentures A/c To Plant and Machinery A/c To Furniture & Fixture A/c To Trade Investment A/c To Inventory A/c To Trade Receivables A/c To Capital Reserve (bal. fig.) (Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)	Dr.	49,85,000	 10,00,000 5,00,000 14,60,000 1,00,000 6,50,000 1,00,000 50,000 2,50,000 1,00,000 7,75,000

Bank Account

		₹			₹
To	Reconstruction (Y)	1,00,000	By	Balance b/d	1,00,000
To	Reconstruction (Z)	60,000	By	Reconstruction A/c	15,000
To	Reconstruction A/c (refund of earlier fees by directors)	1,00,000		(capital commitment penalty paid)	
			By	Reconstruction A/c (reconstruction expenses paid)	15,000
			By	Provision for tax A/c (tax paid)	75,000
			By	Balance c/d	55,000
		2,60,000			2,60,000

Reconstruction Account

		₹			₹
To	Bank (penalty)	15,000	By	Equity Share	
To	Bank (reconstruction expenses)	15,000		Capital A/c	25,00,000
To	Goodwill	10,00,000	By	9% Pref. Share	
To	Patent	5,00,000		Capital A/c	10,00,000
To	P&LA/c	14,60,000	By	Mr. Y (Settlement)	5,78,000
To	Discount on issue of debentures	1,00,000	By	Mr. Z (Settlement)	3,82,000
To	P&M	6,50,000	By	Trade Payables A/c	1,70,000
To	Furniture and Fixtures	1,00,000	By	Director's loan	60,000
To	Trade investment	50,000	By	Bank	1,00,000
To	Inventory	2,50,000	By	Provision for tax	25,000
To	Trade Receivables	1,00,000	By	Land and Building	2,00,000
To	Capital Reserve (bal. fig.)	7,75,000			
		50,15,000			50,15,000

Question 24

The Balance Sheet of Lion Limited as on 31-03-2018 is given below:

Particulars	Note No.	Amount (₹ in lakh)
Equity & Liabilities		
Shareholders' Funds		
Shares' Capital	1	1,400
Reserves & Surplus	2	(522)
Non-Current Liabilities		
Long term Borrowings	3	700
Current Liabilities		
Trade Payables	4	102
Other Liabilities	5	24
Total		1,704
Assets		
Non-Current Assets		
Property, Plants Equipment		
Tangible Assets	6	750
Current Assets		
Current Investments	7	200
Inventories	8	300
Trade Receivables	9	450
Cash & Cash Equivalents	10	4
Total		1,704

Notes to Accounts:

		₹ in Lakhs
(1)	Share Capital Authorised:	
	200 lakh shares of ₹10 each	2,000
	8 lakh, 8% Preference Shares of ₹100 each	800
		2,800
	Issued, Subscribed and paid up:	
	100 lakh Equity Shares of ₹10 each, full paid up	1,000
	4 lakh 8% Preference Shares of ₹100 each, fully paid up	400
	Total	1,400
(2)	Reserves and Surplus	
	Debit balance of Profit & Loss A/c	(522)
(3)	Long Term Borrowings	
	6% Debentures (Secured by Freehold Property)	400
	Directors' Loan	300
		700

		₹ in Lakhs
(4)	Trade Payables	
	Trade payables for Goods	102
(5)	Other Current Liabilities	
	Interest Accrued and Due on 6% Debentures	24
(6)	Tangible Assets	
	Freehold Property	550
	Plant & Machinery	200
		750
(7)	Current Investment	
	Investment in Equity Instruments	200
(8)	Inventories	
	Finished Goods	300
(9)	Trade Receivables	
	Trade receivables for Goods	450
(10)	Cash and Cash Equivalents	
	Balance with Bank	4

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹80 each and Equity Shares to ₹2 each.
(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹2 each to be allotted.
(3) Debenture holders agreed to take one Freehold Property at its book value of ₹300 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
(4) Interest accrued and due on Debentures to be paid in cash.
(5) Remaining Freehold Property to be valued at ₹400 lakh.
(6) All investments sold out for ₹250 lakh.
(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹2 each to be allowed.
(8) 40% of Trade receivables and 80% of Inventories to be written off.
(9) Company's contractual commitments amounting to ₹600 lakh have been settled by paying 5% penalty of contract value.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;
(b) Prepare Reconstruction Account; and
(c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction.

(*RTP May, 2019*)

Answer

(a) Journal Entries in the books of Lion Ltd.

	Particulars		Debit (₹ in lakhs)	Credit (₹ in lakhs)
(i)	8% Preference share capital A/c (7100 each)	Dr.	400	
	To 8% Preference share capital A/c (780 each)			320
	To Capital Reduction A/c			80
	(Being the preference shares of ₹100each reduced to ₹80 each as per the approved scheme)			
(ii)	Equity share capital A/c (₹10 each)	Dr.	1,000	
	To Equity share capital A/c (₹2 each)			200
	To Capital Reduction A/c			800
	(Being the equity shares of ₹10 each reduced to ₹2 each)			
(iii)	Capital Reduction A/c	Dr.	32	
	To Equity share capital A/c (₹2 each)			32
	(Being 1/3rd arrears of preference share dividend of 3 years to be satisfied by issue of 16 lakhs equity shares of ₹2 each)			

	Particulars		Debit (₹ in lakhs)	Credit (₹ in lakhs)
(iv)	6% Debentures A/c	Dr.	300	
	To Freehold property A/c			300
	(Being claim of Debenture holders settled in part by transfer of freehold property)			
(v)	Accrued debenture interest A/c	Dr.	24	
	To Bank A/c			24
	(Being accrued debenture interest paid)			
(vi)	Freehold property A/c	Dr.	150	
	To Capital Reduction A/c			150
	(Being appreciation in the value of freehold property)			
(vii)	Bank A/c	Dr.	250	
	To Investments A/c			250
	To Capital Reduction A/c			
	(Being investment sold at profit)			
(viii)	Director's loan A/c	Dr.	300	
	To Equity share capital A/c (₹2 each)			300
	To Capital Reduction A/c			
	(Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of ₹2 each)			
(ix)	Capital Reduction A/c	Dr.	972	
	To Profit and loss A/c			972
	To Trade receivables A/c (450 x 40%)			
	To Inventories-in-trade A/c (300x 80%)			
	To Bank At (600 x5%)			
	(Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account)			
(x)	Capital Reduction A/c	Dr.	286	
	To Capital reserve A/c			286
	(Being balance transferred to capital reserve account as per the scheme)			

(b) Capital Reduction Account

Dr. **Cr.**

	(₹ in lakhs)		*(₹ in lakhs)*
To Equity Share Capital	32	By Preference Share Capital	80
To Trade receivables	180	By Equity Share Capital	800
To Finished Goods	240	By Freehold Property	150
To Profit & Loss A/c	522	By Bank	50
To Bank A/c	30	By Director's Loan	210
To Capital Reserve	286		
	1,290		1,290

(c) Notes to Balance Sheet

		(₹ in lakhs)	*(₹ in lakhs)*
1.	Share Capital		
	Authorised:		
	200 lakhs Equity shares of ₹2 each		400
	8 lakhs 8% Preference shares of ₹80 each		640
			1,040
	Issued:		
	161 lakhs equity shares of 72 each		322
	4 lakhs Preference Shares of 780 each		320
			642
2.	Tangible Assets		
	Freehold Property	550	
	Less: Utilized to pay Debenture holders	(300)	
		250	
	Add: Appreciation	150	400
	Plant and Machinery		200
			600

Question 25

The shareholders of Lili Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2017 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Lili Ltd.

Summarised Balance Sheet of Lili Ltd. as on 31.3.2017

Liabilities		**₹**	**Assets**		**₹**
Share Capital			**Fixed Assets**		
30,000 Equity shares of ₹10 each		3,00,000	Trade marks and Patents		1,10,000
40,000 8% Cumulative Preference shares ₹10 each		4,00,000	Goodwill at cost		36,100
			Freehold Land		1,20,000
Reserves and Surplus			Freehold Premises		2,44,000
Securities Premium Account		10,000	Plant and Equipment		3,20,000
Profit and Loss Account		(1,38,400)	*Investment* (marked to market)		
Secured Borrowings					64,000
9% Debentures (₹100)	1,20,000		*Current Assets*		
Accrued Interest	5,400	1,25,400	Inventories:		
Current liabilities			Raw materials and packing		
Trade payables		1,20,000	materials	60,000	
Tax payable		50,000	Finished goods	16,000	76,000
Temporary bank overdraft		2,23,100	Trade receivables		1,20,000
		10,90,100			10,90,100

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

(1) The authorized capital of the Company to be re-fixed at ₹10 lakhs (preference capital of ₹3 lakhs and equity capital of ₹7 lakhs). Both classes of shares are of ₹10 each.

(2) The preference shares are to be reduced to ₹5 each and equity shares reduced by ₹3 per share. Post reduction, both classes of shares to be re-consolidated into ₹10 shares.

(3) Trade Investments are to be liquidated in open market.

(4) One fresh equity shares of ₹10 to be issued for every ₹40 of preference dividends in arrears (ignore taxation).

(5) Expenses for the scheme were ₹10,000.

(6) The debenture holders took over freehold land at ₹2,10,000 and settled the balance after adjusting their dues.

(7) Unprovided contingent liabilities were settled at ₹54,000 and a pending insurance claim receivable settled at ₹12,500.

(8) The intangible assets were all to be written off along with ₹10,000 worth obsolete packing material and 10% of the receivables.

(9) Remaining cash available as a result of the above transactions is to be utilized to payoff the bank overdraft to that extent.

(10) The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.

(MTP-March 2019) (15 Marks)

Answer*:*

(i) In the books of Lili Ltd.
Journal Entries

				Dr.	**Cr.**
	2017			**₹**	**₹**
1.	March 31	Equity Share Capital A/c (₹10)	Dr.	3,00,000	
		To Capital Reduction A/c			90,000
		To Equity Share Capital A/c (₹7)			2,10,000
		(Being reduction of equity shares of ₹10 each to shares of ₹7 each as per Reconstruction Scheme dated...)			
2.		8% Cum. Preference Share Capital A/c (₹10)	Dr.	4,00,000	
		To Capital Reduction A/c			2,00,000
		To Preference Share Capital A/c (₹5)			2,00,000
		ng reduction of preference shares of ₹10 each to shares of ₹5 each as per reconstruction scheme)			

				Dr.	Cr.
	2017			₹	₹
3.		Equity Share Capital A/c (30,000 x ₹7) Preference Share Capital A/c (40,000 x ₹5) To Equity Share Capital A/c (21,000 x ₹10) To Preference Share Capital A/c (20,000 x ₹10) (Being post reduction, both classes of shares reconsolidated into ₹10 each)		2,10,000 2,00,000	 2,10,000 2,00,000
4.		Cash Account To Trade Investments (Being trade investments liquidated in the open market)		64,000	 64,000
5.		Capital Reduction Account To Equity Share Capital Account (Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of ₹10 each)		32,000	 32,000
6.		Capital Reduction Account To Cash Account (Being expenses of reconstruction scheme paid in cash)		10,000	 10,000
7.		9% Debentures Account Accrued Interest Account To Debenture holders Account (Being amount due to debenture holders)		1,20,000 5,400	1,25,400
8.		Debenture holders Account Cash Account (2,10,000 - 1,25,400) To Freehold Land To Capital Reduction Account (2,10,000 -1,20,000) (Being Debenture holders took over freehold land at ₹2,10,000 and settled the balance)		1,25,400 84,600	 1,20,000 90,000
9.		Capital Reduction Account To Cash Account (Being contingent liability of ₹54,000 paid)		54,000	 54,000
10.		Cash Account To Capital Reduction Account (Being pending insurance claim received)		12,500	 12,500
11.		Capital Reduction Account To Trade marks and Patents To Goodwill To Raw materials & Packing materials To Trade receivables (Being intangible assets written off along with raw materials and packing materials worth ₹10,000 and 10% of trade receivables)		1,68,100	 1,10,000 36,100 10,000 12,000
12.		Cash Account To Equity Share Capital Account (Being 12,600 shares issued to existing shareholders)		1,26,000	 1,26,000
13.		Bank Overdraft Account To Cash Account (Being cash balance utilized to pay off bank overdraft)	Dr.	2,23,100	 2,23,100
14.		Capital Reduction Account To Capital reserve Account (Being balance of capital reduction account transferred to capital reserve account)	Dr.	1,28,400	 1,28,400

(ii) Capital Reduction Account

Particulars	₹	Particulars	₹
To Equity share capital	32,000	By Preference share capital	2,00,000
To Cash (contingent liability settled)	54,000	By Equity share capital	90,000
To Trademarks and Patents	1,10,000	By Freehold land	90,000
To Goodwill	36,100	By Cash (insurance claim)	12,500
To Raw material and Packing materials	10,000		
To Trade receivables	12,000		
To Cash account	10,000		
To Capital reserve account	1,28.400		
	3,92,500		3,92,500

(iii) Cash Account

Particulars	₹	*Particulars*		₹
To Investment	64,000	By Capital reduction (Contingent liability)		54,000
To 9% Debenture holders (2,10,000-1,25,400)	84,600	By Expenses		10,000
To Capital reduction (insurance claim)	12,500	By Temporary bank overdraft - From available cash (64,000+84,600+12,500 -54,000-10,000)	97,100	
To Equity share capital 12,600 shares @ ₹10 each		- From proceeds of equity share capital (2,23,100-97.100)	1,26,000	2,23,100
	1,26,000			
	2,87,100			2,87,100

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft = ₹2,23,100 - ₹97,100 = ₹1,26,000

Question 26

Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the draft Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital			
50,000 shares of ₹50		Goodwill	
each fully paid up	25,00,000	Land & Building	22,00,000
1,00,000 shares of ₹50		Machinery	42,70,000
each ₹40 paid up	40,00,000	Computers	8,50,000
Capital Reserve	5,00,000	Inventories	5,20,000
8% Debentures of ₹100 each	4,00,000	Trade receivables	3,20,000
12% Debentures of ₹100 each	6,00,000	Cash at Bank	10,90,000
Trade payables	12,40,000	Profit & Loss Account	2,68,000
Outstanding Expenses	10,60,000		7,82,000
Total	1,03,00,000	Total	1,03,00,000

Following is the interest of Mr. Shiv and Mr. Ganesh in 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	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹40 each.

(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for ₹12,50,000.

(3) Trade payables 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 payables 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 debentures 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 agrees to subscribe further 15% Debentures 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, Inventories at ₹3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.

(7) Outstanding Expenses are fully paid in cash.

(8) Goodwill and Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

(*RTP November 2019*)

Answer:

Journal Entries in the books of Platinum Ltd.

			₹	₹
	Bank A/c (1,00,000 x ₹10)	Dr.	10,00,000	
	To Equity share capital A/c			10,00,000
	(Being money on final call received)			
	Equity share capital (₹50) A/c	Dr.	75,00,000	
	To Equity share capital (₹40) A/c			60,00,000
	To Capital Reduction A/c			15,00,000
	(Being conversion of equity share capital of ₹50 each into ₹40 each as per reconstruction scheme)			
	Bank A/c	Dr.	12,50,000	
	To Equity Share Capital A/c			12,50,000
	(Being new shares allotted at ₹40 each)			
	Trade payables A/c	Dr.	12,40,000	
	To Equity share capital A/c			7,50,000
	To Bank A/c (4,90,000 x 70%)			3,43,000
	To Capital Reduction A/c			1,47,000
	(Being payment made to trade payables in shares or cash to the extent of 70% as per reconstruction scheme)			
	8% Debentures A/c	Dr.	3,00,000	
	12% Debentures A/c	Dr.	4,00,000	
	To Shiv A/c			7,00,000
	(Being cancellation of 8% and 12% debentures of Shiv)			
	Bank A/c	Dr.	1,00,000	
	To Shiv A/c			1,00,000
	(Being new debentures subscribed by Shiv)			
	Shiv A/c	Dr.	8,00,000	
	To 15% Debentures A/c			6,00,000
	To Capital Reduction A/c			2,00,000
	(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
	8% Debentures A/c	Dr.	1,00,000	
	12% Debentures A/c	Dr.	2,00,000	
	To Ganesh A/c			3,00,000
	(Being cancellation of 8% and 12% debentures of Ganesh)			
	Ganesh A/c	Dr.	3,00,000	
	To 15% Debentures A/c			2,50,000
	To Capital Reduction A/c			50,000
	(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
	Land and Building (51,84,000 – 42,70,000)	Dr.	9,14,000	
	Inventories	Dr.	30,000	
	To Capital Reduction A/c			9,44,000

		₹	₹
	(Being value of assets appreciated)		
	Outstanding expenses A/c Dr.	10,60,000	
	To Bank A/c		10,60,000
	(Being outstanding expenses paid in cash)		
	Capital Reduction A/c Dr.	33,41,000	
	To Machinery A/c		1,30,000
	To Computers A/c		1,20,000
	To Trade receivables A/c		1,09,000
	To Goodwill A/c		22,00,000
	To Profit and Loss A/c		7,82,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance, goodwill and downfall in value of other assets)		
	Capital Reserve A/c Dr.	5,00,000	
	To Capital Reduction A/c		5,00,000
	(Being debit balance of capital reduction account adjusted against capital reserve)		

Balance Sheet (as reduced) as on 31.3.2019

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	80,00,000
2		**Non-current liabilities**		
	(a)	Long-term borrowings	2	8,50,000
		Total		**88,50,000**
		Assets		
1		**Non-current assets**		
	(a)	Property, Plant and Equipment Tangible assets	3	63,04,000
2		**Current assets**		
	(a)	Inventories		3,50,000
	(b)	Trade receivables		9,81,000
	(c)	Cash and cash equivalents		12,15,000
		Total		**88,50,000**

Notes to accounts

			₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹40		80,00,000
2.	**Long-term borrowings**		
	Secured		
	15% Debentures(assumed to be secured)		8,50,000
3.	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. Cash at Bank Account

Particulars		₹	Particulars		₹
To	Balance b/d	2,68,000	By	Trade Creditors A/c	3,43,000
To	Equity Share capital A/c	10,00,000	By	Outstanding expenses A/c	10,60,000
To	Equity Share Capital A/c	12,50,000	By	Balance c/d (bal. fig.)	12,15,000
To	Shiv A/c	1,00,000			
		26,18,000			26,18,000

2. Capital Reduction Account

Particulars		₹	Particulars		₹
To	Machinery A/c	1,30,000	By	Equity Share Capital A/c	15,00,000
To	Computers A/c	1,20,000	By	Trade Creditors A/c	1,47,000
To	Trade receivables A/c	1,09,000	By	Shiv A/c	2,00,000
To	Goodwill A/c	22,00,000	By	Ganesh A/c	50,000
To	Profit and Loss A/c	7,82,000	By	Land & Building	9,14,000
			By	Inventories	30,000
			By	Capital Reserve A/c	5,00,000
		33,41,000			33,41,000

Question 27

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.

(*November 2019, New Course, 15 Marks*)

Answer

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

M/s Xylem Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital		Land & Building	42,70,000
50,000 shares of ₹50		Machinery	8,50,000
each fully paid up	25,00,000	Computers	5,20,000
1,00,000 shares of ₹50		Inventories	3,20,000
each ₹40 paid up	40,00,000	Trade receivables	10,90,000
Capital Reserve	5,00,000	Cash at Bank	2,68,000
8% Debentures of ₹100 each	4,00,000	Profit & Loss Account	29,82,000
12% Debentures of ₹100 each	6,00,000		
Trade payables	12,40,000		
Outstanding Expenses	10,60,000		
	1,03,00,000		1,03,00,000

Following is the interest of Mr. A and Mr. B in M/s Xylem Limited:

	Mr. A	Mr. B
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹40 each.
(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for ₹12,50,000.
(3) Trade payables 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 payables for ₹7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
(4) Mr. A agrees to cancel debentures amounting to ₹2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to ₹1,00,000.
(5) Mr. B 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, Inventories at ₹3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.
(7) Outstanding Expenses are fully paid in cash.
(8) Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

[*MTP October, 2019, 15 Marks*]

Answer

Journal Entries

		₹	₹
Bank A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Being money on final call received)			
Equity share capital (₹50) A/c	Dr.	75,00,000	
To Equity share capital (₹40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of ₹50 each into ₹40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at ₹40 each)			
Trade payables A/c	Dr.	12,40,000	
To Equity share capital A/c			7,50,000
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to trade payables in shares or cash to the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To A A/c			7,00,000
(Being cancellation of 8% and 12% debentures of A)			
A A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To A A/c			1,00,000
(Being new debentures subscribed by A)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c	Dr.	2,00,000	
To B A/c			3,00,000
(Being cancellation of 8% and 12% debentures of B)			
B A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Land and Building	Dr.		
(51,84,000-42,70,000)		9,14,000	
Inventories	Dr.	30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000
(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Profit and Loss A/c			29,82,000

	₹	₹
(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance and downfall in value of other assets)		
Capital Reserve A/c Dr.	5,00,000	
To Capital Reduction A/c		5,00,000
(Being debit balance of capital reduction account adjusted against capital reserve)		

Balance Sheet of Xylem Ltd. (as reduced) as on 31.3.2019

Particulars	Notes	₹
Equity and Liabilities		
1 Shareholders' funds		
(a) Share capital	1	80,00,000
2 Non-current liabilities		
(a) Long-term borrowings	2	8,50,000
Total		**88,50,000**
Assets		
1 Non-current assets		
(a) Property, Plant and Equipment		
Tangible assets	3	63,04,000
2 Current assets		
(a) Inventories		3,50,000
(b) Trade receivables		9,81,000
(c) Cash and cash equivalents		12,15,000
Total		**88,50,000**

Notes to accounts

			₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹40		80,00,000
2.	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3.	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. Cash at Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	2,68,000	By Trade payables A/c	3,43,000
To Equity Share capital A/c	10,00,000	By Outstanding expenses A/c	10,60,000
To Equity Share Capital A/c	12,50,000	By Balance c/d (bal. fig.)	12,15,000
To A A/c	1,00,000		
	26,18,000		26,18.000

2. Capital Reduction Account

Particulars	₹	Particulars	₹
To Machinery A/c	1,30,000	By Equity Share Capital A/c	15,00,000
To Computers A/c	1,20,000	By Trade payables A/c	1,47,000
To Trade receivables A/c	1,09,000	By A A/c	2,00,000
To Profit and Loss A/c	29,82,000	By BA/c	50,000
		By Land & Building	9,14,000
		By Inventories	30,000
		By Capital Reserve A/c	5,00,000
	33,41,000		33,41,000

Question 29

The following is the Balance Sheet of Star Ltd. as on 31st March, 2019:

	₹
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 & Loss Account	(2,00,000)
2. Non-current liabilities:	
"A" 6% Debentures (Secured on Bombay Works)	3,00,000
"B" 6% Debentures (Secured on Chennai Works)	3,50,000
3. Current Liabilities and Provisions:	
(a) Workmen's Compensation Fund:	
Bombay Works	10,000
Chennai Works	5,000
(b) Trade Payables	1,25,000
Total	24,90,000
B. Assets:	
Non- current Assets:	
1. PPE:	
Bombay Works	9,50,000
Chennai Works	7,75,000
2. Investment:	
Investments for Workman's Compensation Fund	15,000
3. Current Assets:	
(a) Inventories	4,50,000
(b) Trade Receivables	2,50,000
(c) Cash at Bank	50,000
	24,90,000

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were as follows:

(i) Paid up value of 7% Preference Share to be reduced to ₹ 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 to refund ₹ 50,000 of the fees previously received by them.

(iv) Debenture holders forego their interest of ₹ 26,000 which is included among the trade payables.

(v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.

(vi) "B" 6% Debenture holders agreed to take over the Chennai Works at ₹ 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 Worksmen'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) Inventory 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-third 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.

(*May 2020*)

Answer

In the books of Star Ltd.
Journal Entries

	Particulars		***Amount*** ₹	***Amount*** ₹
(i)	7% Preference share capital (₹ 100)	Dr.	9,00,000	
	To 9% Preference share capital (₹ 80)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being preference shares reduced to ₹ 80 and 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.	50,000	
	To Capital reduction A/c			50,000
	(Being directors refunded the fee amount)			
(iv)	Trade payables A/c (Interest on debentures)	Dr.	26,000	
	To Capital reduction A/c			26,000
	(Being interest forgone by the debenture holders)			
(v)	No entry required			
(vi) (a)	'B' 6% Debentures A/c	Dr.	3,50,000	
	To Debentures holders A/c			3,50,000
	(Being amount due to Debentures holders)			
(b)	Debentures holders A/c	Dr.	4,40,000	
	To Chennai Works A/c			4,25,000
	To Equity share capital A/c			15,000
	(Being Chennai works taken over and equity shares issued to 'B' 6% Debenture holders)			
(c)	Equity share of Zia ltd. A/c	Dr.	90,000	
	To Debentures holders A/c			90,000
	(Being 9,000 equity shares of Zia Ltd. issued by Debentures holders)			
(vii) (a)	Chennai Works – Workmen Compensation Fund	Dr.	4,000	
	To Capital reduction A/c			4,000
	(Being difference due to reduced amount of actual liability transferred to capital reduction account)			
(b)	Bank A/c	Dr.	15,400	
	To Investment for Workmen Compensation Fund			14,000
	To Capital reduction A/c			1,400
	(Being investment for Workmen Compensation Fund sold @ 10% profit)			
(C)	Trade Payables A/c	Dr.	15,400	
	To Bank A/c			15,400
	(Being part payment made to trade payables)			
(viii)	Capital reduction A/c	Dr.	2,10,000	
	To Provision for Doubtful Debts A/c			20,000
	To Inventory A/c			1,90,000
	(Being assets revalued)			
(ix)	Capital reduction A/c	Dr.	5,50,000	
	To Profit & Loss A/c			2,00,000
	To PPE – Chennai Works			3,50,000
	(Being assets revalued and losses written off)			

	Particulars		***Amount*** ₹	***Amount*** ₹
(x)	Capital reduction A/c	Dr.	4,01,400	
	To PPE – Bombay Works			2,67,600
	To Capital reserve A/c			1,33,800
	(Being assets revalued and remaining amount transferred to capital reserve account)			

Question 30

The following information pertains to Z Limited as on 31st March, 2019:

	Amount in ₹
Share Capital:	
5,00,000 Equity shares of ₹ 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹ 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account	(14,60,000)
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Non-Current Assets:	
(a) Tangible Assets:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
(b) Intangible Assets:	
Goodwill	11,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000

Note: Preference dividend is in arrears for last 2 years. Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹ 1,00,000 and ₹ 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.

(ii) The Preference shares be reduced to ₹ 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.

(vii) Directors refunded ₹ 1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid ₹ 15,000.

(ix) The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to pass journal entries for all the above-mentioned transactions including amounts of Goodwill, Patents, Loss in Profit and Loss account to be written off. Also prepare Bank Account and Reconstruction A/c.

(*RTP, November, 2020*)

Answer

Journal Entries in the Books of Z Ltd.

			Dr.	Cr.
			₹	₹
(i)	Equity Share Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (₹ 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures outstanding A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			

			Dr.	Cr.
			₹	₹
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
(xii)	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c			11,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

		₹			₹
To	Reconstruction (Y)	1,00,000	By	Balance b/d	1,00,000
To	Reconstruction(Z)	60,000	By	Reconstruction A/c	15,000
To	Reconstruction A/c (refund of earlier fees by directors)	1,00,000		(capital commitment penalty paid)	
			By	Reconstruction A/c (reconstruction expenses paid)	15,000
			By	Provision for tax A/c (tax paid)	75,000
			By	Balance c/d	55,000
		2,60,000			2,60,000

Reconstruction Account

		₹			₹
To	Bank (penalty)	15,000	By	Equity Share	
To	Bank (reconstruction expenses)	15,000		Capital A/c	25,00,000
To	Goodwill	11,00,000	By	9% Pref. Share	
To	Patent	5,00,000		Capital A/c	10,00,000
To	P & L A/c	14,60,000	By	Mr. Y (Settlement)	5,78,000
			By	Mr. Z (Settlement)	3,82,000
To	P & M	6,50,000	By	Trade Payables A/c	1,70,000
To	Furniture and Fixtures	1,00,000	By	Director's loan	60,000
To	Trade investment	50,000	By	Bank	1,00,000
To	Inventory	2,50,000	By	Provision for tax	25,000
To	Trade Receivables	1,00,000	By	Land and Building	2,00,000
To	Capital Reserve (bal. fig.)	7,75,000			
		50,15,000			50,15,000

Question 31

The summarised Balance Sheet of Preeti Limited as on 31st March 2019, was as follows:

Liabilities	(₹)	Assets	(₹)
Authorized and subscribed capital:		Property, plant and equipment:	
20,000 Equity shares of ₹ 100 each fully paid	20,00,000	Machineries	7,00,000
Unsecured loans:		Current Assets:	
15% Debentures	6,00,000	Inventory	5,06,000
Interest payable thereon	90,000	Trade receivables	4,60,000
Current Liabilities:		Bank	40,000
Trade payables	1,04,000	Profit & loss A/c	11,60,000
Provision for income tax	72,000		
	28,66,000		28,66,000

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from the appropriate authorities. Accordingly, it was decided that:

(i) Each share be sub-divided into 10 fully paid up equity shares of ₹ 10 each.

(ii) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debenture holders and trade payables as necessary.

(iii) Out of shares surrendered 20,000 shares of ₹ 10 each shall be converted into 10% Preference shares of ₹ 10 each fully paid up.

(iv) The claims of the debenture holders shall be reduced by 50%. In consideration of the reduction, the debenture holder shall receive Preference Shares of ₹ 2,00,000 which are converted out of shares surrendered.

(v) Trade payables claim shall be reduced by 25%. Remaining trade payables are to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.

(vi) Balance of Profit and Loss account to be written off.

(vii) The shares surrendered and not re-issued shall be cancelled.

Pass Journal Entries giving effect to the above

(*MTP, October, 2020*) (*8 Marks*)

Answer

In the books of Preeti Limited Journal Entries

			₹	₹
(i)	Equity Share Capital (₹ 100) A/c	Dr.	20,00,000	
	To Share Surrender A/c			10,00,000
	To Equity Share Capital (₹ 10) A/c			10,00,000
	(Sub-division of 20,000 equity shares of ₹ 100 each into 2,00,000 equity shares of ₹ 10 each and surrender of 1,00,000 of such sub-divided shares as per capital reduction scheme)			
(ii)	15% Debentures A/c	Dr.	3,00,000	
	Interest payable A/c (proportionate 50%)	Dr.	45,000	
	To Reconstruction A/c			3,45,000
	(Transferred 50% of the claims of the debenture holders to Reconstruction A/c in consideration of which 10% Preference shares are being issued, out of share surrender A/c as per capital reduction scheme)			
(iii)	Trade payables A/c	Dr.	1,04,000	
	To Reconstruction A/c			1,04,000
	(Transferred claims of the trade payables to Reconstruction A/c, 25% of which is reduction and equity shares are issued in consideration of the balance amount)			
(iv)	Share Surrender A/c	Dr.	10,00,000	
	To 10% Preference Share Capital A/c			2,00,000
	To Equity Share Capital A/c			78,000
	To Reconstruction A/c			7,22,000
	(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as per scheme and the balance in share surrender account is transferred to reconstruction account)			

		₹	₹
(v)	Reconstruction A/c Dr.	11,71,000	
	To Profit & Loss A/c		11,60,000
	To Capital Reserve A/c		11,000
	(Adjusted debit balance of profit and loss account against reconstruction account and the balance is transferred to Capital Reserve account)		

Note: Alternative set of correct journal entries may be given for transfer of surrendered shares to trade payables and debenture holders.

Question 32

Meghna Limited gives the following information as on 31-03-2021:

Particulars	***Amount (₹ in lakh)***
Share capital	
Issued, subscribed and paid up:	
100 lakh Equity Shares of ₹ 10 each, full paid up	1,000
4 lakh 8% Preference Shares of ₹ 100 each, fully paid up	400
Debit balance of Profit & Loss A/c	522
6% Debentures (secured by Freehold Property)	400
Directors' Loan	300
Trade Payables	102
Interest accrued and outstanding on 6% Debentures	24
Freehold Property	550
Plant & Machinery	200
Current Investments (Investment in Equity Instruments)	200
Inventories (Finished goods)	300
Trade Receivables	450
Bank balance	4

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹ 80 each and Equity Shares to ₹ 2 each.
(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹ 2 each to be allotted.
(3) Debenture holders agreed to take one Freehold Property at its book value of ₹ 300 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
(4) Interest accrued and due on Debentures to be paid in cash.
(5) Remaining Freehold Property to be valued at ₹ 400 lakh.
(6) All investments sold out for ₹ 250 lakh.
(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹ 2 each to be allowed.
(8) 40% of Trade receivables and 80% of Inventories to be written off.
(9) Company's contractual commitments amounting to ₹ 600 lakh have been settled by paying 5% penalty of contract value.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;
(b) Prepare Capital Reduction Account.

(*MTP, April, 2021*) (*16 marks*)

Answer

Journal Entries in the books of Meghna Ltd.

	Particulars	***Debit (₹ in lakhs)***	***Credit (₹ in lakhs)***
(i)	8% Preference share capital A/c (₹ 100 each) Dr. To 8% Preference share capital A/c (₹ 80 each)	400	 320
(ii)	To Capital Reduction A/c (Being the preference shares of ₹ 100 each reduced to₹ 80 each as per the approved scheme)		80
	Equity share capital A/c (₹ 10 each) Dr. To Equity share capital A/c (₹ 2 each) To Capital Reduction A/c (Being the equity shares of ₹ 10 each reduced to ₹ 2 each)	1,000	 200 800

	Particulars		Debit (₹ in lakhs)	Credit (₹ in lakhs)
(iii)	Capital Reduction A/c	Dr.	32	
	To Equity share capital A/c (₹ 2 each)			32
	(Being 1/3rd arrears of preference share dividend of 3 years to be satisfied by issue of 8 lakhs equity shares of ₹ 2 each)			
(iv)	6% Debentures A/c	Dr.	300	
	To Freehold property A/c			300
	(Being claim of Debenture holders settled in part by transfer of freehold property)			
(v)	Accrued debenture interest A/c To Bank A/c	Dr.	24	
	(Being accrued debenture interest paid)			24
(vi)	Freehold property A/c	Dr.	150	
	To Capital Reduction A/c			150
	(Being appreciation in the value of freehold property)			
(vii)	Bank A/c	Dr.	250	
	To Investments A/c			200
	To Capital Reduction A/c (Being investment sold at profit)			50
(viii)	Director's loan A/c	Dr.	300	
	To Equity share capital A/c (₹ 2 each)			90
	To Capital Reduction A/c			210
	(Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of ₹ 2 each)			
(ix)	Capital Reduction A/c	Dr.	972	
	To Profit and loss A/c			522
	To Trade receivables A/c (450x 40%) To Inventories-in-trade A/c (300x 80%) To Bank A/c (600 x 5%)			180 240
	(Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account)			30
(x)	Capital Reduction A/c		286	
	To Capital reserve A/c			286
	(Being balance transferred to capital reserve account as per the scheme)			

Capital Reduction Account

		(₹ in lakhs)			(₹ in lakhs)
To	Equity Share Capital	32	By	Preference Share Capital	80
To	Trade receivables	180	By	Equity Share Capital	800
To	Finished Goods	240	By	Freehold Property	150
To	Profit & Loss A/c	522	By	Bank	50
To	Bank A/c	30	By	Director's Loan	210
To	Capital Reserve	286			
		1,290			1,290

Question 33

Recover Ltd decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March, 2020 is as follows—

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	3,50,000
	B	Reserves and surplus	2	(70,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	55,000
3		**Current liabilities**		

		Particulars	***Notes***	***₹***
	A	Trade Payables		80,000
	B	Short term Borrowings – Bank overdraft		90,000
		Assets		5,05,000
1		**Non-current assets**		
	A	Property, Plant Equipment	4	3,35,000
	B	Intangible assets	5	50,000
	C	Non-current investments	6	40,000
2		**Current assets**		
	A	Inventories		30,000
	B	Trade receivables		50,000
				5,05,000

Notes to accounts:

1	**Share Capital**		₹
	Equity share capital:		
	20,000 Equity Shares of ₹ 10 each		2,00,000
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of ₹ 10 each (preference dividend has been in arrears for 4 years)		1,50,000
2	**Reserves and surplus**		3,50,000
	Securities premium		10,000
	Profit and loss account (debit balance)		(80,000)
3	**Long-term borrowings**		(70,000)
	Secured		
	9% Debentures (secured on the freehold property		50,000
	Accrued interest on 9% debentures		5,000
4	**Property, Plant and Equipment**		55,000
	Freehold property		1,20,000
	Leasehold property		85,000
	Plant and machinery		1,30,000
			3,35,000
5	**Intangible assets**		50,000
	Goodwill		
6	**Non-current investments**		50,000
	Non-Trade investments at cost		40,000
			40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

(i) The preference shares were reduced to ₹ 2.5 per share, and the equity shares to ₹ 1 per share.

(ii) One new equity share of ₹ 1 was issued for the arrears of preferred dividend for past 4 years.

(iii) The balance on Securities Premium Account was utilized and was transferred to capital reduction account.

(iv) The debenture holders took over the freehold property at an agreed figure of ₹ 75,000 and paid the balance to the company after deducting the amount due to them.

(v) Plant and Machinery was written down to ₹ 1,00,000.

(vi) Non-trade Investments were sold for ₹ 32,000.

(vii) Goodwill and obsolete stock (included in the value of inventories) of ₹ 10,000 were written off.

(viii) A contingent liability of which no provision had been made was settled at ₹ 7,000 and of this amount, ₹ 6,300 was recovered from the insurance.

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

(*RTP, May, 2021*)

Answer

In the books of Recover Ltd
Journal entries

Particulars		Dr. ₹	Cr. ₹
8% Cumulative Preference share capital (₹ 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (₹2.5) A/c			37,500
To Capital reduction (₹ 7.5) A/c			1,12,500
(Preference shares being reduced to shares of ₹ 2.5 per share and remaining transferred to capital reduction account as per capital reduction scheme)			
Equity share capital A/c (₹10)	Dr.	2,00,000	
To Equity Share capital A/c (₹ 1)			20,000
To Capital reduction A/c (₹ 9)			1,80,000
(Equity shares reduced to ₹ 1 per share with the remaining amount transferred to capital reduction A/c as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
Securities Premium A/c	Dr.	10,000	
To Capital reduction A/c			10,000
(Amount from the securities premium utilized towards the capital reduction a/c as a part of the internal reconstruction scheme)			
9% Debentures A/c	Dr.	50,000	
Accrued interest on debentures A/c	Dr	5,000	
Bank A/c	Dr.	20,000	
Capital reduction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the capital reduction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Capital reduction A/c	Dr.	8,000	
To Investments A/c			40,000
(Investments sold at a loss debited to capital reduction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Capital reduction A/c	Dr.	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingency payment amount)			
Capital reduction A/c	Dr.	80,000	
To Profit and loss A/c			80,000
(Accumulated losses written off to capital reduction account as a part of the internal reconstruction scheme).			
Capital reduction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in capital reduction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 2020 (and reduced)

		Particulars	*Notes*	*₹*
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	1,05,500
	B	Reserves and surplus	2	30,800
2		**Non-current liabilities**		
	A	Long-term borrowings		-
3		**Current liabilities**		
	A	Trade Payables		80,000
	B	Bank Overdraft		90,000
				3,06,300
		Total		
		Assets		
1		**Non-current assets**		
	A	Property, Plant and Equipment	3	1,85,000
2		**Current assets**		
	A	Inventories		20,000
	B	Trade receivables		50,000
	C	Cash and cash equivalents	4	51,300
		Total		**3,06,300**

Notes to accounts:

1	**Share Capital**	₹
	Equity share capital	
	68,000 Equity Shares of ₹ 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of ₹ 2.5 each	37,500
		1,05,500
2	**Reserves and surplus**	
	Capital reserve	30,800
3	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
		1,85,000
4	**Cash and cash equivalents**	51,300
	Bank A/c (20,000+32,000-7000+6,300)	

Question 34

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.

(*July, 2021 Suggested)* (*5 Marks*)

Answer

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 35

Shine Ltd. provides the following information as on 31st March, 2021:

(₹in '000)

	Amount
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
Property, Plant and Equipment	43,750
Investments (Market value ₹ 3325 thousand)	3,500
Current Assets (Including Bank Balance)	35,000
Profit and Loss Account (Dr. balance)	2,100

The following Scheme of Internal Reconstruction is approved and put into effect on 31st March, 2021.

(i) All the existing equity shares are reduced to ₹ 4 each.

(ii) All preference shares are reduced to ₹ 60 each.

(iii) 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.

(iv) Investments are to be brought to their market value.

(v) The Taxation Liability is settled at ₹ 5,25,000 out of current Assets.

(vi) The balance of Profit and Loss Account to be written off and balance of Current Assets left after settlement of taxation liability are revalued at ₹1,57,50,000.

(vii) 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.

(viii) Property, plant and equipment to be written down to 80%.

You are required to give journal entries for the above transactions and prepare capital reduction account.

(*RTP November 2021*)

Answer

Journal Entries in the books of Shine 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 share capital 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 PPE A/c		8,750
	To Current Assets A/c		18,725
	To Investments A/c		175
	To Capital Reserve A/c (Bal. fig.)		4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)		

Capital Reduction Account

To	Liability for taxation A/c	175	By	Equity share capital	21,000
To	P & L A/c	2,100	By	8% Cumulative preferences	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 36

Z Limited provides the following information as on 31st March, 2021:

Particulars	Amount in ₹
Share Capital:	
5,00,000 Equity shares of ₹ 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹ 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account (Dr. balance)	14,60,000
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Non-Current Assets:	
Property, plant and Equipment:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
Intangible Assets:	
Goodwill	11,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹ 1,00,000 and ₹ 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.

(ii) The Preference shares be reduced to ₹ 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.

(vii) Directors refunded ₹ 1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid ₹ 15,000.

(ix) The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to pass journal entries for all the above-mentioned transactions including amounts to be written off for Goodwill, Patents and Loss in Profit and Loss account. Also prepare Bank Account and Reconstruction A/c.

(*RTP May, 2022*)

Answer

Journal Entries in the Books of Z Ltd.

			₹	₹
(i)	Equity Share Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (₹ 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures payable A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures payable A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 8,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			

			₹	₹
(xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
(xii)	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c			11,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

		₹			₹
To	Reconstruction (Y)	1,00,000	By	Balance b/d (overdraft)	1,00,000
To	Reconstruction (Z)	60,000	By	Reconstruction A/c (capital commitment penalty paid)	15,000
To	Reconstruction A/c (refund of earlier fees by directors)	1,00,000			
			By	Reconstruction A/c (reconstruction expenses paid)	15,000
			By	Provision for tax A/c (tax paid)	75,000
			By	Balance c/d	55,000
		2,60,000			2,60,000

Reconstruction Account

		₹			₹
To	Bank (penalty)	15,000	By	Equity Share Capital A/c	25,00,000
To	Bank (reconstruction expenses)	15,000			
To	Goodwill	11,00,000	By	9% Pref. Share Capital A/c	10,00,000
To	Patent	5,00,000			
To	P & L A/c	14,60,000	By	Mr. Y (Settlement)	5,78,000
To	P & M	6,50,000	By	Mr. Z (Settlement)	3,82,000
To	Furniture and Fixtures	1,00,000	By	Trade Payables A/c	1,70,000
To	Trade investment	50,000	By	Director's loan	60,000
To	Inventory	2,50,000	By	Bank	1,00,000
To	Trade Receivables	1,00,000	By	Provision for tax	25,000
To	Capital Reserve (bal. fig.)	7,75,000	By	Land and Building	2,00,000
		50,15,000			50,15,000

Question 37

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*

Particulars	*Notes*	*Amount in ₹*
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. (20 Marks)

Answer

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

	Particulars		Debit (₹)	Credit (₹)
	To Plant and Machinery A/c			96,000
	To Trade Receivables A/c (Book debts)			14,400
	To Patents A/c (Bal. fig.)			24,000
	To Profit and loss A/c			30,000
	(Being losses and assets written off to the extent required)			
4.	Bank A/c	Dr.	4,80,000	
	To Bank Loan A/c			4,80,000
	(Being Loan taken)			
5.	Bank overdraft A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being Bank overdraft repaid)			

Capital Reduction Account

	Particulars	₹		Particulars	₹
To	Goodwill A/c	84,600	By	Equity Share Capital A/c	1,80,000
To	Land & Building A/c	81,000	By	6% Preference Share Capital A/c	1,50,000
To	Plant and Machinery A/c	96,000			
To	Trade receivables (Book Debts) A/c	14,400			
To	Profit & Loss A/c	30,000			
To	Patents A/c (Bal. fig.)	24,000			
		3,30,000			3,30,000

Balance Sheet of Purple Ltd. (and reduced) as at 31.3.2022

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	(a)	Share capital	1	11,70,000
	(b)	Reserves and surplus	2	(2,70,000)
2		**Current liabilities**		
	(a)	Short term borrowings (Secured Bank Loan)		4,80,000
	(b)	Trade Payables		2,20,000
		Total		16,00,000
		Assets		
1		**Non-current assets**		
	(a)	Property, plant and equipment	3	8,43,000
	(b)	Intangible assets	4	12,000
2		**Current Assets**		
	(a)	Inventory		1,70,000
	(b)	Trade receivables	5	2,87,400
	(c)	Cash and cash equivalents (7,600+4,80,000-2,00,000)		2,87,600
		Total		16,00,000

Notes to Accounts:

			₹
1.	Share Capital		
	Authorized		
	Issued, subscribed and paid up:		
	90,000 equity shares of ₹ 8 each fully paid	7,20,000	
	8% Preference share capital*	4,50,000	11,70,000
2.	Reserves and Surplus		
	Profit and Loss Account (Dr. balance)		(2,70,000)
3.	Property plant and equipment		
	Land and Building	4,59,000	
	Plant and Machinery	3,84,000	8,43,000

			₹
4.	Intangible assets		
	Patent ₹ (36,000 - 24,000)		12,000
5.	Trade Receivables		
	Sundry Debtors	3,01,800	
	Less: Bad debts	(14,400)	2,87,400

**Note: ***Face value of preference share is not given in the question (pre and post reconstruction) and hence any suitable value of preference share may be assumed.

Working Notes:

1. Calculation of new Preference Shares

Rate of return	:	6% on Preference Shares	
Dividend	:	(6/100) x ₹ 6,00,000	= ₹ 36,000
Rate of return	:	8% on Preference Shares	
Dividend	:	(8/100) x X =	₹ 36,000
		X = (36,000/8) x 100 =	₹ 4,50,000

New Preference Share Capital	=	₹ 4,50,000
Old Preference Share Capital	=	₹ 6,00,000
(6,00,000 – 4,50,000)	=	₹ 1,50,000 Amount taken to Capital Reduction A/c.

2. Since the company expects to earn a profit of ₹ 90,000 p.a. consecutively for three years and it shall be used to write-off debit balance of P & L account, hence ₹ 2,70,000 being loss shall be shown in the Balance Sheet under Reserve & Surplus head and ₹ 30,000 shall be written-off from Capital Reduction A/c.

3. Calculation of Amount written off on Land & Building and Plant & Machinery

Land & Building	= (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 38

Internal Reconstruction of a Company

Planet Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the balance sheet of the company as on 31st March, 2022 before reconstruction:

Particulars	Note No.	Amount (₹ In lakh)
Equity & Liabilities		
Shareholders' Funds		
Share Capital	1	2,100
Reserves & Surplus	2	(783)
Non-Current Liabilities		
Long term Borrowings	3	1,050
Current Liabilities		
Trade Payables	4	153
Other Liabilities	5	36
Total		**2,556**
Assets		
Non-Current Assets:		
PPE	6	1,125
Current Investments	7	300
Inventories	8	450
Trade Receivables	9	675
Cash & Cash Equivalents	10	6
Total		**2,556**

Notes to Accounts:

		₹ In lakh
(1)	Share capital	
	Authorised:	
	300 lakh Equity shares of ₹ 10 each	3,000
	12 lakh, 8% preference Shares of ₹ 100 each	1,200
		4,200
	Issued, Subscribed and Paid up:	
	150 Lakh Equity Shares of ₹ 10 each, fully paid up	1,500
	6 lakh 8% Preference Shares of ₹ 100 each, fully paid up	600
		2,100
(2)	Reserves and Surplus	
	Debit balance of Profit & Loss A/c	(783)
(3)	Long term borrowings	
	6% Debentures (Secured by freehold property)	600
	Director's Loan	450
		1,050
(4)	Trade payables	
	Trade payables for Goods	153
(5)	Other Liabilities	
	Interest Accrued and Due on 6% Debentures	36
(6)	PPE	
	Freehold Property	825
	Plant & machinery	300
		1,125
(7)	Current Investment	
	Investment in Equity Instruments	300
(8)	Inventories	
	Finished Goods	450
(9)	Trade Receivables	
	Trade receivables for Goods	675
(10)	Cash and Cash equivalents	
	Balance with bank	6

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

(1) Preference Shares are to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.

(2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹ 2 each to be allotted.

(3) Debenture holders agreed to take one Freehold Property at its book value of ₹ 450 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.

(4) Interest accrued and due on Debentures to be paid in cash.

(5) Remaining Freehold Property to be valued at ₹ 550 lakh.

(6) All investments sold out for ₹ 425 lakh.

(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹ 2 each to be alloted.

(8) 40% of Trade receivables and 80% of Inventories to be written off.

(9) Company's contractual commitments amounting to ₹ 900 lakh have been settled by paying penalty of ₹ 72 lakhs.

You are required to:

(a) Pass Journal Entries for all the transactions related to internal reconstruction;

(b) Prepare Capital Reduction Account, Bank Account; and

(c) Prepare Notes to Accounts on Share Capital and PPE, immediately after the implementation of internal reconstruction.

(*RTP November, 2022*)

Answer

Journal Entries related to internal reconstruction in the books of Planet Ltd.

(₹ in lakhs)

	Particulars		Debit ₹	Credit ₹
(i)	8% Preference share capital A/c (₹ 100 each)	Dr.	600	
	To 8% Preference share capital A/c (₹ 75 each)			450
	To Capital reduction A/c			150
	(Being the preference shares of ₹ 100 each reduced t ₹ 75 each as per the approved scheme)			
(ii)	Equity share capital A/c (₹ 10 each)	Dr.	1,500	
	To Equity share capital A/c (₹ 2 each)			300
	To Capital reduction A/c			1,200
	(Being the equity shares of ₹ 10 each reduced to ₹ 2 each)			
(iii)	Capital reduction A/c	Dr.	48	
	To Equity share capital A/c (₹ 2 each)			48
	(Being 1/3rd of arrears of preference share dividend of three years to be satisfied by issue of 24 lakh equity shares of ₹ 2 each)			
(iv)	6% Debentures A/c	Dr.	450	
	To Freehold property A/c			450
	(Being claim settled in part by transfer of freehold property)			
(v)	Accrued debenture interest A/c	Dr.	36	
	To Bank A/c			36
	(Being accrued debenture interest paid)			
(vi)	Freehold property A/c	Dr.	175	
	To Capital reduction A/c			175
	(Being appreciation (550-375) in the value of freehold property)			
(vii)	Bank A/c	Dr.	425	
	To Investment A/c			300
	To Capital reduction A/c			125
	(Being investment sold on profit)			
(viii)	Director's loan A/c	Dr.	450	
	To Equity share capital A/c (₹ 2 each)			135
	To Capital reduction A/c			315
	(Being director's loan waived by 70% and balance being discharged by issue of 67.5 lakh equity shares of ₹ 2 each)			
(ix)	Capital Reduction A/c	Dr.	1,485	
	To Profit and loss A/c			783
	To Trade receivables A/c (675 x 40%)			270
	To Inventories-in-trade A/c (450 x 80%)			360
	To Bank A/c			72
	(Being various assets, penalty on cancellation of contract, profit and loss account debit balance written off through capital reduction account)			
	Capital Reduction A/c			
(x)	To Capital reserve A/c	Dr.	432	
	(Being balance transferred to capital reserve account as per the scheme)			432

Capital Reduction Account **(₹ in lakhs)**

To	Equity Share Capital	48	By	8% Pref. Share Capital	150
To	P & L A/c	783	By	Equity Share Capital	1,200
To	Trade Receivables	270	By	Freehold property	175
To	Inventories	360	By	Bank (profit on sale of investment)	125
To	Bank	72	By	Director's loan	315
To	Capital Reserve	432			
		1,965			1,965

Bank Account **(₹ in lakhs)**

To	Balance b/d	6	By	Accrued debenture interest	36
To	Investments	300	By	Capital Reduction Account (Penalty on cancellation of contract)	72
To	Capital reduction	125	By	Balance c/d	323
		431			431

Note to Accounts on Share Capital and PPE after implementation of internal reconstruction

Share Capital		***(₹ in lakhs)***
Authorised:		
300 lakh shares of ₹ 2 each		600
12 lakh, 8% Preference shares of ₹ 75 each		900
		1,500
Issued, subscribed and paid up:		
241.5 lakh Equity shares of ₹ 2 each		483
(out of which 91.5 lakh shares have been issued for consideration other than cash)		
6 lakh, 8% Preference shares of ₹75 each fully paid up		
		450
	Total	933
PPE		
Freehold property	825	
Less: Utilised to pay Debenture holders	(450)	
Add: Appreciation	175	550
Plant and machinery		300
	Total	850

Working Note:

Calculation of number of equity shares issued

To equity shareholders	150 Lakh
To Preference shareholders (in lieu of arrear of preference dividend)	24 Lakh
To Directors	67.5 Lakh
	241.5 Lakh

Question 39

Internal Reconstruction of a Company

The following information is being provided by Fortunate Ltd. as on 31st March, 2022.

Particulars	**Amount (₹)**
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	7,50,000
(b) 18,750 Equity shares of ₹ 50 each	9,37,500
Profit and Loss Account (Dr. balance)	5,63,750
Loan	7,16,250
Trade Payables	2,58,750
Other Liabilities	43,750
Building at cost less depreciation	5,00,000
Plant at cost less depreciation	3,35,000
Trademarks and goodwill at cost	3,97,500
Inventory	5,00,000
Trade Receivables	4,10,000

(Note: Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and not earnings profits. A scheme of reconstruction has been approved by both the classes of shareholders. The summarized scheme of reconstruction is as follows:

(i) The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 5 by cancellation of ₹ 45.00 per share. They have also agreed to subscribe for three new equity shares of ₹ 5.00 each for each equity share held.

(ii) The preference shareholders have agreed to forego the arrears of dividends and to accept for each ₹ 50 preference share, 4 new 6% preference shares of ₹ 10 each, plus 3 new equity shares of ₹ 5.00 each, all credited as fully paid.

(iii) Lenders to the company for ₹ 1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of ₹ 10 each and 7,500 new equity shares of ₹ 5.00 each.

(iv) The directors have agreed to subscribe in cash for 25,000 new equity shares of ₹ 5.00 each in addition to any shares to be subscribed by them under (i) above.

(v) Of the cash received by the issue of new shares, ₹ 2,50,000 is to be used to reduce the loan due by the company.
(vi) The equity share capital cancelled is to be applied:
  (a) To write off the debit balance in the Profit and Loss A/c, and
  (b) To write off ₹ 43,750 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital, as reduced, is to be increased to ₹ 8,12,500 for preference share capital and ₹ 9,37,500 for equity share capital.

You are required to pass journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction.

(*RTP May, 2023*)

Answer

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 31.3.2022

		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		

		Particulars	***Notes***	***₹***
	(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 40

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.

(*G-II, May, 2023*) (*5 Marks*)

Question 41

Following information from Balance Sheet of Ruby Limited as on 31st March, 2023.

	Amount ₹
Authorised and Issued equity share capital:	
60,000 shares of ₹ 100 each fully paid	*60,00,000*
40,000 7% cumulative preference shares of ₹ 100 each fully paid	*40,00,000*
General Reserve	*12,00,000*
Loan from Director	*8,80,000*
Trade Payables	*49,20,000*
Outstanding expenses	*6,40,000*
Bank loan	*6,00,000*
Patent	*8,00,000*

	Amount ₹
Plant & machinery	*60,00,000*
Building	*11,00,000*
Trade receivables	*47,00,000*
Inventory	*32,60,000*
Cash	*2,40,000*
Bank Balance	*4,60,000*
Profit and Loss account	*16,80,000*

Note: The arrears of preference dividend amount to ₹5,60,000.

The company had suffered losses since last 3 years due to bad market conditions and hope for a better position in the future.

The following scheme of reconstruction has been agreed upon and duly approved by all concerned:

(1) Equity shares to be converted into 6,00,000 shares of ₹10 each.

(2) Equity shareholders to surrender to the company 80 percent of their holdings.

(3) Preference shareholders agree to forgo their right on arrears of dividends in consideration of which 7% preference shares are to be converted into 8% preference shares.

(4) Trade payables agree to reduce their claim by one fourth in consideration of their getting shares of ₹10,00,000 out of the surrendered equity shares.

(5) Directors agree to forego the amounts due on account of loan.

(6) Surrendered shares not otherwise utilized to be cancelled.

(7) Assets to be reduced as under:

	₹
Patent to	*Nil*
Plant & Machinery by	*8,00,000*
Inventory by	*6,80,000*

(8) Trade receivables to the extent of ₹34,00,000 are considered good.

(9) Revalued figures for building is accepted at ₹14,00,000.

(10) Bank loan is paid.

(11) Any surplus after meeting the losses should be utilized in writing down the value of the plant further.

(12) Expenses of reconstruction amounted to ₹1,20,000.

(13) Further 80,000 equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid up.

You are required to pass the Journal Entries for giving effect to the above arrangement and also to draw up the resultant Balance Sheet of the Company.

(*RTP November, 2023*) (*Advance Accounts*) (*14 Marks*)

Answer

Books of Ruby Ltd.
Journal Entries

Particulars		**Debit (₹)**	**Credit (₹)**
Equity Share Capital (₹ 100 each) a/c	Dr	60,00,000	
To Equity share capital (₹ 10 each) A/c			60,00,000
(Sub division of equity share into ₹ 10 each)			
Equity Share Capital (₹ 10) A/c	Dr.	48,00,000	
To Share surrendered A/c			48,00,000
(Surrender of 80% of share holding by equity share holders)			
7% Cumulative preference share capital A/c	Dr.	40,00,000	
To 8% cumulative preference share capital A/c			40,00,000
(Conversion of 7% Cumulative Preference share capital into 8% Cumulative Preference share capital. They also forgo their right to arrears of dividends)			
Shares Surrendered A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Surrendered share issued against trade payables under reconstruction scheme)			
Bank loan A/c	Dr.	6,00,000	
Expenses of reconstruction A/c	Dr.	1,20,000	
To Bank A/c			7,20,000
(Bank loan and reconstruction expenses paid)			

Particulars		Debit (₹)	Credit (₹)
Share surrendered A/c	Dr.	38,00,000	
To Capital Reduction A/c			38,00,000
(Cancellation of unissued surrendered shares) (48,00,000-10,00,000)			
Loan from Director A/c	Dr.	8,80,000	
Trade Payables A/c	Dr.	12,30,000	
Building A/c	Dr.	3,00,000	
To Capital reduction A/c			24,10,000
(Amount sacrificed by directors and trade payables and appreciation in value of building)			
Capital reduction A/c	Dr.	62,10,000	
To Patent A/c			8,00,000
To Trade receivables A/c			13,00,000
To Inventory A/c			6,80,000
To Profit and Loss A/c			16,80,000
To Expenses on Reconstruction A/c			1,20,000
To Plant A/c (bal. fig) (8,00,000+8,30,000)			16,30,000
(Various assets and expenses written off)			
Bank A/c	Dr.	8,00,000	
To Share application money A/c			8,00,000
(Application money received on full and final payment)			
Share application money A/c	Dr.	8,00,000	
To Share capital A/c			8,00,000
(Being 80,000 equity shares of ₹ 10 each issued and fully paid up)			

Note: Cancellation of preference dividend need not be journalised. On cancellation, it ceases to be contingent liability and hence no further disclosure required.

Balance Sheet of Ruby Ltd. (and Reduced) as at 31st March, 2023

	Particulars	Note	Amount (₹)
I.	**EQUITY AND LIABILITIES**		
	1. Shareholders' funds		
	(a) Share capital	1	70,00 000
	(b) General reserve		12,00 000
	2. Current liabilities		
	(a) Trade payables (49,20,000-12,30,000)		36,90,000
	(b) Other current liabilities (outstanding expenses)		6,40,000
	Total		125,30,000
II.	**ASSETS**		
	1. Non-current assets		
	(i) Property, Plant and Equipments	2	57,70,000
	(ii) Intangible assets	3	-
	2. Current assets		
	(a) Inventories (32,60,000- 6,80,000)		25,80,000
	(b) Trade receivables (47,00,000 - 13,00,000)		34,00,000
	(c) Cash and cash equivalents	4	7,80,000
	Total		125,30,000

Notes to the financial statements

(1) Share capital

	Particulars	Amount (₹)
(a)	Authorised	
	• 6,00,000 equity shares of ₹ 10 each	60,00,000
	• 40,000 8% cumulative preference shares of ₹ 100 each	40,00,000
(b)	Issued, subscribed and fully paid up	
	• 3,00,000 equity shares of ₹ 10 each (of the above, 1,00,000 shares were issued as fully paid up for consideration other than cash under the scheme of reconstruction)	30,00,000
	• 40,000 8% cumulative preference shares of ₹ 100 each	40,00,000
	Total	**70,00,000**

(2) Property, Plant and Equipments

Particulars	₹
Plant (60,00,000-16,30,000)	43,70,000
Building (11,00,000 + 3,00,000)	14,00,000
Total	57,70,000

(3) Intangible assets

Particulars	₹
Patent (8,00,000-8,00,000)	-

(4) Cash and cash equivalents

	Particulars	₹
(a)	Balance with bank (4,60,000-6,00,000-1,20,000+8,00,000)	5,40,000
(b)	Cash on hand	2,40,000
	Total	7,80,000

Question 42

Accounting for Reconstruction of companies

As a part of the reconstruction scheme of Getting better Ltd, the following terms were agreed upon-

1. The shareholders to receive in lieu of their present holdings (viz. 10,000 shares of ₹ 50 each), the following-
   (a) 15,000 Fully paid equity shares of ₹ 10 each;
   (b) 12% fully paid preference shares to the extent of 2/5 of total equity shares;
   (c) To pay them ₹ 50,000 and transfer the remaining to the reconstruction account.
2. 8% Preference share capital - ₹ 3,00,000
   To write down the value of preference shares to ₹ 50 (original face value ₹ 100).
3. 14% debentures of the nominal value of ₹ 2,00,000 along with accrued interest ₹ 56,000 was waived off for three fourths of the total amount, and the remaining being paid in cash.

Show the necessary journal entries in the books of Getting better company based on the above scheme.

(*RTP May, 2024*)

Answer

Journal entries in the books of Getting better Co.

Date	Particulars		Dr.	Cr.
			₹	₹
	Share capital A/c (₹50)	Dr.	5,00,000	
	To Share capital A/c (₹10)			1,50,000
	To 12% Preference share capital A/c			2,00,000
	To Bank A/c			50,000
	To Reconstruction A/c			1,00,000
	(Being 15,000 equity shares of ₹ 10 and 12% preference shares issued,paid in cash and remaining forgone as a part of Reconstruction Scheme dated...)			
	Preference Share capital A/c (₹ 100)	Dr.	3,00,000	
	To Preference share capital A/c (₹ 50)			1,50,000
	To Reconstruction A/c			1,50,000
	(Being the preference share capital reduced and forfeited as per reconstruction scheme)			
	14% Debenture A/c	Dr.	2,00,000	
	Interest accrued on Debentures A/c To Bank A/c	Dr.	56,000	
	To Reconstruction A/c			64,000
	(Being the debenture holders paid their interest and amount foregone as per reconstruction scheme)			1,92,000
	Reconstruction A/c	Dr.	4,42,000	
	To Capital Reserve A/c			4,42,000
	(Being the balance in reconstruction ac transferred to capital reserve as per reconstruction scheme)			

Question 43

C Ltd. had ₹ 5,00,000 authorized capital on 31-12-2021 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully paid up. In June 2022 the Company decided to convert the issued shares into stock. But in June, 2023 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 31-12-2022 and 31-12-2023.

(*MTP Advanced Accounting April, 2024*) (*4 Marks*)

Answer

Journal Entries

			₹	₹
2022	Equity Share Capital A/c	Dr.	4,00,000	
June	To Equity Stock A/c			4,00,000
2023	(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated…)			
June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Question 44

The Balance Sheet of Radhika Ltd. as at 31-3-2024 is as follows:

		Particulars	Notes	₹
		Equity and Liabilities		
1		Shareholders' funds		
	a	Share capital	1	13,80,000
	b	Reserves and Surplus	2	(6,42,000)
2		Non-current liabilities		
	a	Long-term borrowings	3	4,50,000
3		Current liabilities		
	a	Trade Payables		3,60,000
	b	Short term borrowings - Bank Overdraft		2,34,000
	c	Other current liabilities	4	1,47,000
		Total		19,29,000
		Assets		
1		Non-current assets		
	a	Property, plant and equipment	5	5,70,000
	b	Intangible assets	6	2,01,000
	c	Non-current investments	7	66,000
2		Current assets		
	a	Inventories		5,10,000
	b	Trade receivables		5,00,000
	c	Cash and Cash Equivalents		82,000
		Total		19,29,000

Notes to accounts

		₹
1	Share Capital	
	Equity share capital:	
	9,000 Equity Shares of ₹100 each	9,00,000
	Preference share capital:	
	4,800 6% Cumulative Preference Shares of ₹100 each	4,80,000
2	Reserves and Surplus	13,80,000
	Debit balance of Profit and loss Account	(6,42,000)
3	Long-term borrowings	
	Secured: 6% Debentures	4,50,000
4	Other current liabilities	
	Loan from directors	1,20,000

		₹
	Interest payable on 6% debentures	27,000
		1,47,000
5	Property Plant and Equipment	
	Freehold property	5,10,000
	Plant	60,000
		5,70,000
6	Intangible assets	
	Goodwill	1,56,000
	Patents	45,000
		2,01,000
7	Non-current investments	
	Investments at cost	66,000

The Court approved a Scheme of re-organization to take effect on 1-4-2024, whereby:

(1) Equity Shares to be reduced to ₹ 20 each.
(2) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.
(3) Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹ 20 each to be allotted for the remaining quarter.
(4) Interest payable on debentures to be paid in cash.
(5) Goodwill to be written off.
(6) Inventory to be written off by ₹65,000.
(7) Amount of ₹ 68,500 to be provided for bad debts.
(8) Freehold property to be revalued at ₹6,49,000
(9) Investments be sold for ₹ 1,40,000.
(10) Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹ 20 each and as to 5% in cash, and balance 5% being waived.
(11) 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.
(12) Ignore taxation and cost of the scheme.
(13) Eliminate debit balance of Profit and Loss A/c

You are requested to prepare the Balance Sheet of the company after completion of the Scheme.

(*MTP Advanced Accounting April, 2024*) (*10 Marks*)

Answer

Balance Sheet of Radhika Ltd. (and Reduced) as on 1.4.2024

			Particulars	Notes	₹
I.			Equity & Liabilities		
	A		Shareholders' Fund		
		a	Share Capital	1	3,16,800
		b	Reserves & Surplus	2	1,10,200
	B		Non-Current Liabilities		
		a	Long Term Borrowings	3	7,86,000
	C		Current Liabilities		
		a	Trade Payables		3,60,000
		b	Short Term borrowings: Bank OD		2,34,000
			Total		18,07,000
II.			Assets		
	A		Non-Current Assets		
		a	Property, Plant & Equipment	4	7,09,000
		b	Intangible assets: Patents		45,000
	B		Current Assets		
			Inventory (5,10,000-65,000)		4,45,000
		a	Trade Receivable	5	4,31,500
		b	Cash & Cash Equivalent		1,76,500
		c			
			Total		18,07,000

Notes to Accounts

		Particulars	₹
1		Share Capital	-
		Authorised, Issued, Subscribed & Paid Up Capital	
		Equity share Capital	
		15,840 Shares of ₹20 Paid up	3,16,800
		(Out of above 6,840 shares are issued for consideration other cash) (W.N 1)	
2		Reserves & Surplus	
		Capital Reserve (W.N 2)	1,10,200
3		Long Term Borrowings Secured	
	a	6% Debentures	4,50,000
	b	11% Debentures (70% of 4,80,000 preference shares)	3,36,000
			7,86,000
4		PPE	
		Freehold property	6,49,000
		Plant	60,000
			7,09,000
5		Trade receivable	5,00,000
		Less: Provision for Doubtful Debts	(68,500)
			4,31,500

Working notes:

1. **Computation of equity shares:**

			Equity share capital	No. of shares at ₹ 20 each
1	After the reduction to ₹ 20 each	90,000 x 20	1,80,000	9,000
2.	Equity shares allotted to preference shareholders for their ¼ arrears.	6% of 4,80,000	28,800	1,440
3.	Equity shares allotted to Directors in settlement of their loan	90% of 1,20,000	1,08,000	5,400
	Total equity shares		3,16,800	15,840

2. Calculation of capital reserve: Equity Share 7,20,000 + Preference share 1,44,000 + Freehold property 1,39,000 + Investment 74,000 + Director Loan 6,000 – Preference share dividend 28,800 - Goodwill 1,56,000 – Inventory 65,000 – Bad debts 68,500 – Profit & Loss A/c 6,42,000 = Capital Reserve 1,22,700

3. Cash balance:

		₹
Cash & cash equivalent		82,000
Add: Investment sold		1,40,000
Less: Directors Loan (1,20,000 x 5%)	6,000	
Penalty (2,50,000x 5%)	12,500	
Interest on debentures (6% on 4,50,000)	27,000	45,500
		1,76,500

Question 45

Following is the Balance Sheet of ABC Ltd. as at 31st March, 2023:

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	26,00,000
	B	Reserves and Surplus	2	(4,05,000)
2		**Non-current liabilities**		
	A	Long-term borrowings	3	12,00,000
3		**Current liabilities**		
	A	Trade Payables		5,92,000
	B	Short term borrowings - Bank overdraft		1,50,000
		Total		41,37,000
		Assets		

		Particulars	Notes	₹
1		**Non-current assets**		
	A	Property, plant and equipment	4	11,50,000
	B	Intangible assets	5	70,000
	C	Non-current investment	6	68,000
2		**Current assets**		
	A	Inventory		14,00,000
	B	Trade receivables		14,39,000
	C	Cash and cash equivalents		10,000
		Total		41,37,000

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital:	
	2,00,000 Equity Shares of ₹ 10 each	20,00,000
	6,000, 8% Preference shares of ₹ 100 each	6,00,000
		26,00,000
2	**Reserves and Surplus**	
	Debit balance of Profit and loss A/c	(4,05,000)
		(4,05,000)
3	**Long-term borrowings**	
	9% debentures	12,00,000
		12,00,000
4	**Property, Plant and Equipment**	
	Plant and machinery	9,00,000
	Furniture and fixtures	2,50,000
		11,50,000
5	**Intangible assets**	
	Patents and copyrights	70,000
		70,000
6	**Non-current investments**	
	Investments (market value of ₹ 55,000)	68,000
		68,000

The following scheme of reconstruction was finalized:

(i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.

(ii) Debenture holders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.

(iii) Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.

(iv) Investment value to be reduced to market price.

(v) 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 extract for Equity & Liabilities of the company after internal reconstruction.

Answer (*MTP Advanced Accounting March, 2024*) (*10 Marks*)

In the Books of ABC Ltd.

Journal Entries

Particulars		₹	₹
8% Preference share capital A/c	Dr.	6,00,000	
To 11% Debentures A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital and issue of 11% debentures]			
9% Debentures A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment of plant & machinery]			

Particulars		₹	₹
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving Inventories]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

Capital Reduction Account

		₹			₹
To	Investments A/c	13,000	By	Preference share capital A/c	1,80,000
To	Profit and loss A/c	4,05,000	By	9% Debenture holders A/c	3,00,000
To	Capital reserve A/c	1,54,000	By	Trade payables A/c	92,000
		5,72,000			5,72,000

Balance Sheet Extract of ABC Ltd. (And Reduced) As at 31st March 2023

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000
Total		28,74,000

Notes to Accounts

		₹
1.	**Share Capital**	
	2,00,000 Equity shares of ₹ 10 each fully paid-up	20,00,000
2.	**Reserve and Surplus**	
	Capital Reserve	1,54,000
3.	**Long Term Borrowings**	
	11% Debentures (₹ 4,20,000 + ₹ 3,00,000)	7,20,000

Question 46

Following is the summarized Balance Sheets of Z Limited as on 31st March, 14 2024:

Particulars	(₹)
EQUITY AND LIABILITIES:	
Share Capital	
Equity share of ₹ 100 each	60,00,000
8% Preference share of ₹ 100 each	21,00,000
10% Debentures of ₹ 100 each	18,00,000
Trade Payables	16,80,000
Total	**1,15,80,000**
ASSETS:	
Goodwill	81,000
Property, Plant and Equipment	72,00,000
Trade Receivables	13,75,000

Particulars	(₹)
Inventories	9,80,000
Cash at Bank	1,33,000
Own Debentures (Nominal value of ₹6 lakhs)	5,76,000
Profit and Loss A/c	12,35,000
Total	**1,15,80,000**

On 1st April, 2024, court approved the following reconstruction scheme for Z Limited:

(i) Each equity share shall be sub-divided into 10 equity shares of ₹10 each fully paid up. After sub-division, equity share capital will be reduced by 40%.

(ii) Preference share dividends are in arrear for last 4 years. Preference shareholders agreed to waive 75% of their dividend claim and accept payment for the balance.

(iii) Own debentures of ₹ 2,40,000 (nominal value) were sold at ₹ 98 cum interest and remaining own debentures were cancelled.

(iv) Debenture holders of ₹ 6,00,000 agreed to accept one machinery of book value of ₹ 9,00,000 in full settlement.

(v) Remaining Property, Plant and Equipment were valued at ₹ 60,00,000.

(vi) Trade Payables, Trade Receivables and Inventories were valued at ₹ 15,00,000; ₹ 13,00,000 and ₹ 9,44,000 respectively. Goodwill and Profit and Loss Account (Debit balance) are to be written off.

(vii) Company paid 60,000 as penalty to avoid capital commitments of ₹12 lakhs.

(viii) Interest on 10% Debentures is paid every year on 31st March.

You are required to:

(1) Pass necessary journal entries in the books of Z Limited to implement the above schemes.

(2) Prepare Capital Reduction Account.

(3) Prepare Bank Account

(*Question Paper May, 2024) (14 Marks*)

MCQs

Question - 1: When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called

Answer:

1. *Internal reconstruction with liquidation*
2. *Internal reconstruction without liquidation of the company*
3. *External reconstruction*
4. *None of the above.*

Question - 2: For reduction of the share capital, the permission has to be sought from

Answer:

1. *Court.*
2. *Controller.*
3. *State government.*
4. *Shareholders.*

Question - 3: Reconstruction is a process by which affairs of a company are reorganized by

Answer:

1. *(a) Revaluation of assets and Reassessment of liabilities.*
2. *(b) Writing off the losses already suffered by reducing the paid-up value of shares and/or varying the rights attached to different classes of shares.*
3. *(c) Both (a) and (b).*
4. *(d) None of the above.*

Question - 4: In case of internal reconstruction

Answer:

1. *Only one company is liquidated.*
2. *Two or more companies are liquidated.*
3. *No company is liquidated.*
4. *Two companies amalgamated.*

Question - 5: The accumulated losses under scheme of internal reconstruction are written off against

Answer:

1. *Capital Reduction account*
2. *Share Capital account*
3. *Shareholders account*
4. *General Reserves.*

Question - 6: The accumulated losses under scheme of internal reconstruction are written off against

Answer:

1. *Capital Reduction account*
2. *Share Capital account*
3. *Shareholders account*
4. *Reserve and surplus.*

Question - 7: A process of reconstruction, which is carried out without liquidating the company and forming a new one is called

Answer:

1. *Internal reconstruction.*
2. *External reconstruction.*
3. *Amalgamation in the nature of merger.*
4. *Amalgamation in the nature of purchase.*

Question - 8: When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called

Answer:

1. *Internal reconstruction with liquidation*
2. *Internal reconstruction without liquidation of the company*
3. *External reconstruction*
4. *None of the above.*

Question - 9: The accumulated losses under scheme of internal reconstruction are written off against
Answer:

1. *Capital Reduction account*
2. *Share Capital account*
3. *Shareholders' account*
4. *Reserve and surplus.*

Question - 10: A process of reconstruction, which is carried out without liquidating the company and forming a new one is called
Answer:

1. *Internal reconstruction.*
2. *External reconstruction.*
3. *Amalgamation in the nature of merger.*
4. *Amalgamation in the nature of purchase.*

Question - 11: Reconstruction is a process by which affairs of a company are reorganized by
Answer:

1. *Revaluation of assets and Reassessment of liabilities.*
2. *Writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.*
3. *Both (a) and (b).*
4. *None of the above.*

Question - 12: For reduction of the share capital, the permission has to be sought from
Answer:

1. *Court.*
2. *Controller.*
3. *State government.*
4. *Shareholders.*

Question - 13: In case of internal reconstruction
Answer:

1. *Only one company is liquidated.*
2. *Two or more companies are liquidated.*
3. *No company is liquidated.*
4. *Two companies amalgamated.*

Question - 14: When the object of reconstruction is usually to re-organise capital or to compound with creditors or to effect economies then such type of reconstruction is called
Answer:

1. *Internal reconstruction with liquidation*
2. *Internal reconstruction without liquidation of the company*
3. *External reconstruction*
4. *None of the above*

Question - 15: A process of reconstruction, which is carried out without liquidating the company and forming a new one is called
Answer:

1. *Internal reconstruction.*
2. *External reconstruction.*
3. *Amalgamation in the nature of merger.*
4. *Amalgamation in the nature of purchase.*

Answer

Q1	***2***	***Q2***	***1***	***Q3***	***3***	***Q4***	***3***	***Q5***	***1***	***Q6***	***1***
Q7	***1***	***Q8***	***2***	***Q9***	***1***	***Q10***	***1***	***Q11***	***3***	***Q12***	***1***
Q13	***3***	***Q14***	***2***	***Q15***	***1***						

Accounting for Branches including Foreign Branches

Question 1

XP Ltd opened a branch at Delhi and sent goods costing ₹50,000 to Delhi branch. Delhi Branch sold entire goods on credit at ₹ 62,000. No other transaction occurred at the branch. Prepare branch account in Head Office Books and find out the profit.

(*Source: Example 1, Study Material*)

Solution

We know that branch earned net profit of ₹12,000, now see how same can be find out by branch account.

Branch Account

Particulars	Amount ₹	Particulars		Amount ₹
To Opening branch assets	Nil	By Closing branch assets		
To Goods sent to branch	50,000	Stock	Nil	
To Net Profit	12,000	Debtor	62,000	62,000
	62,000			62,000

Question 2

XP Ltd opened a new branch at Delhi. XP Ltd sent goods costing ₹ 50,000 to Delhi branch. Delhi branch sold entire goods in cash at ₹ 70,000. Branch paid expenses of ₹ 8,000. No other transaction occurred at the branch. Prepare branch account in HO Books and find out the profit.

(*Source: Example 2, Study Material*)

Solution

We know that branch earned net profit of ₹12,000 (i.e. Gross Profit ₹ 20,000 less expenses of ₹ 8,000), Let's see how same can be find out by branch account:

Branch Account

Particulars	Amount	Particulars		Amount
To Opening branch assets	Nil	By Closing branch assets		
		Stock	Nil	
To Goods sent to branch	50,000	Debtor	Nil	
To Net Profit transferred General to P&L A/c	12,000	Cash (70,000 - 8,000)	62,000	62,000
	62,000			62,000

Question 3

Prepare branch account and find out profit earned by branch if transactions are as under:

Goods sent to branch	*₹ 50,000*
Furniture sent to branch	*₹ 10,000 (at the beginning of year)*
Credit sales at branch	*₹ 62,000*
Bad Debts	*₹ 1,000*
Other information:	
Closing stock at branch	*₹10,000*
Closing Debtor	*₹61,000*
Furniture (after depreciation@20%)	*₹ 8,000*

(*Source: Example 3, Study Material*)

Solution

Branch Account

Particulars	Amount	Particulars		Amount
To Opening branch assets-				
(Furniture)	10,000	By Closing branch assets-		
To Goods sent to branch	50,000	Stock	10,000	
To Net Profit transferred to General P&L A/c	19,000	Debtor	61,000	
		Furniture	8,000	79,000
	79,000			79,000

Question 4

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 by Debtors method:

	₹		₹
Opening balance (1-1-20X1)		*Bad Debts*	*1,000*
Imprest Cash	*2,000*		
Sundry Debtors	*25,000*	*Discount to Customers*	*2,000*
Stock: Transferred from H.O.	*24,000*	*Remittances to H.O.*	
Stock: Direct Purchases	*16,000*	*(received by H.O.)*	*1,65,000*
Cash Sales	*45,000*	*Remittances to H.O.*	
Credit Sales	*1,30,000*	*(not received by H.O. so far)*	*5,000*
Direct Purchases	*45,000*	*Branch Exp. directly paid by H.O.*	*30,000*
Returns from Customers	*3,000*	*Closing Balance (31-12- 20X1)*	
Goods sent to branch from H.O.	*60,000*	*Stock: Direct Purchase*	*10,000*
Transfer from H.O. for Petty	*4,000*	*Stock: Transfer from H.O.*	*15,000*
Cash expenses		*Debtors*	*?*
		Imprest Cash	*?*
		Petty Cash expenses	*4,000*

(*Source: Illustration 1(a), Study Material*)

Solution

In the Books of Buckingham Bros, Bombay Nagpur Branch Account

Particulars	***₹***	***Particulars***		***₹***
To Opening Branch Assets-		By Bank – Remittances received from branch		
Stock (24,000+16,000)	40,000	Cash Sales	45,000	
Debtors	25,000	Cash from Debtors *	1,20,000	
		Cash in transit *	5,000	1,70,000
Imprest Cash	2,000	By Closing Branch Assets		
To Goods sent to Branch A/c	60,000	Stock (15,000 +10,000)		25,000
To Creditors (Direct Purchases)	45,000	Debtors (W.N. 1)		24,000
		Imprest Cash (W.N. 2)		2,000
To Bank (Sundry exp.)	30,000			
To Bank (Petty cash exp.)	4,000			
To Net Profit transferred to General Profit & Loss A/c	15,000			
	2,21,000			2,21,000

Working Notes:

1. Memorandum Debtors A/c

Particulars		**₹**	**Particulars**		**₹**
To	To Bal b/d	25,000	By	By Sales Return	3,000
To	To Sales	130,000	By	By Bad Debts	1,000
			By	By Discount	2,000
			By	By Cash *	125,000
			By	By Bal c/d	24,000
		155,000			155,000

2. Memorandum Petty Cash

Particulars	**₹**	**Particulars**	**₹**
To Bal b/d	2,000	By Expenses (met by Branch)	4,000
To Transfer from H.O.	4,000	By Bal c/d	2,000
	6,000		6,000

***** Collection from Debtors = Total Remittances (1,65,000+5,000) – Cash Sales (45,000) = ₹ 1,25,000

Question 5

From the information given in the question, prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

(*Source: Illustration 1(b), Study Material*)

Solution

Buckingham Bros. Bombay

Nagpur Branch-Trading and Profit and Loss Account for the year ending 31st December, 20X1

Particulars	***₹***	***Particulars***	***₹***	***₹***
To Opening Stock	40,000	By Sales		
To Goods transferred from Head Office	60,000	Cash	45,000	
		Credit sales	1,30,000	
To Purchases	45,000		1,75,000	

Particulars	₹	Particulars	₹	₹
To Gross Profit c/d	52,000	*Less:* Returns	(3,000)	1,72,000
		By Closing Stock		25,000
	1,97,000			1,97,000
To Expenses	30,000	By Gross Profit b/d		52,000
To Discounts	2,000			
To Bad Debts	1,000			
To Petty Cash Expenses	4,000			
To Net Profit transferred to General P&L A/c	15,000			
	52,000			52,000

Question 6

The Bombay Traders 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, 20X1.

	₹		₹
Balances as on 1.1.20X1:			
Stock	*7,000*	*Bad Debts*	*600*
Debtors	*12,600*	*Goods returned by customers*	*500*
Petty Cash,	*200*	*Salaries & Wages*	*6,200*
Goods sent from H.O.	*26,000*	*Rent & Rates*	*1,200*
Goods returned to H.O.	*1,000*	*Sundry Expenses*	*800*
Cash Sales	*17,500*	*Cash received from Sundry*	
Credit Sales	*28,400*	*Debtors*	*28,500*
Allowances to customers	*200*	*Balances as on 31.12.20X1:*	
Discount to customers	*1,400*	*Stock*	*6,500*
		Debtors	*9,800*
		Petty Cash	*100*

Prepare: (*a*) *Branch Account* (*Debtors Method*), (*b*) *Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and* (*c*) *Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.*

(*Source: Illustration 2, Study Material*)

Solution

(a) Debtors Method

Delhi Branch Account

20X1		₹	₹	20X1		₹	₹
Jan. 1	To Opening branch assets:			Dec 31	24 Bank		
	Stock	7,000			Cash Sales	17,500	
	Debtors	12,600			Cash from sundry Debtors	28,500	46,000
	Petty cash	200	19,800				
Dec. 31	To Goods sent to Branch A/c		26,000		By Goods sent to Branch A/c –		

20X1		₹	₹	20X1		₹	₹
	To Bank:				Returns to H.O.		1,000
	Salaries & Wages	6,200			By Closing branch assets		
	Rent & Rates	1,200			Stock	6,500	
	Sundry Exp.	800	8,200		Debtors	9,800	
					Petty Cash	100	16,400
	To Net profit ts/f to General P&L A/c		9,400				
			63,400				63,400
Jan. 1, 20X2	To Balance b/d		16,400				

(b) Stock and Debtors Method

Branch Stock Account

20X1		₹	20X1			₹
Jan. 1	To Balance b/d - Opening Stock	7,000	Dec. 31	By Sales:		
Dec. 31	To Goods Sent to Branch A/c	26,000		Cash	17,500	
				Credit	28,400	
	To Branch P&L A/c	19,900		Less: Return	(500)	45,400
				By Goods sent to Branch A/c - Return		1,000
				By Balance c/d-Closing Stock		6,500
		52,900				52,900
20X2 Jan. 1	To Balance b/d - Opening Stock	6,500				

Delhi Branch Debtors Account

20X1		₹	20X1		₹
Jan. 1	To Balance b/d	12,600	Dec. 31	By Cash	28,500
Dec. 31	To Sales	28,400		By Returns	500
				By Allowances	200
				By Discounts	1,400
				By Bad debts	600
				By Balance c/d	9,800
		41,000			41,000
20X2 Jan. 1	To Balance b/d	9,800			

Delhi Branch Expenses Account

20X1		₹	20X1		₹
Dec. 31	To Salaries & Wages	6,200	Dec. 31	By Branch P&L A/c	10,500
	To Rent & Rates	1,200			
	To Sundry Expenses	800			
	To Petty Cash expenses (200-100)	100			

20X1		₹	20X1		₹
	To Allowance to customers	200			
	To Discount	1,400			
	To Bad Debts	600			
		10,500			10,500

Delhi Branch Profit & Loss Account

20X1		₹	20X1		₹
Dec. 31	To Branch Exp. A/c	10,500	Dec. 31	By Gross Profit b/d	19,900
	To Net Profit ts/f to General P & L A/c	9,400			
		19,900			19,900

(c) **Branch Trading and Profit and Loss Account**

		₹	₹				₹	₹
To	Stock		7,000	By	Sales:			
To	Goods sent				Cash		17,500	
	from H.O.	26,000			Credit	28,400		
	Less: Returns to H.O.	(1,000)	25,000		Less: returns	(500)	27,900	45,400
To	Gross profit c/d		19,900	By	Closing Stock			6,500
			51,900					51,900
To	Salaries & Wages		6,200	By	Gross Profit b/d			19,900
To	Rent & Rates		1,200					
To	Sundry Exp.		800					
To	Petty Cash Exp.		100					
To	Allowances to Customers		200					
To	Discounts		1,400					
To	Bad Debts		600					
To	Net Profit		9,400					
			19,900					19,900

Question 7

Harrison of Chennai 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, 20X1:

	₹
Cost of goods sent to Branch at cost	*2,00,000*
Goods received by Branch till 31-12-20X1 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	*1-1-20X1*	*31-12-20X1*
	₹	*₹*
Stock	*25,000* (*Cost*)	*28,000* (*invoice price*)
Debtors	*32,750*	*26,000*
Cash in Hand	*5,000*	*2,500*

Show necessary ledger accounts in the books of the head office and determine the Profit or Loss of the Branch for the year ended 31st December, 20X1.

(*Source: Illustration 3(a), Study Material*)

Solution

Books of Harrison Branch Stock Account

	₹		₹
To Balance b/d – Op Stock	30,000	By Branch Debtors (Sales)	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Cash	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	
(Balancing Figure – Excess of Sale over Invoice Price)		Goods in Transit (₹ 2,40,000 – ₹ 2,20,000)	20,000
		Closing Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	₹		₹
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock A/c (Sales)	1,65,000	By Branch Cash (bal. fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Branch Cash Account

	₹		₹
To Balance b/d	5,000	By Bank Remittance to H.O.	2,22,500
To Branch Stock	59,000	By Branch Expenses	10,000
To Branch Debtors	1,71,000	[met by Branch (Bal. fig.)]	
		By Balance c/d	2,500
	2,35,000		2,35,000

Branch Adjustment Account

	₹		₹
		By Stock Reserve opening (25,000 × 20%)	5,000
To Branch P &L - Gross Profit (Bal. fig.)	39,000	By Goods sent to Branch A/c	40,000
To Stock Reserve (on closing stock (48,000 × 1/6)	8,000	By Branch Stock A/c	2,000
	47,000		47,000

Branch Expenses

	₹		₹
To Cash (H.O)	12,000		
To Branch Cash	10,000	By Branch P&L A/c	22,000
	22,000		22,000

Branch Profit and Loss Account

	₹		₹
To Branch Expenses	22,000	By Gross Profit (from Branch Adjustment A/c)	39,000
To Branch Debtors (bad debts)	750		
To Net Profit	16,250		
	39,000		39,000

Goods Sent to Branch Account

	₹		₹
To Branch Adjustment A/c	40,000	By Branch to Stock A/c	2,40,000
To Purchase A/c - Transfer	2,00,000		
	2,40,000		2,40,000

Question 8

Take figures from Question 7 and prepare branch account following debtors' method.

(*Source: Illustration 3(b), Study Material*)

Solution

Books of Harrison New Delhi Branch Account

	₹		₹
To Balance B/d			
Stock	30,000	By Stock Reserve	5,000
Debtors	32,750		
Cash	5,000		
To Goods Sent to Branch A/c (2,00,000 + 20%)	2,40,000	By Goods Sent to Branch A/c	40,000
To Cash (Exp. paid by H.O.)	12,000	By Cash – Remittance from branch :	
To Net Profit ts/f to H.O.	16,250	Cash Sales 59,000	
Profit & Loss A/c (Balancing Figure)		Debtors (W.N.1) 1,63,500	2,22,500
		By Balance c/d Debtors	26,000
To Stock reserve (48,000X20/120)	8,000	Stock (including Transit– W.N 2)	48,000
		Cash	2,500
	3,44,000		3,44,000

Working Note:

1. Closing Stock = Stock at branch + Stock in Transit (Goods sent by HO – Goods Received by Branch) = ₹ 28,000 + (₹ 2,40,000 - ₹ 2,20,000) = ₹ 48,000.

Question 9

Sell Well who carried on a retail business opened a branch X on January 1st, 20X1 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. 20X1	***Feb. 20X1***	***March 20X1***
	₹	*₹*	*₹*
Goods sent to Branch (*Purchase Price*)	*40,000*	*50,000*	*60,000*
Sales as shown by the branch monthly report	*38,000*	*42,000*	*55,000*
Cash received from Debtors and remitted to H.O.	*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, 20X1 amounted to ₹ 53,400 at invoice to branch.

Record these transactions in the Head Office books, showing balances as on 31st March, 20X1 and the branch gross profit for the three months ended on that date.

All workings should form part of your solution.

(*Source: Illustration 4, Study Material*)

Solution

Books of Sell Well Branch Account

	₹			₹
To Goods sent to Branch A/c (1,50,000+10%)	1,65,000	By Goods sent to Branch-Loading		15,000
To Goods sent to Branch A/c (4,200 X 10/110)	382	By Goods sent to Branch-returns		4,200
		By Bank		1,06,000
		By Balance c/d - Closing Branch Assets		
To Stock Reserve (53,400 × 10/110)	4,855	Stock	53,400	
To Net Profit (Bal fig) ts/f to General P&L A/c	37,363	Debtors (Sales- Collection)	29,000	82,400
	2,07,600			2,07,600

Working Note:

Memorandum Branch Debtors Account

	₹		₹
To Balance b/d	---	By Cash/Bank	1,06,000
To Sales	1,35,000	By Balance c/d	29,000
	1,35,000		1,35,000

Goods Sent to Branch Account

	₹		₹
To Branch A/c – Loading	15,000	By Branch A/c	1,65,000
To Branch A/c – Returns	4,200	By Branch A/c – Loading on returns	382
To Purchases A/c	1,46,182		
	1,65,382		1,65,382

Question 10

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 20X2 from the following:

(1) Goods are invoiced to the branch at cost plus 20%.

(2) The sale price is cost plus 50%.

(3) Other information:

	₹
Stock as on 01.04.20X1(invoice price)	*2,20,000*
Goods sent during the year (invoice price)	*11,00,000*
Sales during the year	*12,00,000*
Expenses incurred at the branch	*45,000*

Ascertain

(i) the profit earned by the branch during the year.

(ii) branch stock reserve in respect of unrealized profit.

(*Source: Illustration 5, Study Material*)

Solution

(i) Calculation of profit earned by the branch In the books of Jammu Branch

Trading Account and Profit and Loss Account

Particulars	***Amount***	***Particulars***	***Amount***
	₹		₹
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit (Bal fig)	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit = ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

	₹	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	₹	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less: Cost of goods sold at invoice price	(9,60,000)	[12,00,000 x (120/150)]
Closing stock	3,60,000	

Question 11

Hindustan Industries Mumbai 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 20X1, 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., 20X1	*60,000*
Sales in the year - Cash	*2,00,000*
Credit	*3,60,000*
Sundry Debtors at Cochin as on 1st Jan. 20X1	*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 Dec. 20X1 at invoice price	*1,20,000*

Prepare Branch accounts in books of head office by Stock and debtors method.

(*Source: Illustration 6, Study Material*)

Solution

Books of Hindustan Industries, Mumbai Cochin Branch Stock Account

	₹		₹
To Balance b/d – Op Stock	60,000	By Bank A/c – Cash Sales	2,00,000
To Branch Debtors A/c – Sales Return	8,000	By Branch Debtors A/c - Credit Sales	3,60,000
To Goods sent to Branch A/c	6,00,000	By Goods sent to Branch (Returns to H.O.)	12,000
To Branch Adjustment A/c (Excess of Selling Price over Invoice Price)	24,000	By Balance c/d - Closing stock	1,20,000
	6,92,000		6,92,000

Cochin Branch Stock Adjustment Account

	₹		₹
To Goods sent to Branch A/c (1/5 of ₹ 12,000) (on returns)	2,400	By Balance b/d (1/5 of ₹ 60,000)	12,000
To Branch P & L A/c (Profit on sale) – Bal fig	1,29,600	By Goods sent to Branch A/c (1/5 of ₹ 6,00,000)	1,20,000
To Balance c/d (1/5 of ₹ 1,20,000)	24,000	By Branch Stock	24,000
	1,56,000		1,56,000

Goods Sent to Branch Account

	₹		₹
To Cochin Branch Stock Adjustment A/c	1,20,000	By Cochin Branch Stock A/c	6,00,000
To Cochin Branch Stock A/c (Returns)	12,000	By Cochin Branch Stock Adj. A/c	2,400
To Purchases A/c	4,70,400		
	6,02,400		6,02,400

Branch Debtors Account

	₹		₹
To Balance b/d	72,000	By Bank	3,20,000
To Branch Stock A/c	3,60,000	By Branch P&L A/c Discount	6,000
		By Branch P&L A/c - Bad Debts	4,000
		By Branch Stock - Sales Returns	8,000
		By Balance c/d	94,000
	4,32,000		4,32,000

Branch Expenses Account

	₹		₹
To Bank A/c (Rent, Rates & Taxes)	18,000	By Branch Profit & Loss A/c (Transfer)	84,000
To Bank A/c (Salaries & Wages)	60,000		
To Bank A/c (office exp.)	6,000		
	84,000		84,000

Branch Profit & Loss Account for the year ending 31st Dec. 20X1

	₹		₹
To Branch Expenses A/c	84,000	By Branch Stock Adj. A/c	1,29,600
To Branch Debtors A/c	6,000		
To Branch Debtors A/c	4,000		
To Net Profit transferred to Profit & Loss A/c	35,600		
	1,29,600		1,29,600

Question 12

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He 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:	*1-1-20X1*	*31-12-20X1*
Stock: Ghee	*1,50,000*	*3,12,500*
Oil	*3,50,000*	*4,17,250*
Debtors	*7,32,750*	-
Cash on Hand	*70,520*	*55,250*
Furniture & Fittings	*21,500*	*19,350*
Plant/Machinery	*3,07,250*	*7,73,500*

	(*Lucknow*)	
Balance as on:	*1-1-20X1*	*31-12-20X1*
Stock: Ghee	*17,000*	*13,250*
Oil	*27,000*	*44,750*
Debtors	*75,750*	*?*

	(*Lucknow*)	
Cash on Hand	*7,540*	*12,350*
Furniture & Fittings	*6,250*	*5,625*
Plant/Machinery	-	

Addition to Plant/Machinery on 1-1-20X1 ₹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 ₹2,000 p.m. General expenses incurred by H.O. ₹24,000.
Prepare Branch Account in the head office books and also prepare the Arnold's
Trading and Profit and Loss A/c (*excluding branch transactions*).

(*Source: Illustration 7, Study Material*)

Solution

In the books of Arnold Lucknow Branch Account

		₹		₹
To	Balance b/d		By Bank (Remittance)	6,13,250
	-Opening Branch Assets		By Closing Branch Assets	
	Opening stock:		Closing stock:	
	Ghee	17,000	Ghee	13,250
	Oil	27,000	Oil	44,750
	Debtors	75,750	Debtors (W.N. 1)	86,900
	Cash on hand	7,540	Cash on hand (W.N. 2)	12,350
	Furniture & fittings	6,250	Furniture & fittings	5,625
To	Goods sent to Branch A/c			
	Ghee (15 x 1500 x 12)	2,70,000		
	Oil (25 x 1000 x 12)	3,00,000		
To	Bank (Expenses paid)	14,250		
To	Branch Manager commission			
	(₹ 58,335 × 1/11)	5,303		
To	Net Profit transferred			
	to General P & L A/c	53,032		
		7,76,125		7,76,125

Arnold

Trading and Profit and Loss account for the year ended 31st December, 20X1
(Excluding branch transactions)

			₹		₹
To	Opening Stock:			By Sales:	
	Ghee		1,50,000	Ghee	18,46,350
	Oil		3,50,000	Oil	27,41,250
To	Purchases:			By Closing Stock:	
	Ghee	14,75,000		Ghee	3,12,500
	Less: Goods sent to Branch	(2,70,000)	12,05,000	Oil	4,17,250
	Oil	29,32,000			
	Less: Goods sent to Branch	(3,00,000)	26,32,000		

		₹		₹
To Direct Expenses		3,83,275		
To Gross Profit c/d		5,97,075		
		53,17,350		53,17,350
To Manager's Salary		24,000	By Gross Profit b/d	5,97,075
To General Expenses		24,000	By Branch Profit transferred	53,032
To Depreciation:				
Furniture @10%	2,150			
Plant & Machinery @ 15% (W.N.3)	1,36,500	1,38,650		
To General Manager's Commission @ 10% (i.e., 4,63,457 × 1/11)		42,132		
To Net profit		4,21,325		
		6,50,107		6,50,107

Working Notes:

(1) Memorandum Branch Debtors Account

	₹		₹
To Balance b/d	75,750	By Cash Collections (including Cash Sales)	6,47,330
To Sales (including Cash Sales)		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		7,34,230

(2) Memorandum Branch Cash Account

	₹		₹
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350
	6,54,870		6,54,870

(3) Depreciation on Plant & Machinery

3,07,250 x 15% + 6,02,750 x 15% = ₹1,36,500

Question 13

M/s Rahul operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell 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 31.3.20X2:

	₹
Stock at the outlet 1.4.20X1	*30,000*
Goods invoiced to the 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 31.3.20X2	*36,000*

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.20X2:

(a) Outlet Stock Account.

(b) Outlet Profit & Loss Account.

(c) Stock Reserve Account.

(*Source: Illustration 8, Study Material*)

Solution

Outlet Stock Account

	₹		₹
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent to outlet	3,24,000	By Goods lost by fire (b.f.)	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

	₹		₹
To Expenses	20,000	By Gross Profit b/d	60,000
To Goods lost by fire (W.N.2)	18,000		
To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

	₹		₹
To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d (Stock Res. required)	7,200	By HO P&L A/c (W.N. 3)	7,200
	13,200		13,200

Working Notes:

		₹
(1) Wholesale Price	100+25	= 125
Retail Price	125 + 20%	= 150
Gross Profit at the outlet		
Wholesale Price – Retail Price	(150 – 125)	25

$$\text{Retailsales value} = \frac{150}{25} = ₹3,60,000$$

(2) Goods lost by fire

Opening Stock + Goods Sent + Gross Profit – Sales – Closing Stock 30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = ₹ 18,000

(3) Stock Reserve

$$\text{Opening Stock} = 30,000 \times \frac{25}{125} = ₹\ 6,000$$

$$\text{Closing Stock} = 30,000 \times \frac{25}{125} = ₹7,200$$

Question 14

Give Journal Entries in the books of an independent Branch to rectify or adjust the following:

(i) 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.

(ii) Asset Purchased by branch for ₹ 25,000, but the Asset account was retained in H.O Books.

(iii) A remittance of ₹8,000 sent by the branch has not been received by H.O.

(iv) H.O collected ₹ 25,000 directly from the customer of Branch but fails to give the intimation to branch.

(v) Remittance of funds by H.O to branch ₹ 5,000 not entered in branch books.

(*Source: Illustration 9, Study Material*)

Solution

Journal Entries in Books of Branch

	Particulars	***Dr. Amount ₹***	***Cr. Amount ₹***
(i)	Head office account Dr. To Salaries account (Being the rectification of salary paid on behalf of H.O.)	5,000	5,000
(ii)	Head office account Dr. To Bank / Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)	25,000	25,000
(iii)	No Entry in Branch Books		
(iv)	Head office account Dr. To Debtors account (Being the amount of branch debtors collected by H.O.)	25,000	25,000
(v)	Bank A/c Dr. To Head Office (Remittance of Funds by H.O. to Branch)	5,000	5,000

Question 15

The following Trial balances as at 31st December, 20X1 have been extracted from the books of Major Ltd. 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 are to be done.

	Head Office		***Branch***	
	Dr. ₹	***Cr. ₹***	***Dr. ₹***	***Cr. ₹***
Share Capital		*1,50,000*		
Fixed Assets	*75,125*		*18,901*	
Current Assets	*1,21,809*		*23,715*	(*Note 3*)
Current Liabilities		*34,567*		*9,721*
Stock Reserve, 1st Jan., 20X1 (*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*

You are required to record the following in the appropriate ledger accounts in both sets of books.

Note:

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, 20X1.*
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, 20X1, as was also a remittance of ₹ 3,500 from the Branch.*
5. *At 31st December, 20X1, the following transactions were reflected in the Head Office books but unrecorded in the Branch books.*

The purchase price of lorry, ₹ 2,500, which reached the Branch on December 25th; a sum received on December 30, 20X1 from one of the Branch debtors, ₹ 750.

(*Source: Illustration 10, Study Material*)

Solution

H.O. Books

Branch Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Balance b/d	31,536	Dec. 31	By Cash in transit	3,500
				By Balance c/d	28,036
		31,536			31,536

Cash in transit Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Branch A/c	3,500	Dec. 31	By Balance c/d	3,500

Stock Reserve Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Balance c/d	746	Jan. 1	By Balance b/d	693
	(4,565+3,641) x 10/110			By Revenue A/c (b.f.)	53
		746			746

Revenue Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Stock Reserve	53	Dec. 31	By Balance b/d	43,210
	To Balance c/d	43,157			
		43,210			43,210

Branch Books

Head Office Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Current Assets	750	Dec. 31	By Balance b/d	22,645
				By Goods in transit	3,641
	To Balance c/d	28,036		By Motor Vehicle	2,500
		28,786			28,786

Goods in Transit Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Head Office	3,641	Dec. 31	By Balance c/d	3,641

Motor Vehicle Account

20X1		*₹*	*20X1*		*₹*
Dec. 31	To Head Office	2,500	Dec. 31	By Balance c/d	2,500

Sundry Current Assets A/c

20X1		₹	*20X1*		₹
Dec. 31	To Balance b/d	23,715	Dec. 31	By H.O. (Remittance by Debtor)	750
				By Balance c/d	22,965
		23,715			23,715

Question 16

KP manufactures a range of goods which it sells to wholesale customers only from its head office. In addition, the H.O. transfers goods to a newly opened branch at factory cost plus 15%. The branch then sells these goods to the general public on only cash basis.

The selling price to wholesale customers is designed to give a factory profit which amounts to 30% of the sales value. The selling price to the general public is designed to give a gross margin (i.e., selling price less cost of goods from H.O.) of 30% of the sales value.

KP operates from rented premises and leases all other types of fixed assets. The rent and hire charges for these are included in the overhead costs shown in the trial balances.

From the information given below, you are required to prepare for the year ended 31st Dec., 20X1 in columnar form.

(a) A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.

(b) Balance Sheet as on 31st Dec., 20X1 for the entire business.

	H.O.		*Branch*	
	₹	₹	₹	₹
Raw materials purchased	*35,000*			
Direct wages	*1,08,500*			
Factory overheads	*39,000*			
Stock on 1-1-20X1				
Raw materials	*1,800*			
Finished goods	*13,000*		*9,200*	
Debtors	*37,000*			
Cash	*22,000*		*1,000*	
Administrative Salaries	*13,900*		*4,000*	
Salesmen Salaries	*22,500*		*6,200*	
Other administrative & selling overheads	*12,500*		*2,300*	
Inter-unit accounts	*5,000*			*2,000*
Capital		*50,000*		
Sundry Creditors		*13,000*		
Provision for unrealized profit in stock		*1,200*		
Sales		*2,00,000*		*65,200*
Goods sent to Branch		*46,000*		
Goods received from H.O.			*44,500*	
	3,10,200	*3,10,200*	*67,200*	*67,200*

Note:

(1) On 28th Dec., 20X1 the branch remitted ₹ 1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also, on the same date, the H.O. dispatched goods to the branch invoiced at ₹ 1,500 and these too have not yet been entered into the branch books. It is the company's policy to adjust items in transit in the books of the recipient.

(2) The stock of raw materials held at the H.O. on 31st Dec., 20X1 was valued at ₹ 2,300.

(3) You are advised that:

- *there were no stock losses incurred at the H.O. or at the branch.*
- *it is KP's practice to value finished goods stock at the H.O. at factory cost.*
- *there were no opening or closing stock of work-in-progress.*

(4) Branch employees are entitled to a bonus of ₹ 156 under a bilateral agreement.

(*Source: Illustration 11, Study Material*)

Solution

In the books of KP

Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

	H.O. ₹	*Branch* ₹	*Total* ₹		*H.O.* ₹	*Branch* ₹	*Total* ₹
To Opening stock of finished goods	13,000	9,200	22,200	By Sales	2,00,000	65,200	2,65,200
To Material consumed (W.N.1)	34,500	-	34,500				
To Wages	1,08,500	-	1,08,500	By Goods Sent to Branch	46,000	-	-
To Factory Overheads	39,000	-	39,000				
To Goods from H.O.		46,000		By Closing stock including transit (W.N.2)	15,000	9,560 (Bal Fig)	24,560
To Gross Profit c/d (W.N.3)	66,000 (Bal Fig)	19,560	85,560				
	2,61,000	74,760	2,89,760		2,61,000	74,760	2,89,760
To Admn. Salaries	13,900	4,000	17,900	By Gross Profit b/d	66,000	19,560	85,560
To Salesmen Salaries	22,500	6,200	28,700				
To Other Admn. & selling Overheads	12,500	2,300	14,800				
To Stock Reserve (W.N.4)	47	-	47				
To Bonus to Staff	-	156	156				
To Net Profit	17,053	6,904	23,957				
	66,000	19,560	85,560		66,000	19,560	85,560

Balance Sheet as on 31st Dec., 20X1

		₹	H.O. ₹	Branch ₹	Total ₹		H.O. ₹	Branch ₹	Total ₹
Capital			50,000	-	50,000	Fixed Assets	-	-	-
Profit:	H.O.	17,053				Current Assets:			
	Branch	6,904	23,957		23,957	Raw material	2,300		2,300
Trade Creditors			13,000		13,000	Finished Goods	15,000	9,560	23,313*
Bonus Payable				156	156	(Less Stock Res.)			
H.O. Account*				10,404		Debtors	37,000	-	37,000
Stock Reserve (W.N.4)			1,247			Cash (including transit item)	23,500	1,000	24,500
						Branch A/c	10,404**		
			88,204	10,560	87,113		88,204	10,560	87,113

*9,560 × 100/115 *i.e.,* (8,313 + 15,000) = ₹ 23,313 or (15,000 + 9,560) – 1,247 (Stock reserve)

** (5,000 + 6,904) – 1500 = ₹ 10,404.

Working Notes:

(1) Material consumed
Opening raw material + Raw Material Purchased – Closing raw material
= 1,800 + 35,000 - 2,300 = 34,500

(2) Closing stock at head office
(a) Calculation of total factor cost = Material consumed + Wages + Factory overhead
= 34,500 + 1,08,500 + 39,000 = 1,82,000
(b) Cost (factory cost) of goods sold = Sales – Gross profit
= 2,00,000 – 2,00,000 x 30% = 1,40,000
(c) Stock transferred to branch = 46,000 x 100/115 = 40,000
(d) Closing stock = 13,000 (Opening Stock) + 1,82,000 – 1,40,000 – 40,000 = 15,000

(3) Gross profit of Branch = Sales x Gross profit ratio = 65,200 x 30% = 19,560

(4) Closing stock reserve = 9,560 x 15/115 = 1,247
Charge to profit and loss = 1,247 – 1,200 (existing) = 47

Question 17

AFFIX of Kolkata has a branch at Delhi to which the goods are supplied from Kolkata but the cost thereof is not recorded in the Head Office books.

On 31st March, 20X1 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 30-9-20X1, 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		*Discount earned*	*1,200*
of ₹ 2,000)	*6,400*	*Cash paid to Creditors*	*60,000*
General Expenses	*1,600*	*Building Account (further payment)*	*4,000*
Fire Insurance (paid for one year)	*3,200*	*Cash in Hand*	*1,600*
Remittance to H.O.	*38,400*	*Cash at Bank*	*28,000*

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-20X1. Also give journal entries in the Delhi books.

(*Source: Illustration 12, Study Material*)

Solution

Journal Entries

20X1 **30 Sept.**		**Dr.** **₹**	**Cr.** **₹**
Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance Account)			
Prepared Insurance A/c (3,200 x 6/12)	Dr.	1,600	
To Fire Insurance A/c			1,600

20X1 **30 Sept.**		**Dr.** ₹	**Cr.** ₹
(Six months premium transferred to the Prepaid Insurance A/c)			
Head Office Account	Dr.	88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c (6,400 – 2,000)			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c (3,200 x 6/12)			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
Sales Accounts	Dr.	2,40,000	
Discount Earned A/c	Dr.	1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			
Head Office Account	Dr.	4,000	
To Building Account			4,000
(Transfer of amounts spent on building extension to H.O. A/c)			

Head Office Account

20X1		**₹**	**20X1**		**₹**
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries (Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 20X1

Liabilities	***₹***	***Assets***	***₹***
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600
		Building Extension A/c transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

	₹			₹
To Balance b/d	8,000	By Wages		20,000
To Collection from Debtors	1,60,000	By Salaries		6,400
		By Insurance		3,200
		By General Exp.		1,600
		By H.O. A/c		38,400
		By Manager's Salary		4,800
		By Creditors		60,000
		By Building A/c		4,000
		By Balance c/d		
		By Cash in Hand	1,600	
		By Cash at Bank	28,000	29,600
	1,68,000			1,68,000

Debtors Account

	₹		₹
To Balance b/d	2,00,000	By Cash Collection	1,60,000
To Sales	2,40,000	By Discount (allowed)	8,000
		By Balance c/d	2,72,000
	4,40,000		4,40,000
To Balance b/d	2,72,000		

Creditors Account

	₹		₹
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000
		By Balance b/d	26,800

Question 18

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used. The following is the trial balance extracted on 31st December, 20X1.

Head Office Trial Balance

	₹	₹
Share Capital (Authorised: 10,000 Equity Shares of ₹ 100 each):		
Issued: 8,000 Equity Shares		*8,00,000*
Profit & Loss Account - 1-1-20X1		*25,310*
General Reserve		*1,00,000*
Fixed Assets	*5,30,000*	
Stock	*2,22,470*	
Debtors and Creditors	*50,500*	*21,900*
Profit for 20X1		*52,200*
Cash Balance	*62,730*	
Branch Current Account	*1,33,710*	
	9,99,410	*9,99,410*

Branch Trial Balance

	₹	₹
Fixed Assets	*95,000*	
Profit for 20X1		*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, 20X1, but received by the Head Office on 1st January 20X2 - ₹ 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 Head Office books after incorporating Branch Trial Balance through journal.

(*Source: Illustration 13, Study Material*)

Solution

The Branch Current Account in the Head Office Books and Head Office Current Account in the Branch Books do not show the same balances. Therefore, in order to reconcile them, the following journal entries will be passed in the Head Office books:

Journal Entries

			Dr.	Cr.
20X1			₹	₹
Dec., 31	Cash in Transit A/c	Dr.	3,000	
	To Branch Current A/c			3,000
	(Cash sent by the Branch on 31st Dec., 20X1 but received at H.O. on 1st Jan., 20X2)			
	Loss by theft A/c	Dr.	1,700	
	To Branch Current A/c			1,700
	(Stock lost in transit from H.O. to Branch)			

In order to incorporate, in the H.O. books, the given Branch trial balance which has been drawn up after preparing the Branch Profit & Loss Account, the following journal entries will be necessary:

Journal Entries

20X1			₹	₹
Dec. 31	Branch Current Account	Dr.	31,700	
	To Profit & Loss Account			31,700
	(Branch Profit for the year)			
	Branch Fixed Assets	Dr.	95,000	
	Branch Stock	Dr.	50,460	
	Branch Debtors	Dr.	19,100	
	Branch Cash	Dr.	6,550	
	To Branch Current Account			1,71,110
	(Branch assets brought into H.O. Books)			
	Branch Current A/c	Dr.	10,400	
	To Branch Creditors			10,400
	(Branch creditors brought into H.O. Books)			

Branch Current Account

	₹		₹
To Balance b/d	1,33,710	By Cash in transit	3,000
To Profit & Loss A/c	31,700	By Loss of theft	1,700
To Branch Creditors	10,400	By Sundry Branch Assets	1,71,110
	1,75,810		1,75,810

Profit and Loss Account for 20X1

	₹			₹
To Loss by Theft	1,700	By Balance b/d		25,310
To Balance c/d	1,07,510	By Year's Profit:	H.O.	52,200
			Branch	31,700
	1,09,210			1,09,210

Question 19

M/s. Ramchand & Co., Hyderabad 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 invoiced 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 fixed Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-20X1

Debit	***₹***	***Credit***	***₹***
Head office opening balance on 1-1-20X1	*15,000*	*Sales*	*1,00,000*
Goods from H.O.	*50,000*	*Goods to H.O.*	*3,000*
Purchases	*20,000*	*Head Office Current A/c*	*15,000*
Opening Stock		*Sundry Creditors*	*3,000*
(*H.O. supplies goods at invoice prices*)	*4,000*		
Opening Stock of other goods	*500*		
Salaries	*7,000*		
Rent	*3,000*		
Office expenditure	*2,000*		
Cash on Hand	*500*		
Cash at Bank	*4,000*		
Sundry Debtors	*15,000*		
	1,21,000		*1,21,000*

The Branch balances as on 1st January, 20X1, were as under: Furniture ₹ 5,000; Sundry Debtors ₹ 9,500; Cash ₹ 1,000, Creditors ₹ 30,000. 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.

(*Source: Illustration 14, Study Material*)

Solution

Delhi Branch Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

			₹				₹
To	Opening Stock:			By	Sales		1,00,000
	Head office Goods	3,200		By	Goods from Branch		3,000
	(4,000 x 80%)			By	Closing Stock:		
	Others	500	3,700		Head Office goods (3,000 x 80%)	2,400	
To	Goods to Branch (50,000 x 80%)		40,000		Others	1,000	3,400
To	Purchases		20,000				
To	Gross Profit c/d		42,700				
			1,06,400				1,06,400
To	Salaries		7,000	By	Gross profit b/d		42,700
To	Rent		3,000				
To	Office Expenses		2,000				
To	Dep. on furniture @ 10%		500				
To	Net profit		30,200				
			42,700				42,700

Branch (Fixed) Assets Account (In Head Office Books)

20X1			₹	20X1			₹
Jan. 1	To	Balance b/d	5,000	Dec. 31	By	Delhi Branch A/c (Depreciation)	500
					By	Balance c/d	4,500
			5,000				5,000
20X2 Jan. 1	To	Balance b/d	4,500				

Note: Furniture A/c is maintained in Head office books; it is not a part of either opening or closing balance.

Question 20

On 31st December, 20X2 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., 20X2	*2,34,000*	
Purchases and Sales	*15,62,500*	*23,43,750*
Debtors and Creditors	*7,65,000*	*5,10,000*
Bills Receivable and Payable	*2,04,000*	*1,78,500*
Salaries and Wages	*1,00,000*	-
Rent, Rates and Taxes	*1,06,250*	-
Furniture	*91,000*	-
Bank A/c	*5,68,650*	
New York Account	-	*5,99,150*
	36,31,400	*36,31,400*

Stock on 31st December, 20X2 was ₹ 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 20X2 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 20X1 was ₹ 52 and on 31st December, 20X2 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 assuming integral foreign operation.

(*Source: Illustration 15, Study Material*)

Solution

In the books of English Firm (Head Office in New York)

Chennai Branch Profit and Loss Account for the year ended 31st December, 20X2

	$		$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Chennai Branch as on 31st December, 20X2

Liabilities	$	$	Assets	$
Head Office A/c	13,400		Furniture	1,750
Add: Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Calculation of Exchange Translation Loss

Chennai Branch Trial Balance (converted in $) as on 31st December, 20X2

	Dr. ₹	Cr. ₹	Conversion Rate	Dr. ($)	Cr. ($)
Stock on 1st Jan., 20X2	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

Question 21

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is an integral foreign operation of S & M Ltd.

At the end of 31st March, 20X2, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office:

	Bombay (₹ thousands)		**Sydney (Austr dollars thousands)**	
	Debit	*Credit*	*Debit*	*Credit*
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors/Creditors	280	200	60	30
Stock (1.4.20X1)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases/Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available:

(1) Stock as at 31.3.20X2:

Bombay ₹ 1,50,000

Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees; (use the following rates of exchange :

Opening rate	*A $ = ₹ 20*
Closing rate	*A $ = ₹ 24*
Average rate	*A $ = ₹ 22*
For Fixed Assets	*A $ = ₹ 18*

(*Source: Illustration 16, Study Material*)

Solution

Sydney Branch Trial Balance (in Rupees)
As on 31st March, 20X2

(₹ '000)

Conversion	*Rate per A$*	*Dr.*	*Cr.*
Plant & Machinery (cost)	₹ 18	36,00	
Plant & Machinery Dep. Reserve	₹ 18		23,40
Debtors/Creditors	₹ 24	14,40	7,20
Stock (1.4.20X1)	₹ 20	4,00	
Cash & Bank Balances	₹ 24	2,40	

Conversion	***Rate per A$***	***Dr.***	***Cr.***
Purchase/Sales	₹ 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	₹ 22	9,90	
Rent	₹ 22	2,64	
Office expenses	₹ 22	3,96	
Commission Receipts	₹ 22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Question 22

M/s Carlin has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch is an integral foreign operation of Carlin & Co.

Mumbai branch furnishes you with its trial balance as on 31st March, 20X2 and the additional information given thereafter:

	Dr.	***Cr.***
	Rupees in thousands	
Stock on 1st April, 20X1	*300*	*–*
Purchases and sales	*800*	*1,200*
Sundry Debtors and creditors	*400*	*300*
Bills 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 $ 6,000 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 31st March, 20X2.

(c) The rates of exchange may be taken as follows:

- *on 1.4.20X1 @ ₹ 40 per US $*
- *on 31.3.20X2 @ ₹ 42 per US $*
- *average exchange rate for the year @ ₹ 41 per US $*
- *conversion in $ shall be made upto two decimal accuracy.*

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 20X2 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 31.3.20X2 in New York books and there were no items pending reconciliation.

(*Source: Illustration 17, Study Material*)

Solution

M/s Carlin

Mumbai Branch Trial Balance in (US $) as on 31st March, 20X2

	Conversion	***Dr.***	***Cr.***
	rate per US $ (₹)	US $	US $
Stock on 1.4.X1	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

Trading and Profit & Loss Account for the year ended 31st March, 20X2

	US $		***US $***
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock (4,20,000/42)	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on computers (US $ 6,000 × 0.6)	3,600.00		
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch as on 31st March, 20X2

Liabilities		***US $***	***Assets***	***US $***	***US $***
New York Office A/c	39,609.18		Computers	6,000.00	
Less: Net Loss	(17,685.38)	21,923.80	*Less:* Depreciation	(3,600.00)	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		2,857.14
		34,780.95			34,780.95

Question 23

Why goods are marked on invoice price by the head office while sending goods to the branch?

(*Source: Question 6, Study Material*)

Answer

Goods are marked on invoice price to achieve the following objectives:

(i) To keep secret from the branch manager, the cost price of the goods and profit made, so that the branch manager may not start a rival and competitive business with the concern; and

(ii) To have effective control on stock i.e. stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.

(iii) To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

Question 24

Differentiate Branch Accounts with Departmental accounts.

(*Source: Question 7, Study Material*)

Answer

Branch accounts may be maintained either at branch or at head office and no allocation problem arises since the expenses in respect of each branch can be identified However, Departmental accounts are maintained at one place only.

Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case.

Question 25

Goods worth ₹ 50,000 sent by head office but the branch has received till the closing date goods for worth ₹ 40,000 only. Give journal entry in the books of H.O. and branch for goods in transit.

(*Source: Question 8, Study Material*)

Answer

Journal entry in the books of Head Office No entry

Journal entry in the books of Branch

		₹	₹
Goods-in-transit account	Dr.	10,000	
To Head Office account			10,000
(Being goods sent by head office is still in transit)			

Question 26

Alphs having head office in Mumbai has a branch in Nagpur. The branch at Nagpur is an independent branch maintaining separate books of account. On 31.3.20X1, 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?

(*Source: Question 9, Study Material*)

Answer

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

[Being Goods sent by Head office is still in transit on the closing date]

Question 27

Show adjustment journal entry in the books of head office at the end of April, 20X1 for incorporation of inter-branch transactions assuming that only head office maintains different branch accounts in its books.

A. Delhi branch:

(1) Received goods from Mumbai – ₹ 35,000 and ₹ 15,000 from Kolkata.

(2) Sent goods to Chennai – ₹ 25,000, Kolkata – ₹ 20,000.

(3) Bill Receivable received – ₹ 20,000 from Chennai.
(4) Acceptances sent to Mumbai – ₹ 25,000, Kolkata – ₹ 10,000.

B. Mumbai Branch (apart from the above) :
(5) Received goods from Kolkata – ₹ 15,000, Delhi – ₹ 20,000.
(6) Cash sent to Delhi – ₹ 15,000, Kolkata – ₹ 7,000.

C. Chennai Branch (apart from the above) :
(7) Received goods from Kolkata – ₹ 30,000.
(8) Acceptances and Cash sent to Kolkata – ₹ 20,000 and ₹10,000 respectively.

D. Kolkata Branch (apart from the above) :
(9) Sent goods to Chennai – ₹ 35,000.
(10) Paid cash to Chennai – ₹15,000.
(11) Acceptances sent to Chennai – ₹15,000.

(*Source: Question 10, Study Material*)

Answer

(a) **Journal entry in the books of Head Office**

Date	***Particulars***	***Dr.***	***Cr.***
		₹	₹
30th April, 20X1		Dr.	
	Mumbai Branch Account	3,000	
	Chennai Branch Account Dr.	70,000	
	To Delhi Branch Account		15,000
	To Kolkata Branch Account		58,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 20X1)		

Working Note:

Inter – Branch transactions

		Delhi	***Mumbai***	***Chennai***	***Kolkata***
		₹	₹	₹	₹
A.	Delhi Branch				
(1)	Received goods	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
(2)	Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
(3)	Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
(4)	Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)
B.	Mumbai Branch				
(5)	Received goods	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)
(6)	Sent cash	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
C.	Chennai Branch				
(7)	Received goods			30,000 (Dr.)	30,000 (Cr.)
(8)	Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D.	Kolkata Branch				
(9)	Sent goods			35,000 (Dr.)	35,000 (Cr.)
(10)	Sent cash			15,000 (Dr.)	15,000 (Cr.)
(11)	Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
		15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Question 28

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) 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.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

(*Source: Question 11, Study Material*)

Answer

Books of Branch A Journal Entries

	Particulars		***Dr.*** **Amount ₹**	***Cr.*** **Amount ₹**
(i)	Expenses account	Dr.	3,500	
	To Head office account			3,500
	(Being the allocated expenditure by the head office recorded in branch books)			
(ii)	Depreciation account	Dr.	1,500	
	To Head office account			1,500
	(Being the depreciation provided)			
(iii)	Head office account	Dr.	2,000	
	To Salaries account			2,000
	(Being the rectification of salary paid on behalf of H.O.)			
(iv)	Head office account	Dr.	10,000	
	To Debtors account			10,000
	(Being the adjustment of collection from branch debtors)			
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account			3,000
	(Being the expenditure on account of Branch B, recorded in books)			

Note: Entry (vi) Inter branch transactions are routed through Head Office.

Question 29

Widespread 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 ₹ 10,000 necessary for meeting immediate requirements of cash. On 31st March, 20X1 the assets at the branch were as follows:

	₹ ('000)
Cash in Hand	10
Trade Debtors	384
Stock, at Invoice Price	1,080
Furniture and Fittings	500

During the accounting year ended 31st March, 20X2 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 1 crore 32 lakhs. 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	9,700
Credit Sales	3,140
Cash collected by Branch from Credit Customers	2,842
Cash Discount allowed to Debtors	58
Returns by Customers	102
Bad Debts written off	37
Expenses paid by Branch	842

On 1st January, 20X2 the branch purchased new furniture for ₹ 1 lakh for which payment was made by head office through a cheque.

On 31st March, 20X2 branch expenses amounting to ₹ 6,000 were outstanding and cash in hand was again ₹ 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 20X2.

(*Source: Question 12, Study Material*)

Answer

In the Head Office Books Branch Account
for the year ended 31st March, 20X2

	₹ '000		***₹'000***
To Balance b/d		By Balance b/d	
Cash in hand	10	Stockreserve ₹1,080 × $\frac{1}{6}$	180
Trade debtors	384		
Stock	1,080	By Goods sent to branch A/c (Returns to H.O.)	72
Furniture and fittings	500		
To Goods sent to branch A/c	13,200	By Goods sent to branch A/c (Loading on net goods sent to branch – $\left(13,128 \times \frac{1}{6}\right)$	2,188
To Bank A/c (Payment for furniture)	100		
To Balance c/d Stock reserve $\left(1,470 \times \frac{1}{6}\right)$	245		
		By Bank A/c (Remittance from branch to H.O.) (W.N.5)	11,700
To Net profit transferred to General P/L account	1,096	By Balance c/d	
		Cash in hand	10
To Balance c/d-Outstanding expenses	6	Trade debtors (W.N.3)	485
		Stock (W.N.1)	1,470
		Furniture and fittings (W.N.4)	516
	16,621		16,621

Working Notes:

1. Invoice price and cost

Let cost be	100
So, invoice price	120
Loading	20
Loading: Invoice price = 20 : 120 = 1 : 6	

2. Memorandum Branch Stock Account

	₹ '000		₹ '000
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. Memorandum Branch Debtors Account

	₹ '000		₹ '000
To Balance b/d	384	By Branch cash	2,842
To Branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses	
		(Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. Memorandum Branch Furniture and Fittings Account

	₹ '000		₹ '000
To Balance b/d	500	By Depreciation [(500x16%) + (100x16%x3/12)]	84
To Bank	100	By Balance c/d	516
	600		600

Note: Since the new furniture was purchased on 1st Jan 20X2 depreciation will be for 3 months.

5. Memorandum Branch Cash Account

	₹ '000		₹ '000
To Balance b/d	10	By Branch expenses	842
To Branch stock	9,700	By Remittances to H.O. (b.f)	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

Question 30

On 31st March, 20X2 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Credit Balances	₹ in lacs
Furniture and Equipment	18
Depreciation on furniture	2
Salaries	25
Rent	10
Advertising	6
Telephone, Postage and Stationery	3
Sundry Office Expenses	1
Stock on 1st April, 20X1	60
Goods Received from Head Office	288
Debtors	20
Cash at bank and in hand	8
Carriage Inwards	7
	448

Credit Balances	₹ in lacs
Outstanding Expenses	3
Goods Returned to Head Office	5
Sales	360
Head Office	80
	448

Additional Information:

Stock on 31st March, 20X2 was valued at ₹ 62 lacs. On 29th March, 20X2 the Head Office dispatched goods costing ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 20X2. Hence, the figure of goods received from Head Office does not include these goods. Also, the head office has charged the branch ₹ 1 lac for centralized services for which the branch has not passed the entry. You are required to:

(i) Pass Journal Entries in the books of the Branch to make the necessary adjustments

(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.

(*Source: Question 13, Study Material*)

Answer

(i) **Books of Branch**

Journal Entries

			(₹ *in lacs*)
		Dr.	***Cr.***
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 20X2)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 20X2

	₹ *in lacs*		₹ *in lacs*
To Opening Stock	60	By Sales	360
To Goods received from		By Closing Stock including transit	72
Head Office 288 +10			
Less: Returns (5)	293		
To Carriage Inwards	7		
To Gross Profit c/d	72		
	432		432
To Salaries	25	By Gross Profit b/d	72
To Depreciation on Furniture	2		
To Rent	10		
To Advertising	6		
To Telephone, Postage & Stationery	3		
To Sundry Office Expenses	1		
To Head Office Expenses (centralised services)	1		
To Net Profit Transferred to Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 20X2

Liabilities	***₹ in lacs***		***Assets***	***₹ in lacs***	
Head Office	80		Furniture & Equipment	20	
Add: Goods in transit	10		*Less:* Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24		Goods in Transit		10
		115	Debtors		20
Outstanding Expenses		3	Cash at bank and in hand		8
		118			118

(iii) **Books of Head Office**

Journal Entries

		₹ ***Dr.***	₹ ***Dr.***
Trading Account	Dr.	365	
To Branch Account			365
(The total of the following items in branch trial balance debited to branch trading account:			
₹ in lacs			
Opening Stock 60			
Goods received from Head Office 288			
Goods purchased but not received 10			
Carriage Inwards 7)			
Branch Account	Dr.	437	
To Trading Account			437
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows:			
₹ in lacs			
Sales 360			
Closing Stock 62			
Goods in transit 10			
Goods returned to Head Office 5)			
Trading Account	Dr.	72	
To Profit and Loss Account			72
(Gross profit earned by branch credited to Branch Profit and Loss Account)			
Profit and Loss Account	Dr.	48	
To Branch Account			48
(Total of the following branch expenses debited to Branch Profit & Loss Account:			
₹ in lacs			
Salaries 25			
Rent 10			
Advertising 6			

			₹ Dr.	₹ Dr.
Telephone, Postage & Stationery	3			
Sundry Office Expenses	1			
Head Office Expenses	1			
Depreciation on furniture	2)			
Branch Profit & Loss Account		Dr.	24	
To Profit and Loss Account				24
(Net profit at branch credited to general Profit & Loss A/c)				
Furniture & Equipment		Dr.	18	
Stock		Dr.	62	
Debtors		Dr.	20	
Cash at Bank and in Hand		Dr.	8	
Goods in Transit		Dr.	10	
To Branch				118
(Incorporation of different assets at the branch in H.O. books)				
Branch		Dr.	3	
To Branch Outstanding Expenses				3
(Incorporation of Branch Outstanding Expenses in H.O. books)				

Question 31

M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch Expenses are paid direct from head office and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit under Stock and Debtors Method'.

Branch does not maintain any books of account, but sends weekly returns to the Head Office.

	₹
Goods received from Head Office at invoice price	45,00,000
Returns to Heads Office at invoice price	90,000
Stock at Bangalore as on 1st January, 20X1	4,50,000
Sales during the year - Cash	15,00,000
- Credit	27,00,000
Sundry Debtors at Bangalore as on 1st January, 20X1	5,40,000
Cash received from Debtors	24,00,000
Discount allowed to Debtors	45,000
Bad Debts in the year	30,000
Sales returns at Bangalore Branch	60,000
Rent, Rates and Taxes at Branch	1,35,000
Salaries, Wages and Bonus at Branch	4,50,000
Office Expenses	45,000
Stock at Branch on 31st December, 20X1 at invoice price	9,00,000

(*Source: Question 14, Study Material*)

Answer

Bangalore Branch Stock Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d Goods sent to	4,50,000	By Goods sent to branch A/c (Returns)	90,000
branch A/c	45,00,000	By Bank A/c (Cash sales)	15,00,000
To Branch debtors A/c (Returns)	60,000	By Branch debtors A/c (credit sales)	27,00,000
To Branch adjustment A/c (Surplus over invoice price)*	1,80,000	By Balance c/d	9,00,000
	51,90,000		51,90,000

**Alternatively, this may directly be transferred to Branch P&L A/c without routing it through Branch Adjustment Account.*

Bangalore Branch Adjustment Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Stock reserve - 20% of ₹ 9,00,000 (closing stock)	1,80,000	By Stock reserve - 20% of ₹ 4,50,000 (Opening stock)	90,000
To Branch profit & loss A/c (Gross profit)	9,72,000	By Goods sent to branch A/c – 20% of ₹ 44,10,000 (45,00,000 – 90,000)	8,82,000
		By Branch stock A/c	1,80,000
	11,52,000		11,52,000

Branch Profit & Loss Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Branch expenses A/c	6,30,000	By Branch adjustment A/c (Gross Profit)	9,72,000
To Branch debtors A/c (Discount)	45,000		
To Branch Debtors A/c (Bad debts)	30,000		
To Net profit (transferred to Profit & Loss A/c)	2,67,000		
	9,72,000		9,72,000

Branch Expenses Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bank A/c (Rent, rates & taxes)	1,35,000	By Branch profit and loss A/c (Transfer)	6,30,000
To Bank A/c (Salaries, wages & bonus)	4,50,000		
To Bank A/c (Office expenses)	45,000		
	6,30,000		6,30,000

Branch Debtors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	5,40,000	By Bank A/c	24,00,000
To Branch stock A/c	27,00,000	By Branch profit and loss A/c (Bad debts and discount)	75,000
		By Branch stock A/c (Sales returns)	60,000
		By Balance c/d (bal. fig.)	7,05,000
	32,40,000		32,40,000

Goods sent to Branch Account

Particulars	***Amount*** **(₹)**	***Particulars***	***Amount*** **(₹)**
To Branch stock A/c	90,000	By Branch stock A/c	45,00,000
To Branch adjustment A/c	8,82,000		
To Purchases A/c	35,28,000		
	45,00,000		45,00,000

Question 32

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.0. 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.

(*Source: Question 15, Study Material*)

Answer

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 33

Pass necessary Journal entries in the books of an independent Branch of a business entity 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) Branch paid ₹3,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.

(iii) Branch incurred travelling expenses of ₹5,000 on behalf of other Branches, this was not recorded in the books of Branch.

(iv) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.

(v) Head Office allocates ₹75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.

(vi) Head Office collected ₹30,000 directly from a Branch Customer. The intimation of the fact has been received by the Branch only now, not recorded till now.

(vii) Goods dispatched by the Head office amounting to ₹10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

(*Source: Question 16, Study Material*)

Answer

Books of Branch Journal Entries

Sr. No	Particulars	Dr.	Amount in ₹ Cr.
(i)	Head Office Account Dr.	2,800	
	To Income Account		2,800
	(Being the income allocated by the Head office not recorded earlier, now recorded)		
(ii)	Head Office Account Dr.	3,000	
	To Salaries Account		3,000
	(Being rectification of salary paid on behalf of Head Office)		
(iii)	Head Office Account Dr.	5,000	
	To Cash Account		5,000
	(Being expenditure incurred on account of other branch, now recorded in books)		

Sr. No	Particulars		Dr.	Amount in ₹ Cr.
(iv)	No entry in Branch Books is required.			
(v)	Expenses Account	Dr.	75,000	
	To Head Office Account			75,000
	(Being allocated expenses of Head Office recorded)			
(vi)	Head Office Account	Dr.	30,000	
	To Debtors Account			30,000
	(Being adjustment entry for collection from Branch Debtors directly by Head Office)			
(vii)	Goods -in- transit Account	Dr.	10,000	
	To Head Office Account			10,000
	(Being goods sent by Head Office still in-transit)			

Question 34

The Washington branch of XYZ Mumbai sent the following trial balance as on 31st December, 20X1:

	$	$
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, 20X1	11,200	_
Goods from H.O.	64,000	_
Expenses	5,000	_
	1,10,200	1,10,200

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

		₹			₹
To	Balance b/d	8,10,000	By	Cash	28,76,000
To	Goods sent to branch	29,26,000	By	Balance c/d	8,60,000
		37,36,000			37,36,000

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired in past, when $ 1.00 = ₹ 40.

Rates of exchange were:

1st January, 20X1	$ 1.00	=	₹ 46
31st December, 20X1	$ 1.00	=	₹48
Average	$ 1.00	=	₹ 47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

(*Source: Question 17, Study Material*)

Answer

(i) **In the Books of Head Office**

Branch Trading and Profit & Loss A/c (in Dollars) for the year ended 31st December, 20X1

Particulars	*$*	*Particulars*	*$*
To Opening stock	11,200	By Sales	84,000
To Goods from H.O.	64,000	By Closing stock (W.N.2)	8,000
To Gross profit c/d	16,800		
	92,000		92,000
To Expenses	5,000	By Gross profit b/d	16,800
To Depreciation (24,000 x 10%)	2,400		
To Manager's commission (W.N.1)	470		
To Net profit c/d	8,930		
	16,800		16,800

(ii) (a) Converted Branch Trial Balance (into Indian Currency)

Particulars	*Rate per $*	*Dr. (₹)*	*Cr. (₹)*
Machinery	40	9,60,000	_
Stock January 1, 20X1	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate (b.f.)		47,000	_
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		₹ 3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 20X1

	₹		*₹*
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from head office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		43,32,000
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on ₹ 9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		8,90,800

(c) Branch Account

	₹			₹
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	*Less:* Depreciation	(96,000)	
To Creditors	1,63,200			8,64,000
To Outstanding		By Closing stock		3,84,000
commission	22,560	By Debtors		2,30,400
		By Cash at bank		57,600
	15,36,000			15,36,000

Working Notes:

1. Calculation of manager's commission @ 5% on profit

i.e. 5% of $[16,800 – (5,000 + 2,400)]

Or 5% × $9,400 = $ 470

Manager's commission in Rupees = $ 470 $ ₹ 48 = ₹ 22,560

2. Calculation of closing stock

	$
Opening stock	11,200
Add: Goods from head office	64,000
Less: Cost of goods sold (at invoice price)	75,200
i.e. $\frac{100}{125} \times 84,000$	(67,200)
Closing stock	8,000

Closing stock in Rupees = $8,000 x ₹ 48 = ₹ 3,84,000.

Note: Manager is entitled to commission on profits earned at the end of the year.

QUESTION BANK

Question 35

M/s Rani & Co. has head office at Singapore and branch at Delhi (India). Delhi branch is an integral foreign operation of M/s Rani & Co., Delhi branch furnishes you with its Trial Balance as on 31st March, 2019 and the additional information thereafter.

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 2018	600	-
Purchases and Sales	1,600	2,400
Sundry Debtors and Creditors	800	600
Bills of Exchange	240	480
Wages	1,120	-
Rent, rates and taxes	720	-
Sundry Expenses	320	-
Computers	600	-
Bank Balance	520	-
Singapore Officer a/c	-	3,040
Total	**6,520**	**6,520**

Additional information:

(a) Computers were acquired from a remittance of Singapore dollar 12,000 received from Singapore Head Office and paid to the supplie ₹ Depreciate Computers at the rate of 40% for the year.

(b) Closing Stock of Delhi branch was ₹ 15,60,000 on 31st March, 2019.

(c) The Rates of Exchange may be taken as follows:

(i) on 1.4.2018 @ ₹ 50 per Singapore Dollar

(ii) on 31.3.2019 @ ₹ 52 per Singapore Dollar

(iii) average Exchange Rate for the year @ ₹ 51 per Singapore Dollar

(iv) conversion in Singapore Dollar shall be made upto two decimal accuracy.

(d) Delhi Branch Account showed a debit balance of Singapore Dollar 59,897.43 on 31.3.2019 in the Head office books and there were no items pending for reconciliation.

In the books of Head office, you are required to prepare:

(1) Revenue statement for the year ended 31st March, 2019. (in Singapore Dollar)

(2) Balance Sheet as on that date. (in Singapore Dollar)

(*May 2019*) (*8 Marks*)

Answer

Revenue Statement
for the year ended 31st March, 2019

	Singapore dollar		Singapore dollar
To Opening Stock	12,000.00	By Sales	47,058.82
To Purchases	31,372.55	By Closing stock	30,000.00
To Wages	21,960.78	(15,60,000/52)	
To Gross profit b/d	11,725.49		
	77,058.82		77,058.82
To Rent, rates and taxes	14,117.65	By Gross profit c/d	11,725.49
To Sundry Expenses	6,274.51	By Net loss b/d	13,466.67
To Depreciation on computers (Singapore dollar 12,000 × 0.4)	4,800.00		
	25,192.16		25,192.16

Balance Sheet of Delhi Branch as on 31st March, 2019

Liabilities		Singapore dollar	*Assets*	Singapore dollar	Singapore dollar
Singapore Office A/c	59,897.43		Computers	12,000.00	
Less: Net Loss	(13,466.67)	46,430.76	*Less:* Depreciation	(4,800.00)	7,200.00
Sundry creditors		11,538.46	Closing stock		30,000.00

Liabilities		**Singapore dollar**	***Assets***	**Singapore dollar**	**Singapore dollar**
Bills payable		9,230.77	Sundry debtors		15,384.61
			Bank balance		10,000.00
			Bills receivable		4,615.38
		67,199.99			67,199.99

Working Note:

M/s Rani & Co.
Delhi Branch Trial Balance in (Singapore $) as on 31st March, 2019

			Conversion	***Dr.***	***Cr.***
			rate per Singapore dollar	**Singapore dollar**	**Singapore dollar**
			(₹)		
Stock on 1.4.18	6,00,000.00		50	12,000.00	–
Purchases and sales	16,00,000.00	24,00,000.00	51	31,372.55	47,058.82
Sundry Debtors and Creditors	8,00,000.00	6,00,000.00	52	15,384.61	11,538.46
Bills of exchange	2,40,000.00	4,80,000.00	52	4,615.38	9,230.77
Wages	11,20,000.00		51	21,960.78	–
Rent, rates and taxes	7,20,000.00		51	14,117.65	–
Sundry Expenses	3,20,000.00		51	6,274.51	–
Computers	6,00,000.00		–	12,000.00	–
Bank balance	5,20,000.00		52	10,000.00	–
Singapore office A/c			–		59,897.43
				1,27,725.48	1,27,725.48

Question 36

Ayan Ltd. invoices goods to its branch at cost plus $33\frac{1}{3}$%*. From the following particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office.

	₹
Stock at commencement at Branch at invoice Price	3,60,000
Stock at close at Branch at Invoice Price	2,88,000
Goods sent to Branch during the year at invoice price (including goods invoiced at ₹ 48,000 to Branch on 31.03.2018 but not received by Branch before close of the year).	24,00,000
Return of goods to head office (invoice Price)	1,20,000
Credit Sales at Branch	1,20,000
Invoice value of goods pilfered	24,000
Normal loss at Branch due to wastage and deterioration of stock (at invoice price)	36,000
Cash Sales at Branch	21,60,000

Ayan closes its books on 31st March, 2018.

(*May 2018*) (*10 Marks*)

Answer

In the books of Head Office
Branch Stock Account

Particulars		**₹**	**Particulars**		**₹**
To	Balance bid	3,60,000	By	Bank A/c (cash Sales)	21,60,000
To	Goods sent to Branch A/c	24,00,000	By	Branch Debtors A/c (Credit Sales)	1,20,000
To	Branch Adjustment A/c - balancing fig. (Surplus)***	36,000	By	Goods sent to Branch A/c (Returns to H.O.)	1,20,000
			By	Branch Adjustment A/c* (*24,000 × 25/100)	6,000

Particulars		₹	Particulars		₹
			By	Branch P&L A/c* (Cost of Abnormal Loss)	18,000
			By	Branch Adjustment A/c** (Invoice price of normal loss)	36,000
			By	Balance c/d:	
				In hand	2,88,000
				In transit	48,000
		27,96,000			27,96,000

* Alternatively, combined posting for the amount of ₹ 24,000 may be passed through Goods pilfered account.

** Alternatively, it may first be transferred to normal Loss account which may ultimately be closed by transfer to Branch Adjustment account. The final amount of net profit will however remain same.

*** It has been considered that the surplus may be due to sale of goods by branch at price higher than invoice price.

Branch Stock Adjustment Account

Particulars	(₹)	Particulars	(₹)
To Branch Stock A/c (Loading on Abnormal Loss)	6,000	By Stock Reserve A/c (₹ 3,60,000 × 25/100)	90,000
To Branch Stock A/c (Normal Loss)	36,000	By Goods Sent to Branch A/c (₹ 24,00,000 - ₹ 1,20,000) × 25/100	5,70,000
To Stock Reserve A/c (₹3,36,000 × 25/100)	84,000	By Branch Stock A/c (Surplus)	36,000
To Gross Profit t/f to P & L A/c	5,70,000		
	6,96,000		6,96,000

Branch Profit and Loss Account

Particulars	₹	Particulars	₹
To Branch Stock A/c (Cost of Abnormal Loss)	18,000	By Branch Adjustment A/c (Gross Profit)	5,70,000
To Net Profit t/f to General P&LA/c	5,52,000		
	5,70,000		5,70,000

Question 37

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, 2018 and the additional information given thereafter:

	Dr.	Cr.
	(Rupees in thousands)	
Stock on 1st April, 2017		
Purchases and Sales	300	
Sundry Debtors & Creditors	800	1,200
Bills of Exchange	400	300
Wages & Salaries	120	240
Rent, Rates & T axes	560	-
Sundry Charges	360	-
Computers	160	-
Bank Balance	240	-
New York Office A/c	420	-
	-	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, 2018.

(c) The rates of exchange may be taken as follows:

- On 01.04.2017 @ ₹ 55 per US $
- On 31.03.2018 @ ₹ 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, 2018 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 31.3.2018 in New York books and there were no items pending reconciliation.

(*RTP May 2019*)

Answer:

M/s ABC & Co.
Bangalore Branch Trial Balance in (US $)
as on 31st March, 2018

	Conversion rate per US $ (₹)	Dr. US $	Cr. US $
Stock on 1.4.17	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, 2018

	US $		US $
To Opening Stock	5,454.55	By Sales	20,689.66
To Purchases	13,793.10	By Closing stock (₹ 4,20,000/60)	7,000.00
To Wages and salaries	9,655.17		
		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 $ 6,000 × 0.6)	3,600.00		
	13,778.68		13,778.68

Balance Sheet of Bangalore Branch as on 31st March, 2018

Liabilities		US $	Assets	US $	US $
New York Office A/c	29,845.35		Computers	6,000.00	
Less: Net Loss	(13,778.68)	16,066.67	*Less:* Depreciation	(3,600.00)	2,400.00
Sundry creditors		5,000.00	Closing stock		7,000.00
Bills payable		4,000.00	Sundry debtors		6,666.67
			Bills receivable		2,000.00
			Bank balance		7,000.00
		25,066.67			25,066.67

Question 38

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars, you are required to prepare branch account in the books of Head Office.

	₹		₹
Stock on 1st April 2017 (invoice price)	30,000	Discount allowed to debtors	160
Sundry Debtors on 1st April, 2017	18,000	Expenses paid by head office:	
Cash in hand as on 1st April, 2017	800	Rent	1,800
Office furniture on 1st April, 2017	3,000	Salary	3,200
Goods invoiced from the head office (invoice price)	1,60,000	Stationery S Printing	800
Goods returned to Head Office	2,000	Petty expenses paid by the branch	600
Goods returned by debtors	960	Depreciation to be provided on branch furniture at 10% p.a.	
Cash received from debtors	60,000	Stock on31st March, 2018	
Cash Sales	1,00,000	(at invoice price)	28,000
Credit sales	60,000		

(*MTP March 2018*) (*10 Marks*)

Answer:

In the books of Head Office - XYZ
Kolkata Branch Account (at invoice)

		₹			₹
To Balance b/d			By Stock reserve (opening)		6,000
Stock		30,000	By Remittances:		
Debtors		18,000	Cash Sales	1,00,000	
Cash in hand		800	Cash from Debtors	60,000	1,60,000
Furniture		3,000	By Goods sent to branch (loading)		32,000
To Goods sent to branch		1,60,000	By Goods returned by branch (Return to H.O.)		2,000
To Goods returned by branch (loading)		400	By Balance c/d		
			Stock		28,000
To Bank (expenses paid by H.O.)			Debtors		16,880
			Cash (800-600)		200
Rent	1,800		Furniture (3,000-300)		2,700
Salary	3,200				
Stationary & printing	800	5,800			
To Stock reserve (closing)		5,600			
To Profit transferred to General Profit & Loss A/c		24,180			
		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.

Question 39

Pass necessary Journal entries in the books of an independent Branch of M/s TPL Sons, wherever required, to rectify or adjust the following transactions:

(i) Branch paid ₹ 5,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.

(ii) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.

(iii) Branch assets accounts retained at head office, depreciation charged for the year ₹15,000 not recorded by Branch.
(iv) Head Office expenses ₹ 75,000 allocated to the Branch, but not yet been recorded by the Branch.
(v) Head Office collected ₹ 60,000 directly from a Branch Customer. The intimation of the fact has not been received by the Branch.
(vi) Goods dispatched by the Head office amounting to ₹ 50,000, but not received by the Branch till date of reconciliation.
(vii) Branch incurred advertisement expenses of ₹ 10,000 on behalf of other Branches, but not recorded in the books of Branch.
(viii) Head office made payment of ₹ 16,000 for purchase of goods by branch, but not recorded in branch books.

(*RTP November 2018*)

Answer:

Books of Branch
Journal Entries

			Amounts ₹	
			Dr.	**Cr.**
(i)	Head Office Account	Dr.	5,000	
	To Salaries Account			5,000
	(Being rectification of salary paid on behalf of Head Office)			
(ii)	No entry in Branch Books is required.			
(iii)	Depreciation A/c	Dr.	15,000	
	To Head Office Account			15,000
	(Being depreciation of assets accounted for)			
(iv)	Expenses Account	Dr.	75,000	
	To Head Office Account			75,000
	(Being allocated expenses of Head Office recorded)			
(v)	Head Office Account	Dr.	60,000	
	To Debtors Account			60,000
	(Being adjustment entry for collection from Branch Debtors directly by Head Office)			
(vi)	Goods in-transit Account	Dr.	50,000	
	To Head Office Account			50,000
	(Being goods sent by Head Office still in-transit)			
(vii)	Head Office Account	Dr.	10,000	
	To expenses Account			10,000
	(Being expenditure incurred, wrongly recorded in books)			
(vii)	Purchases account A/c	Dr.	16,000	
	To Head Office Account			16,000
	(Being purchases booked)			

Question 40

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31st March, 2017.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated before charging his commission but subject to a deduction from such commission equal in 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch in head office.

The following details for the year ended 31st March, 2017 are given as follows:

	₹		₹
Opening Stock (at cost)	74,736	Chargeable expenses	49,120
Goods sent to branch (at cost)	2,89,680	Closing Stock (Selling Price)	1,23,328
Sales	3,61,280		
Manager's commission paid on account	2,400		

From the above details, you are required to calculate the commission due to manager for the year ended 31st March, 2017.

(*RTP May 2018*)

Answer

Step 1: Calculation of Deficiency

Branch stock account (at invoice price)

Particulars	₹	Particulars	₹
To Opening Stock (₹ 74,736 + 1/3 of ₹ 74,736)	99,648	By Sales	3,61,280
		By Closing Stock	1,23,328
To Goods sent to Branch A/c (₹ 2,89,680 + 1/3 of ₹ 2,89,680)	3,86,240	By Deficiency at sale price [Balancing figure]	1,280
	4,85,888		4,85,888

Step 2: Calculation of Net Profit before Commission

Branch account

Particulars	₹	Particulars	₹
To Opening [₹74,736 + 1/3 of ₹ 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (₹2,89,680 + 1/3 of ₹ 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Stock Reserve A/c	24,912
To Expenses	49,120	By goods sent to Branch A/c	96,560
To Stock Reserve A/c (₹1,23,328x25/100)	30,832		
To Net Profit - subject to manager's commission	40,240		
	6,06,080		6,06,080

Step 3: Calculation of Commission still due to manager

		₹
A	Calculation at 10% profit before charging his commission [₹ 40,240x 10/100]	4,024
B	Less: 25% of cost of deficiency in stock (25% of (75% of ₹ 1,280)	(240)
C	Commission for the year [A-B]	3,784
D	Less: Paid on account	(2,400)
E	Balance due (C-D)	1,384

Question 41

XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars, you are required to prepare branch account in the books of Head Office.

	(₹)		(₹)
Stock on 1st April 2017 (invoice price)	30,000	Discount allowed to debtors	160
Sundry Debtors on 1st April, 2017	18,000	Expenses paid by head office:	
Cash in hand as on 1st April, 2017	-	Rent	1,800
Office furniture on 1st April, 2017	3,000	Salary	3,200
Goods invoiced from the head office (invoice price)	1,60,000	Stationery & Printing	800
Goods returned to Head Office (invoice price)	2,000	Petty expenses paid by the branch	600
Goods returned by debtors	960	Depreciation to be provided on branch furniture at 10% p.a.	
Cash received from debtors	60,000		
Cash Sales	1,00,000	Stock on 31st March, 2018 (at invoice price)	28,000
Credit sales	60,000		

(*MTP March 2019*) (*8 Marks*)

Answer

In the books of Head Office – XYZ
Kolkata Branch Account (at invoice)

		₹			₹
To Balance b/d			By Stock reserve (opening)		6,000
Stock		30,000	By Remittances:		
Debtors		18,000	Cash Sales	1,00,000	
Furniture		3,000	Cash from Debtors	60,000	
To Goods sent to			*Less:* Petty expenses	(600)	1,59,400
branch		1,60,000	By Goods sent to branch (loading)		32,000
To Goods returned by		400	By Goods returned by		
branch (loading)			branch (Return to H.O.)		2,000
To Bank (expenses			By Balance c /d		
paid by H.O.)			Stock		28,000
Rent	1,800		Debtors		16,880
Salary	3,200		Furniture (3,000-300)		2,700
Stationary &					
printing	800	5,800			
To Stock reserve (c losing)		5,600			
To Profit transferred to					
General Profit & Loss A/c		24,180			
		2,46,980			2,46,980

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 ac count	160
		By Balance c /d	16,880
	78,000		78,000

Note: In the absence of opening c ash balance, remittance to Head Office has been made after payment of petty expenses.

Question 42

On 31st December, 2016 the following balances appeared in the books of Kolkata Branch of an English firm having its HO office in New York:

	Amount in ₹	Amount in ₹
Stock on 1st Jan., 2016	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and T axes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account	-	5,99,150
	36,31,400	36,31,400

Stock on 31st December, 2016 was ₹ 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 2016 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange on 31st December, 2015 was ₹ 52 and on 31st December, 2016 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

(*MTP April 2019*) (*10 Marks*)

Answer

In the books of English Firm (Head Office in New York)
Kolkata Branch Profit and Loss Account
for the year ended 31st December, 2016

	$		$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c /d	23,625	(6,37,500/51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c /d	17,500		
	23,625		23,625

Balance Sheet of Kolkata Branch as on 31st December, 2016

Liabilities	$	$	Assets	$
Head Office A/c	13,400		Furniture	1,750
Add : Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Require for calculation of Exchange Translation Loss
Kolkata Branch Trial Balance (converted in $) as on 31st December, 2016

	Dr.	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	₹	*₹*	*rate*	*($)*	*($)*
Stock on 1st Jan., 2016	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and T axes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

Question 43

M/s Heera & Co. has head office at U.S.A. and branch in Patna (India). Patna branch is an integral foreign operation of Heera & Co.

Patna branch furnishes you with its trial balance as on 31st March, 2018 and the additional information given thereafter:

	Dr.	Cr.
	(Rupees in thousands)	
Stock on 1st April, 2017	300	
Purchases and Sales	800	1,200
Sundry Debtors & Creditors	400	300
Bills of Exchange	120	240
Wages & Salaries	560	-
Rent, Rates & Taxes	360	-
Sundry Charges	160	-
Plant	240	-
Bank Balance	420	-
New York Office A/c	-	1,620
	3,360	3,360

Information:

(a) Plant was acquired from a remittance of US $ 6,000 received from USA head office and paid to the suppliers. Depreciate Plant at 60% for the year.

(b) Unsold stock of Patna branch was worth ₹ 4,20,000 on 31st March, 2018.

(c) The rates of exchange may be taken as follows:

- On 01.04.2017 @ ₹ 55 per US $
- On 31.03.2018 @ ₹ 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, 2018 and the balance sheet as on that date of Patna branch as would appear in the books of USA head office of Heera & Co. You are informed that Patna branch account showed a debit balance of US $ 29845.35 on 31.3.2018 in USA books and there were no items pending reconciliation.

(*MTP August, 2018*) (*12 Marks*)

Answer

M/s Heera & Co.
Patna Branch Trial Balance in (US $)
as on 31st March, 2018

	Conversion rate per US $ (₹)	*Dr. US $*	*Cr. US $*
Stock on 1.4.15	55	5,454.55	–
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	-
Rent, rates and taxes	58	6,206.90	-
Sundry charges	58	2,758.62	-
Plant	–	6,000.00	-
Bank balance	60	7,000.00	-
USA office A/c	–	-	29,845.35
		59,535.01	59,535.01

Trading and Profit & Loss Account
for the year ended 31st March, 2018

	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 Plant (US $ 6,000 × 0.6)	3,600.00		
	13,778.68		13,778.68

Balance Sheet of Patna Branch
as on 31st March, 2018

Liabilities		*US $*	*Assets*	*US $*	*US $*
USA Office A/c	29,845.35		Plant	6,000.00	
Less: Net Loss	(13,778.68)	16,066.67	*Less:* Depreciation	(3,600.00)	2,400.00
Sundry creditors		5,000.00	Closing stock		7,000.00
Bills payable		4,000.00	Sundry debtors		6,666.67
			Bills receivable		2,000.00
			Bank balance		7,000.00
		25,066.67			25,066.67

Question 44

On 31st December, 2016 the following balances appeared in the books of Kolkata Branch of an English firm having its Head office in New York:

	Amount in ₹	Amount in ₹
Stock on 1st Jan., 2016	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account	-	5,99,150
	36,31,400	36,31,400

Stock on 31st December, 2016 was ₹6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st December, 2016 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange on 31st December, 2015 was ₹ 52 and on 31st December, 2016 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 assuming branch to be an integral foreign operation of H.O.

(*MTP October, 2018*) (*10 Marks*)

Answer

In the books of English Firm (Head Office in New York)
Kolkata Branch Profit and Loss Account
for the year ended 31st December, 2016

	$		$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Kolkata Branch as on 31st December, 2016

Liabilities	*$*	*$*	*Assets*	*$*
Head Office A/c	13,400		Furniture	1,750
Add : Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working Note:

Calculation of Exchange Translation Loss
Kolkata Branch Trial Balance (converted in $)
as on 31st December, 2016

	Dr.	Cr.	Conversion	Dr.	Cr.
	₹	₹	rate	($)	($)
Stock on 1st Jan., 2016	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	

	Dr.	Cr.	Conversion	Dr.	Cr.
	₹	₹	rate	($)	($)
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

Question 45

From the following particulars relating to Pune branch for the year ending December 31, 2018, prepare Branch Account in the books of Head office.

		₹
Stock at Branch on January 1, 2018		10,000
Branch Debtors on January 1, 2018		4,000
Branch Debtors on Dec. 31, 2018		4,900
Petty cash at branch on January 1, 2018		500
Furniture at branch on January 1, 2018		2,000
Prepaid fire insurance premium on January 1, 2018		150
Salaries outstanding at branch on January 1, 2018		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Annual Insurance up to March 31, 2019	600	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2018		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing ₹ 1,200 were destroyed due to fire and a sum of ₹ 1,000 was received from the Insurance Company.

(*RTP November 2019*)

Answer

Pune Branch Account

Particulars		₹	Particulars	₹	₹
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash Paid by debtors directly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received from Insurance Company	1,000	1,68,000
To Bank (expenses)			By Goods sent to branch		1,000
Rent	2,000		(return of goods by		
Salaries	2,400		the branch to H.O.)		
Petty Cash	1,000		By Closing Balances:		
Insurance	600	6,000	Stock		5,000

Particulars		₹	Particulars	₹	₹
To Net Profit		78,950	Petty Cash		650
			Debtors		4,900
			Furniture (2,000 – 10% depreciation)		1,800
			Prepaid insurance (1/4 x ₹ 600)		150
		1,81,600			1,81,600

Working Note:

Calculation of petty cash balance at the end:	₹
Opening balance	500
Add: Cash received form the Head Office	1,000
Total Cash with branch	1,500
Less: Spent by the branch	850
Closing balance	650

Question 46

M & S Co. of Lucknow has a branch in Canberra, Australia (as an integral foreign operation of M & S Co.). At the end of 31st March 2019, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

		Lucknow office	Canberra Branch	
		(₹ In thousand)	(Aust. Dollars in thousand)	
	Dr.	Cr.	Dr.	Cr.
Capital		2,000		
Reserves & Surplus		1,000		
Land	500			
Buildings (Cost)	1,000			
Buildings Dep. Reserves		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery Dep. Reserves		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1-4-2018	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salary	75		45	
Rent			12	
Office Expenses	25		18	
Commission Receipts		256		100
Branch/HO Current Account	120			7
	4,880	4,880	390	390

The following information is also available:

(i) Stock as at 31st March, 2019
Lucknow ₹1,50,000
Canberra A$ 3125 (all stock are out of purchases made at Abroad)

(ii) Head Office always sent goods to the Branch at cost plus 25%

(iii) Provision is to be made for doubtful debts at 5%

(iv) Depreciation is to be provided on Buildings at 10% and on Plant and Machinery at 20% on written down value.

You are required to:

(1) Convert the Branch Trial Balance into rupees by using the following exchange rates:

Opening rate	1A$ = ₹50
Closing rate	1A$ = ₹53
Average rate	1A$ = ₹51.00
For Fixed Assets	1A$ = ₹46.00

(2) Prepare Trading and Profit and Loss Account for the year ended 31st March 2019 showing to the extent possible H.O. results and Branch results separately.

[*MTP October, 2019, 12 marks*]

Answer

M & S Co. Ltd.
Canberra, Australia Branch Trial Balance
As on 31st March 2019

	($ 'thousands)				(₹ thousands)
	Dr.	**Cr.**	**Conversion rate per $**	**Dr.**	**Cr.**
Plant & Machinery (cost)	200		₹ 46	9,200	
Plants Machinery Dep. Reserve		130	₹ 46		5,980
Trade receivable/payable	60	30	₹ 53	3;180	1,590
Stock (1.4.2018)	20		₹ 50	1,000	
Cash & Bank Balances	10		₹ 53	530	
Purchase/Sales	20	123	₹ 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		₹ 51	2,295	
Rent	12		₹ 51	612	
Office expenses	18		₹ 51	918	
Commission Receipts		100	₹ 51		5,100
H.O. Current Ale		7	Actual		120
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				208	
	390	390		19,063	19,063
Closing stock	3.125		53	165.625	

Trading and Profit & Loss Account for the year ended 31st March, 2019

							(₹ '000)
	H.O.	**Branch**	**Total**		**H.O.**	**Branch**	**Total**
To Opening Stock	100	1,000.000	1,100.000	By Sales	520	6,273.000	6,793.000
To Purchases	240	1,020.000	1,260.000	By Goods sent to Branch	100	-	100.000
To Goods received from Head Office	-	100.000	100.000	By Closing Stock	150	165.625	315.625
To Wages & Salaries	75	2,295.000	2,370.000				
To Gross profit c/d	355	2,023.625	2,378.625				
	770	6,438.625	7,208.625		770	6,438.625	7,208.625
To Rent	-	612.000	612.000	By Gross profit bid	355	2,023.625	2,378.625
To Office expenses To Provision for	25	918.000	943.000	By Commission receipts	256	5,100.000	5,356.000
doubtful debts @ 5%	14	159.000	173.000				
To Depreciation	460	644.000	1,104.000				
(W. N.)							
To Balance c/d	112	4,790.625	4,902.625				
	611	7,123.625	7,734.625		611	7,123.625	7,734.625
To Managing Partner's Salary			30.000	By Balance bid			4,902.625
To Exchange Loss			208.000	By Branch stock reserve			4.000
To Balance c/d			4,668.625				
			4,906.625				4,906.625

Working Note:
Calculation of Depreciation

	H.O ₹ 000	Branch ₹ 000
Building - Cost	1,000	
Less: Dep. Reserve	(200)	
	800	
Depreciation @ 10% (A)	80	
Plant & Machinery Cost	2,500	9,200
Less: Dep. Reserve	(600)	(5,980)
	1,900	3,220
Depreciation @ 20% (B)	380	644
Total Depreciation (A+B)	460	644

Note: As the closing stock of Branch does not consist any stock transferred from MS S Co., there is no need to create closing stock reserve. But the opening branch stock reserve has to be reversed in the P&L A/c.

Question 47

On 31st March, 2019 Chennai Branch submits the following Trial Balance to its Head Office at Lucknow:

Debit Balances	₹ in lacs
Furniture and Equipment	18
Depreciation on furniture	2
Salaries	25
Rent	10
Advertising	6
Telephone, Postage and Stationery	3
Sundry Office Expenses	1
Stock on 1st April, 2018	60
Goods Received from Head Office	288
Debtors	20
Cash at bank and in hand	8
Carriage Inwards	7
Credit Balances	448
Outstanding Expenses	3
Goods Returned to Head Office	5
Sales	360
Head Office	80
	448

Additional Information:

Stock on 31st March, 2019 was valued at ₹ 62 lacs. On 29th March, 2019 the Head Office dispatched goods costing ₹ 10 lacs to its branch. Branch did not receive these goods before 1st April, 2019. Hence, the figure of goods received from Head Office does not include these goods. Also the head office has charged the branch ₹ 1 lac for centralized services for which the branch has not passed the entry.

You are required to: (i) pass Journal Entries in the books of the Branch to make the necessary adjustments and (ii) prepare Final Accounts of the Branch including Balance Sheet.

[*RTP May 2020*]

Answer

(i) Books of Branch

Journal Entries

			(₹ in lacs)
		Dr.	***Cr.***
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 2019)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 2019

		₹ *in lacs*		₹ *in lacs*
To Opening Stock		60	By Sales	360
To Goods received from			By Closing Stock	62
Head Office	288			
Less: Returns	(5)	283		
To Carriage Inwards		7		
To Gross Profit c/d		72		
		422		422
To Salaries		25	By Gross Profit b/d	72
To Depreciation on Furniture		2		
To Rent		10		
To Advertising		6		
To Telephone, Postage & Stationery		3		
To Sundry Office Expenses		1		
To Head Office Expenses		1		
To Net Profit Transferred to Head Office A/c		24		—
		72		72

Balance Sheet as on 31st March, 2019

Liabilities	₹ *in lacs*		*Assets*	₹ *in lacs*	
Head Office	80		Furniture & Equipment	20	
Add: Goods in transit	10		*Less:* Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	24	115	Goods in Transit		10
Outstanding Expenses		3	Debtors		20
			Cash at bank and in hand		8
		118			118

Question 48

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 (S) Cr.**
Fixed assets	8,000	
Opening inventory	800	
Cash	700	
Goods received form Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account		4,300
	28,350	28,350

(i) Fixed assets were purchased on 1st April, 2015.
(ii) Depreciation at 10% is to be charged on fixed assets on straight line method.
(iii) Closing inventory at branch is $ 700 as on 31-3-2019.
(iv) Goods received form Head Office (HO) were recorded at ₹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.

(*November 2019*) (*5 Marks*)

Answer

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 49

M & S Co. of Lucknow has an integral foreign branch in Canberra, Australia. At the end of 31st March 2020, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

	Lucknow office (₹ In thousand)		***Canberra Branch (Aust. Dollars in thousand)***	
	Dr.	*Cr.*	*Dr.*	*Cr.*
Capital		2,000		
Reserves & Surplus		1,000		
Land	500			
Buildings (Cost)	1,000			
Buildings Dep. Reserves		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery Dep. Reserves		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1- 4-2019	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salaries	75		45	
Rent			12	
Office Expenses	25		18	
Commission Receipts		256		100
Branch/HO Current Account	120			7
	4,880	4,880	390	390

You are required to convert the Branch Trial Balance given above into rupees by using the following exchange rates:

Opening rate	1 A $ = ₹ 50
Closing rate	1 A $ = ₹ 53
Average rate	1 A $ = ₹ 51.00
for Fixed Assets	1 A $ = ₹ 46.00

[*RTP, November 2020*]

Answer

M & S Co. Ltd.

Canberra, Australia Branch Trial Balance As on 31st March 2020

	($ 'thousands)				(₹ 'thousands)
	Dr.	**Cr.**	**Conversion rate per $**	**Dr.**	**Cr.**
Plant & Machinery (cost)	200		₹ 46	9,200	
Plant & Machinery Dep. Reserve		130	₹ 46		5,980
Trade receivable/payable	60	30	₹ 53	3,180	1,590
Stock (1.4.2019)	20		₹ 50	1,000	
Cash & Bank Balances	10		₹ 53	530	
Purchase / Sales	20	123	₹ 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		₹ 51	2,295	
Rent	12		₹ 51	612	
Office expenses	18		₹ 51	918	
Commission Receipts		100	₹ 51		5,100
H.O. Current A/c		7	Actual		120
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				208	
	390	390		19,063	19,063

Question 50

From the following details of Western Branch Office of M/s. XYZ Corp. for the year ending 31st March, 2020, ascertain branch stock reserve in respect of unrealized profit in opening stock and closing stock:

(i) Goods are sent to the branch at invoice price and branch also maintains stock at the same price.
(ii) Sale price is cost plus 40%.
(iii) Invoice price is cost plus 15%.
(iv) Other information from accounts of branch:

Opening Stock as on 01-04-2019	3,45,000
Goods sent during the year by Head Office to Branch	16,10,000
Sales during the year	21,00,000
Expenses incurred at the branch	45,000

(4 Marks) (MTP, May 2020)

Answer:

Branch Stock Reserve in respect of unrealized profit

on opening stock = ₹ 3,45,000 x (15/115) = ₹ 45,000

on closing stock = ₹ 2,30,000 x (15/115) = ₹ 30,000

Working Note:

	₹
Cost Price	100
Invoice Price	115
Sale Price	140
Calculation of closing stock at invoice price	₹
Opening stock at invoice price	3,45,000
Goods received during the year at invoice price	16,10,000
	19,55,000
Less: Cost of goods sold at invoice price [21,00,000 X (115/140)]	(17,25,000)
Closing stock	2,30,000

Question 51

L Ltd. has its head office at Mumbai and two branches at Pune and Goa. The branches purchase goods independently. Pune branch makes a profit of one third on cost and Goa branch makes a profit of 20% on sales. Goods are also supplied by one branch to another at the respective sales price. From the following particulars, prepare the Trading and Profit and Loss Account of Pune branch and find out the profit or loss made by it considering the reserve for unrealised profits:

Particulars	*Pune Branch ₹*	*Goa Branch ₹*
Opening Stock	40,000	30,000
Purchases (Including Inter Branch transfers)	2,00,000	2,50,000
Sales	2,80,000	2,95,625
Chargeable Expenses	15,000	27,500
Closing Stock	30,000	43,500
Office and Administration Expenses	13,250	7,000
Selling and Distribution Expenses	15,000	10,000

Information:

(i) Opening stock at Pune Branch includes goods of ₹ 10,000 (invoice price) taken from Goa Branch,
(ii) Opening stock at Goa Branch includes goods of invoice price ₹ 17,000 taken from Pune Branch,
(iii) The Pune Branch sales includes transfer of goods to Goa Branch at selling price ₹ 20,000
(iv) The sales of Goa Branch include transfer of goods to Pune Branch at selling price ₹ 15,000.
(v) Closing stock at Pune Branch includes goods received from Goa Branch (invoice price ₹ 5,000).
(vi) Closing stock at Goa Branch includes goods of ₹ 4,000 (invoice price).

(MTP, October, 2020) (MTP March, 2022) (*6 marks*)

Answer

Pune Branch Trading and Profit and Loss Account

Particulars		*₹*	*Particulars*		*₹*
To	Opening Stock (including ₹10,000 from Goa Branch)	40,000	By	Sales (including ₹20,000 to Goa Branch)	2,80,000
To	Purchases	2,00,000	By	Closing Stock (including ₹5,000 from Goa Branch)	30,000
To	Chargeable Expenses	15,000			
To	Gross Profit c/d (before making adjustment for unrealised profit)	55,000			
		3,10,000			3,10,000
To	Stock Reserve (for unrealised profit in Closing Stock lying at Goa Branch) (₹4,000 x 25/100)	1,000	By	Gross Profit b/d	55,000
To	Office & Adm. Expenses	13,250	By	Stock Reserve (for unrealised profit in Opening Stock lying at Goa Branch) (₹ 17,000 x 25/100)	4,250
To	Selling & Distribution Expenses	15,000			
	To Net Profit	30,000			
		59,250			59,250

Question 52

Ganesh Ltd. has head office at Delhi (India) and branch at New York. New York branch is an integral foreign operation of Ganesh Ltd. New York branch furnishes you with its trial balance as on 31st March, 2020 and the additional information given thereafter:

	Dr. ($)	*Cr. ($)*
Stock on 1st April, 2019	300	–
5Purchases and sales	800	1,500
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Sundry expenses	1,080	–
Bank balance	420	–
Delhi office A/c	–	1,080
	3,120	3,120

The rates of exchange may be taken as follows:

- on 1.4.2019 @ ₹40 per US $
- on 31.3.2020 @ ₹42 per US $
- average exchange rate for the year @ ₹ 41 per US $.

New York branch account showed a debit balance of ₹ 44,380 on 31.3.2020 in Delhi books and there were no items pending reconciliation.

You are asked to prepare trial balance of New York in ₹ in the books of Ganesh Ltd.

(MTP, October, 2020) (MTP March, 2022) (*4 marks*)

Answer

In the books of Ganesh Ltd. New York Branch Trial Balance in (₹) as on 31st March, 2020

	Conversion rate per US $ (₹)	*Dr.* ₹	*Cr.* ₹
Stock on 1.4.19	40	12,000	
Purchases and sales	41	32,800	61,500
Sundry debtors and creditors	42	16,800	12,600
Bills of exchange	42	5,040	10,080
Sundry expenses	41	44,280	
Bank balance	42	17,640	
Delhi office A/c	–		44,380
		1,28,560	1,28,560

Question 53

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.

(*Suggested January 2021*)

Answer

Journal Entries in Books of Branch A

	Particulars	*Dr. Amount* ₹	*Cr. Amount* ₹
(i)	Head office account Dr. To Salaries account (Being the rectification of salary paid on behalf of H.O.)	5,000	5,000
(ii)	Head office account Dr. To Bank /Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)	25,000	25,000
(iii)	No Entry in Branch Books		
(iv)	Head office account Dr. To Debtors account (Being the amount of branch debtors collected by H.O.)	25,000	25,000
(v)	Bank A/c Dr. To Head Office (Remittance of Funds by H.O. to Branch)	5,000	5,000

Question 54

Moon Star has a branch at Virginia (USA). The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2020 is as follows:

Particulars	**US $**	
	Dr.	**Cr.**
Office equipments	48,000	
Furniture and Fixtures	3,200	
Stock (April 1, 2019)	22,400	
Purchases	96,000	
Sales	---	1,66,400
Goods sent from H.O	32,000	
Salaries	3,200	
Carriage inward	400	
Rent, Rates & Taxes	800	
Insurance	400	
Trade Expenses	400	

Particulars	US $	
	Dr.	Cr.
Head Office Account	---	45,600
Sundry Debtors	9,600	
Sundry Creditors	---	6,800
Cash at Bank	2,000	
Cash in Hand	400	
	2,18,800	2,18,800

The following further information is given:

(1) Salaries outstanding $ 400.

(2) Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.

(3) The Head Office sent goods to Branch for ₹15,80,000.

(4) The Head Office shows an amount of ₹ 20,50,000 due from Branch.

(5) Stock on 31st March, 2020 -$21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1, 2018 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2019, the rate was 47 per $. On March 31, 2020 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare Trial balance incorporating adjustments given converting dollars into rupees and Trading, Profit and Loss Account for the year ended 31st March, 2020 of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet.

(*MTP, March 2021*) (*8 Marks*)

Answer

In the books of Moon Star

Trial Balance (in Rupees) of Virginia (USA) Branch as on 31st March, 2020

	Dr.	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	*₹*	*₹*
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2019)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange gain (bal. fig.)					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Question 55

DM Delhi has a branch in London which is an integral foreign operation of DM. At the end of the year 31st March, 2021, the branch furnishes the following trial balance in U.K. Pound:

Particulars	£	£
	Dr.	Cr.
Fixed assets (Acquired on 1st April, 2017)	24,000	
Stock as on 1st April, 2020	11,200	
Goods from head Office	64,000	
Expenses	4,800	
Debtors	4,800	
Creditors		3,200
Cash at bank	1,200	
Head Office Account		22,800
Purchases	12,000	
Sales		96,000
	1,22,000	1,22,000

In head office books, the branch account stood as shown below:

London Branch A/c

Particulars	Amount ₹	Particulars	Amount ₹
To Balance b/d	20,10,000	By Bank A/c	52,16,000
To Goods sent to branch	49,26,000	By Balance c/d	17,20,000
	69,36,000		69,36,000

The following further information is given:

(a) Fixed assets are to be depreciated @ 10% p.a. on WDV.

(b) On 31st March, 2021:

Expenses outstanding	-	£ 400
Prepaid expenses	-	£ 200
Closing stock	-	£ 8,000

(c) Rate of Exchange:

1st April, 2017	-	₹ 70 to £ 1
1st April, 2020	-	₹ 76 to £ 1
31st March, 2021	-	₹ 77 to £ 1
Average	-	₹ 75 to £ 1

You are required to prepare: (1) Trial balance, incorporating adjustments of outstanding and prepaid expenses, converting U.K. pound into Indian rupees; and (2) Trading and profit and loss account for the year ended 31st March, 2021 of London branch as would appear in the books of Delhi head office of DM.

(*MTP April, 2021*) (*MTP April, 2022*) (*8 Marks*)

Answer

Trial Balance of London Branch as on 31st March, 2021

Particulars	*U.K. Pound*	*Rate Per U.K. Pound*	*Dr. (₹)*	*Cr. (₹)*
Fixed Assets	24,000	70	16,80,000	
Stock (as on 1st April, 2020)	11,200	76	8,51,200	
Goods from Head Office	64,000	-	49,26,000	
Sales	96,000	75		72,00,000
Purchases	12,000	75	9,00,000	
Expenses (4,800 + 400 – 200)	5,000	75	3,75,000	
Debtors	4,800	77	3,69,600	
Creditors	3,200	77		2,46,400
Outstanding Expenses	400	77		30,800
Prepaid expenses	200	77	15,400	
Cash at Bank	1,200	77	92,400	
Head office Account		-		17,20,000
Difference in Exchange				12,400
			92,09,600	92,09,600

Closing stock will be (8,000 × 77) = ₹ 6,16,000

Trading and Profit & Loss A/c for the year ended 31st March, 2021

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Opening Stock	8,51,200	By By Sales	72,00,000
To Purchases	9,00,000	Closing Stock	6,16,000
To Goods from H.O.	49,26,000		
To Gross Profit	11,38,800		
	78,16,000	By By	78,16,000
To Expenses	3,75,000	Gross Profit	11,38,800
To Depreciation	1,68,000	Profit due to Exchange difference	
To Net Profit	6,08,200		12,400
	11,51,200		11,51,200

Working Note:

Since London Branch is an integral foreign operation. Hence, (1) Fixed assets (cost and depreciation) are translated using the exchange rate at the date of purchase of the assets. (2) Exchange difference arising on translation of the financial statement is charged to Profit and Loss Account.

Question 56

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
		Cash paid to creditors	88,500
General Expenses	7,800	Building Account :	14,000
Fire Insurance (Paid for one year)	11,200	(further payment) Cash in Hand	5,600
Remittance to H;O.	52,900	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. (*Suggested July 2021*) (*10 Marks*)

Answer

Journal Entries in the Books of Noida Branch

Particulars		Debit (₹)	Credit (₹)
Salary Advance A/c	Dr.	5,000	
To Salaries A/c			5,000
(Being the amount paid as advance adjusted by debit to Salary Advance A/c)			
Prepaid Insurance A/c (11,200 X 6/12)	Dr.	5,600	
To Fire Insurance A/c			5,600
(Being the six months premium transferred to the Prepaid Insurance A/c)			
Head Office A/c	Dr.	1,44,900	
To Purchases A/c			64,500
To Wages A/c			24,000
To Salaries A/c (15,600 - 5000)			10,600
To General Expenses A/c			7,800
To Fire Insurance A/c (11,200 X 6/12)			5,600
To Manager's Salary A/c			16,400
To Discount Allowed A/c			16,000

Particulars		Debit (₹)	Credit (₹)
(Being the transfer of various revenue accounts to the HO A/c for closing the accounts)			
Sales A/c	Dr.	2,78,000	
Discount Earned A/c	Dr.	4,600	
To Head Office A/c			2,82,600
(Being the transfer of various revenue accounts to HO)			
Head Office A/c	Dr.	14,000	
To Building A/c			14,000
(Being the transfer of amounts spent on building extension to HO A/c)			

Head Office Account

2020	Particulars	Amount (₹)	2020	Particulars	Amount (₹)
Sept 30	To Cash Remittance	52,900	April 1	By Balance b/d	1,88,000
	To Sundries* (Revenue)	1,44,900		By Sundries* (Revenue)	2,82,600
	To Building A/c	14,000			
	To Balance c/d	2,58,800			
	Total	4,70,600		Total	4,70,600

* Instead of using Sundries *(*Revenue*)* A/c, the concerned revenue accounts can be posted in the ledger.

Balance Sheet of Noida Branch
As at 30th Sept 2020

Liabilities	Amt (₹)	Assets	Amt (₹)
Creditors	33,400	Debtors	2,29,000
Head Office A/c	2,58,800	Salary Advance	5,000
		Prepaid Insurance	5,600
		Building Extension A/c transferred to HO	
		Cash in Hand	5,600
		Cash at Bank	47,000
Total	2,92,200	Total	2,92,200

Working Notes

Cash and Bank Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	26,000	By Wages	24,000
To Collection from debtors	2,57,000	By Salaries	15,600
		By Insurance	11,200
		By General Expenses	7,800
		By HO A/c	52,900
		By Manager's Salary	16,400
		By Creditors	88,500
		By Building A/c	14,000
		By Balance c/d	
		- Cash in Hand	5,600
		- Cash at bank	47,000
Total	2,83,000	Total	2,83,000

Debtors Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	2,24,000	By Cash Collection	2,57,000
To Sales A/c	2,78,000	By Discount (Allowed)	16,000
		By Balance c/d	2,29,000
Total	5,02,000	Total	5,02,000

Creditors Account

Particulars	Amt (₹)	Particulars	Amt (₹)
To Cash A/c	88,500	By Balance b/d	62,000
To Discount (Earned)	4,600	By Purchases	64,500
To Balance c/d	33,400		
Total	1,26,500	Total	1,26,500

Note:

Since the date of payment of fire insurance has not been mentioned in the question, it is assumed that it was paid on 01 April 2020. Alternative answer considering otherwise also possible.

Question 57

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31st March, 2020.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated before charging his commission but subject to a deduction from such commission equal to 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch from head office.

The following details for the year ended 31st March, 2020 are given as follows:

	₹		₹
Opening Stock (at cost)	74,736	Chargeable expenses	49,120
Goods sent to branch (at cost)	2,89,680	Closing Stock (Selling Price)	1,23,328
Sales	3,61,280		
Manager's commission paid on account	2,400		

From the above details, you are required to calculate the commission due to manager for the year ended 31st March, 2020. (*RTP, May 2021*)

Answer

In the books of Alpha Ltd.

Step 1: Calculation of Deficiency

Branch stock account (at invoice price)

Particulars	***₹***	***Particulars***	***₹***
To Opening Stock (₹ 74,736 + 1/3 of ₹ 74,736)	99,648	By Sales	3,61,280
To Goods sent to Branch A/c (₹ 2,89,680 + 1/3 of ₹ 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Deficiency at sale price [Balancing figure]	1,280
	4,85,888		4,85,888

Step 2: Calculation of Net Profit before Commission

Branch account

Particulars	***₹***	***Particulars***	***₹***
To Opening Stock [₹74,736 + 1/3 of ₹ 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (₹ 2,89,680 + 1/3 of ₹ 2,89,680)	3,86,240	By Closing Stock	1,23,328
To Expenses	49,120	By Stock Reserve A/c	24,912
To Stock Reserve [₹ 1,23,328 x 25/100] A/c	30,832	By Goods Branch A/c sent to	96,560
To Net Profit–subject manager's commission to	40,240		
	6,06,080		6,06,080

Step 3: **Calculation of Commission still due to manager**

		₹
A	Calculation at 10% profit before charging his commission [₹ 40,240 x 10/100]	4,024
B	*Less:* 25% of cost of deficiency in stock [25% of (75% of ₹ 1,280)]	(240)
C	Commission for the year [A-B]	3,784
D	*Less:* Paid on account	(2,400)
E	Balance due (C-D)	1,384

Question 58

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.

(*10 Marks*) (*November 2020*)

Answer

Branch Stock Account

			₹				₹	₹	₹
1.4.19	To	Balance b/d (opening stock)	72,000	31.3.20	By	Sales:			
31.3.20	To	Goods Sent to Branch A/c	8,40,000			Cash		1,85,000	
						Credit	6,25,000		
	To	Branch P&L	94,000			Less:			
						Return	(14,000)	6,11,000	7,96,000
					By	Goods sent to branch - returns			60,000
					By	Balance c/d (closing stock)			1,50,000
1.4.20	To	Balance b/d	10,06,000						10,06,000
			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			By	Branch Stock Adjustment account	1,17,000
		General P & L A/c	93,800		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 (1,50,000 x 1/6)	25,000				
			1,52,000				1,52,000

Question 59

From the following details of Western Branch Office of M/s. Alpha for the year ending 31st March, 2020, ascertain branch stock reserve in respect of unrealized profit in opening stock and closing stock:

(i) Goods are sent to the branch at invoice price and branch also maintains stock at the same price.
(ii) Sale price is cost plus 40%.
(iii) Invoice price is cost plus 15%.
(iv) Other information from accounts of branch:

Opening Stock as on 01-04-2019	3,45,000
Goods sent during the year by Head Office to Branch	16,10,000
Sales during the year	21,00,000
Expenses incurred at the branch	45,000

(MTP, October 2021) (4 Marks)

Answer

Branch Stock Reserve in respect of unrealized profit

on opening stock = ₹ 3,45,000 x (15/115) = ₹ 45,000
on closing stock = ₹ 2,30,000 x (15/115) = ₹ 30,000

Working Note:

	₹
Cost Price	100
Invoice Price	115
Sale Price	140
Calculation of closing stock at invoice price	₹
Opening stock at invoice price	3,45,000
Goods received during the year at invoice price	16,10,000
	19,55,000
Less: Cost of goods sold at invoice price [21,00,000 X (115/140)]	(17,25,000)
Closing stock	2,30,000

Question 60

Pass necessary Journal entries in the books of an independent Branch of a Company, wherever required, to rectify or adjust the following:

(i) Branch incurred travelling expenses of ₹ 4,000 on behalf of other Branches, but not recorded in the books of Branch.

(ii) Goods dispatched by the Head office amounting to ₹ 8,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

(iii) Provision for doubtful debts, whose accounts are kept by the Head Office, not provided earlier for ₹ 2,000.

(iv) Branch paid ₹ 2,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account. (*MTP, November, 2021*) (*4 Marks*)

Answer

Journal Entries in Books of Branch

			Amount in ₹	
			Dr.	***Cr.***
(i)	Head Office Account	Dr.	4,000	
	To Cash Account			4,000
	(Being expenditure incurred on account of other branch, now recorded in books)			
(ii)	Goods-in-transit Account	Dr.	8,000	
	To Head Office Account			8,000
	(Being goods sent by Head Office still in-transit)			
(iii)	Profit and Loss Account	Dr.	2,000	
	To Head Office Account			2,000
	(Being the provision for doubtful debts not provided earlier, now provided for)			
(iv)	Head Office Account	Dr.	2,000	
	To Salaries Account			2,000
	(Being rectification of salary paid on behalf of Head Office)			

Question 61

Lal & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (₹)
Goods received from Head office at Invoice Price	4,20,000
Goods returned to Head office at Invoice Price	30,000
Cash sales for the year 2019-20	92,500
Credit Sales for the year 2019-20	3,12,500
Stock at Branch as on 01-04-2019 at Invoice price	36,000
Sundry Debtors at Patna branch as on 01-04-2019	48,000
Cash received from Debtors	2,19,000
Discount allowed to Debtors	3,750
Goods returned by customer at Patna Branch	7,000
Bad debts written off	2,750
Amount recovered from Bad debts previously written off as Bad	500
Rent, Rates & taxes at Branch	12,000
Salaries & wages at Branch	36,000
Office Expenses (at Branch)	4,600
Stock at Branch as on 31-03-2020 at cost price	62,500

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit.

(RTP, November 2021)

Answer

Branch Stock Account

			₹				₹	₹	₹
1.4.19	To	Balance b/d (opening stock)	36,000	31.3.20	By	Sales:			
31.3.20	To	Goods Sent to Branch A/c	4,20,000			Cash		92,500	
						Credit	3,12,500		
	To	Branch P&L	47,000			Less: Return	(7,000)	3,05,500	3,98,000
					By	Goods sent to branch - returns			30,000
					By	Balance c/d (closing stock)			75,000
			5,03,000						5,03,000
1.4.20	To	Balance b/d	75,000						

Branch Debtors Account

			₹				₹
1.4.19	To	Balance b/d	48,000	31.3.20	By	Cash	2,19,000
31.3.20	To	Sales	3,12,500		By	Returns	7,000
					By	Discounts	3,750
					By	Bad debts	2,750
					By	Balance c/d	1,28,000
			3,60,500				3,60,500
1.4.20	To	Balance b/d	1,28,000				

Branch Expenses Account

			₹				₹
31.3.20	To	Salaries & Wages	36,000	31.3.20	By	Branch P&L A/c	59,100
	To	Rent, Rates & Taxes	12,000				
	To	Office Expenses	4,600				
	To	Discounts	3,750				
	To	Bad Debts	2,750				
			59,100				59,100

Branch Profit & Loss Account for year ended 31.3.20

			₹				₹
31.3.20	To	Branch Expenses A/c	59,100	31.3.20	By	Branch stock	47,000
	To	Net Profit transferred to			By	Branch Stock Adjustment account	58,500
		General P & L A/c	46,900		By	Bad debts recovered	500
			1,06,000				106,000

Branch Stock Adjustment Account for year ended 31.3.20

			₹				₹
31.3.20	To	Goods sent to branch (30,000x1/6)-returns	5,000	31.3.20	By	Balance b/d (36,000x1/6)	6,000
	To	Branch P & L A/c	58,500		By	Goods sent to branch (4,20,000x1/6)	70,000
	To	Balance c/d (75,000x1/6)	12,500				
			76,000				76,000

Question 62

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 31st March, 2021

Following information related to Branch is given (₹)

Stock on 1st April, 2020 (Invoice price)	31,200	Goods returned by Debtors	3,000
		Surplus in stock (Invoice price)	600
Debtors on 1st April, 2020	17,400	Expenses at Branch	13,400
Goods invoiced at cost	72,000	Discount allowed to Debtors	700
Sales at Branch: Cash sales	20,000	Debtors on 31st March, 2021	14,300
Credit sales	68,200		

(*Suggested December 2021*) *(10 Marks)*

Answer

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 63

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 Debtor Account for the year ended 31st March, 2022.

(*Question Paper, May 2022*) (*10 Marks*)

Question 64

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 on27thMarch,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 31stMarch,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.

(*10 Marks*)

Answer

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 65

Accounting for Branches

PQR has a branch at Houston (USA). Business of the Branch is carried out substantially independent by way of accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. The trial balance of the Branch as at 31st March, 2022 is as follows:

	US$	
Particulars	**Debit**	**Credit**
Office equipment (Cost)	56,400	
Opening Accumulated Depreciation (Office equipment)		5,400
Furniture and Fixtures (Cost)	36,000	
Opening Accumulated Depreciation (Furniture and Fixtures)		6,840
Opening Stock as on 1st April, 2021	24,500	
Purchases	96,500	
Sales		1,76,250
Salaries	4,250	

	US$	
Particulars	**Debit**	**Credit**
Carriage inward	256	
Rent, Rates & Taxes	956	
Trade receivables	12,560	
Trade payables		8,650
Cash at bank	2,540	
Cash in hand	500	
Head office Account		37,322
Total	2,34,462	2,34,462

Following further information are given:

(i) Salaries outstanding as on 31st March, 2022 is US$ 600.

(ii) Depreciate office equipment and furniture & fixtures @ 10% at written down value.

(iii) Closing stock as on 31st March, 2022 is US $, 24,650.

(iv) You are informed that the Head office is showing receivable from the Branch as ₹ 23,75,614 as on 31st March, 2022. No transaction in respect of the Branch is pending in Head office.

(v) Office equipment (cost) includes one office equipment of US $ 2,400 purchased on 1/04/2021.

(vi) One furniture of carrying value of US $ 450 as on 01/04/2021 (cost: US $ 500 and Accumulated depreciation: US $ 50) has been sold for US $ 405 on 31/03/2022 to Mr. M at no profit no loss. Mr. M has not paid the amount till the finalization of branch account. No entry has been passed for this sale of furniture in the above trial balance.

(vii) The rate of exchange on different dates *are:*

Date	1 US $ is equivalent to
1st April, 2021	₹ 64
31st December, 2021	₹ 70
31st March, 2022	₹ 75
Average for the year	₹ 72

You are required to prepare the trial Balance after incorporating adjustments given and converting US $ into rupees.

(RTP May, 2023)

Answer

In the books of PQR
Trial Balance (in Rupees) of Houston (USA) Branch – Non Integral foreign operation
as on 31st March, 2022

	Dr.	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	*₹*	*₹*
Office Equipment	56,400		75	42,30,000	
Depreciation on Office Equipment (Accumulated) (5,400+5,100)		10,500	75		7,87,500
Depreciation	8,016		75	6,01,200	
Furniture and fixtures (36,000-500)	35,500		75	26,62,500	
Depreciation on furniture and fixtures (Accumulated) (6,840-50-45 +2,916)		9,661	75		7,24,575
Stock (1st April, 2021)	24,500		64	15,68,000	
Purchases	96,500		72	69,48,000	
Sales		1,76,250	72		126,90,000
Carriage inward	256		72	18,432	
Salaries (4,250+600)	4,850		72	3,49,200	
Rent, rates and taxes	956		72	68,832	
Salaries payable		600	75		45,000
Head Office A/c		37,322			23,75,614 (given)
Trade receivables	12,560		75	9,42,000	
Trade payables		8,650	75		6,48,750
Cash at bank	2,540		75	1,90,500	
Cash in hand	500		75	37,500	
Mr. M (Receivable for sale of furniture)	405		75	30,375	
Exchange gain (bal. fig.)					3,75,100
	2,42,983	2,42,983		176,46,539	176,46,539

Closing stock 24,650 US$ x ₹ 75 = ₹18,48,750.

Question 66

Art is 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 & Hand	800	-
Total	**1,59,000**	**1,59,000**

The following information is given:

(i) Salaries outstanding are $ 500.

(ii) The Head Office sent goods to Branch for ₹24,00,000.

(iii) The Head Office shows an amount of ₹21,90,000 due from Branch.

The exchange rates were as below:

- On 1st January 2022 - ₹79 to 1$
- On 31st December 2022 - ₹83 to 1 $
- Average rate during the year was ₹79.50 to 1 $

You are required to prepare the Seattle Branch Trial Balance incorporating adjustments given above, converting dollars into rupees.

(*G-I, May, 2023*) (*5 Marks*)

Question 67

Jolly Industries of Delhi is a trader in spices. It has a branch at Jalandhar to which Head office invoice goods at 20% on sales. The Jalandhar branch sells spices both on cash and credit. Branch remit all the cash received to Head Office Bank account, thus all expenses of branch are also directly paid from head office.

From the following information given, Prepare Branch Accounts in the Head office ledger using Stock and Debtors Method.

Branch does not maintain any books of account, but send fortnightly returns to Head office.

	₹
Stock at Jalandhar as on 1st April 2022 (Cost Price)	*1,00,000*
Sundry Debtors at Jalandhar as on 1st April 2022	*1,10,000*
Cash received from Debtors	*3,45,000*
Bad debts during the year	*9,500*
Discount allowed to Debtors	*5,500*
Goods received from Head Office at Invoice Price	*6,00,000*
Returns to Head office at Invoice Price	*60,000*
Normal loss of goods during transport (Out of Goods sent by H.O. to Branch)	*12,000*
Sale's returns at Jalandhar Branch	*11,000*
Salaries and staff welfare expenses at Branch	*54,000*
Rent and taxes at Branch	*9,000*
Other Office Expenses	*2,500*
Sundry Debtors at Branch as at 31st March 2023	*1,55,000*
Stock at Jalandhar as on 31st March, 2023 (Cost Price)	*1,20,000*

Credit sales at Branch are four times of the cash Sales at Branch.

(*10 Marks*) (*November, 2023 Accounting*)

Answer

Books of Jolly Industries, Delhi
Jalandhar Branch Stock Account

Particulars	₹	*Particulars*	₹
To Balance b/d – Op Stock	1,25,000	By Bank A/c – Cash Sales	1,04,000
To Branch Debtors A/c – Sales Return	11,000	By Branch Debtors A/c - Credit Sales	4,16,000
To Goods sent to Branch A/c (6,00,000 +12,000)	6,12,000	By Goods sent to Branch (Returns to H.O.)	60,000
		By Branch Stock Adjustment A/c (Normal Loss)	12,000
		By Branch Stock Adjustment A/c (Abnormal Loss) (bal. fig.)	6,000
		By Balance c/d - Closing stock	1,50,000
	7,48,000		7,48,000

Jalandhar Branch Stock Adjustment Account

Particulars	₹	*Particulars*	₹
To Goods sent to Branch A/c (1/5 of ₹60,000) (on returns)	12,000	By Balance b/d (20% of 1,25,000)	25,000
To Branch Stock A/c (abnormal Loss) (6,000x1/5)	1,200	By Goods sent to Branch A/c (1/5 of ₹ 6,12,000)	1,22,400
To Branch Stock A/c (Normal Loss)	12,000		
To Balance c/d (1/5 of ₹ 1,50,000)	30,000		
To Branch P & L A/c (Profit on sale) – Bal fig	92,200		
	1,47,400		1,47,400

Goods Sent to Branch Account

Particulars	₹	*Particulars*	₹
To Jalandhar Branch Stock Adjustment A/c	1,22,400	By Jalandhar Branch Stock A/c	6,12,000
To Jalandhar Branch Stock A/c (Returns)	60,000	By Jalandhar Branch Stock Adjustment A/c	12,000
To Purchases A/c	4,41,600		
	6,24,000		6,24,000

Branch Debtors Account

Particulars	₹	*Particulars*	₹
To Balance b/d	1,10,000	By Bank	3,45,000
To Branch Stock A/c	4,16,000	By Branch P&L A/c - Discount	5,500
		By Branch P&L A/c - Bad Debts	9,500
		By Branch Stock - Sales Returns	11,000
		By Balance c/d	1,55,000
	5,26,000		5,26,000

Branch Expenses Account

Particulars	₹	*Particulars*	₹
To Bank A/c (Rent & Taxes)	9,000	By Branch Profit & Loss A/c (Transfer)	65,500
To Bank A/c (Salaries & Staff Welfare expenses)	54,000		
To Bank A/c (office expenses)	2,500		
	65,500		65,500

Branch Profit & Loss Account for the year ending 31st March 2023

Particulars	₹	*Particulars*	₹
To Branch Expenses A/c	**65,500**	By Branch Stock Adj. A/c	**92,200**
To Branch Debtors A/c	5,500		
To Branch Debtors A/c	9,500		
To Abnormal Loss (cost)	4,800		
To Net Profit transferred to Profit & Loss A/c	6,900		
	92,200		92,200

Question 68

Treadmill invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding ₹ 20,000 necessary for meeting immediate requirements of cash. On 31st March, 2022 the assets at the branch were as follows:

	₹ ('000)
Cash in Hand	*20*
Trade Debtors	*768*
Stock, at Invoice Price	*2,160*
Furniture and Fittings	*1,000*

During the accounting year ended 31st March, 2023 the invoice price of goods dispatched by the head office to the branch amounted to ₹ 2 crore 64 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at ₹ 1,44,000. Other transactions at the branch during the year were as follows:

	(₹ '000)
Cash Sales	*19,400*
Credit Sales	*6,280*
Cash collected by Branch from Credit Customers	*5,684*
Cash Discount allowed to Debtors	*116*
Returns by Customers direct to Head office (at invoice price)	*204*
Bad Debts written off	*74*
Expenses paid by Branch	*1,684*

On 1st January, 2023 the branch purchased new furniture for ₹ 2 lakh for which payment was made by head office through a cheque.

On 31st March, 2023 branch expenses amounting to ₹ 12,000 were outstanding and cash in hand was again ₹ 20,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 2023.

(*10 Marks*) (*RTP November, 2023*) (*Accounts*)

Answer

In the Head Office Books
Branch Account
for the year ended 31st March, 2023

	₹ '000			₹'000
To Balance b/d		By	Balance b/d	
Cash in hand Trade debtors	20		Stock reserve ₹ 2,160 × 1 6	360
	768			
Stock	2,160	By	Goods sent to branch A/c (Returns to H.O.) {144 + [204 -34 (loading]}	314
Furniture and fittings	1,000			
To Goods sent to branch A/c	26,400	By	Goods sent to branch A/c (Loading on net goods sent to branch – (26,256 x 1/6)	4,376
To Bank A/c (Payment for furniture)	200			
To Balance c/d	456	By	Bank A/c (Remittance from branch to H.O.)	23,400
Stock reserve (2,736 x 1/6)				
To Outstanding expenses	12	By	Balance c/d	
To Profit and loss A/c (Net Profit)	2,192		Cash in hand	20
			Trade debtors	970
			Stock	2,736
			Furniture and fittings	1,032
	33,208			33,208

Working Notes:

1. Invoice price and cost

Let cost be	100
So, invoice price	120
Loading	20
Loading: Invoice price	= 20 : 120 = 1 : 6

2. Invoice price of closing stock in branch

Branch Stock Account

	₹ '000		₹ '000
To Balance b/d	2,160	By Goods sent to branch	144
To Goods sent to branch	26,400	By Branch Cash	19,400
		By Branch debtors	6,280
		By Balance c/d (Bal fig)	2,736
	28,560		28,560

Note: adjustment regarding returns by Customers direct to Head office has not been made in branch stock account.

3. Closing balance of branch debtors

Branch Debtors Account

	₹ '000		₹ '000
To Balance b/d	768	By Branch cash	5,684
To Branch stock	6,280	By Branch expenses discount	116
		By Goods sent to Branch (Returns)	204
		By Branch expenses (Bad debts)	74
		By Balance c/d (Bal fig)	970
	7,048		7,048

4. Closing balance of furniture and fittings

Branch Furniture and Fittings Account

	₹ '000		₹ '000
To Balance b/d	1,000	By Depreciation (160+8)	168
To Bank	200	By Balance c/d	1,032
	1,200		1,200

Note: Since the new furniture was purchased on 1st Jan 2023 depreciation will be for 3 months.

5. Remittance by branch to head office

Branch Cash Account

	₹ '000		₹ '000
To Balance b/d	20	By Branch expenses	1,684
To Branch stock	19,400	By Remittances to H.O.	23,400
To Branch debtors	5,684	By Balance b/d	20
	25,104		25,104

Question 69

Alfa of Chennai has a branch at Mumbai 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, 2023:

		₹
Cost of goods sent to Branch at cost		2,00,000
Goods received by Branch till 31-12-2023 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	1-1-2023	31-12-2023
	₹	₹
Stock	25,000 (Cost)	28,000 (invoice price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,500

You are required to prepare Branch stock account and branch debtor account in the books of the head office for the year ended 31st December, 2023.

(*MTP Advanced Accounting April, 2024*) (*6 Marks*)

Answer

Books of Harrison
Branch Stock Account

	₹		₹
To Balance b/d – Op Stock	30,000	By Branch Debtors (Sales)	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Cash	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	
(Balancing Figure – Excess of Sale over Invoice Price)		Goods in Transit (₹ 2,40,000 – ₹ 2,20,000)	20,000
		Closing Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	₹		₹
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock A/c (Sales)	1,65,000	By Branch Cash (bal. fig.)	1,71,000
		By Balance c/d	26,000
	1,97,750		1,97,750

Question 70

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 2023 from the following:

(1) Goods are invoiced to the branch at cost plus 20%.

(2) The sale price is cost plus 50%.

(3) Other information:

	₹
Stock as on 01.04.2022(invoice price)	2,20,000
Goods sent during the year (invoice price)	11,00,000
Sales during the year	12,00,000
Expenses incurred at the branch	45,000

Ascertain

(i) the profit earned by the branch during the year.

(ii) branch stock reserve in respect of unrealized profit.

(*MTP Advanced Accounting March, 2024*) (*6 Marks*)

Answer

(i) Calculation of profit earned by the branch In the books of Jammu Branch Trading Account and Profit and Loss Account

Particulars	Amount	Particulars	Amount
	₹		₹
To Opening stock	2,20,000	By Sales	12,00,000
To Goods received by Head office	11,00,000	By Closing stock (Refer W.N.)	3,60,000
To Expenses	45,000		
To Net profit (Bal fig)	1,95,000		
	15,60,000		15,60,000

(ii) Stock reserve in respect of unrealised profit

= ₹ 3,60,000 x (20/120) = ₹ 60,000

Working Note:

	₹	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	**₹**	
Opening stock at invoice price	2,20,000	
Goods received during the year at invoice price	11,00,000	
	13,20,000	
Less: Cost of goods sold at invoice price	(9,60,000)	
Closing stock	3,60,000	[12,00,000 x (120/150)]

Question 71

Smart Limited is an Indian Company and has its Branch at New York. The following balances in respect of Smart Limited's USA Branch office are provided:

(i)	Debit Balances (in USD)		
	Expenditure (excluding Depreciation)	:	1,03,095
	Cash & bank balances	:	2,175
	Debtors	:	7,365
	Fixed Assets (Gross)	:	34,200
	(Rate of Depreciation on Fixed Assets: 20%)		
	Inventory- Stock 'P'	:	5,520
	Inventory- Stock 'Q'	:	1,035
(ii)	Credit Balances (in USD)		
	Incomes	:	1,32,000
	Creditors	:	15,570
	HO Control a/c	:	5,820

The following additional information is provided:

(1) The average exchange rate during the above financial year was 1 USD = ₹56.

(2) The fixed assets were purchased when the exchange rate was 1 USD = ₹ 55.

(3) The closing exchange rate on reporting date is 1 USD = ₹58.

(4) Stock item 'P' is valued at cost of USD 5,520, purchased when the exchange rate was₹ 56.50. The present net realizable value of this item is ₹ 2,85,000.

(5) Stock item 'Q' is carried at net realizable value of USD 1,035, but its cost in USD is 1,065. It was purchased when exchange rate was 1 USD = ₹53.

(6) Branch Control Account as per HO books was = ₹ 2,66,265.

You are required to show how it will be reflected in the books of Head Office in the form of Trial Balance, if the USA Branch Office is classified as an integral Foreign Operation.

(*Question Paper May, 2024) (6 Marks*)

MCQs

Question - 1: All of the following are examples of monetary items except:
Answer:

1. *Trade Payables.*
2. *Inventory.*
3. *Trade Receivables.*
4. *Share Capital*

Question - 2: Goods may be invoiced to branch at
Answer:

1. *(a) Cost or Selling price.*
2. *(b) Wholesale price.*
3. *(c) Both (a) and (b).*
4. *(d) Either (a) or (b).*

Question - 3: Incomes and expenses of a NFO is translated at
Answer:

1. *Average rate that approximates the actual exchange rates.*
2. *Exchange rate at the date of transaction.*
3. *Either 1or 2.*
4. *Both 1and 2.*

Question - 4: Under debtors method, opening balance of debtors is
Answer:

1. *Debited to branch account.*
2. *Credited to branch account.*
3. *Debited to H.O account.*
4. *Credited to H.O account.*

Question - 5: Under branch trading and profit loss account method
Answer:

1. *(a) H.O prepares profit and loss account.*
2. *(b) Each branch is treated separate entity.*
3. *(c) Both (a) and (b).*
4. *(d) Either (a) or (b).*

Question - 6: If goods are invoiced to branches at cost, trading results of branch can be ascertained by
Answer:

1. *(a) Debtors method.*
2. *(b) Stock and debtors method.*
3. *(c) Either (a) or (b).*
4. *(d) Both (a) and (b).*

Question - 7: Assets and liabilities of a non-integral foreign operation should be converted at
Answer:

1. *Closing exchange rate.*
2. *Average exchange rate.*
3. *Opening exchange rate.*
4. *none of the above*

Question - 8: If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed assets is translated at
Answer:

1. *Average exchange rate.*
2. *Closing exchange rate.*
3. *Exchange rate at the date of purchase of asset.*
4. *Opening exchange rate.*

Question - 9: Cost of goods returned by branch will have the following effect
Answer:

1. *(a) Goods sent to branch account will be debited.*
2. *(b) Branch stock account will be credited.*
3. *(c) Both (a) and (b).*
4. *(d) Either (a) or (b).*

Question - 10: AS 11 classifies foreign branches are classified as
Answer:

1. *Autonomous branches and non-autonomous branches.*
2. *Uncontrolled controlled branches.*
3. *Integral and non-integral foreign operations.*
4. *Fully controlled branches.*

Question - 11: If goods are invoiced to branches at cost, trading results of branch can be ascertained by
Answer:

1. *Debtors method.*
2. *Stock and debtors method.*
3. *Either (a) or (b).*
4. *Both (a) and (b).*

Question - 12: Under branch trading and profit loss account method
Answer:

1. *H.O prepares profit and loss account.*
2. *Each branch is treated separate entity.*
3. *Both (a) and (b).*
4. *Either (a) or (b).*

Question - 13: Goods may be invoiced to branch at
Answer:

1. *Cost or Selling price.*
2. *Wholesale price.*
3. *Both (a) and (b).*
4. *Either (a) or (b).*

Question - 14: Under debtors method, opening balance of debtors is
Answer:

1. *Debited to branch account.*
2. *Credited to branch account.*
3. *Debited to H.O account.*
4. *Credited to H.O account.*

Question - 15: Cost of goods returned by branch will have the following effect
Answer:

1. *Goods sent to branch account will be debited.*
2. *Branch stock account will be credited.*
3. *Both (a) and (b).*
4. *Either (a) or (b).*

Question - 16: Cost of goods returned by branch will have the following effect
Answer:

1. *Goods sent to branch account will be debited.*
2. *Branch stock account will be credited.*
3. *Both (a) and (b).*
4. *Either (a) or (b).*

Answer

Q1	***2***	***Q2***	***3***	***Q3***	***2***	***Q4***	***1***	***Q5***	***3***	***Q6***	***3***
Q7	***1***	***Q8***	***3***	***Q9***	***3***	***Q10***	***3***	***Q11***	***3***	***Q12***	***3***
Q13	***3***	***Q14***	***1***	***Q15***	***3***	***Q16***	***3***				

Intermediate
Course: Paper 1

ADVANCED ACCOUNTING

(New Scheme of Education and Training)

Part 3

By

CA. PARVEEN SHARMA

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Dedicated

To My Parents

Late Sh. SATPAL SHARMA

Smt. JANKI DEVI

Syllabus

PAPER 1: ADVANCED ACCOUNTING

(One paper – Three hours – 100 Marks)

Objective:

To acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities.

Contents:

1. Process of formulation of Accounting Standards including Indian Accounting Standards (IFRS converged standards) and IFRSs; Convergence vs Adoption; Objective and Concepts of carve outs.
2. Framework for Preparation and Presentation of Financial Statements (as per Accounting Standards).
3. (i) Applicability of Accounting Standards to various entities

   (ii) Application of Accounting Standards:

   AS 1: Disclosure of Accounting Policies

   AS 2: Valuation of Inventories

   AS 3: Cash Flow Statements

   AS 4: Contingencies and Events Occurring After the Balance Sheet Date

   AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

   AS 7: Construction Contracts

   AS 9: Revenue Recognition

   AS 10: Property, Plant and Equipment

   AS 11: The Effects of Changes in Foreign Exchange Rates

   AS 12: Accounting for Government Grants

   AS 13: Accounting for Investments

   AS14: Accounting for Amalgamations (excluding inter- company holdings)

   AS 15: Employee Benefits

   AS 16: Borrowing Costs

   AS 17: Segment Reporting

   AS 18: Related Party Disclosures

   AS 19: Leases

AS 20: Earnings Per Share

AS21: Consolidated Financial Statements of single subsidiaries (excluding problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries).

AS 22: Accounting for Taxes on Income

AS 23: Accounting for Investment in Associates in Consolidated Financial Statements

AS 24: Discontinuing Operations

AS 25: Interim Financial Reporting

AS 26: Intangible Assets

AS 27: Financial Reporting of Interests in Joint Ventures

AS 28: Impairment of Assets

AS 29: Provisions, Contingent Liabilities and Contingent Assets

4. Company Accounts
   (i) Schedule III to the Companies Act, 2013 (Division I)
   (ii) Preparation of financial statements – Statement of Profit and Loss, Balance Sheet and Cash Flow Statement
   (iii) Buy back of securities
   (iv) Accounting for reconstruction of companies.
5. Accounting for Branches including foreign branches.

Note: If either new Accounting Standards (AS), Announcements and Limited Revisions to AS are issued or the earlier ones are withdrawn or new AS, Announcements and Limited Revisions to AS are issued in place of existing AS, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

Contents

Accounting Standard 18 Related Party Disclosures 7.1
QUESTION BANK 7.9
MCQs 7.15

Accounting Standard 25 Interim Financial Reporting 10.1
MCQs 10.7

Accounting Standard 13 Accounting for Investments 11.1
QUESTION BANK 11.15
MCQs 11.41

Accounting Standard 19 Leases 12.1
QUESTION BANK 12.8
MCQs 12.17

Accounting Standard 26 Intangible Assets 13.1
QUESTION BANK 13.5
MCQs 13.16

Accounting Standard 28 Impairment of Assets 14.1
QUESTION BANK 14.8
MCQs 14.9

Accounting Standard 15 Employee Benefits 15.1
QUESTION BANK 15.8
MCQs 15.9

Accounting Standard 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets 16.1
QUESTION BANK 16.4
MCQs 16.14

Accounting Standard 4 Contingencies and Events Occurring after the Balance Sheet Date 17.1
QUESTION BANK 17.4
MCQs 17.12

Accounting Standard 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies 18.1
QUESTION BANK 18.4
MCQs 18.10

Accounting Standards 22 Accounting for Taxes on Income 19.1
QUESTION BANK 19.5
MCQs 19.12

Accounting Standard 21 Consolidated Financial Statements 23.1
QUESTION BANK 23.37
MCQs 23.111

Accounting Standard 23 Accounting for Investments in Associates in Consolidated Financial Statements 24.1
MCQs 24.7

Accounting Standard 27 Financial Reporting of Interests in Joint Ventures 25.1
MCQs 25.11

Important Questions

Topic	Important Questions
Accounting Standard 18	8, 9, 10, 12, 20, 25, 30
Accounting Standard 25	6, 1, 3, 5, 7, 2, 10
Accounting Standard 13	2, 3, 4, 5, 6, 8, 9, 14, 16, 17, 26, 28, 29, 32, 35, 41, 44, 45, 46
Accounting Standard 19	8, 17, 1, 16, 19, 2, 15, 9, 11, 27, 3, 25, 26, 27
Accounting Standard 26	2, 3, 9, 11, 14, 16, 18, 23, 24, 26, 31
Accounting Standard 28	1, 2, 3, 7, 9, 10, 11, 12
Accounting Standard 15	3, 6, 7, 12, 8, 9, 10
Accounting Standard 29	1, 2, 4, 15, 5, 18, 14, 9, 10, 11, 24, 25, 26, 27, 29, 3, 6, 16
Accounting Standard 4	2, 3, 5, 6, 8, 9, 11, 16, 18, 19, 26, 29
Accounting Standard 5	2, 4, 5, 6, 7, 10, 16, 19
Accounting Standard 22	1, 7, 2, 3, 4, 6, 8, 9, 15, 19, 22
Accounting Standard 21	1, 2, 3, 4, 6, 9, 13, 14, 15, 16, 20, 21, 52, 57, 63, 73, 80, 81, 82
Accounting Standard 23	1, 2, 3, 4, 5, 6
Accounting Standard 27	1, 2, 3, 4, 8

Accounting Standard 18 Related Party Disclosures

Question 1

Identify the related parties in the following case 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.

(*Source: Illustration 1, Study Material*)

Answer

In relation to Reporting enterprise - A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related party In relation to Reporting enterprise - B Ltd.
- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party In relation to Reporting enterprise - O Ltd.
- A Ltd. (ultimate holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party (O Ltd being Associate of Z Ltd)

Reporting enterprise - Z Ltd.

- O Ltd. (Associate) is a related party

Question 2

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.?

(*Source: Illustration 2, Study Material*)

Answer

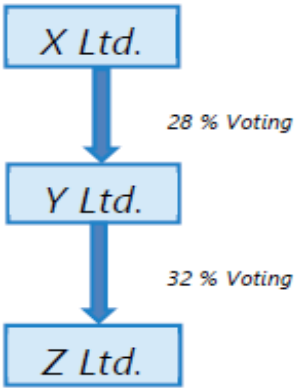
Yes – in relation to A Ltd. (the reporting enterprise), C Ltd. is a related party under AS-18. This is because A Ltd. *indirectly controls* C Ltd.

In this case, A Ltd. (together with its subsidiary B Ltd.) controls *more than one half of the voting right*s of C Ltd.

Question 3

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.?

(*Source: Illustration 3, Study Material*)

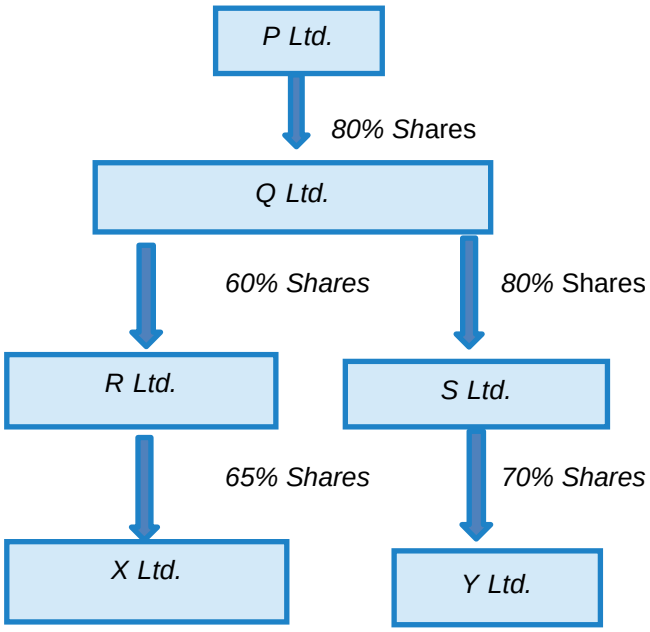
Answer

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 4

Consider the following organization structure related to P Ltd.



Given the above structure: Identify related party relationships, if R Ltd. is the reporting enterprise

(*Source: Illustration 4, Study Material*)

Answer

The following table identifies the related party relationships for R Ltd. (being the reporting enterprise):

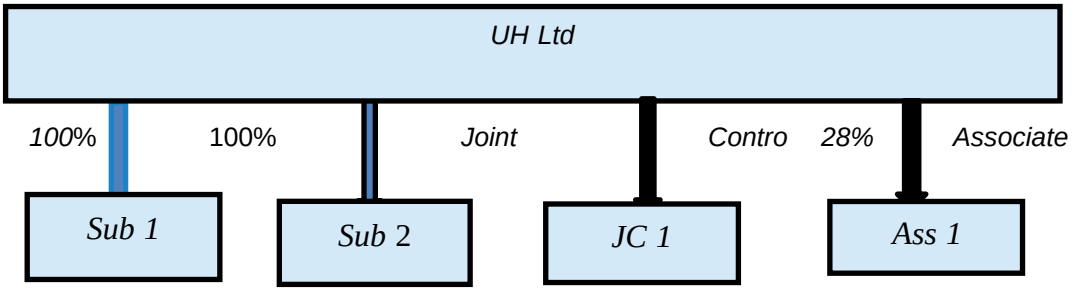
Party Name	Relationship under AS-18
P Ltd.	• P Ltd. has *indirect control* on R Ltd. (through Q Ltd.) • Hence R Ltd. is related to P Ltd.

Party Name	Relationship under AS-18
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 5

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

(*Source: Illustration 5, Study Material*)

Answer

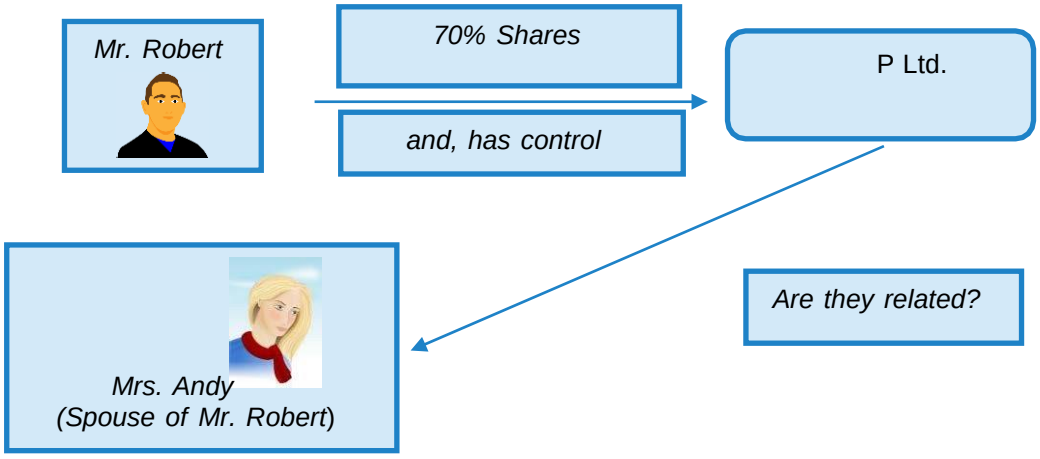
The following table identifies the related party relationships for each of the entities in the Group:

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 6

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?

(*Source: Illustration 6, Study Material*)

Answer

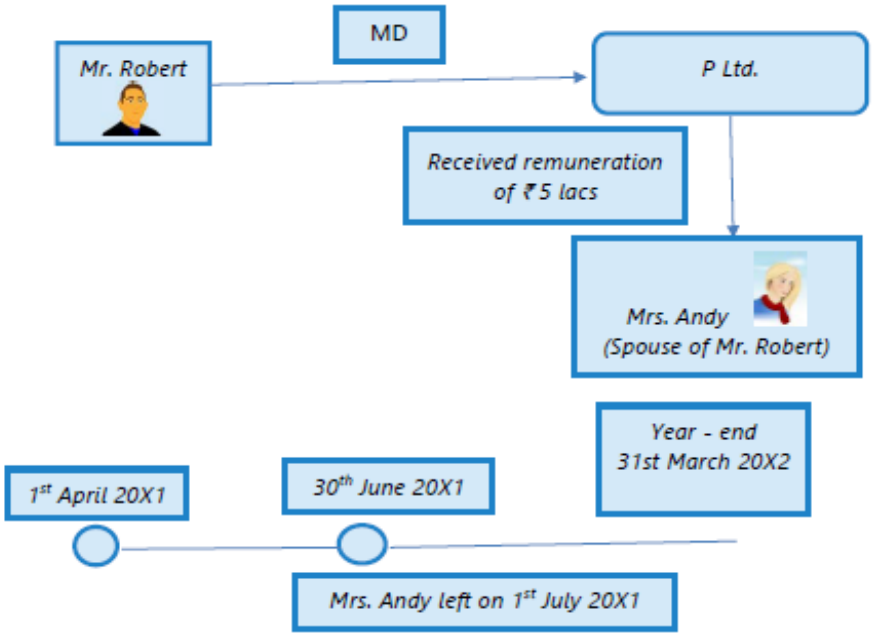
Yes – Andy is a related party to P Ltd., in view of the requirements of AS-18.

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 7

Consider a scenario wherein:

- *Mr. Robert is a Managing Director of P Ltd.*
- *Andy (spouse of Robert) received a remuneration of ₹ 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?

(*Source: Illustration 7, Study Material*)

Answer

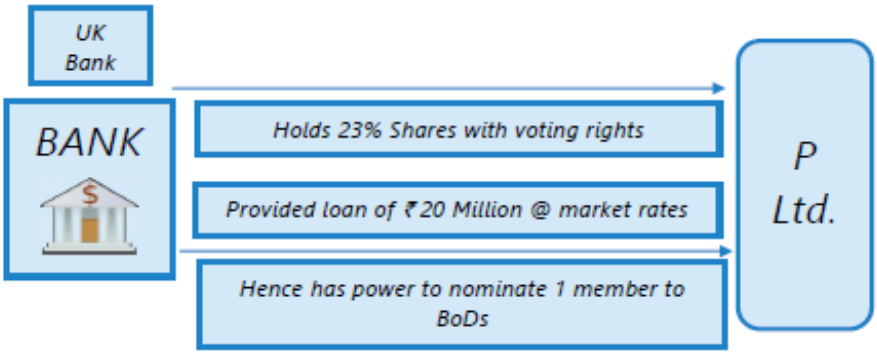
Yes – This is because as per AS-18, parties are considered to be related if *at any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

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 8

Consider a scenario wherein:

- *UK Bank holds 23% equity shares with voting rights in P Ltd.*
- *The bank has provided a loan of ₹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)?

(*Source: Illustration 8, Study Material*)

Answer

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.

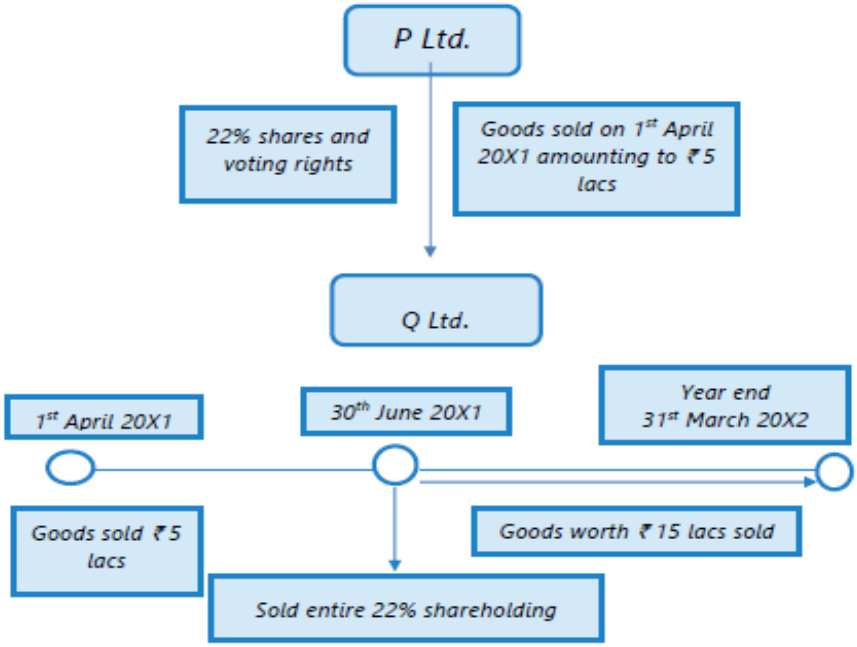
The bank is also a provider of finance to P Ltd. (the reporting enterprise) and as per AS-18, parties like providers of finance are deemed ***not to be considered*** as a related party in the course of *normal dealings with an enterprise* by virtue ***only of those dealings*.** However, this exemption 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.

Question 9

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 ₹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 ₹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.

(*Source: Illustration 9, Study Material*)

Answer

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 ₹ 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 10

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?

(*Source: Illustration 10, Study Material*)

Answer

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 11

Who are related parties under AS 18? What are the related party disclosure requirements?

(*Source: Question 6, Study Material*)

Answer

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 12

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?

(*Source: Question 7, Study Material*)

Answer

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 13

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?

(*Source: Question 8, Study Material*)

Answer

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 14

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?

(*Source: Question 9, Study Material*)

Answer

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 15

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.

(*Source: Question 10, Study Material*)

Answer

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 16

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.)

(*Source: Question 11, Study Material*)

Answer

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 BANK

Question 17

Is remuneration paid to Board of Directors a related party transaction? Explain.

(*RTP May 2018*)

Answer

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP).

Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 18

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.

(November 2018) (5 marks)

Answer

(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 for his services in the company from 1st 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 entity with its associate company for the first quarter ending 30.06.2017 only are required to be disclosed as related party transactions. Transactions of the entire year need not be disclosed as related party transactions and transactions for the period (after 1st July) in which related party relationship did not exist need not be reported.

Hence transaction of sale of goods with the associate company for first quarter ending 30th June, 2017 for ₹50 Lakhs only are required to be disclosed as related party transaction on 31.3.18.

Question 19

Sun Ltd. sold goods for ₹50 lakhs to Moon Ltd. during financial year ended 31st March 2017 at normal selling price followed by Sun Ltd. The Managing Director of Sun Ltd. holds 75% shares of Moon Ltd. The Chief accountant of Sun 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. You are required to examine and advise whether the contention of the Chief Accountant is correct?

(*RTP November 2018*)

Answer:

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, Sun Ltd. and Moon 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 Sun Ltd is wrong.

Question 20

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited"?

Answer

Mr. A will not be considered as a related party of SP Hotels Limited in view of paragraph 3(c) of AS 18 which states, Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual". In the above example, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to director instruct the board of directors does not qualify him as a key management personnel.

Question 21

Identify the related parties in the following cases as per AS-18

(i) May 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. (B Ltd. is subsidiary of A Ltd.)

(*May 2019*) (*5 Marks*)

Answer

(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 22

Arohi Ltd. sold goods for ₹90 lakhs to Anya Ltd. during financial year ended 31-3-2019. The Managing Director of Arohi Ltd. own 100% of Anya Ltd. The sales were made to Anya Ltd. at normal selling prices followed by Arohi Ltd. The Chief accountant of Arohi Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct? Comment in accordance with AS 18.

(*May 2020*)

Answer

As per AS 18 'Related Party Disclosures', Enterprises over which the 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 that have a member of key management in common with the reporting enterprise. In the given case, Arohi Ltd. and Anya Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Arohi Ltd. is wrong.

Question 23

You are required to identify the related parties in the following cases as per AS 18: M Ltd. holds 61 % shares of S Ltd.
S Ltd. holds 51 % shares of F Ltd.
C Ltd. holds 49% shares of F Ltd.
(Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.)

(*MTP, May, 2020*) (*5 marks*)

Answer

(i) (a) Reporting entity- M Ltd.
- S Ltd. (subsidiary) is a related party
- F Ltd.(subsidiary) is a related party

(b) Reporting entity- S Ltd.
- M Ltd. (holding company) is a related party
- F Ltd. (subsidiary) is a related party

(c) Reporting entity- F Ltd.
- M Ltd. (holding company) is a related party
- S Ltd. (holding company) is a related party
- C Ltd. (investor/ investing party) is a related party

(d) Reporting entity- C Ltd.
- F Ltd. (associate) is a related party

Question 24

(i) Mr. Arnav a relative of key management personnel received remuneration of ₹3,00,000 for his services in the company for the period April 1, 2019 to June 30, 2019. On July 1, 2019 he left the job. Should Mr. Arnav be identified as Related Party at the closing date i.e. March 31, 2020 for the purposes of AS 18?

(ii) A limited company sold goods to its associate company for the 1st quarter ending June 30, 2020. After that, the related party relationship ceased to exist. However, goods were supplied continuously even after June 30, 2020 as was supplied to another ordinary customer. Does this require disclosure as related party transaction for the entire financial year?

(*MTP, October, 2020*) (*5 marks*)

Answer

(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. Arnav a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2020.

(ii) As per AS 18, transactions of company with its associate company for the first quarter ending 30.06.2020 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

Question 25

On the basis of provisions of AS 18 'Related Party Disclosures':

(i) Identify the related parties in the following cases:
X Limited holds 60% shares of Y Limited
Y Limited holds 55% shares of W Limited
Z Limited holds 35% shares of W Limited

(ii) Himalaya Limited sold goods for ₹40 Lakhs to Aravalli Limited during financial year ended on March 31, 2019. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per AS 18. You are required to comment on this.

(*RTP, November, 2020*)

Answer

(i) X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor significant influence exists between them.

(ii) Himalaya Ltd. and Aravalli Ltd are related parties since key management personnel of Himalaya Ltd. ie. its managing director holds 80% in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Himalaya Ltd that these sales require no disclosure under related party Transactions, is wrong.

Question 26

(i) Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by. Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited.

(ii) Shri Bhanu a relative of key management personnel received remuneration of ₹3,50,000 for his services in the company for the period from 1st April, 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.

(*July, 2021 Suggested*) (*5 Marks*)

Answer

(i) Mr. Happy will not be considered as a related party of Khushi Limited in view of provisions of AS 18 "Related Party Disclosures" which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties".

In the given case, in the absence of share ownership, Mr. Happy would not be considered to exercise significant influence on Khushi Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr Happy does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

(ii) 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, Shri Bhanu, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021 as he received remuneration for his services in the company for the period from 1st April,2020 to 30th June,2020.

Question 27

(a) Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (reporting enterprise)?

(b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would B Limited be considered a related party for the purpose of financial statements of C Limited?

(*RTP November 2021*)

Answer

(a) Omega Bank Limited would be a related party of B Limited. As per AS 18 "associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venturer" are related party relationship. Further, an associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies". Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power.

Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

(b) Both B Limited and C Limited are 'associates' of A Limited. Follow-associates cannot be regarded as a related parties only by virtue of the relationship. AS 18 states that "enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are related parties. Further, it is given that "associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venturer" are also related parties. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.

Question 28

(a) In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier and the company be considered as related parties?

(b) Define "Key management personnel" in the context of AS 18.

(*RTP May, 2022*)

Answer

(a) The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties. Paragraph 3 of AS 18 states that "enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are considered to be related party relationships. However, the conditions which define the existence of control, as follows, are not satisfied in the given example.

- 'ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise".

Paragraph 10 of the standard defines significant influence as "participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies". In the given example, although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions. Therefore, as the conditions specified by the Standard for being classified

as a related party are not satisfied in the given example, the company cannot be said to be related to the supplier. This view is supported by paragraph 4(b) of the Standard which states that "a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence" would not be deemed to be related parties.

(b) In context of AS 18, "Key management personnel" are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

Question 29

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited?

(*RTP November, 2022*)

Answer

Mr. A will not be considered as a related party of SP Hotels Limited in view of AS 18 which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual". In the given case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

Question 30

Is remuneration paid to Board of Directors a related party transaction? Explain.

(*RTP May, 2023*)

Answer

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP).

Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Further, as per Companies Act, 2013, a related party includes a director or his relative. The Act, defines a director as a director appointed to the Board of a Company.

Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 31

Answer the following with respect to AS-18

(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.

(*G-II, May, 2023*) (*5 Marks*)

Question 32

(i) A Ltd. enter into an agreement with Mr. Bhola for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by Mr. Bhola, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Bhola does not own any voting power in A Limited.

(ii) Shri Manoj a relative of key management personnel received remuneration of ₹ 3,50,000 for his services in the company for the period from 1st April, 2022 to 30th June, 2022. On 1st July, 2022, 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, 2023 for the purposes of AS 18- Related Party Disclosures.

(*RTP May, 2024*)

Answer

(i) Mr. Bhola will not be considered as a related party of A Ltd. in view of provisions of AS 18 "Related Party Disclosures" which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties".

In the given case, in the absence of share ownership, Mr. Bhola would not be considered to exercise significant influence on A Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr Bhola does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

(ii) 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, Shri Manoj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2023 as he received remuneration for his services in the company for the period from 1st April,2022 to 30th June,2022.

MCQs

Question - 1: Which of the following may be treated as Related party as per AS 18?

Answer:

1. *A Limited & B Limited only because Mr. X is a common director in both the company*
2. *A Limited & B Limited are totally independent company, however, majority of the Board of Directors of both the company are same*
3. *Mr. S & A limited only because Mr. S purchases majority of the products of A Limited.*
4. *ABC Bank & N Limited because all borrowings of N Limited is financed by ABC Bank.*

Question - 2: According to AS-18 Related Party Disclosures, which ONE of the following is not a related party of Skyline Limited?

Answer:

1. *A shareholder of Skyline Limited owning 30% of the ordinary share capital*
2. *An entity providing banking facilities to Skyline Limited in the normal course of business*
3. *An associate of Skyline Limited*
4. *Key management personnel of Skyline Limited*

Question - 3: Are the following statements in relation to related parties true or false, according to AS-18 Related Party Disclosures?

Answer:

(A) A party is related to another entity that it is jointly controlled by.

(B) A party is related to another entity that it controls. Statement (A) Statement (B)

1. *False False*
2. *False True*
3. *True False*
4. *True True*

Question - 4: Which of the following is <u>not</u> a related party as envisaged by AS-18 Related Party Disclosures?

Answer:

1. *A director of the entity*
2. *The parent company of the entity*
3. *A shareholder of the entity that holds 1% stake in the entity*
4. *The spouse of the managing director of the entity*

Question - 5: According to AS-18 Related Party Disclosures, related party transaction is a transfer of resources or obligations between related parties – provided a price is charged for such transfer.

Answer:

1. *True*
2. *False*

Question - 6: According to AS-18 Related Party Disclosures, parties are considered to be related, if and only if at the end of 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.

Answer:

1. *True*
2. *False*

Question - 7: A Ltd. sold goods for ₹90 lakhs to B Ltd. during financial year ended 31-3-2023. The Managing Directors of A Ltd. exercise 100% control in B Ltd. The sales were made to B Ltd. at normal selling prices followed by A Ltd. What should be treatment for this transaction in the financial statements of A Ltd.?

Answer:

1. *Sales need not require a different treatment from the other sales made by the company.*
2. *A Ltd. and B Ltd. are not related parties.*
3. *A Ltd. and B Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.*

Question - 8: Which of the following disclosure is required as per AS 18?

Answer:

1. *Disclosure of Intra-group transactions in Stand alone Financial Statements.*
2. *Transaction of one Central government controlled enterprise with other State government controlled enterprise.*
3. *Transaction of one Central government controlled enterprise with other Central government controlled enterprise.*
4. *Transaction of one State government controlled enterprise with other State government controlled enterprise.*

Answer

Q1	***2***	***Q2***	***2***	***Q3***	***4***	***Q4***	***3***
Q5	***2***	***Q6***	***2***	***Q7***	***3***	***Q8***	***1***

Accounting Standard 25
Interim Financial Reporting

Question 1

Sincere Corporation is dealing in seasonal product. Sales pattern of the product quarter-wise is as follows:

1st quarter 30th June	*10%*
2nd quarter 30th September	*10%*
3rd quarter 31st December	*60%*
4th quarter 31st March	*20%*

Information regarding the 1st quarter ended on 30th June, 20X1 is as follows:

Sales	*80 crores*
Salary and other expenses	*60 crores*
Advertisement expenses (routine)	*4 crores*
Administrative and selling expenses	*8 crores*

While preparing interim financial report for first quarter Sincere Corporation wants to defer ₹10 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, the third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.

Answer

Particulars	**(₹In crores)**	
Result of first quarter ended 30th June, *20X1*	80	
Turnover Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

According to AS 25, the Income and Expense should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized when they occur. Thus, the company's view is not as per AS 25.

Question 2

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.

Answer

Calculation of tax expense

1st quarter ending on 31st December, 20X0	200 ×20%	₹40 lakhs
2nd quarter ending on 31st March, 20X1	200 ×20%	₹40 lakhs
3rd quarter ending on 30th June, 20X1	200 ×30%	₹60 lakhs
4th quarter ending on 30th September, 20X1	200 ×30%	₹60 lakhs

Question 3

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.

Answer

In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹20,000 to the next quarter. Therefore, ₹20,000 should be deducted from ₹7,20,000. The treatment of extra-ordinary loss of ₹35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of ₹45,000 in the same quarter is in tune with AS 25. Hence no adjustments are required for these two items.

Poornima Ltd should report quarterly income as ₹7,00,000 (₹7,20,000 – ₹20,000).

Question 4

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.

Answer

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 5

What are the periods for which Interim financial Statements are required to be presented? You are required to answer your question in light of preparation of financial statements for the period ended and as at 31st December, 20X1. The Financial Year is FY 20X1-X2.

(*Source: Question 5, Study Material*)

Answer

As per Accounting Standard 25, Interim reports should include interim financial statements (condensed or complete) for periods as given below.

Statement	***Current period***	***Comparative period***
Balance sheet	End of current interim period	End of immediately preceding financial year
Statement of profit and loss	Current interim period and cumulatively for the year-to-date	Comparable interim period and year-to-date of immediately preceding financial year
Cash flow statement	Cumulatively for the current financial year-to-date	Comparable year-to-date of immediately preceding financial year

In light of the above, following periods needs to be covered in interim financial statements for the period ended and as at 31st December*, 20X1:*

Balance Sheet	as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year (As at 31 December 20X1 and 31 March 20X1).
Statements of Profit and Loss	for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. (for 3 months and 9 months i.e., year to date ended 31 December 20X1 and same for 31 December 20X0 being comparative period).

Cash Flow Statement	cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year. (year to date i.e., 1 April 20X1 to 31 December 20X1 and 1 April 20X0 to 31 December 20X0).

Question 6

Whether quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises meet the definition of 'interim financial report' as per AS 25 and the provisions of AS 25 should be applied on the same?

(*Source: Question 6, Study Material*)

Answer

The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise.

The quarterly financial results presented under Clause 41 of the Listing Agreement do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

Question 7

Whether the impairment loss recognized on property, plant and equipment in first quarter of the financial year can be reversed in the second quarter in that financial year?

(*Source: Question 7, Study Material*)

Answer

As per AS 25, the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount. In light of the same, the impairment loss recognized in one quarter can be reversed in the another quarter of the financial year, if favourable indicator exists as per AS 28 and the recoverable amount increased in comparison to earlier period.

Question 8

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?

(*Source: Question 8, Study Material*)

Answer

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 9

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.

(*Source: Question 9, Study Material*)

Answer

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 10

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.

(*Source: Question 10, Study Material*)

Answer

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 =

$$\frac{B}{A} = \frac{3,50,000}{10,00,000} = 35\%$$

A 10,00,000

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 11

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.

(*Source: Question 11, Study Material*)

Answer

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise's financial year. Therefore, dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per AS 10, Property, Plant and Equipment, if there is change in the depreciation method, such a change should be accounted for as a change in accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, and applied prospectively. Therefore, no adjustment would be required due to change in the method of depreciation.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹(4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in the method	-
Extra ordinary gain ₹(2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹(3-2) lakhs	1
	9
	(12)
Less: Sales promotion expenses (80% of ₹15 lakhs)	(5)
Gain on sale of investment (occasional gain should not be deferred)	
Adjusted Profit before tax for the third quarter	(8)

MCQs

Question – 1: ABC Limited has reported ₹85,000 as per tax profit in first quarter and expects a loss of ₹25,000 each in subsequent quarters. It has corporate tax rate slab of 20% on the first ₹20,000 earnings and 40% on all additional earnings. Calculate tax expenses that should report in first quarter interim financial report.

Answer:

1. *₹ 17,000*
2. *₹ 30,000*
3. *₹ 2,000*
4. *AS 25 does not mandate to report tax expenses*

Question - 2: XYZ limited is incorporated on 01.10.2022 in India. Its first financial statement is prepared on 31.03.2023 for 6 months. AS 25 is applicable for XYZ Limited if financial statements are published:

Answer:

1. *From 01.10.2022 to 31.03.2023*
2. *From 01.10.2022 to 31.12.2024*
3. *From 01.10.2022 to 31.12.2022*
4. *AS 25 is not applicable during 1st year of operations.*

Question - 3: Interim period as per AS 25 means:

Answer:

1. *A Quarter*
2. *Half year*
3. *a Calendar year*
4. *Any period shorter than a full financial year*

Question - 4: Following is not part of Minimum component of an Interim Financial Report:

Answer:

1. *Condensed Cashflow statement*
2. *Condensed Director's Report*
3. *Condensed profit & loss statement*
4. *Selected Explanatory Notes*

Question - 5: AS 25 mandates the following in relation to interim financial reports.

Answer:

1. *which entities should publish interim financial reports.*
2. *how frequently it should publish interim financial reports.*
3. *how soon it should publish after the end of interim period.*
4. *none of the above.*

Question - 6: The standard defines Interim financial Report as a financial report for an interim period that contains a set of financial statements.

Answer:

1. *Complete*
2. *Condensed*
3. *Financial statement similar to annual*
4. *Either complete or condensed*

Question - 7: ABC Limited has reported ₹85,000 as per tax profit in first quarter and expects a loss of ₹25,000 each in subsequent quarters. It has corporate tax rate slab of 20% on the first ₹20,000 earnings and 40% on all additional earnings. Calculate tax expenses that should report in first quarter interim financial report.

Answer:

1. *₹17,000*
2. *₹30,000*
3. *₹2,000*
4. *AS 25 does not mandate to report tax expenses*

Question - 8: According to AS-18 Related Party Disclosures, which ONE of the following is not a related party of Skyline Limited?

(a) *A shareholder of Skyline Limited owning 30% of the ordinary share capital*
(b) *An entity providing banking facilities to Skyline Limited in the normal course of business*
(c) *An associate of Skyline Limited*
(d) *Key management personnel of Skyline Limited*

Answer

Q1	***1***	***Q2***	***3***	***Q3***	***4***	***Q4***	***2***
Q5	***4***	***Q6***	***4***	***Q7***	***1***	***Q8***	***2***

Accounting Standard 13
Accounting for Investments

Question 1

An unquoted long term investment is carried in the books at a cost of ₹2 lakhs. The published accounts of the unlisted company received in May, 20X1 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 20X1?

(*Source: Illustration 1, Study Material*)

Answer

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. AS 13 (Revised) 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On the above basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹20,000 in the financial statements for the year ended 31st March, 20X1.

Question 2

X Ltd. on 1-1-20X1 had made an investment of ₹600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31 -3-20X1 became ₹200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31 -3-20X1?

(*Source: Illustration 2, Study Material*)

Answer

X Ltd. invested ₹600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹300 lakhs and remaining as temporary (current) investment i.e. ₹300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.20X1 to 31.3.20X1), AS 13 (Revised) lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.20X1 became ₹200 lakhs i.e. ₹100 lakhs in respect of current investment and ₹100 lakhs in respect of long term investment.

As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at ₹100 lakhs. The reduction of ₹200 lakhs in the carrying value of current investment will be charged to the profit and loss account.

The Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in the long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹200 lakhs and show the investments at ₹100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of ₹200 lakhs in the carrying value of long term investment will also be charged to the Statement of profit and loss.

Question 3

ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised). Decide and state on the amount of transfer, based on the following information:

(1) A portion of current investments purchased for ₹20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹25 lakhs.

(2) Another portion of current investments purchased for ₹15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹6.5 lakhs.

(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹18 lakhs but had been written down to ₹12 lakhs to recognise other than temporary decline as per AS 13 (Revised).

(*Source: Illustration 3, Study Material*)

Answer

As per AS 13 (Revised), where investments are reclassified from current to long- term, transfers are made at the lower of cost and fair value at the date of transfer.

(1) In the first case, the market value of the investment is ₹25 lakhs, which is higher than its cost i.e. ₹20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ₹20 lakhs.

(2) In the second case, the market value of the investment is ₹6.5 lakhs, which is lower than its cost i.e. ₹15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. ₹6.5 lakhs. The loss of ₹8.5 lakhs should be charged to profit and loss account.

As per AS 13 (Revised), where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(3) In the third case, the book value of the investment is ₹12 lakhs, which is lower than its cost i.e. ₹18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at ₹12 lakhs.

Question 4

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 20X3 at a cost of ₹2,50,000. It also earlier purchased Gold of ₹4,00,000 and Silver of ₹2,00,000 on 1st March, 20X1. Market value as on 31st March, 20X4 of above investments are as follows:

	₹
Shares	*2,25,000*
Gold	*6,00,000*
Silver	*3,50,000*

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 20 X4 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

(*Source: Illustration 4, Study Material*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹2,50,000) and market value (₹2,25,000) as on 31 March 20X4, i.e., ₹2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognise a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 20X1) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 20X4, i.e., ₹4,00,000 and ₹2,00,000 respectively, though their market values have been increased.

Question 5

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ₹100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at ₹101 ex-interest price, also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at ₹103 ex-interest price, again paying brokerage @ 1% of ex-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

(*Source: Illustration 5, Study Material*)

Answer

In the books of M/s Bull & Bear
Investment Account
for the period from 1st December 20X2 to 1st March, 20X3
(Scrip: 12% Debentures of M/s. Wye Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.20X2	To Bank A/c (W.N.1)	10,00,000	20,000	10,20,100	1.03.20X3	By Bank A/c (W.N.2)	10,00,000	50,000	10,19,700
1.3.20X3	To Profit & loss A/c* (b.f.)	-	30,000		1.3.20X3	By Profit & loss A/c (b.f.)			400
		10,00,000	50,000	10,20,100			10,00,000	50,000	10,20,100

** This represents income for M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3, i.e., interest for three months- 1st December, 20X2 to 28 February, 20X3).*

Working Notes:

1.	Cost of 12% debentures purchased on 1.12.20X2		₹
	Cost Value (10,000 × ₹101)	=	10,10,000
	Add: Brokerage (1% of ₹10,10,000)	=	10,100
	Total	=	10,20,100
2.	Sale proceeds of 12% debentures sold		₹
	Sales Price (10,000 × ₹103)	=	10,30,000
	Less: Brokerage (1% of ₹10,30,000)	=	(10,300)
	Total	=	10,19,700

Question 6

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of ₹100 each in TELCO Ltd. @ ₹120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ₹100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ₹175 per share and ₹90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

(*Source: Illustration 6, Study Material*)

Answer

In the books of Mr. Krishna Murty
Investment Account for the year ended 31st March, 20X2
(Scrip: Equity Shares of TELCO Ltd.)

Date	*Particulars*	*Nominal Value (₹)*	*Cost (₹)*	*Date*	*Particulars*	*Nominal Value (₹)*	*Cost (₹)*
1.4.20X1	To Bank A/c (W.N.1)	1,00,000	1,23,000	31.3.20X2	By Bank A/c (W.N.2)	50,000	44,100
31.1.20X2	To Bonus shares (W.N.5)	50,000	—	31.3.20X2	By Balance c/d (W.N.4)	1,00,000	82,000
31.3.20X2	To Profit & loss A/c (W.N.3)	—	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

Working Notes:

1. Cost of equity shares purchased on 1.4.20X1 = (1,000 × ₹120) + (2% of ₹1,20,000) + (½% of ₹1,20,000) = ₹1,23,000
2. Sale proceeds of equity shares (bonus) sold on 31st March, 20X2= (500 × ₹90) – (2% of ₹45,000) = ₹44,100.
3. Profit on sale of bonus shares on 31st March, 20X2
   = Sale proceeds – Average Cost
   Sale proceeds = ₹44,100
   Average cost = ₹(1,23,000 /1,50,000) x 50,000 = ₹41,000
   Profit = ₹44,100 – ₹41,000 = ₹3,100.
4. Valuation of equity shares on 31st March, 20X2
   Cost = (₹1,23,000/1,50,000) x 1,00,000 = ₹82,000
   Market Value = 1,000 shares × ₹90 = ₹90,000
   Closing balance has been valued at ₹82,000 being lower than the market value.
5. Bonus shares do not have any cost.

Question 7

Mr. X purchased 500 equity shares of ₹100 each in Omega Co. Ltd. for ₹62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profits and to issue to the holders of equity shares, one equity bonus share for every share held by them. Prior to capitalisation, the shares of Omega Co. Ltd. were quoted at ₹175 per share. After the capitalisation, the shares were quoted at ₹92.50 per share. Mr. X. sold the bonus shares and received at ₹90 per share.

Prepare the Investment Account in X's books on average cost basis.

(*Source: Illustration 7, Study Material*)

Answer

In the books of X Investment Account
[Scrip: Equity shares in Omega Co. Ltd.]

Particulars	Nominal Value ₹	Cost ₹	Particulars	Nominal Value ₹	Cost ₹
To Cash	50,000	62,500	By Cash - Sale (500 x 90)	50,000	45,000
To Bonus shares (W.N.1)	50,000	-	By Balance c/d (W.N. 3)	50,000	31,250
To P & L A/c (W.N. 2)	-	13,750			
	1,00,000	76,250		1,00,000	76,250
To Balance b/d	50,000	31,250			

Working Notes:

1. Bonus shares do not have any cost.
2. Profit on sale of bonus shares = Sales proceeds – Average cost

   Sales proceeds = ₹45,000

   Average cost = $\frac{500}{1000} \times 62{,}500$ = ₹31,250

   Profit = ₹45,000 – ₹31,250 = ₹13,750.
3. Valuation of Closing Balance of Shares at the end of year

   The total cost of 1,000 share including bonus is ₹62,500

   Therefore, cost of 500 shares

   (carried forward) is = $\frac{500}{1000} \times 62{,}500$ = ₹31,250

   Market price of 500 shares = 92.50 x 500 = ₹46,250

   Cost being lower than the market price, therefore shares are carried forward at cost.

Question 8

On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹15 per share (nominal value ₹10 each). He provides you the further information:

(1) On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at ₹16 per share.

(2) On 1st August, 20X1, P Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31st October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of ₹2 per share and subscribed the rest on 5th November, 20X1.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 20X2.

(*Source: Illustration 8, Study Material*)

Answer

In the books of Rajat
Investment Account
(Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.X1	To Balance b/d	50,000	7,50,000	31.3.X2	By Balance c/d (Bal. fig.)	90,000	12,10,000
20.6.X1	To Bank A/c	10,000	1,60,000				
1.8.X1	To Bonus issue (W.N.1)	10,000	-				
5.11.X1	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

Working Notes:

(1) Bonus shares = $\frac{50{,}000 + 10{,}000}{6}$ = 10,000 shares

(2) Right shares = $\frac{50{,}000 + 10{,}000 + 10{,}000}{7} \times 3$ = 30,000 shares

(3) Sale of rights = 30,000 shares × $\frac{1}{3}$ × ₹2 = ₹20,000 to be credited to statement of profit and loss

(4) Rights subscribed = 30,000 shares × $\frac{2}{3}$ × ₹15 × ₹ 30,000

Question 9

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of ₹15 per share (Nominal value ₹10). On 20.6.20X1, he purchased another 5,000 shares of the company at ₹16 per share. The directors of X Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of the issue are as follows:

Bonus basis 1:6 (Date 16.8.20X1).

Rights basis 3:7 (Date 31.8.20X1) Price ₹15 per share. Due date for payment 30.9.20X1.

Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of ₹2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of ₹5 per share. You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1 and shares are valued at average cost.

(*Source: Illustration 9, Study Material*)

Answer

Books of Sundar Investment Account
(Scrip: Equity Shares in X Ltd.)

		No.	Amount ₹			No.	Amount ₹
1.4.20X1	To Bal b/d	25,000	3,75,000	31.10.20X1	By Bank (dividend	—	10,000
20.6.20X1	To Bank	5,000	80,000				
16.8.20X1	To Bonus (W.N.1)	5,000	—		On shares acquired on 20/6/20X1) (W.N.4)		
30.9.20X1	To Bank (Rights Shares) (W.N.3)	10,000	1,50,000				
15.11.20X1	To Profit (on sale of shares)		44,444	15.11.20X1	By Bank (Sale of shares)	25,000	3,75,000
				31.12.20X1	By Bal. c/d (W.N.6)	20,000	2,64,444
		45,000	6,49,444			45,000	6,49,444

Profit and Loss Account (An extract)

To Balance c/d	1,04,444	By Profit transferred	44,444
		By Sale of rights (W.N.3)	10,000
		By Dividend (W.N.4)	50,000
	1,04,444		1,04,444

Working Notes:

(1) **Bonus shares =** $\frac{(25,000 + 5,000)}{6}$ = 5,000 shares

(2) **Right shares =** $\frac{25,000 + 5,000 + 5,000}{7} \times 3$ = 15,000 shares

(3) Right shares renounced = 15,000×1/3 = 5,000 shares

Sale of right shares = 5,000 x 2 = ₹10,000

Right shares subscribed = 15,000 – 5,000 = 10,000 shares

Amount paid for subscription of right shares = 10,000 x 15 = ₹1,50,000

(4) Dividend received = 25,000 (shares as on 1st April 20X1) × 10 × 20% = ₹50,000

Dividend on shares purchased on 20.6.20X1 = 5,000×10×20% = ₹10,000 is adjusted to Investment A/c

(5) Profit on sale of 25,000 shares

= Sales proceeds – Average cost

Sales proceeds = ₹3,75,000

Average cost $= \left(\frac{(3,75,000+80,000+1,50,000-10,000)}{45,000}\right)\times 25,000 =$ ₹3,30,556

Profit = ₹3,75,000– ₹3,30,556= ₹44,444.

(6) Cost of shares on 31.12.20X1

$$\left(\frac{(3,75,000+80,000+1,50,000-10,000)}{45,000}\right)\times 20,000 = ₹2,64,444$$

Reference: The students are also advised to refer the full bare text of AS 13 (Revised) "Accounting for Investments".

Question 10

Briefly explain disclosure requirements for Investments as per AS-13.

(*Source: Question 6, Study Material*)

Answer

The disclosure requirements as per AS 13 (Revised) are as follows:

(i) Accounting policies followed for the determination of carrying amount of investments.

(ii) Classification of investment into current and long term.

(iii) The amount included in profit and loss statements for

- (a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;
- (b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;
- (c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises

Question 11

How will you classify the investments as per AS 13? Explain in Brief.

(*Source: Question 7, Study Material*)

Answer

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments.

A current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. The reduction in carrying amount is charged to the statement of profit and loss.

Question 12

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? Explain in brief.

(*Source: Question 8, Study Material*)

Answer

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made.

Question 13

Mr. X acquires 200 shares of a company on cum-right basis for ₹70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹107 each. He does not subscribe but sells all the rights for ₹12,000. The market value of the shares after their becoming ex- rights has also gone down to ₹60,000. What should be the accounting treatment in this case?

(*Source: Question 9, Study Material*)

Answer

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹60,000. In this case, out of sale proceeds of ₹12,000, ₹10,000 may be applied to reduce the carrying amount to bring it to the market value and ₹2,000 would be credited to the profit and loss account.

Question 14

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹15 per share (nominal value ₹10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹1,00,000. ABC Ltd. announced a bonus and right issue.

(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.

(2) Right shares are to be issued to the existing shareholders on 1st September 20X1. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.

(3) Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 20X1.

XY Ltd.

(i) Took up half the right issue.

(ii) Sold the remaining rights for ₹8 per share.

(iii) Sold half of its shareholdings on 1st January 20X2 at ₹16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended

31st March 20X2 assuming the shares are being valued at average cost.

(*Source: Question 10, Study Material*)

Answer

In the books of XY Ltd.

Investment in equity shares of ABC Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend	Amount
20X1 April 1	To Balance b/d	15,000	-	2,25,000	20X1 Oct. 31	By Bank A/c (W.N. 5)	-	30,000	10,000
June 1	To Bank A/c	5,000	--	1,00,000	20X2 Jan. 1	By Bank A/c (W.N.4)	13,000	-	2,12,355
July 1	To Bonus Issue (W.N. 1)	4,000	-	-	March 31	By Balance c/d (W.N. 6)	13,000	-	1,69,500
Sept.1	To Bank A/c (W.N. 2)	2,000	-	24,000					
20X2 Jan 1	To P & L A/c (W.N. 4)	-	-	42,855					
"20X2 March 31	To P & L A/c	-	30,000	-					
		26,000	30,000	3,91,855			26,000	30,000	3,91,855

Working Notes:

1. **Calculation of no. of bonus shares issued**

$$\text{Bonus Shares} = \frac{15,000 \text{ shares} + 5,000 \text{ shares}}{5} \text{ x } 1 = 4,000 \text{ shares}$$

2. **Calculation of right shares subscribed**

$$\text{Right Shares} = \frac{15,000 \text{ shares} + 5,000 \text{ shares} + 4,000 \text{ shares}}{6} = 4,000 \text{ shares}$$

$$\text{Shares subscribed by XY Ltd.} = \frac{4,000}{2} = 2,000 \text{ shares}$$

Value of right shares subscribed = 2,000 shares @ ₹12 per share

= ₹24,000

3. **Calculation of sale of right entitlement**

2,000 shares x ₹8 per share = ₹16,000

Amount received from sale of rights will be credited to statement of profit and loss.

4. **Calculation of profit on sale of shares**

Total holding =	15,000 shares	original
	5,000 shares	purchased
	4,000 shares	bonus
	2,000 shares	right shares
	26,000 shares	

50% of the holdings were sold

i.e. 13,000 shares (26,000 x1/2) were sold.

Cost of total holdings of 26,000 shares (on average basis)

= ₹2,25,000 + ₹1,00,000 + ₹24,000– ₹10,000 = ₹3,39,000

Average cost of 13,000 shares would be

$$= \frac{3,39,000}{26,000} \times 13,000 = ₹1,69,500$$

Sale proceeds of 13,000 shares (13,000 x ₹16.50)	2,14,500
Less: 1% Brokerage	(2,145)
	2,12,355
Less: Cost of 13,000 shares	(1,69,500)
Profit on sale	42,855

5. Dividend received on investment held as on 1st April, 20X1

= 15,000 shares x ₹ 10 x 20%

= ₹ 30,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st June, 20X1

= 5,000 shares x ₹10 x 20% = ₹10,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 1st July, 20X1 and dividend pertains to the year ended 31.3.20X1.

6. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

$$13,000 \times \frac{3,39,000}{26,000} = ₹1,69,500$$

Question 15

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (nominal value) ₹1,20,000, Cost ₹1,18,000 (Nominal value of each unit is ₹100).

1.3.20X1 Purchased 200 units, ex-interest at ₹98.

1.7.20X1 Sold 500 units, ex-interest out of original holding at ₹100.

1.10.20X1 Purchased 150 units at ₹98, cum interest.

1.11.20X1 Sold 300 units, ex-interest at ₹99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.

(*Source: Question 11, Study Material*)

Answer

In the Books of Mr. Z

9% Central Government Bonds (Investment) Account

Particulars		Nominal Value	Interest	Principal	Particulars		Nominal Value	Interest	Principal
20X1		₹	₹	₹	20X1		₹	₹	₹
Jan.1	To Balance b/d (W.N.1)	1,20,000	2,700	1,18,000	Mar. 31	By Bank A/c (W.N.3)	-	6,300	-
March 1	To Bank A/c (W.N.2)	20,000	750	19,600	July 1	By Bank A/c (W.N.4)	50,000	1,125	50,000
July 1	To P&L A/c (W.N.5)	-	-	833	Sept. 30	By Bank A/c (W.N.6)	-	4,050	-
Oct. 1	To Bank A/c (150 x 98)	15,000	-	14,700	Nov. 1	By Bank A/c (W.N.7)	30,000	225	29,700
Nov. 1	To P&L A/c (W.N.8)	-	-	200	Dec. 31	By Balance c/d (W.N. 9 & W.N.10)	75,000	1,688	73,633
Dec. 31	To P&L A/c (b.f.) (Transfer)		9,938						
		1,55,000	13,388	1,53,333			1,55,000	13,388	1,53,333

Working Note:

1. Interest element in opening balance of bonds = 1,20,000 x 9% x 3/12 = ₹2,700
2. **Purchase of bonds on 1. 3.20X1**

   Interest element in purchase of bonds = 200 x 100 x 9% x 5/12 = ₹750 Investment element in purchase of bonds = 200 x 98 = ₹19,600
3. Interest for half-year ended 31 March = 1,400 x 100 x 9% x 6/12 = ₹6,300
4. **Sale of bonds on 1.7.20X1**

   Interest element = 500 x 100 x 9% x 3/12 = ₹1,125

   Investment element = 500 x 100 = ₹50,000
5. **Profit on sale of bonds on 1.7.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 500 = ₹49,167 Sale proceeds = ₹50,000

   Profit element = ₹833
6. **Interest for half-year ended 30 September**

   = 900 x 100 x 9% x 6/12 = ₹4,050
7. **Sale of bonds on 1.11.20X1**

   Interest element = 300 x 100 x 9% x 1/12 = ₹225

   Investment element = 300 x 99 = ₹29,700
8. **Profit on sale of bonds on 1.11.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 300 = ₹29,500 Sale proceeds = ₹29,700

   Profit element = ₹200
9. **Closing value of investment**

Calculation of closing balance:	***Nominal value***		***₹***
Bonds in hand remained in hand at 31st December 20X1			
From original holding (1,20,000 – 50,000 – 30,000) =	40,000	$\frac{1,18,000}{1,20,000} \times 40,000$	39,333
Purchased on 1st March	20,000		19,600
Purchased on 1st October	15,000		14,700
	75,000		73,633

10. Interest element in closing balance of bonds = 750 x 100 x 9% x 3/12 = ₹1,688

Question 16

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹100 each) of P Ltd., held as Current assets:

1.4.20X1 Opening balance – Nominal value ₹1,20,000, Cost ₹1,18,000

1.7.20X1 100 Debentures purchased ex-interest at ₹98

1.10.20X1 Sold 200 Debentures ex-interest at ₹100

1.1.20X2 Purchased 50 Debentures at ₹98 ex-interest

1.2.20X2 Sold 200 Debentures ex-interest at ₹99

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction (at ex-interest price). Show Investment account as it would appear in his books. Assume FIFO method. Market value of 8% Debentures of P Limited on 31.3.20X2 is ₹99.

(*Source: Question 12, Study Material*)

Answer

Investment A/c of Mr. Purohit for the year ending on 31-3-20X2
(Scrip: 8% Debentures of P Limited)
(Interest Payable on 30th September and 31st March)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
			₹	₹				₹	₹
1.4.20X1	To Balance b/d	1,20,000	-	1,18,000	30.9.20X1	By Bank (1,300 x 100 x 8% x 6/12)	-	5,200	-
1.7.20X1	To Bank (ex-Interest) (W.N.1)	10,000	200	9,898	1.10.20X1	By Bank (W.N.4)	20,000	-	19,800
1.10.20X1	To Profit & Loss A/c (W.N.4)			133	1.2.20X2	By Bank (ex-Interest) (W.N.5)	20,000	533	19,602
1.1.20X2	To Bank (ex-Interest) (W.N.2)	5,000	100	4,949	1.2.20X2	By Profit & Loss A/c (W.N.5)			64
31.3.20X2	To Profit & Loss A/c (Bal. fig.)	-	9,233		31.3.20X2	By Bank (950 x 100 x 8% x 6/12)	-	3,800	-
					31.3.20X2	By Balance c/d (W.N.3)	95,000	-	93,514
		1,35,000	9,533	1,32,980			1,35,000	9,533	1,32,980

Working Notes:

1. **Purchase of debentures on 1.7.20X1**
   Interest element = 100 x 100 x 8% x 3/12 = ₹200
   Investment element = (100 x 98) + [1% (100 x 98)] = ₹9,898
2. **Purchase of debentures on 1.1.20X2**
   Interest element = 50 x 100 x 8% x 3/12 = ₹100
   Investment element = {(50 x 98) + [1%(50 x 98)]} = ₹4,949
3. **Valuation of closing balance as on 31.3.20X2:**
   Market value of 950 Debentures at ₹99 = ₹94,050 Cost of
   800 Debentures cost = $\left(\frac{1,18,000}{1,20,000} \times 80,000\right)$ =78,667

100 Debentures cost	=	9,898
50 Debentures cost	=	4,949
		93,514

   Value at the end = ₹93,514, i.e., whichever is less
4. **Profit on sale of debentures as on 1.10.20X1**

	₹
Sales price of debentures (200 x ₹100)	20,000
Less: Brokerage @ 1%	(200)
	19,800
Less: Cost of Debentures $\left(\frac{1,18,000}{1,20,000} \times 20,000\right) =$	(19,667)
Profit on sale	133

5. Loss on sale of debentures as on 1.2.20X2

	₹
Sales price of debentures (200 x ₹99)	19,800
Less: Brokerage @ 1%	(198)
	19,602
Less: Cost of Debentures $\left(\frac{1,18,000}{1,20,000} \times 20,000\right) =$	(19,666)
Loss on sale	64
Interest element in sale of investment = 200 x 100 x 8% x 4/12	₹533

Question 17

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of ₹4,50,000 (Face Value ₹10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for ₹80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.

On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹2 per share.

On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.

On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of ₹5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost.

(*Source: Question 13, Study Material*)

Answer

Investment Account in Books of Vijay (Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.20X1	To Bal b/d	30,000	4,50,000	31.10.20X1	By Bank (dividend on shares acquired on 22.6.20X1)	—	10,000
22.6.20X1	To Bank	5,000	80,000				
10.8.20X1	To Bonus	5,000	–				
30.9.20X1	To Bank (Rights Shares)	10,000	1,50,000				
15.11.20X1	To P&L A/c (Profit on sale of shares)		32,000	15.11.20X1	By Bank (Sale of shares)	20,000	3,00,000
				31.3.20X2	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) **Bonus Shares** = (30,000 + 5,000) / 7 = 5,000 shares

(2) **Right Shares** $= \frac{(30,000\ 5,000\ 5,000)}{8} \times 3 = 15,000$ shares

(3) **Rights shares sold** = 15,000×1/3 = 5,000 shares

(4) **Dividend received** = 30,000×10×20% = ₹60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.20X1

= 5,000×10×20%

= ₹10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost Sales proceeds

= ₹3,00,000

$$\text{Average cost} = \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 20,000$$

= ₹2,68,000

Profit = ₹3,00,000– ₹2,68,000= ₹32,000.

(7) Cost of shares on 31.3.20X2

$$\frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 30,000 = ₹4,02,000$$

(8) Sale of rights amounting ₹10,000 (₹2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

Question 18

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investments in Company A, costing ₹8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹6.5 lakhs to recognise 'other than temporary' decline in value. The fair value on date of transfer is ₹6.8 lakhs.

(ii) Long term investments in Company B, costing ₹7 lakhs are to be re-classified as current. The fair value on date of transfer is ₹8 lakhs and book value is ₹7 lakhs.

(iii) Current investment in Company C, costing ₹10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is ₹12 lakhs.

(*Source: Question 14, Study Material*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer**.** And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹6.5 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. ₹7 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹7 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹10 lakhs as cost is less than its market value of ₹12 lakhs.

QUESTION BANK

Question 19

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decided and state the amount of transfer, based on the following information:

(1) A portion of long term investments purchases on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was ₹14 lakhs but had been written down by ₹2 lakhs (to recognize 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was ₹11 lakhs.

(2) Another portion of long term investments purchases on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was ₹7 lakhs but had been written down to ₹5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was ₹4.5 lakhs.

(3) A portion of current investments purchases on 15th March, 2018 for ₹7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was ₹6 lakhs and fair value on 15th June, 2018 was ₹8.5 lakhs.

(4) Another portion of current investments purchases on 7th December, 2017 for ₹4 lakhs are to be re-classified as long term investments. The market value of these investments was :

on 31st March, 2018	₹3.5 lakhs
on 15th June, 2018	₹3.8 lakhs

(*May 2019*) (*5 Marks*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are **made at the lower of cost and carrying amount** at the date of transfer; and where investments are reclassified from current to long term, transfers are made **at lower of cost and fair value** on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹12 lakhs in the books.

(ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹5 lakhs in the books.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹7 lakhs as cost is less than its fair value of ₹8.5 lakhs on the date of transfer.

(iv) In this case, market value (considered as fair value) is ₹3.8 lakhs on the date of transfer which is lower than the cost of ₹4 lakhs. The reclassification of current investment into long-term investments will be made at ₹3.8 lakhs.

Question 20

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

As per the provisions of AS-13, a current investments is an investment that is by its nature is readily realizable and is intended to be held for not more than six months from the date on which such investment is made.

(*May 2019*) (*1 Marks*)

Answer

False: A current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

Question 21

Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for ₹5 lakhs, which the company want to reclassify as long term investment on 31.3.2018. The market value of these investments as on date of Balance Sheet was ₹2.5 lakhs. How will you deal with this as on 31.3.18 with reference to AS-13?

(*RTP May 2019*)

Answer:

As per AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost or fair value at the date of transfer.

In the given case, the market value of the investment (X Ltd. shares) is ₹2.50 lakhs, which is lower than its cost i.e. ₹5 lakhs. Therefore, the transfer to long term investments should be made at cost of ₹2.50 lakhs. The loss of ₹2.50 lakhs should be charged to profit and loss account.

Question 22

Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2012 at a cost of ₹3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in January, 2017 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than ₹45,000.

You are required to explain how you wilt deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.17 with reference to AS 13?

(*RTP May 2018*)

Answer:

As per AS 13, "Accounting for Investments" Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

On this basis, the facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares to ₹45,000 in the financial statements for the year ended 31st March, 2017 and charge the difference of loss of ₹2,55,000 to profit and loss account.

Question 23

M/s Active Builders Ltd. invested in the shares of another company (with an intention to hold the shares for short term period) on 31st October, 2016 at a cost of ₹4,50,000. It also earlier purchased Gold of ₹5,00,000 and Silver of ₹2,25,000 on 31st March, 2014.

Market values as on 31st March, 2017 of the above investments are as follows:

Shares ₹3,75,000; Gold ₹7,50,000 and Silver ₹4,35,000

You are required explain how will the above investments be shown in the books of account of M/s Active Builders Ltd. for the year ending 31st March, 2017 as per the provisions of AS 13?

(*RTP November 2018*)

Answer

As per AS 13 'Accounting for Investments', if the shares are purchased with an intention to hold for short-term period then investment will be shown at the realizable value. In the given case, shares purchased on 31st October, 2016, will be valued at ₹3,75,000 as on 31st March, 2017.

Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in gold and silver (purchased on 31st March, 2014) shall continue to be shown at cost as on 31st March, 2017 i.e., ₹5,00,000 and ₹2,25,000 respectively, though their realizable values have been increased.

Thus the shares, gold and silver will be shown at ₹3,75,000, ₹5,00,000 and ₹2,25,000 respectively and hence, total investment will be valued at ₹11,00,000 in the books of account of M/s Active Builders for the year ending 31st March, 2017 as per provisions of AS 13.

Question 24

Z Bank has classified its total investment on 31-3-2021 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines. 'Held to maturity' investments are carried at acquisition cost less amortized amount. 'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13?

(*MTP, November, 2021/RTP, November 2021*) (*5 Marks*)

Answer

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

Question 25

Mr. Mohan has invested some money in various Mutual funds.

Following information in this regard is given:

Mutual Funds	Date of purchase	Purchase cost (₹)	Brokerage Cost (₹)	Stamp duty (₹)	Market value as on 31.03.2021 (₹)
A	01.05.2017	50,000	200	20	48,225
B	05.08.2020	25,000	150	25	24,220
C	01.01.2021	75,000	300	75	78,190
D	07.05.2020	70,000	275	50	65,880

You are required to;

1. Classify his investment in accordance with AS-13 (revised).
2. Value of Investment in mutual fund as on 31.03.2021

(*Suggested December 2021*) (*5 Marks*)

Answer

As per AS 13 "Accounting for Investments", a current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. If there is a decline, other than temporary, in the value of a long-term investment; the carrying amount is reduced to recognize the decline.

Mutual Funds	Classification	Cost (₹)	Market value (₹)	Carrying value (₹)
A	Long-term Investment	50,220	48,225*	50,220
B	Current Investment	25,175	24,220	24,220
C	Current Investment	75,375	78,190	75,375
D	Current Investment	70,325	65,880	65,880
Total				2,15,695

**Note: ***The reduction in value of Mutual fund A is considered to be temporary. If reduction in Market value is assumed as other than temporary in nature, then the carrying value of ₹48,225 will be considered.

Question 26

On 1st January 20X1, Singh had 20,000 equity shares in X Ltd. Nominal value of the shares was ₹10 each but their book value was ₹16 per share. On 1st June 20X1, Singh purchased 5,000 more equity shares in the company at a premium of ₹4 per share.

On 30th June, 20X1, the directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 20X1.

The terms of the rights issue were:

(a) Rights shares to be issued to the existing holders on 10th August, 20X1.

(b) Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at ₹15 per share-the whole sum being payable by 30th September, 20X1.

(c) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(d) Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of ₹1.50 per share.

(e) Dividends for the year ended 31st March, 20X1, at the rate of 15% were declared by the Company and received by Singh on 20th October, 20X1.

(f) On 1st November, 20X1, Singh sold 20,000 equity shares at a premium of ₹3 per share.

The market price of share on 31-12-20X1 was ₹14. Show the Investment Account as it would appear in Singh's books on 31-12-20X1 and the value of shares held on that date.

(*Study Material*)

Answer

Investment Account-Equity Shares in X Ltd.

Date		*No. of shares*	*Dividend*	*Amount*	*Date*		*No. of shares*	*Dividend*	*Amount*
			₹	₹				₹	₹
20X1					20X1				
Jan. 1	To Bal. b/d	20,000	-	3,20,000	Oct. 20	By Bank (dividend) [20,000 x 10 x 15%] [5,000 x 10 x 15%]		30,000	7,500
June 1	To Bank	5,000	-	70,000	Nov. 1	By Bank	20,000		2,60,000
Aug. 2	To Bonus Issue	5,000		—	Nov. 1	By P & L A/c (W.N.2)			1,429
Sep. 30	To Bank (Right) (W.N.1)	5,000	-	75,000	Dec. 31	By Balance c/d (W.N.3)	15,000		1,96,071
Dec.31	To Profit & Loss A/c (Dividend income)		30,000						
		35,000	30,000	4,65,000			35,000	30,000	4,65,000
Jan. 1, 20X2	To Balance b/d	15,000		1,96,071					

Working Notes:

1. Right shares

No. of right shares issued = (20,000 + 5,000 + 5,000)/ 3 = 10,000 shares No. of right shares subscribed = 10,000 x 50% = 5,000 shares

Amount of right shares issued = 5,000 x 15 = ₹ 75,000 No. of right shares sold = 10,000 – 5,000 = 5,000 shares

Sale of right shares = 5,000 x 1.5 = ₹ 7,500 to be credited to statement of profit and loss

2. Cost of shares sold — Amount paid for 35,000 shares

	₹
(₹3,20,000 + ₹ 70,000 + ₹ 75,000)	4,65,000
Less: Dividend on shares purchased on June 1 (since the dividend pertains to the year ended 31st March, 20x1, i.e., the pre- acquisition period)	(7,500)
Cost of 35,000 shares	4,57,500
Cost of 20,000 shares (Average cost basis)	2,61,429
Sale proceeds	2,60,000
Loss on sale	1,429

3. Value of investment at the end of the year

Assuming investment as current investment, closing balance will be valued based on lower of cost or net realisable value.

Here, Net realisable value is ₹14 per share i.e. 15,000 shares x ₹ 14 = ₹ 2,10,000 and cost = $\frac{4,57,500}{35,000} \times 15,000 =$ ₹ 1,96,071. Therefore, value of investment at the 35,000 end of the year will be ₹ 1,96,071.

Question 27

A Limited purchased 5,000 equity shares (nominal value ₹ 100 each) of Allianz Limited for ₹ 105 each on 1st April, 20X1. The shares were quoted cum dividend. On 15th May, 20X1, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 20X1. On 30th June, 20X1 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 20X1 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share. A Limited subscribed to half of the rights issue and the balance was sold at ₹ 5 per right entitlement. The company declared interim dividend of 1% on 30th November, 20X1. Right shares were not entitled to dividend. The company sold 3,000 shares on 31st December, 20X1 at ₹ 95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares.

You are required to prepare Investment Account in books of A Ltd for the year ended 31st March, 20X2.

(*Study Material*)

Answer

In the books of A Ltd.

Investment in equity shares of Allianz Ltd. for the year ended 31st March, 20X2

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
20X1					20X1				
April 1	To Bank A/c (W.N.1)	5,000	-	5,35,500	May 15	By Bank A/c (dividend) (W.N.6)	-	-	10,000
June 30	To Bonus Issue (W.N 2)	1,000	-	-					
Oct. 1	To Bank A/c (W.N. 3)	250	-	11,250	Nov. 30	By Bank A/c (Interim dividend) (W.N.7)	-	6,000	-
Dec.31	To P & L A/c (W.N. 5)	-	-	21,660	Dec. 31	By Bank A/c (W.N. 5)	3,000	-	2,79,300
20X2					20X2				
March 31	To P & L A/c (b.f.)	-	6,000	-	March 31	By Balance c/d (W.N. 7)	3,250	-	2,79,110
		6,250	6,000	5,68,410			6,250	6,000	5,68,410

Working Notes:

1. Calculation of cost of purchase on 1st April, 20X1

₹ 105 X 5,000 shares = ₹ 5,25,000

Add: Brokerage (2%) = ₹ 10,500

₹ 5,35,500

2. Calculation of number of bonus shares issued

$$\text{Bonus Shares} = \frac{5,000}{5} \times 1 = 1,000$$

3. Calculation of right shares subscribed

$$\text{Right Shares} = \frac{6,000}{12} = 500 \text{ shares}$$

$$\text{Shares subscribed} = \frac{500}{2} = 250 \text{ shares}$$

Value of right shares subscribed = 250 shares @ ₹ 45 per share = ₹ 11,250

4. Calculation of sale of right entitlement

250 shares x ₹ 5 per share = ₹ 1,250

(Amount received from sale of rights will be credited to P&L a/c)

5. Calculation of profit on sale of shares

Total holding	= 5,000 shares	original
	1,000 shares	bonus
	250 shares	right shares
	6,250 shares	

3,000 shares were sold on 31.12.20X1

Cost of total holdings of 6,250 shares (on average basis)

= ₹ 5,35,500 + ₹ 11,250 – ₹ 10,000 = ₹ 5,36,750

Average cost of 3,000 shares would be

$$= \frac{5,36,750}{6,250} \times 3,000 = ₹\ 2,57,640$$

	₹
Sale proceeds of 3,000 shares (3,000 x ₹ 95)	2,85,000
Less: 2% Brokerage	(5,700)
	2,79,300
Less: Cost of 3,000 shares	(2,57,640)
Profit on sale	21,660

6. Dividend received on investment held as on 15th May, 20X1

= ₹ 10,000 (5,000 x ₹ 100 x 2%) adjusted to Investment A/c

7. Dividend amounting ₹ 6,000 received on 30.11.20X1 will be credited to P&L A/c

8. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

$$= \frac{5,36,750}{6,250} \times 3,250 = ₹\ 2,79,110$$

Question 28

Smart Investments made the following investments in the year 20X1-X2: 12% State Government Bonds having nominal value ₹100

Date	Particulars
01.04.20X1	*Opening Balance (1200 bonds) book value of ₹126,000*
02.05.20X1	*Purchased 2,000 bonds @ ₹100 cum interest*
30.09.20X1	*Sold 1,500 bonds at ₹105 ex interest*

Interest on the bonds is received on 30th June and 31st Dec. each year.

Equity Shares of X Ltd.	
15.04.20X1	*Purchased 5,000 equity shares @ ₹200 on cum right basis; Brokerage of 1% (on cum-right price) was paid in addition (Nominal Value of shares ₹10)*
03.06.20X1	*The company announced a bonus issue of 2 shares for every 5 shares held.*
16.08.20X1	*The company made a rights issue of 1 share for every 7 shares held at ₹250 per share. The entire money was payable by 31.08.20X1.*
22.8.20X1	*Rights to the extent of 20% was sold @ ₹60. The remaining rights were subscribed.*

Equity Shares of X Ltd.	
02.09.20X1	*Dividend @ 15% for the year ended 31.03.20X1 was received on 16.09.20X1*
15.12.20X1	*Sold 3,000 shares @ ₹300. Brokerage of 1% was incurred extra.*
15.01.20X2	*Received interim dividend @ 10% for the year 20X1 –X2*
31.03.20X2	*The shares were quoted in the stock exchange @ ₹220*

Prepare Investment Accounts in the books of Smart Investments. Assume that the average cost method is followed.

(*Study Material*)

Answer

In the books of Smart Investments
12% Govt. Bonds for the year ended 31st March, 20X2

Date	Particulars	Nos.	Interest	Amount	Date	Particulars	Nos.	Interest	Amount
1.4.X1	To Opening balance b/d (W.N.7)	1,200	3,600	1,26,000	30.6.X1	By Bank A/c (Interest) (3,200 x 100 x 12% x 6/12)	-	19,200	-
2.5.X1	To Bank A/c (W.N.8)	2,000	8,000	1,92,000	30.9.X1	By Bank A/c (W.N.1 & W.N.9)	1,500	4,500	1,57,500
30.9.X1	To P & L A/c (Profit on Sale) (W.N.1)			8,437.50	31.12.X1	By Bank A/c (Interest) (1,700 x 100 x 12% x 6/12)	-	10,200	-
31.3.X2	To P & L A/c (Interest)		27,400		31.3.X2	By Bal. c/d (W.N.2 & W.N.10)	1,700	5,100	1,68,937.50
		3,200	39,000	3,26,437.50			3,200	39,000	3,26,437.50

Investments in Equity shares of X Ltd. for year ended 31.3.20X2

Date	Particulars	Nos.	Dividend	Amount	Date	Particulars	Nos.	Dividend	Amount
15.4.X1	To Bank A/c (W.N.3)	5,000		10,10,000					
3.6.X1	To Bonus Issue	2,000	-	-	16.9.X1	By Bank (Dividend) (5,000 x 10 x 15%) (refer note 1 and 2)	-	-	7,500
31.8.X1	To Bank A/c (W.N.11)	800		2,00,000	15.12.X1	By Bank (Sale) (W.N.4)	3,000	-	8,91,000
15.12.X1	To P & L A/c (W.N.5)			4,28,500	15.1.X2	By Bank (interim dividend) (W.N.12)		4,800	
31.3.X2	To P & L A/c		4,800		31.3.X2	By Bal. c/d (W.N.6)	4,800		7,40,000
		7800	4,800	16,38,500			7800	4,800	16,38,500

Working Notes:

1. **Profit on sale of bonds on 30.9.X1**
   = Sales proceeds – Average cost
   Sales proceeds = ₹1,57,500 (i.e., 1,500 x 105)
   Average cost = ₹ [(1,26,000+1,92,000) ×1,500/3,200] = 1,49,062.50 Profit = 1,57,500– ₹ 1,49,062.50=₹8,437.50
2. **Valuation of bonds on 31st March, 20X2**
   Cost = ₹3,18,000/3,200 x1,700 = 1,68,937.50
3. **Cost of equity shares purchased on 15/4/20X1**
   = Cost + Brokerage
   = (5,000 ×₹ 200) + 1% of (5,000 ×₹ 200) =₹ 10,10,000
4. **Sale proceeds of equity shares on 15/12/20X1**
   = Sale price – Brokerage
   = (3,000 ×₹ 300) – 1% of (3,000 ×₹ 300) =₹ 8,91,000.
5. **Profit on sale of shares on 15/12/20X1**
   = Sales proceeds – Average cost
   Sales proceeds = ₹ 8,91,000
   Average cost = ₹ [(10,10,000+2,00,000-7,500) × 3,000/7,800]
   = ₹ [12,02,500 × 3,000/7,800] = 4,62,500
   Profit = ₹ 8,91,000 – ₹4,62,500=₹ 4,28,500.

6. Valuation of equity shares on 31st March, 20X2

Cost = ₹ [12,02,500× 4,800/7,800]= ₹ 7,40,000

Market Value = 4,800 shares × ₹ 220 = ₹ 10,56,000

Closing stock of equity shares has been valued at ₹ 7,40,000 i.e. cost being lower than the market value.

7. Interest accrued on opening balance of bonds = 1,200 x 100 x 12% x 3/12

= ₹ 3,600

8. Interest element in bonds purchased on 02.05.20X1

= 2,000 x 100 x 12% x 4/12 = ₹ 8,000

Cost of investment (amount in investment column)

= (2,000 x 100) – 8,000 = ₹ 1,92,000

9. Interest element in bonds sold on 30.09.20X1

= 1,500 x 100 x 12% x 3/12 = ₹ 4,500

10. Interest accrued on closing balance of bonds

= 1,700 x 100 x 12% x 3/12 = ₹ 5,100

11. Right shares

No. of right shares issued = (5,000 + 2,000) x 1/7 = 1,000 shares

No. of right shares sold = 1,000 x 20% = 200 shares

Proceeds from sale of right shares to be credited to statement of profit and loss = 200 x 60 = ₹ 12,000

No. of right shares subscribed = 1,000 – 200 = 800 shares

Amount of right shares subscribed = 800 x 250 = ₹ 2,00,000

12. Amount of interim dividend = (5,000 + 2,000 + 800 – 3,000) x 10 x 10%

= ₹ 4,800

Note:

1. It is presumed that no dividend is received on bonus shares as bonus shares are declared on 3.6.20X1 and dividend pertains to the year ended 31.03.20X1.
2. The amount of dividend for the period, for which shares were not held by the investor, has been treated as capital receipt.

Question 29

Mr. Brown has made following transactions during the financial year 20X1-X2:

Date	***Particulars***
01.05.20X1	*Purchased 24,000 12% Bonds of ₹100 each at ₹84 cum-interest. Interest is payable on 30th September and 31st March every year.*
15.06.20X1	*Purchased 1,50,000 equity shares of ₹10 each in Alpha Limited for ₹25 each through a broker, who charged brokerage @ 2%.*
10.07.20X1	*Purchased 60,000 equity shares of ₹10 each in Beeta Limited for ₹44 each through a broker, who charged brokerage @2%.*
14.10.20X1	*Alpha Limited made a bonus issue of two shares for every three shares held.*
31.10.20X1	*Sold 80,000 shares in Alpha Limited for ₹22 each.*
01.01.20X2	*Received 15% interim dividend on equity shares of Alpha Limited. 15.01.20X2 Beeta Limited made a right issue of one equity share for every four shares held at ₹5 per share. Mr. Brown exercised his option for 40% of his entitlements and sold the balance rights in the market at ₹2.25 per share.*
01.03.20X2	*Sold 15,000 12% Bonds at ₹90 ex-interest.*
15.03.20X2	*Received 18% interim dividend on equity shares of Beeta Limited. Interest on 12% Bonds was duly received on due dates.*

Prepare separate investment account for 12% Bonds, Equity Shares of Alpha Limited and Equity Shares of Beeta Limited in the books of Mr. Brown for the year ended on 31st March, 20X2.

(*Study Material*)

Answer

In the books of Mr. Brown

12% Bonds for the year ended 31st March, 20X2

Date	***Particulars***	***No.***	***Income*** ₹	***Amount*** ₹	***Date***	***Particulars***	***No.***	***Income*** ₹	***Amount*** ₹
20X1 May, 1	To Bank A/c (W.N.7)	24,000	24,000	19,92,000	20X1 Sept. 30	By Bank-Interest (24,000 x 100 × 12% x 6/12)	-	1,44,000	
20X2 March 1	To P & L A/c (W.N.1)	-	-	1,05,000	20X2 Mar. 1	By Bank A/c (W.N.8)	15,000	75,000	13,50,000

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
20X2 March 31	To P & L A/c (b.f.)		2,49,000		20X2 Mar. 31	By Bank-Interest (9,000 x 100 x 12% x 6/12)		54,000	
						By Balance c/d (W.N.2)	9,000	-	7,47,000
		24,000	2,73,000	20,97,000			24,000	2,73,000	20,97,000

Investment in Equity shares of Alpha Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
20X1 June 15	To Bank A/c ([1,50,000 x 25] + [2% x (1,50,000 x 25)])	1,50,000	--	38,25,000	20X1 Oct. 31	By Bank A/c	80,000	-	17,60,000
Oct. 14	To Bonus Issue (1,50,000/3 x 2)	1,00,000	-	-	20X2 Jan. 1	By Bank A/c – dividend (1,70,000 x 10 x 15%)		2,55,000	
20X1 Oct. 31	To P & L A/c (W.N.3)			5,36,000	March 31	By Balance c/d (W.N.4)	1,70,000	-	26,01,000
20X2 Mar. 31	To P & L A/c		2,55,000						
		2,50,000	2,55,000	43,61,000			2,50,000	2,55,000	43,61,000

Investment in Equity shares of Beeta Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
20X1 July 10	To Bank A/c ([60,000 x 44] + [2% x (60,000 x 44)])	60,000	--	26,92,800	20X2 Mar. 15	By Bank – dividend [(60,000 + 6,000) x 10 x 18%]	-	1,18,800	
20X2 Jan. 15	To Bank A/c (W.N. 5)	6,000	-	30,000	March 31	By Balance c/d (bal. fig.)	66,000	-	27,22,800
March 31	To P & L A/c	-	1,18,800	-					
		66,000	1,18,800	27,22,800			66,000	1,18,800	27,22,800

Working Notes:

1. **Profit on sale of 12% Bond**

   Sales price ₹ 13,50,000

   Less: Cost of bond sold $= \frac{19,92,000}{24,000} \times 15,000$ (₹ 12,45,000)

   Profit on sale ₹ 1,05,000

2. **Closing balance as on 31.3.20X2 of 12 % Bond**

   $= \frac{19,92,000}{24,000} \times 9,000 = ₹7,47,000$

3. **Profit on sale of equity shares of Alpha Ltd.**

   Sales price ₹ 17,60,000

   Less: Cost of bond sold = $= \frac{38,25,000}{2,50,000} \times 80,000$ (₹12,24,000)

   Profit on sale ₹ 5,36,000

4. **Closing balance as on 31.3.20X2 of equity shares of Alpha Ltd.**

   $= \frac{38,25,000}{2,50,000} \times 1,70,000$ = (₹ 26,01,000)

5. **Calculation of right shares subscribed by Beeta Ltd.**

   $\text{Right Shares} = \frac{60,000 \text{ shares}}{4} \times 1 = 15,000 \text{ shares}$

   Shares subscribed by Mr. Brown = 15,000 x 40%= 6,000 shares

   Value of right shares subscribed = 6,000 shares @ ₹ 5 per share = ₹ 30,000

6. Calculation of sale of right entitlement by Beeta Ltd.

No. of right shares sold = 15,000 - 6,000 = 9,000 shares

Sale value of right = 9,000 shares x ₹ 2.25 per share = ₹ 20,250

Note: As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.

7. Purchase of bonds on 01.05.20X1

Interest element in purchase of bonds = 24,000 x 100 x 12% x 1/12 = ₹ 24,000 Investment element in purchase of bonds = (24,000 x 84) – 24,000 = ₹ 19,92,000

8. Sale of bonds on 01.03.20X2

Interest element in purchase of bonds = 15,000 x 100 x 12% x 5/12 = ₹ 75,000 Investment element in purchase of bonds = 15,000 x 90 = ₹ 13,50,000

Question 30

Following transactions of Nisha took place during the financial year 2017-18:

1st April, 2017	Purchased 9,000 8% bonds of ₹100 each at ₹80.50 cum-interest. Interest is payable on 1st November and 1st May.
1st May, 2017	Received half year's interest on 8% bonds.
10th July, 2017	Purchased 12,000 equity shares of ₹10 each in Moon Limited for ₹44 each through a broker, who charged brokerage @ 2%.
1st October, 2017	Sold 2,250 8% bonds at ₹81 Ex-interest.
1st November, 2017	Received half year's interest on 8% bonds.
15th January, 2018	Moon Limited made a rights issue of one equity share for every four Equity shares held at ₹5 per share. Nisha exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹2.25 per share.
15th March, 2018	Received 18% interim dividend on equity shares of Moon Limited.

Prepare separate investment account for 8% bonds and equity shares of Moon Limited in the books of Nisha for the year ended on 31st March, 2018. Assume that the average cost method is followed.

(*November 2018*) (*10 Marks*)

Answer

In the books of Nisha

8% Bonds for the year ended 31st March, 2018

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
2017 1 April,	To Bank A/c	9,000	30,000	6,94,500	1 May 2017	By Bank-Interest	-	36,000	
Oct. 1 2018 March 31	To P & L A/c (W.N .1)	-	-	8,625	1 Oct. 2017	By Bank A/c	2,250	7,500	1,82,250
	To P & L A/c		63,000		1 Nov. 2018	By Bank-Interest		27,000	
					2018 Mar. 31	By Balance c/d (W.N .2)	6,750	22,500	5,20,875
		9,000	70,500	7,03,125			9,000	70,500	7,03,125

Investment in Equity shares of Moon Ltd. for the year ended 31st March, 2018

Date	*Particulars*	*No.*	*Income* ₹	*Amount* ₹	*Date*	*Particulars*	*No.*	*Income* ₹	*Amount* ₹
2017 July 10	To Bank A/c	12,000	—	5,38,560	2018 March 15	By Bank – dividend *	—	23,760	
2018 Jan. 15	To Bank A/c (W.N. 3)	1,200	—	6,000	March 31	By Balance c/d (bal. fig.)	13,200	—	5,44,560
March 31	To P & L A/c	—	23,760						
		13,200	23,760	5,44,560			13,200	23,760	5,44,560

***** Considering that dividend was received on right shares also.

Working Notes:

1. Profit on sale of 8% Bonds

Sales price	₹ 1,82,250
Less: Cost of bond sold = 6,94,500/9,000x 2,250	(₹ 1,73,625)
Profit on sale	₹ 8,625

2. **Closing balance as on 31.3.2018 of 8 % Bonds**
   6,94,500/ 9,000 x 6,750= ₹ 5,20,875
3. **Calculation of right shares subscribed by Moon Ltd.**
   Right Shares = 12,000/4 x 1= 3,000 shares
   Shares subscribed by Nisha = 3,000 x 40%= 1,200 shares
   Value of right shares subscribed = 1,200 shares @ ₹ 5 per share = ₹ 6,000
4. **Calculation of sale of right entitlement by Moon Ltd.**
   No. of right shares sold = 3,000 – 1,200 = 1,800 rights for ₹ 4,050
   Note: As per para 13 of AS 13, sale proceeds of rights are to be credited to P & L A/c.

Question 31

A Ltd. purchased on 1st April, 2018 8% convertible debenture in C Ltd. of face value of ₹ 2,00,000 @ ₹ 108. On 1st July, 2018 A Ltd. purchased another ₹ 1,00,000 debenture @ ₹ 112 cum interest.

On 1st October, 2018 ₹ 80,000 debenture was sold @ ₹ 105. On 1st December, 2018, C Ltd. give option for conversion of 8% convertible debentures into equity share of ₹ 10 each. A Ltd. receive 5,000 equity share in C Ltd. in conversion of 25% debenture held on that date. The market price of debenture and equity share in C Ltd. at the end of year 2018 is ₹ 110 and ₹ 15 respectively.

Interest on debenture is payable each year on 31st March, and 30th September.

The accounting year of A Ltd. is calendar year.

Prepare investment account in the books of A Ltd. on average cost basis.

(*RTP May 2019*) (*MTP April, 2022, 8 Marks*)

Answer

Investment Account for the year ending on 31st December, 2018
Scrip : 8% Convertible Debentures in C Ltd.
[Interest Payable on 31st March and 30th September]

Date	Particulars	Nominal value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.4.18	To Bank A/c	2,00,000	-	2,16,000	30.09.18	By Bank A/c	-	12,000	-
1.7.18	To Bank A/c (W.N .1)	1,00,000	2,000	1,10,000		[₹3,00,000 x 8% x (6/12]			
31.12.18	To P & L A/c [Interest]	-	14,033	-	1.10.18	By Bank A/c	80,000		84,000
					1.10.18	By P&L A/c (loss) (W.N .1)			2,933
					1.12.18	By Bank A/c (Accrued interest) (₹ 55,000 x .08 x 2/12)		733	
					1.12.18	By Equity shares in C Ltd. (W.N . 3 and 4)	55,000		59,767
					31.12.18	By Balance c/d (W.N .5)	1,65,000	3,300	1,79,300
		3,00,000	16,033	3,26,000			3,00,000	16,033	3,26,000

SCRIP: Equity Shares in C LTD.

Date	Particulars	Cost (₹)	Date	Particulars	Cost (₹)
1.12.18	T o 8 % debentures	59,767	31.12.18	By balance c /d	59,767

Working Notes:

(i) Cost of Debenture purchased on 1st July = ₹1,12,000 – ₹2,000 (Interest)
= ₹1,10,000

(ii) Cost of Debentures sold on 1st Oct.
= (₹2,16,000 + ₹1,10,000) x 80,000/3,00,000 = ₹ 86,933

(iii) Loss on sale of Debentures = ₹ 86,933– ₹84,000 = ₹2,933
Nominal value of debentures converted into equity shares = ₹ 55,000
[(₹ 3,00,000 – 80,000) x.25]
Interest received before the conversion of debentures
Interest on 25% of total debentures = 55,000 x 8% x 2/12 = 733

(iv) Cost of Debentures converted = (₹ 2,16,000 + ₹1,10,000) x 55,000/3,00,000
= ₹ 59,767

(v) Cost of closing balance of Debentures = (₹ 2,16,000 + ₹1,10,000) x 1,65,000 / 3,00,000
= ₹ 1,79,300

(vii) Closing balance of Debentures has been valued at cost being lower than the market value i.e. ₹ 1,81,500 (₹ 1,65,000 @ ₹ 110)

(viii) 5,000 equity Shares in C Ltd. will be valued at cost of ₹ 59,767 being lower than the market value ₹ 75,000 (₹ 15 x5,000)

Note: It is assumed that interest on debentures, which are converted into cash, has been received at the time of conversion.

Question 32

Akash Ltd. had 4,000 equity share of X Limited, at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April 2017. On 1st September 2017, Akash Ltd. acquired 1,000 equity shares of X Limited at a premium of ₹ 4 per share. X Limited announced a bonus and right issue for existing shareholders.

The terms of bonus and right issue were—

(1) Bonus was declared, at the rate of two equity shares for every five equity shares held on 30th September, 2017.

(2) Right shares are to be issued to the existing shareholders on 1st December, 2017. The company issued two right shares for every seven shares held at 25% premium. No dividend was payable on these shares. The whole sum being payable by 31st December, 2017.

(3) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(4) Akash Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹ 8 per share.

(5) Dividend for the year ended 31st March 2017, at the rate of 20% was declared by the company and received by Akash Ltd., on 20th January 2018.

(6) On 1st February 2018, Akash Ltd., sold half of its shareholdings at a premium of ₹ 4 per share.

(7) The market price of share on 31.03.2018 was ₹ 13 per share.

You are required to prepare the Investment Account of Akash Ltd. for the year ended 31st March, 2018 and determine the value of share held on that date assuming the investment as current investment. Consider average cost basis for ascertainment of cost for equity share sold.

(*RTP November 2018*)

Answer

Investment Account-Equity Shares in X Ltd.

Date		No. of shares	Dividend	Amount	Date		No. of shares	Dividend	Amount
		₹	₹	₹			₹	₹	₹
2017					2018				
April 1	To Balance b/d	4,000	-	60,000	Jan. 20	By Bank (dividend)		8,000	2,000
Sept 1	To Bank	1,000	-	14,000	Feb.1	By Bank	4,000		56,000
Sept.30	To Bonus Issue	2,000		—	Mar. 31	By Balance c/d	4,000		42,250
Dec.1	To Bank (Right)	1,000	-	12,500					
2018									
Feb. 1	To Profit & Loss A/c			13,750					
Mar. 31	To Profit & Loss A/c (Dividend income)		8,000						
		8,000	8,000	1,00,250			8,000	8,000	1,00,250
April. 1	To Balance b/d	4,000		42,250					

Working Notes:

1. Cost of shares sold — Amount paid for 8,000 shares

	₹
(₹ 60,000 + ₹ 14,000 + ₹ 12,500)	86,500
Less: Dividend on shares purchased on 1st Sept, 2017	(2,000)
Cost of 8,000 shares	84,500
Cost of 4,000 shares (Average cost basis*)	42,250
Sale proceeds (4,000 shares @ 14)	56,000
Profit on sale	13,750

* For ascertainment of cost for equity shares sold, average cost basis has been applied.

2. Value of investment at the end of the year

Closing balance will be valued based on lower of cost (₹ 42,250) or net realizable value (₹13 × 4,000). Thus investment will be valued at ₹ 42,250.

3. Calculation of sale of right entitlement

1,000 shares × ₹ 8 per share = ₹ 8,000

Amount received from sale of rights will be credited to P & L A/c as per AS 13 'Accounting for Investments'.

4. Dividend received on investment held as on 1st April, 2017

= 4,000 shares × ₹ 10 × 20%

= ₹ 8,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st Sep. 2017

= 1,000 shares × ₹ 10 × 20% = ₹ 2,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30st Sept., 2017 and dividend pertains to the year ended 31.3.2017.

Question 33

Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2017 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On August 1st 2017 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On October 1st, 2017 the company sold 2,000 Debentures @ ₹ 103 each on ex-interest basis. The market value of the debentures as at the close of the year was ₹ 106. You are required to prepare the Investment in Debentures Account in the books of Alpha Ltd. for the year ended 31st Dec. 2017 on Average Cost Basis.

(*RTP May 2018*)

Answer:

8. Books of Alpha Ltd.
Investment in 13.5% Debentures in Pergot Ltd. Account
(Interest payable on 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
2017		**₹**	**₹**	**₹**	**2017**		**₹**	**₹**	**₹**
May 1	To Bank	5,00,000	5,625	5,19,375	Sept.30	By Bank (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec.31	To P&L A/c		52,313		Dec.31	By Balance c/d	5,50,000	18,563	5,60,542
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note: Cost being lower than Market Value the debentures are carried forward at Cost.

Working Notes:

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2017 for the month of April 2017, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2017
   On ₹ 5,00,000 = 5,00,000 x 13.5% x 1/2 = 33,750
   On ₹ 2,50,000 = 2,50,000 x 13.5% x 1/2 = 16,875
   Total ₹ 50,625
3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2017 for April 2017 to July 2017 as part of purchase price: 2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833
   Less: Sale Price (2,000 x 103) = 2,06,000
   Profit on sale = ₹ 2,167
5. Cost of Balance Debentures
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 5,50,000/₹ 7,50,000 = ₹ 5,60,542
6. Interest on Closing Debentures for period Oct.-Dec. 2017 carried forward (accrued interest)
   ₹ 5,50,000 x 13.5% x 3/12 = ₹ 18,563

Question 34

In 2015, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 2016, M/s. Kumar purchased 10,000 of these debentures at ₹101 cum-interest price, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 2017 the firm sold all of these debentures at ₹106 cum-interest price, again paying brokerage @ 1 % of cum-interest amount. Prepare Investment Account in the books of M/s. Kumar for the period 1st December, 2016 to 1st March, 2017.

(*MTP March 2019*) (*6 Marks*)

Answer

In the books of M/s Kumar
Investment Account
for the period from 1st December 2016 to 1st March, 2017
(Scrip: 12% Debentures of Royal Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.2016	To Bank A/c (W.N .1)	10,00,000	20,000	10,00,100	1.03.2017	By Bank A/c (W.N .2)	10,00,000	50,000	9,99,400
1.3.2017	To Profit & loss A/c	-	30,000		1.3.2017	By Profit & loss A/c			700
		10,00,000	50,000	10,00,100			10,00,000	50,000	10,00,100

Working Notes:

(i) Cost of 12% debentures purchased on 1.12.2016

	₹
Cost Value (10,000 × ₹101)	= 10,10,000
Add: Brokerage (1% of ₹10,10,000)	= 10,100
Less: Cum Interest (10,000 x 100 x12% x 2/12)	= (20,000)
Total	= 10,00,100

(ii) Sale proceeds of 12% debentures sold on 1st March, 2017

	₹
Sales Price (10,000 × ₹106)	= 10,60,000
Less: Brokerage (1% of ₹10,60,000)	= (10,600)
Less: Cum Interest (10,000 x 100 x12% x 5/12)	= (50,000)
Total	= 9,99,400

Question 35

Gopal holds 2,000, 15% Debentures of ₹ 100 each in Ritu Industries Ltd. as on April 1, 2015 at a cost of ₹2,10,000. Interest is payable on June, 30 and December, 31 each year. On May 1, 2015, 1,000 debentures are purchased cum-interest at ₹ 1,07,000. On November 1, 2015, 1,200 debentures are sold ex-interest at ₹1,14,600. On November 30, 2015, 800 debentures are purchased ex-interest at ₹ 76,800. On December 31, 2015, 800 debentures are sold cum-interest for ₹ 1,10,000. You are required to prepare the Investment Account showing value of holdings on March 31, 2016 at cost, using FIFO Method.

(*MTP April 2019*) (*10 Marks*)

Answer

Investment Account of Gopal
For the year ended 31.3.2016
(Script: 15% Debentures in Ritu Industries Ltd.)
(Interest payable on 30th June and 31st December)

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.04.15	To Balance A/c	2,00,000	7,500	2,10,000	30.06.15	By Bank A/c	-	22,500	
1.05.15	To Bank A/c	1,00,000	5,000	1,02,000	1.11.15	By Bank A/c	1,20,000	6,000	1,14,600
30.11.15	To Bank A/c	80,000	5,000	76,800	1.11.15	By Profit & Loss A/c	-	-	11,400
31.12.15	To Profit & Loss A/c			20,000	31.12.15	By Bank A/c	80,000	6,000	1,04,000
31.03.16	To Profit & Loss A/c		37,250		31.12.15	By Bank A/c	-	13,500	-
	(Bal. fig.)				31.12.15	By Bank A/c	-	6,750	-
					31.3.16	By Bal. c/d	1,80,000	-	1,78,800
		3,80,000	54,750	4,08,800			3,80,000	54,750	4,08,800

Working Notes:

(i) Accrued Interest as on 1st April, 2015 = ₹ $2,00,000 \times \frac{15}{100} \times \frac{3}{12} = ₹\,7,500$

(ii) Accrued Interest as on 1.5.2015 = ₹ $1,00,000 \times \frac{15}{100} \times \frac{4}{12} = ₹\,5,000$

(iii) Cost of Investment for purchase on 1st May = ₹ 1,07,000 – ₹ 5,000 = ₹ 1,02,000

(iv) Interest received as on 30.6.2015 = ₹ $3,00,000 \times \frac{15}{100} \times \frac{6}{12} = ₹\,22,500$

(v) Accrued Interest on debentures sold on 1.11.2015= ₹ $1,20,000 \times \frac{15}{100} \times \frac{4}{12} = ₹\,6,000$

(vi) Accrued Interest = ₹ $80,000 \times \frac{15}{100} \times \frac{5}{12} = ₹\,5,000$

(vii) Accrued Interest on sold debentures 31.12.2015 = ₹ $80,000 \times \frac{15}{100} \times \frac{6}{12} = ₹\,6,000$

(viii) Sale Price of Investment on 31st Dec. = ₹ 1,10,000 – ₹ 6,000 = ₹ 1,04,000

(ix) Loss on Sale of Debenture on 1.1.2015

Sale Price of Debenture	1,14,600
Less: Cost Price of debenture	
$\frac{2,10,000}{2,00,000} \times ₹\,1,20,000$	1,26,000
Loss on sale	11,400

(x) Accrued interest as on 31.12.2015 = ₹ $1,80,000 \times \frac{15}{100} \times \frac{6}{12} = ₹\,13,500$

(xi) Accrued Interest = ₹ $1,80,000 \times \frac{15}{100} \times \frac{3}{12} = ₹\,6,750$

(xii) Cost of investment as on 31st Marc h = ₹ 1,02,000 + ₹ 76,800 = ₹ 1,78,800

(xiii) Profit on debentures sold on 31st Dec ember
= ₹ 1,04,000 –(₹ 2,10,000x800/2,000) =₹ 20,000

Question 36

Meera carried out the following transactions in the shares of Kumar Ltd.:

(1) On 1st April, 2017 she purchased 40,000 equity shares of ₹ 1 each fully paid up for ₹ 60,000.

(2) On 15th May 2017, Meera sold 8,000 shares for ₹ 15,200.

(3) At a meeting on 15th June 2017, the company decided:

(i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2017, and

(ii) To give its members the right to apply for one share for every five shares held on 1st June 2017 at a price of ₹ 1.50 per share of which 75 paise is payable on or before 15th July 2017 and the balance, 75 paise per share, on or before 15th September, 2017.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2017.

(a) Meera received her bonus shares and took up 4000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30 th September 2017.

(b) On 15th March 2018, she received a dividend from Kumar Ltd. of 15 per cent in respect of the year ended 31st Dec 2017.

(c) On 30th March, 2018 she received ₹ 28,000 from the sale of 20,000 shares.

You are required to record these transactions in the Investment Account in Meera's books for the year ended 31st March 2018 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis. Expenses and tax to be ignored.

(*MTP October, 2018*) (*8 Marks*)

Answer

In the books of Meera Investment Account (Shares in Kumar Limited)

Date	Particulars	No. of Shares	Income	Amount	Date	Particulars	No. of Shares	Income	Amount
2017			₹	₹	**2017**			₹	₹
April 1	To Bank (Purchases)	40,000	-	60,000	May	By Bank (Sale)	8,000	-	15,200
May	To Profit & Loss A/c (W.N.1)	-	-	3,200					
June	To Bonus Issue	8,000	-	Nil	2018				
July	To Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By Bank (Dividend @ 15% on ₹ 32,000)		4,800	-
Sept.	To Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By Bank (Sale)	20,000	-	28,000
2018 Mar. 31	To Profit & Loss A/c (W.N.2)			3,455		By Balance c/d	24,000	-	29,455
	To Profit & Loss A/c	-	4,800		Mar. 31	$\left(\frac{24,000}{44,000} \times 54,000\right)$			
		52,000	4,800	72,655			52,000	4,800	72,655

Working Notes:

(1)	**Profit on Sale on 15-5-2017:**		
	Cost of 8,000 shares @ ₹1.50	₹ 12,000	
	Less: Sales price	₹ 15,200	
	Profit		₹ 3,200
(2)	**Cost of 20,000 shares sold:**		
	Cost of 44,000 shares (48,000 + 6,000)		₹ 54,000
	$\therefore$ Cost of 20,000 shares $\left(\frac{\text{Rs. } 54,000}{44,000} \times 20,000 \text{ shares}\right)$		₹ 24,545
	Profit on sale of 20,000 shares (₹ 28,000 – ₹ 24,545)		₹ 3,455

Question 37

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of ₹ 100 each of P Ltd. on 1st May 2018 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st 2018 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On 1st October, 2018 the company sold 2,000 Debentures @ ₹ 103 each. On 31st December, 2018 the company received 10,000 equity shares of ₹ 10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018. The market value of the debentures and equity shares as at the close of the year were ₹ 106 and ₹ 9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis.

(*RTP November 2019*)

Answer

Books of A Pvt. Ltd.
Investment in 13.5% Convertible Debentures in P Ltd. Account
(Interest payable 31st March & 30th September)

Date	*Particulars*	*Nominal*	*Interest*	*Amount*	*Date*	*Particulars*	*Nominal*	*Interest*	*Amount*
		₹	₹	₹			₹	₹	₹
2018					2018				
May 1	To Bank	5,00,000	5,625	5,19,375	Sept. 30	By Bank (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec. 31	To P&L A/c		52,313		Dec. 31	By Equity share	1,10,000		1,12,108
					Dec. 31	By Bank (See note1)		3,713	
					Dec. 31	By Balance c/d	4,40,000	14,850	4,48,434
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542

Note 1: ₹ 3,713 received on 31.12.2018 represents interest on the debentures converted till date of conversion.
Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

Investment in Equity shares in P Ltd. Account

Date	*Particulars*	*Nominal*	*Amount*	*Date*	*Particulars*	*Nominal*	*Amount*
		₹	₹			₹	₹
2018				2018			
Dec 31	To 13.5% Deb.	1,00,000	1,12,108	Dec.31	By P&L A/c		22,108
				Dec.31	By Bal. c/d	1,00,000	90,000
		1,00,000	1,12,108			1,00,000	1,12,108

Note 1: Cost being higher than Market Value the shares are carried forward at Market Value.

Working Notes:

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2018 for the month of April 2018, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2018

On ₹ 5,00,000 = 5,00,000 x 13.5% x ½ = 33,750
On ₹ 2,50,000 = 2,50,000 x 13.5% x ½ = 16,875
Total ₹ 50,625

3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018 as part of purchase price: 2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition

(₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833
Less: Sale Price (2,000 x 103) = 2,06,000
Profit on sale = ₹ 2,167

5. Interest on 1,100 Debentures (being those converted) for 3 months i.e. Oct-Dec. 2018 1,10,000 x 13.5% x 3/12 = ₹ 3,713
6. Cost of Debentures converted to Equity Shares

(₹ 5,19,375 + ₹ 2,45,000) x 1,10,000/7,50,000= ₹ 1,12,108

7. Cost of Balance Debentures

(₹ 5,19,375 + ₹ 2,45,000) x ₹ 4,40,000/₹ 7,50,000 = ₹ 4,48,434

8. Interest on Closing Debentures for period Oct.- Dec. 2018 carried forward (accrued interest)

₹ 4,40,000 x 13.5% x 3/12 = ₹ 14,850

Question 38

Mr. Harsh provides the following details relating to his holding in 10% debentures (face value of ₹100 each) of Exe Ltd., held as current assets:

1.4.2018	opening balance - 12,500 debentures, cost ₹12,25,000
1.6.2018	purchased 9,000 debentures @ ₹98 each ex-interest
1.11.2018	purchased 12,000 debentures @ ₹115 each cum-interest
31.1.2019	soled 13,500 debentures @ ₹110 each cum-interest
31.3.2019	Market value of debentures @ ₹115 each

Due dates of interest are 30th June and 31st December
Brokerage at 1% is to be paid for each transaction. Mr. Harsh closes his books on 31.3.2019.
Show investment account as it would appear in his books assuming FIFO method is followed

(*Suggested November 2019*) (*10 Marks*)/(*RTP May 2022*)

Answer

Investment Account of Mr. Harsh for the year ending on 31-3-2019
(Scrip: 10% Debentures of Exe Limited)
(Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
		₹	₹	₹			₹	₹	₹
1.4.18	To Balance b/d	12,50,000	31,250	12,25,000	30.6.18	By Bank 21,500 x 100 x 10% x 1/2	-	1,07,500	-
1.6.18	To Bank (ex-Interest) (W.N.1)	9,00,000	37,500	8,90,820	31.12.19	By Bank 33,500 x 100x10% x 1/2		1,67,500	

Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹	Date	Particulars	Nominal Value ₹	Interest ₹	Cost ₹
1.11.18	To Bank (cum-Interest) (W.N.2)	12,00,000	40,000	13,53,800	31.1.19	By Bank (W.N.3)	13,50,000	11,250	14,58,900
31.1.19	To Profit & Loss A/c (W.N.3)			1,34,920	31.3.19	By Balance c/d (W.N.4)	20,00,000	50,000	21,45,640
31.3.19	To Profit & Loss A/c (Bal. fig.)		2,27,500						-
		33,50,000	3,36,250	36,04,540			33,50,000	3,36,250	36,04,540

Working Notes:

1. **Purchase of debentures on 1.6.18**
   Interest element = 9,000 x 100 x 10% x 5/12 = ₹ 37,500
   Investment element = (9,000 x 98) + [1%(9,000 x 98)] = ₹ 8,90,820
2. **Purchase of debentures on 1.11.2018**
   Interest element = 12,000 x 100 x 10% x 4/12 = ₹ 40,000
   Investment element = 12,000 X 1 15 X 101% less 40,000 = ₹ 13,53,800
3. **Profit on sale of debentures as on 31.1.19**

	₹
Sales price of debentures (13,500 x ₹ 110)	14,85,000
Less: Brokerage @ 1%	(14,850)
	14,70,150
Less: Interest (1,35,000/ 12)	(11,250)
	14,58,900
Less: Cost of Debentures [(12,25,000 + (890820 X 1,00,000/ 9,00,000)]	(13,23,980)
Profit on sale	1,34,920

4. **Valuation of closing balance as on 31.3.2019:**
   Market value of 20,000 Debentures at ₹ 115 = ₹ 23,00,000
   Cost of
   8,000 Debentures = 8,90,820/ 9,000 X 8,000 = 7,91,840
   12,000 Debentures = 13,53,800
   Total 21,45,640
   Value at the end is ₹ 21,45,640, i.e., which is less than market value of ₹ 23,00,000.

Question 39

(a) In 2018, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year. On 1st December, 2019, M/s. Kumar purchased 10,000 of these debentures at ₹ 101 (cum-interest) price. On 1st March, 2020 the firm sold all of these debentures at ₹ 106 (cum-interest) price.

You are required to prepare Investment (Debentures) Account in the books of M/s. Kumar for the period 1st December, 2019 to 1st March, 2020.

(b) Mr. X acquires 200 shares of a company on cum-right basis for ₹ 60,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 105 each. He does not subscribe but sells all the rights for ₹ 15,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 50,000. What should be the accounting treatment in this case?

[*RTP, November 2020*]

Answer

(a) Investment Account in the books of M/s Kumar for the period from 1st December 2019 to 1st March, 2020
(Scrip: 12% Debentures of Royal Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.2019	To Bank A/c (W.N.1)	10,00,000	20,000	9,90,000	1.03.2020	By Bank A/c (W.N.2)	10,00,000	50,000	10,10,000
1.3.2020	To Profit & loss A/c		30,000	20,000					
		10,00,000	50,000	10,10,000			10,00,000	50,000	10,10,000

Working Notes:

(i)	Cost of 12% debentures purchased on 1.12.2019		₹
	Cost Value (10,000 x ₹101)	=	10,10,000
	Less: Interest (10,000 x 100 x12% x 2/12)	=	(20,000)
	Total	=	9,90,000
(ii)	Sale proceeds of 12% debentures sold on 1st March, 2020 Sales Price (10,000 x ₹106)		₹
		=	10,60,000
	Less: Interest (10,000 x 100 x12% x 5/12)	=	(50,000)
	Total	=	10,10,000

(b) As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹50,000. In this case, out of sale proceeds of ₹ 15,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value ₹50,000 and ₹ 5,000 would be credited to the profit and loss account.

Question 40

On 1st April, 2019, Mr. Vijay had 30,000 Equity shares in X Ltd. (the company) at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 2019, he purchased another 5000 shares of the same company for ₹ 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 2019.

On 31st August, 2019 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 2019, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31stOctober,2019, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 2019. Dividend for the shares acquired by him on 22ndJune,2019 to be adjusted against the cost of purchase.

On 15th November, 2019 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 2020 assuming the shares are being valued at average cost.

(10 Marks) (MTP, May 2020)

Answer

Books of Vijay
Investment Account
(Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.2019	To Bal b/d	30,000	4,50,000	31.10.2019	By Bank	—	10,000
22.6.2019	To Bank	5,000	80,000		(dividend		
10.8.2019	To Bonus	5,000	-		on shares		
30.9.2019	To Bank (Rights Shares)	10,000	1,50,000		acquired on 22/6/2019)		
15.11.2019	To Profit (on sale of shares)		32,000	15.11.2019	By Bank (Sale of shares)	20,000	3,00,000
				31.3.2020	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) Bonus Shares = (30,000 + 5,000) / 7 = 5,000 shares

(2) Right Shares $= \frac{(30,000 + 5,000 + 5,000)}{8} \times 3 = 15,000 \text{shares}$

(3) Rights shares sold = 15,000×1/3 = 5,000 shares

(4) Dividend received = 30,000×10×20% = ₹60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.2019= 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost Sales proceeds = ₹ 3,00,000

Average cost = $= \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 20,000 = \text{Rs.}2,68,000$

Profit = ₹ 3,00,000– ₹2,68,000= ₹32,000.

(7) Cost of shares on 31.3.2018

$$= \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 30,000 = \text{Rs.}4,02,000$$

(8) Sale of rights amounting ₹ 10,000 (₹ 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

Question 41

P Ltd. had 8,000 equity shares of K Ltd., at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April, 2019. On 1st September, 2019, P Ltd. acquired another 2,000 equity shares of K Ltd. at a premium of ₹4 per share. K Ltd. announced a bonus and right issue for existing shareholders.

The term of bonus and right issue were:

(i) Bonus was declared at the rate for two equity shares for every five shares held on 30th September, 2019.

(ii) Right shares are to be issued to the existing shareholders on 1st December, 219. The Company had issued two right shares for every seven shares held at 25% premium on face value. No dividend was payable on these shares. The whole sum being payable by 31st December, 2019.

(iii) Existing shareholders were entitled to transfer their right to outsiders either wholly or in part.

(iv) P Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹8 per share.

(v) Dividend for the year ended 31st March, 2019 at the rate of 20% was declared by K Ltd. and received by P Ltd. on 20th January, 2020.

(vi) On 1st February, 2020, P Ltd. sold half of its shareholdings at a premium of ₹ 4 per share.

(vii) The market price of share on 31st March, 2020 was ₹13 per share.

You are required to prepare the Investment account of P Ltd. for the year ended 31st March,2020 and determine the value of shares held on that date, assuming the investment as current investment. Consider average cost basis for ascertainment for cost for equity shares sold. (*Suggested, January, 2021*) (*10 marks*)

Answer

Investment Account-Equity Shares in K Ltd.

Date		*No. of shares*	*Dividend*	*Amount*	*Date*		*No. of shares*	*Dividend*	*Amount*
			₹	₹				₹	₹
1.4.19	To Bal.b/d	8,000	-	1,20,000	20.1.20	By Bank (dividend) [8,000 x 10 x 20%] and		16,000	4,000
1.9.19	To Bank	2,000	-	28,000	1.2.20	[2,000 x 10 x 20%]	8,000		1,12,000
30.9.19	To Bonus Issue	4,000		—		By Bank	8,000		
31.12.19	To Bank (Right) (W.N.1)	2,000	-	25,000	31.3.20	By Balance c/d (W.N. 3)			84,500
20.1.20	To Profit & Loss A/c (Dividend income)		16,000						
1.2.20	To P& L A/c (profit on sale)			27,500					
		16,000	16,000	2,00,500			16,000	16,000	2,00,500

Working Notes:

1. **Right shares**

   No. of right shares issued = (8,000 + 2,000 + 4,000)/ 7 X 2= 4,000 No. of right shares subscribed = 4,000 x 50% = 2,000 shares Value of right shares issued = 2,000 x ₹12.50 = ₹ 25,000

   No. of right shares sold = 2,000 shares

   Sale of right shares = 2,000 x ₹ 8 = ₹ 16,000 to be credited to statement of profit and loss

2. **Cost of shares sold — Amount paid for 16,000 shares**

	₹
(₹1,20,000 + ₹ 28,000 + ₹ 25,000)	1,73,000
Less: Dividend on shares purchased on Sept. 1 (since the dividend pertains to the year ended 31st March, 2019, i.e., the pre-acquisition period)	(4,000)
Cost of 16,000 shares	1,69,000
Cost of 8,000 shares (Average cost basis)	84,500
Sale proceeds (8,000 X ₹14)	1,12,000
Profit on sale	27,500

3. **Value of investment at the end of the year**
   Assuming investment as current investment, closing balance will be valued based on lower of cost or net realizable value.
   Here, Net realizable value is ₹13 per share i.e., 8,000 shares x ₹ 13 = ₹ 1,04,000 and cost = 84,500. Therefore, value of investment at the end of the year will be ₹ 84,500.

Question 42

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd ₹ 1,20,000 (face value ₹100 each).

On 5.04.2019 he further purchased 200 cum-right shares for ₹ 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of ₹ 20 each.

All the shares held by Shyam had been acquired on cum right basis and the total market price (ex-right) of all these shares after the declaration of rights got reduced by ₹ 3,400.

On 10.10.2019 Shyam sold 350 shares for ₹ 140 each. 31.03.2020 The market price of each share is ₹ 125 each.

You are required to prepare the Investment account in the books of Mr. Shyam for the year ended 31.03.2020 assuming that the shares are being valued at average cost. (*RTP, May 2021*)

Answer

In the books of Mr. Shyam

for the year ending on 31-3-2020 (Scrip: Equity Shares of X Limited)

Date	Particulars	Qty	Amount	Date	Particulars	Qty	Amount
1.4.2019	To Balance b/d	1000	1,20,000	8.04.2019	By Bank A/c (W.N.1)		3,400
5.04.2019	To Bank (200x ₹135)	200	27,000	10.10.2019	By Bank A/c (350x ₹140)	350	49,000
10.10.2019	To Profit & Loss A/c (W.N.2)		7,117	31.3.2020	By Balance c/d (W.N.3)	850	1,01,717
		1200	1,54,117			1200	1,54,117

Working Notes:

1. Sale of Rights ₹ 4,000
The market price of all shares of X Ltd after shares becoming ex-rights has been reduced by ₹ 3,400
In this case out of sale proceeds of ₹4,000; ₹ 3,400 may be applied to reduce the carrying amount to the market value and ₹ 600 would be credited to the profit and loss account.

2. Profit on sale of 350 shares

	Amount
Sale price of 350 shares (350 shares X 140 each)	₹ 49,000
Less: Cost of 350 shares [(1,20,000+27,000-3,400) X350]/1200	₹ 41,883
Profit	₹ 7,117

3. Valuation of 850 shares as on 31.03.2020

Particulars	Amount
Cost price of 850 shares [(1,20,000 +27,000 -3,400) x 850 /1,200]	₹ 1,01,717
Fair Value as on 31.03.2020 [850 X ₹ 125 each]	₹ 1,06,250
Cost price or fair value whichever is less	₹ 1,01,717

Question 43

On 1st April, 2019 Mr. H had 30,000 equity shares of ABC Ltd. at book value of ₹ 18 per share (Nominal value 10 per share). On 10th June, 2019, H purchased another 10,000 equity shares of the ABC ltd. at ₹ 16 per share through a broker who charged 1.5% brokerage.

The directors of ABC Ltd. announced a bonus and a right issue. The terms of the issues were as follows:

(i) Bonus shares were declared at the rate of one equity share for every four shares held on 15th July, 2019.
(ii) Right shares were to be issued to the existing equity shareholders on 31st August, 2019. The company decides to issue one right share for every five equity shares held at 20% premium and the due date for payment will be 30th September, 2019. Shareholders were entitled to transfer their rights in full or in part.
(iii) No dividend was payable on these issues.

Mr. H subscribed 60% of the rights entitlements and sold the remaining rights for consideration of ₹ 5 per share.

Dividends for the year ending 31st March, 2019 was declared by ABC Ltd. at the rate of 20% and received by Mr. H on 31st October, 2019.

On 15th January, 2020 Mr. H sold half of his shareholdings at ₹ 17.50 per share and brokerage was charged @1%.

You are required to prepare Investment account in the books of Mr. H for the year ending 31st March, 2020, assuming the shares are valued at average cost.

(*10 Marks*) (*Suggested November 2020*)

Answer

In the books of Mr. H

Investment in equity shares of ABC Ltd. for the year ended 31st March, 2020

Date	Particulars	No.	Income ₹	Amount ₹	Date	Particulars	No.	Income ₹	Amount ₹
2019 April 1	To Balance b/d	30,000	-	5,40,000	2019 Oct.	By Bank A/c (W.N. 5)	-	60,000	20,000
June	To Bank A/c	10,000	--	1,62,400	20X2 Jan.	By Bank A/c (W.N.4)	28,000	-	4,85,100
July	To Bonus Issue (W.N. 1)	10,000	-	-	March 31	By Balance c/d (W.N. 6)	28,000	-	3,77,200
Sept.	To Bank A/c (W.N. 2)	6,000	-	72,000					
2020 Jan.	To P & L A/c (W.N. 4)	-	-	1,07,900					
March 31	To P & L A/c	-	60,000	-					
		56,000	60,000	8,82,300			56,000	60,000	8,82,300

Working Notes:

1. Calculation of no. of bonus shares issued
Bonus Shares = (30,000 + 10,000) divided by 4= 10,000 shares

2. Calculation of right shares subscribed

$$\text{Right Shares} = \frac{30,000 \text{ shares} + 10,000 \text{ shares} + 10,000 \text{ shares}}{5}$$

10,000 shares
Shares subscribed 10,000 x 60% = 6,000 shares
Value of right shares subscribed = 6,000 shares @ ₹ 12 per share = ₹ 72,000

3. Calculation of sale of right entitlement
Amount received from sale of rights will be 4,000 shares x ₹ 5 per share
= ₹ 20,000 and it will be credited to statement of profit and loss.

4. Calculation of profit/loss on sale of shares-
Total holding = 30,000 shares original
10,000 shares purchased
10,000 shares bonus
6,000 shares right shares
56,000
50% of the holdings were sold i.e. 28,000 shares (56,000 x1/2) were sold. Cost of total holdings of 56,000 shares = ₹ 5,40,000 + ₹ 1,62,400 + ₹ 72,000– ₹ 20,000 = ₹ 7,54,400
Average cost of shares sold would be:

$$= \frac{7,54,400 \times 28,000}{56,000} \times 28,000 = ₹3,77,200$$

	₹
Sale proceeds of 28,000 shares (28,000 x ₹17.50)	4,90,000
Less: 1% Brokerage	(4,900)
	4,85,100
Less: Cost of 28,000 shares sold	(3,77,200)
Profit on sale	1,07,900

5. Dividend received on investment held as on 1st April, 2019
= 30,000 shares x ₹ 10 x 20%
= ₹ 60,000 will be transferred to Profit and Loss A/c and Dividend received on shares purchased on 10th June, 2019
= 10,000 shares x ₹ 10 x 20% = ₹20,000 will be adjusted to Investment A/c

6. Calculation of closing value of shares (on average basis) as on 31st March, 2020

$$\frac{7,54,400}{56,000} \times 28,000 = ₹\,3,77,200$$

Question 44

Remo Ltd. held on 1st April, 2021, 1000 9% Government Securities at ₹ 90,000 (Face Value of Security ₹ 100 each). Three month's interest had accrued on the above date. On 1st May, the company purchased the same Government Securities of the face value of ₹ 80,000 at ₹ 95 cum-interest. On 1st June, ₹ 60,000 face value of the security was sold at ₹ 94 cum-interest. Interest on the security was paid each year on 30th June and 31st December and was credited by the bank on the same date. On 30th September, ₹ 40,000 face value of the Govt. securities were sold at ₹ 97 cum-interest. On 1st December, the company purchased the same security ₹ 10,000 at par ex-interest. On 1st March, the company sold ₹ 10,000 face value of the government securities at ₹ 95 ex- interest.

You are required to draw up the 9% Government Security Account in the books of Remo Limited. FIFO method shall be followed.

Calculation shall be made to the nearest rupee or multiple thereof.

(*RTP May, 2023*)

Answer

In the Books of Remo Ltd.
9% Government Securities (Investment) Account

Particulars		*Face Value*	*Interest*	*Cost*	*Particulars*		*Face Value*	*Interest*	*Cost*
2021		*₹*	*₹*	*₹*	*2021*		*₹*	*₹*	*₹*
April 1	To Balance b/d	1,00,000	2,250	90,000	June 1	By Bank A/c	60,000	2,250	54,150
May 1	To Bank A/c	80,000	2,400	73,600	June 30	By Bank A/c	-	5,400	-
June 1	To P&L A/c	-	-	150	Sept. 30	By Bank A/c	40,000	900	37,900
Sept. 30	To P & L A/c	-	-	1,900	Dec. 31	By Bank A/c	-	4,050	-
Dec. 1	To Bank A/c	10,000	375	10,000	Mar.1 2022	By Bank A/c	10,000	150	9,500
Mar. 1 2022	To P&L A/c	-	-	300	Mar. 31 2022	By Balance c/d	80,000	1,800	74,400
Mar. 31, 2022	To P&L A/c (Transfer)	-	9,525	-					
		1,90,000	14,550	1,75,950			1,90,000	14,550	1,75,950

Working Notes:

1. Interest accrued on 1st April 2021 = ₹1,00,000 x 9% x 3/12 = ₹ 2,250
2. Accrued Interest on 800 units as on 01 05.2021 = ₹ 80,000 x 9/100 x 4/12 = ₹ 2,400
3. Cost of Investment for purchase on 01.05.2021 = ₹ 76,000 - ₹ 2,400 = ₹ 73,600
4. Accrued Interest on 600 units as on 01 06.2021 = ₹ 60,000 x 9/100 x 5/12 = ₹ 2,250
5. Profit on Securities sold on 1st June = ₹ 54,150 (56,400 – 2,250)- ₹ 54,000 (60,000 x 90,000/1,00,000) = ₹ 150
6. Interest received on 30 06.2021 = ₹1,20,000 x 9/100 x 6/12 = ₹ 5,400
7. Accrued Interest on 400 units as on 30 09.2021 = ₹ 40,000 x 9/100 x 3/12 = ₹ 900
8. Cost of 400 Govt. Securities sold on 30.09.2021 = 40,000 x 90,000/1,00,000 = ₹ 36,000
9. Profit on securities sold on 30th September = ₹37,900 (38,800-900) - ₹ 36,000 = ₹ 1,900
10. Accrued Interest on 1 12.2021 = ₹ 10,000 x 9/100 x 5/12 = ₹ 375
11. Interest received on 31 12.2021 = ₹ 90,000 x 9/100 x 6/12 = ₹ 4,050
12. Accrued Interest on 100 units as on 01 03.2022 = ₹ 10,000 x 9/100 x 2/12 = ₹ 150
13. Cost of 100 Govt. Securities sold on 01.03.2022 = ₹ 10,000 x 73,600/80,000 = ₹ 9,200
14. Profit on securities sold on 01.03.2022 = ₹ 9,500 - ₹ 9,200 = ₹ 300
15.

Calculation of closing balance:	*Units*	*₹*
Securities in hand remained in hand at 31/3/2022		
From original holding (1,00,000 – 60,000 – 40,000)		-
Purchased on 1st May (80,000 – 10,000)	70,000	64,400
Purchased on 1st December	10,000	10,000
	80,000	74,400

Question 45

The following information is given for Mr. Atwood for the year ended 31.03.2023 :

01.04.2022	Mr. Atwood has 3,000 equity shares in Sun Limited at a book value of ₹3,30,000 (nominal value ₹ 100 each).
01.07.2022	Purchased 1,500 equity shares in Sun Limited for ₹1,38,600.
01.08.2022	Purchased 5,000, 9% Bonds at ₹97 cum-interest (face value ₹100). The due dates of interest are 1st September and 1sl March.
02.10.2022	Dividend declared on equity shares and paid by Sun Limited for the year 2021-2022 @ 10%.
15.10.2022	Sun Limited made a bonus issue of two equity shares for every five shares held.
01.01.2023	1,000 equity shares in Sun Limited sold @ ₹115 per share.
31.03.2023	Sold 4,000, 9% Bonds @ ₹99 ex-interest

- The market price of Equity Shares of Sun Limited is ₹125 each and Bonds ₹98 each on 31st March 2023.
- Interest on bonds was received on due dates.

You are required to prepare Investment Account in the books of Mr. Atwood for the year ended 31st March 2023, assuming that the investments are valued at the average cost or market value, whichever is lower. (Round off to nearest Rupee)

(*G-I, May, 2023*) (*10 Marks*)

Question 46

On 1st April, 2022, Alpha has 1,00,000 equity shares of Beta Ltd. at a book value of ₹ 15 per share (*nominal value ₹ 10 each*)*. He provides you the further information:*

(1) On 20th June, 2022 he purchased another 20,000 shares of Beta Ltd. at ₹ 16 per share.

(2) On 1st August, 2022, Beta Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31st October, 2022, the directors of Beta Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹ 15 per share. Shareholders can transfer their rights in full or in part.

Alpha sold 1/3rd of entitlement to Umang for a consideration of ₹ 2 per share and subscribed the rest on 5th November, 2022.

You are required to prepare Investment A/c in the books of Alpha for the year ending 31st March, 2023.

(*5 Marks*) (*RTP November, 2023*) (*Accounts*)

Answer

In the books of Alpha

Investment Account (Equity shares in Beta Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.2022	To Balance b/d	1,00,000	15,00,000	31.3.2023	By Balance c/d (Bal. fig.)	1,80,000	24,20,000
20.6.2022	To Bank A/c	20,000	3,20,000				
1.8.2022	To Bonus issue (W.N.1)	20,000	-				
5.11.2022	To Bank A/c (right shares) (W.N.4)	40,000	6,00,000				
		1,80,000	24,20,000			1,80,000	24,20,000

Working Notes:

(1) Bonus shares = $\frac{1,00,000 + 20,000}{6} = 20,000 \text{ shares}$

(2) Right shares = $\frac{1,00,000 + 20,000 + 20,000}{7} \times 3 = 60,000 \text{ shares}$

(3) Sale of rights = $= 60,000 \text{ shares} \times \frac{1}{3} \times$ ₹2= ₹40,000 to be credited to statement of profit and loss

(4) Rights subscribed $= 60,000 \text{ shares} \times \frac{2}{3} \times ₹15 = ₹\,6,00,000$

Question 47

Kunal Securities Ltd. wants to reclassify its investments in accordance with AS -13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investment in Company A, costing ₹ 10.5 lakhs is to be re-classified as current investment. The company had reduced the value of these investments to ₹ 9 lakhs to recognize a permanent decline in value. The fair value on the date of reclassification is ₹ 9.3 lakhs.

(ii) Long term investment in Company B, costing ₹ 14 lakhs is to be re-classified as current investment The fair value on the date of reclassification is ₹ 16 lakhs and book value is ₹ 14 lakhs.

(iii) Current investment in Company C, costing ₹12 lakhs is to be re-classified as long term investment as the company wants to retain them. The market value on the date of reclassification is ₹ 13.5 lakhs.

(iv) Current investment in Company D, costing ₹ 18 lakhs is to be re-classified as long term investment. The market value on the date of reclassification is ₹ 16.5 lakhs.

(MTP September, 2023) (Accounts) (5 Marks)

Answer

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 9 lakhs in the books.

(ii) The carrying/book value of the long-term investment is same as cost i.e., ₹ 14 lakhs. Hence this long-term investment will be reclassified as current investment at book value of ₹ 14 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹ 12 lakhs as cost are less than its market value of ₹ 13.5 lakhs.

(iv) Market value of the investment is ₹ 16.5 lakhs, which is lower than its cost i.e., ₹ 18 lakhs. Therefore, the transfer to long term investments should be done in the books at the market value i.e., ₹ 16.5 lakhs.

Question 48

On 15th June, 2024, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decide and state the amount of transfer, based on the following information:

(1) A portion of long term investments purchased on 1st March, 2023 are to be re-classified as current investments. The original cost of these investments was ₹ 14 lakhs but had been written down by ₹ 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2024 was ₹ 11 lakhs.

(2) A portion of current investments purchased on 15th March, 2024 for ₹ 7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2024 was ₹ 6 lakhs and fair value on 15th June 2018 was ₹ 8.5 lakhs.

(*MTP Advanced Accounting April, 2024*) (*4 Marks*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are **made at the lower of cost and carrying amount** at the date of transfer; and where investments are reclassified from current to long term, transfers are made **at lower of cost and fair value** on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 12 lakhs in the books.

(ii) In this case, reclassification of current investment into long-term investments will be made at ₹ 7 lakhs as cost is less than its fair value of ₹ 8.5 lakhs on the date of transfer.

Question 49

Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2022 at a cost of ₹ 2,50,000. It also earlier purchased Gold of ₹ 4,00,000 and Silver of ₹ 2,00,000 on 1st March, 2020. Market value as on 31st March, 2023 of above investments are as follows:

	₹
Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2023 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

(*MTP Advanced Accounting March, 2024*) (*5 Marks*)

Answer

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹ 2,50,000) and market value (₹ 2,25,000) as on 31 March 2023, i.e., ₹ 2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognise a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 2020) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 2023, i.e., ₹ 4,00,000 and ₹ 2,00,000 respectively, though their market values have been increased.

Question 50

AS 13 "Accounting for Investments"

ABC Ltd. holds 2,000, 15% Debentures of ₹ 100 each in XYZ Ltd. as on April 1, 2022 at a cost of ₹ 2,50,000.

Interest is payable on June, 30 and December, 31 each year.

Following are the details of 15% Debentures purchased and sold during the year 2022-23.

Particulars
On May 1, 2022, 1,000 debentures are purchased cum-interest at ₹ 1,05,000.
On November 1, 2022, 1200 debentures are sold ex-interest at ₹ 1,28,200.
On November 30, 2022, 500 debentures are purchased ex-interest at ₹ 54,500.
On December 31, 2022, 900 debentures are sold cum-interest for ₹ 1,18,000

You are required to prepare the investment Account showing value of holdings on March 31, 2023 at cost, using FIFO Method.

(*RTP May, 2024*)

Answer

In the Books of ABC Ltd

15% Debentures (Investment) Account

Particulars		Face Value	Interest	Principal	Particulars		Face Value	Interest	Principal
		₹	₹	₹			₹	₹	₹
1.4.22	To Balance b/d	2,00,000	7,500	2,50,000	30.6.22	By Bank A/c		22,500	
					1.11.22	By Bank A/c	1,20,000	6,000	1,28,200
1.5.22	To Bank A/c	1,00,000	5,000	1,00,000	1.11.22	By P&L A/c			21,800
					31.12.22	By Bank A/c	90,000	6,750	1,11,250
30.11.22	To Bank A/c	50,000	3,125	54,500	31.12.22	By Bank A/c		10,500	
31.12.22	To P&L A/c		35,375	1,250	31.3.23	By Balance c/d	1,40,000	5,250	1,44,500
31.3.23	To P&L A/c (Transfer)	3,50,000	51,000	4,05,750			3,50,000	51,000	4,05,750

1. Loss on sale of debentures on 1.11.22

   Cost = 2,50,000/2,000X 1,200 = ₹ 1,50,000

   Sale proceeds = ₹ 1,28,200

   Loss = ₹ 1,50,000 less ₹ 1,28,200 = ₹ 21,800

2. Profit on sale of debentures on 31.12.22

   Cost = 2,50,000/2,000X 800 + 1,00,000/1,000X 100 = ₹ 1,10,000 (1,00,000+10,000)

   Sale proceeds = ₹ 1,11,250

   Loss = ₹ 1,11,250 less ₹ 1,10,000 = ₹ 1,250

3.

Calculation of closing balance:	**Units**		**₹**
Debentures in hand remained			
in hand at 1.4.23			
Purchased on 1st May, 22	900	1,00,000 x 9/10	90,000
Purchased on 30th Nov. 22	500	54,500	54,500
	1,400		1,44,500

MCQs

Question - 1: A current investment is an investment

Answer:

1. *That is readily realisable.*
2. *That is intended to be held for not more than one year from the date on which such investment is made.*
3. *Both 1 and 2*
4. *That is intended to be held for not more than two years from the date on which such investment is made.*

Question - 2: When long-term investments are reclassified as current investments, current investments are valued at

Answer:

1. *Cost.*
2. *Carrying amount.*
3. *Lower of Cost and Carrying amount.*
4. *Higher of Cost and Carrying amount.*

Question - 3: If an investment is acquired in exchange for another asset, it will be valued at

Answer:

1. *Fair value of the asset given up.*
2. *Fair value of the investment acquired.*
3. *Either (a) or (b), whichever is more clearly evident.*
4. *Book value of the asset given up.*

Question - 4: The cost of Right shares is

Answer:

1. *added to the cost of investments.*
2. *subtracted from the cost of investments.*
3. *no treatment is required.*
4. *added to cost of investments at market value.*

Question - 5: Long term investments are carried at

Answer:

1. *fair value.*
2. *cost less 'other than temporary' decline.*
3. *Cost and market value whichever is less.*
4. *Cost and market value whichever is higher.*

Question - 6: Current investments are carried at

Answer:

1. *Fair value.*
2. *cost.*
3. *Cost and fair value, whichever is less.*
4. *Cost and fair value, whichever is higher.*

Question - 7: A Ltd. acquired 2,000 equity shares of Omega Ltd. on cum-right basis at ₹75 per share. Subsequently, omega Ltd. made a right issue of 1:1 at ₹60 per share, which was subscribed for by A. Total cost of investments at the year- end will be

Answer:

1. *2,70,000.*
2. *1,50,000.*
3. *1,20,000.*
4. *1,70,000.*

Question - 8: Cost of investment includes

Answer:

1. *Purchase costs.*
2. *Brokerage and Stamp duty paid.*
3. *Both (a) and (b).*
4. *none of the above*

Question - 9: All the following are fixed income bearing securities except

Answer:

1. *Debentures.*
2. *Equity shares.*
3. *Govt. Bonds.*
4. *Loan.*

Answer

Q1	**3**	**Q2**	**3**	**Q3**	**3**	**Q4**	**1**
Q5	**2**	**Q6**	**3**	**Q7**	**1**	**Q8**	**3**
Q9	**2**						

Accounting Standard 19 Leases

Question 1

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

(*Source: Illustration 1, Study Material*)

Answer

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 2

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.

(*Source: Illustration 2, Study Material*)

Answer

As per AS 19 on Leases, ***unearned finance income*** is the difference between (a) the ***gross investment*** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

(a) ***Gross investment*** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹8,00,000 × 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 3

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.

(*Source: Illustration 3, Study Material*)

Answer

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 4

Explain the types of lease as per AS 19.

(*Source: Question 6, Study Material*)

Answer

For the purpose of accounting AS 19, classifies leases into two categories as follows:

1. Finance Lease
2. Operating Lease

Finance Lease:

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

As per para 8 of the standard, in following situations, the lease transactions are called Finance lease:

1. The lessee will get the ownership of leased asset at the end of the lease term.
2. The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.
3. The lease term covers the major part of the life of asset even if title is not transferred.
4. At the beginning of lease term, present value of minimum lease rental covers the initial fair value.
5. The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

Operating Lease:

It is lease, which does not transfer all the risks and rewards incidental to ownership.

Question 5

Explain the accounting treatment for a sale and leaseback transaction under Operating lease.

(*Source: Question 7, Study Material*)

Answer

As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately. Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Question 6

What do you understand by the term "Interest rate implicit on lease"?

(*Source: Question 8, Study Material*)

Answer

As per para 3 of AS 19 'Leases' the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Question 7

What are the disclosures requirements for operating leases by the lessee as per AS-19?

(*Source: Question 9, Study Material*)

Answer

As per AS 19, lessees are required to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:
   - (i) not later than one year;
   - (ii) later than one year and not later than five years;
   - (iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non- cancelable subleases at the balance sheet date;

(c) lease payments recognized in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognized in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:
   - (i) the basis on which contingent rent payments are determined;
   - (ii) the existence and terms of renewal or purchase options and escalation clauses; and
   - (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Question 8

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".

(*Source: Question 10, Study Material*)

Answer

(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 9

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.

(*Source: Question 11, Study Material*)

Answer

(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**.**

Question 10

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.

(*Source: Question 12, Study Material*)

Answer

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 11

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.

(*Source: Question 13, Study Material*)

Answer

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

Classification 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 12

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.

(*Source: Question 14, Study Material*)

Answer

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.

QUESTION BANK

Question 13

State any four situations when a lease would be classified as Finance Lease.

(May, 2015, 4 Marks)

Answer

Finance Lease is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership. As per AS 19, in following situations, the lease transactions would be classified as Finance lease:

(i) The lessee will get the ownership of leased asset at the end of the lease term.

(ii) The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.

(iii) The lease term covers the major part of the life of asset even if title is not transferred.

(iv) At the beginning of lease term, present value of minimum lease rental covers the initial fair value.

Question 14

Aksat International Limited has given a machinery on lease for 36 months and its useful life is 60 months. Cost & fair market value of the machinery is ₹5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹50,000. IRR of investment is 10% and present value of annuity factor of ₹1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

(*November 2015, 5 Marks*)

Answer:

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year

= ₹50,000 x 0.7513

= ₹37,565

Present value of lease payments = ₹5,00,000 – ₹37,565

= ₹4,62,435

The percentage of present value of lease payments to fair value of the equipment is

(₹4,62,435/ ₹5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment	=	₹4,62,435/ 2.4868 =₹1,85,956 (approx.)
Gross investment in the lease	=	Total minimum lease payments + unguaranteed residual value
	=	(₹1,85,956 × 3) + ₹50,000
	=	₹5,57,868 + ₹50,000 = ₹6,07,868
Unearned finance income	=	Gross investment - Present value of minimum lease payments and unguaranteed residual value
	=	₹6,07,868 – ₹5,00,000 = ₹1,07,868

Question 15

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP May 2018*)

Answer:

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹1,33,500 x 0.751)	1,00,258.50

	₹
Fair value to be recovered from lease payments (₹16,99,999.5 - ₹1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹15,99,741/2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

		₹
Total lease payments (₹6,43,500 x 3)		19,30,500
Add:	Unguaranteed residual value	1,33,500
	Gross investment in the lease	20,64,000.00
Less:	Present value of investment (lease payments and residual value) (₹1,00,258.5 + ₹15,99,741)	(16,99,999.50)
Unearned finance income		3,64,000.50

Question 16

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays ₹3,50,000. The lessee has guaranteed a residual value of ₹50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the salvage value of the machine will be only ₹35,000 only. It was not practicable for the lessee to determine the interest rate implicit in the lease, However the incremental borrowing rate of ABC Ltd. is determined at 16.4%. PV factors at 16.4% for year 1, year 2, year 3 and year 4 are 0.8591, 0.7381, 0.6341 and 0.5447 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

(*MTP April 2018/2019; March 2019; October 2019 & RTP November 2018/May 2020*) (*5 Marks*)

Answer:

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease 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.

Value of machinery

In the given case, fair value of the machinery is ₹10, 00,000 which is more than net present value of minimum lease payments of ₹9,98,835 (Refer working Note). Hence, the machine and the corresponding liability will be recorded at value of ₹9,98,835 in the books of ABC Ltd.

Calculation of finance charges for each year

Year	Finance charge	Payment	Reduction in outstanding liability	Outstanding liability
1st year beginning	-	-	-	9,98,835
End of 1st year	1,63,809	3,50,000	1,86,191	8,12,644
End of 2nd year	1,33,274	3,50,000	2,16,726	5,95,918
End of 3rd year	97,731	3,50,000	2,52,269	3,43,649
End of 4th year	56,358	4,00,000*	3,43,642	7**

Working Note:

Present value of minimum lease payments

Annual lease rental x PV factor 3,50,000 x (0.8591+ 0.7381+ 0.6341+ 0.5447)	₹9,71,600
Present value of guaranteed residual value 50,000 x (0.5447)	₹27,235
	₹9,98,835

** includes guaranteed residual value of ₹50,000 (considered to be paid).*

*** it should be nil, difference of ₹7 due to approximations.*

Question 17

Sun Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Su n Limited is not sure about the treatment of these lease rentals and seeks your advise. You are required to explain the necessary accounting treatment in line with AS 19. (use annuity factor at @ 15% for 3 years as 3.36)

(*MTP August 2018*) (*5 Marks*)

Answer:

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the

implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV - Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5)	3.36 (approx.)
Present Value of minimum lease payments (₹3 lakhs each year)	₹10.08 lakhs (approx.)

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 18

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 years, 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.

(*May 2019*) (*5 Marks*)

Answer:

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

* *Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 3,50,000 + 70,000 = 4,20,000.*

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 19

Sun Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

(*RTP November 2019*)

Answer:

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment• amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 3)	3.36
Present Value of minimum lease payments (₹3 lakhs each year)	₹10.08 lakhs (approx.)

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

- In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

Question 20

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.

(*November 2019, New Course, 5 Marks*)

Answer

(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 21

(a) Classify the following into either operating or finance lease:
  (i) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".
  (ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;
  (iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee .

(b) Viral Ltd. sold machinery having WDV of ₹40 lakhs to Saral Ltd. for ₹50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –
  (i) Fair value is ₹45 lakhs and sale price is ₹38 lakhs.
  (ii) Fair value is ₹40 lakhs and sale price is ₹50 lakhs.
  (iii) Fair value is ₹46 lakhs and sale price is ₹50 lakhs

(*RTP, November, 2020*)

Answer

(a) (i) The lease is a finance lease if X = Y, or if X substantially equals Y otherwise operating.
(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.
(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(b) As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately.

Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Following will be the treatment in the situations given in the question:

(i) When fair value of leased machinery is ₹45 lakhs & sales price is ₹38 lakhs, then loss of ₹2 lakhs (40 – 38) to be immediately recognized by A Ltd. in its books provided loss is not compensated by future lease payment.
(ii) When fair value is ₹40 lakhs & sales price is ₹50 lakhs then, profit of ₹10 lakhs is to be deferred and amortized over the lease period.
(iii) When fair value is ₹46 lakhs & sales price is ₹50 lakhs, profit of ₹6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of ₹4 lakhs (50-46) is to be amortized/deferred over lease period.

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.

You are required to compute: (i) Annual Lease Rent and (ii) Lease Rent income to be recognized in each operating year.

(*MTP, March, 2021*) (*5 marks*)

Answer

(i) Annual lease rent

Total lease rent

$$= 130\% \text{ of Rs. } 1,50,000 \times \frac{\text{Output during lease period}}{\text{Total output}}$$

= 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 recognized as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹26,000,

Year 2 ₹32,500 and

Year 3 ₹39,000.

Question 23

You are required to give the necessary journal entry at the inception of lease to record the asset taken on finance lease in books of lessee from the following information:

Lease period	=	5 years;
Annual lease rents	=	₹50,000 at the end of each year.
Guaranteed residual value	=	₹25,000
Fair Value at the inception (beginning) of lease	=	₹2,00,000

Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively).

(*MTP, April, 2021*) (*5 marks*)

Answer

Present value of minimum lease payment is computed below:

Year	MLP ₹	DF (12.6%)	PV ₹
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
			1,91,500

Present value of minimum lease payment = ₹1,91,500 Fair value of leased asset = ₹2,00,000

As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease payments from the standpoint of the lessee. The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

	₹	₹
Asset A/c Dr.	1,91,500	
To Lessor (Lease Liability) A/c		1,91,500
(Being recognition of finance lease as asset and liability)		

Question 24

Sooraj Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sooraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

(*RTP, May, 2021*)

Answer

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment* amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

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* *In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.*

Annuity Factor (Year 1 to Year 3)	3.36
Present Value of minimum lease payments (₹3 lakhs each year)	₹10.08 lakhs

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 25

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.

(Suggested, January, 2021) (5 marks)

Answer

Following will be the treatment in the given cases:

(i) When sale price of ₹400 lakhs is equal to fair value, X Ltd. should immediately recognise the profit of ₹100 lakhs (i.e. 400 – 300) in its books.
(ii) When fair value is ₹450 lakhs then also profit of ₹100 lakhs should be immediately recognised 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 recognised 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 amortised 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 recognised by X Ltd. in its books and profit of ₹40 lakhs (290-250) should be amortised/deferred over lease period.

Question 26

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 I 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 recognised in each operating year and
(iii) Depreciation for 3 years of lease

(*Question Paper of December 2021*) *(5 Marks)*

Answer

(i) Annual lease rent

Total lease rent
= 130% of ₹2,25,000 × Output during lease period/ Total output
= 130% of ₹2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)
= 2,92,500 x 2,25,000 units/4,50,000 units = ₹1,46,250
Annual lease rent = ₹1,46,250 / 3 = ₹48,750

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:
Year 1 ₹39,000,
Year 2 ₹48,750 and
Year 3 ₹58,500.

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹2,25,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is ₹30,000, year 2 = 37,500 and year 3 = 45,000.

Question 27

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipment's costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%. You are required to compute the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP November, 2022*)

Answer

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) (₹1,00,258.5+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question 28

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP May, 2023*)

Answer

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = ₹ 15,99,741/ 2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) (₹ 1,00,258.5+ ₹ 15,99,741)	(16,99,999.50)
Unearned finance income	3,64,000.50

Question 29

Aksat International Limited has given a machinery on lease for 36 months, and its useful life is 60 months. Cost & fair market value of the machinery is ₹ 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and present value of annuity factor of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹ 1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

(MTP September, 2023) (Advance Accounts) (5 Marks)

Answer

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year

= ₹ 50,000 x 0.7513 = ₹ 37,565

Present value of lease payments = ₹ 5,00,000 – ₹ 37,565 = ₹ 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (₹ 4,62,435/ ₹ 5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435/ 2.4868 = ₹ 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

= (₹ 1,85,956 × 3) + ₹ 50,000

= ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value = ₹ 6,07,868 – ₹ 5,00,000 = ₹ 1,07,868

Question 30

AS 19 "Leases"

Sooraj Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sooraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 2.28)

(*RTP May, 2024*)

Answer

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment[1] amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 3)	2.28
Present Value of minimum lease payments (₹ 3 lakhs each year)	₹ 6.84 lakhs

Thus present value of minimum lease payments is ₹ 6.84 lakhs and the fair value of the machine is ₹ 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 31

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.

(*MTP Advanced Accounting March, 2024*) (*5 Marks*)

Answer

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

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1 In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

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 32

Colour Limited leased a Machine to Red Limited on 1st April, 2021 on the following terms:

Cost of the machine	₹ 18,00,000
Lease term	3 years
Fair market value of the machine	₹ 18,00,000
Unguaranteed residual value as on 31.3.2024	₹ 2,00,000
Internal rate of return	12%

Other information:

The expected useful life of the machine is 5 years. The machine will revert to Colour Limited on termination of the lease. The lease payment is to be made at the end of each year in 3 equal parts.

The present value of ₹1 due at the end of 3rd year at 12% rate of interest is ₹ 0.7118. The present value of annuity of ₹ 1 due at the end of 3rd year at 12% IRR is ₹ 2.4018.

You are required to analyze whether lease constitutes finance lease. Also calculate unearned finance income, if any.

(*Question Paper May, 2024) (4 Marks*)

MCQs

Question - 1: X limited has taken machinery on Operating lease for 3 years. Initial yearly rent is ₹10,000. Rent is subject to 5% escalation every year. General inflation rate in the country is also 5% per year. What amount will be charged in the statement of P&L in the first year? Present value of Total rent payment over 3 years is ₹26051.

Answer:

1. *₹10508.33*
2. *₹10000*
3. *₹26051*
4. *₹11302.55*

Question - 2: As per AS 19, a leased asset should be depreciated over the

Answer:

1. *Shorter of the lease term and the assets useful life*
2. *Longer of the lease term and the assets useful life*
3. *Entire lease term*
4. *Useful life of the asset.*

Question - 3: In the books of seller-lessee, If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount is:

Answer:

1. *immediately recognised as income or loss in the financial statements.*
2. *deferred and amortised over the lease term in proportion to the depreciation of the leased asset.*
3. *If there is loss, then immediately recognized in P&L statement and if there is gain, then amortised over the lease term.*
4. *Either A or B*

Question - 4: If Sale and leaseback transaction results in an operating lease and sale price is more than fair value, the Excess amount is

Answer:

1. *credited to Profit and Loss statement.*
2. *deferred and amortized over expected period of use of the asset.*
3. *deferred and amortized over period of five years.*
4. *amortized in proportion to lease payments.*

Question - 5: If Sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should be

Answer:

1. *credited to Profit and Loss statement.*
2. *deferred and amortized over the lease term in proportion to the depreciation of the leased asset.*
3. *deferred and amortized over period of five years.*
4. *amortized in proportion to lease payments*

Question - 6: N Limited has taken a lease of land from S Limited for 15 years. Following are the terms of lease agreement: - N Limited to make payment of ₹1 lakh for 15 years. - N Limited to reimburse ₹10,000 tax to S limited every year. - If N Limited makes petrol pump on the land, then it has to pay ₹50,000 extra every year. N Limited is not sure about the receipt of approval for making petrol pump. - N Limited has option to purchase land for extra ₹10 lakh after end of lease. It is beneficial for N Limited to purchase land. Present Value of ₹1 lakh for 15 years is ₹12 lakh, Present value of ₹10 lakh after 15th year is 5.5 lakh. Calculate Minimum Lease Payment for N Limited.

Answer:

1. *₹25 Lakh*
2. *₹17.5 Lakh*
3. *₹34 Lakh*
4. *₹24.7 Lakh*

Question - 7: N Limited has entered into lease agreement for machinery from S Limited for 10 years for ₹1 lakh per year. Guaranteed scrap value of machinery after 15 years is ₹0.5 lakh unguaranteed scrap value is ₹0.2 lakh. Present Value of ₹1 lakh for 10 years is ₹7 lakh, Present value of ₹0.5 lakh after 15th year is 0.18 lakh & of ₹0.2 lakh is 0.07 lakh. Calculate Unearned Finance Income for S Limited.

Answer:

1. *₹3.45 Lakh*
2. *₹3 Lakh*
3. *₹3.32 Lakh*
4. *₹3.13 Lakh*

Question - 8: A Ltd. sold machinery having WDV of ₹40 lakhs to B Ltd. for ₹50 lakhs (Fair value ₹50 lakhs) and same machinery was leased back by B Ltd. to A Ltd. The lease back is in nature of operating lease. The treatment will be

Answer:

1. *A Ltd. should amortise the profit of ₹10 lakhs over lease term.*
2. *A Ltd. should recognise the profit of ₹10 lakhs immediately.*
3. *A Ltd. should defer the profit of ₹10 lakhs.*
4. *B Ltd. should recognise the profit of ₹10 lakhs immediately.*

Question - 9: In case of an operating lease – identify which statement is correct:

Answer:

1. *The lessor continues to show the leased asset in its books of accounts.*
2. *The lessor de-recognises the asset from its Balance Sheet.*
3. *The lessor discontinues to claim depreciation in its books.*
4. *The lessee recognises the asset in its Balance Sheet.*

Question - 10: In case of finance lease, if the asset is returned back to the lessor at the end of the lease term - the lessee always claims depreciation based on which of the following:

Answer:

1. *Useful life.*
2. *Lease term.*
3. *Useful life or lease term whichever is less.*
4. *Useful life or lease term whichever is higher.*

Question - 11: AS 19 lays down 5 deterministic conditions to classify the lease as a finance lease. To classify the lease as an operating lease – which statement is correct?

Answer:

1. *Any 1 condition fails.*
2. *Majority of the 5 conditions fail.*
3. *All 5 conditions fail.*
4. *Any 2 conditions fails.*

Question - 12: The basis of classification of a lease is:

Answer:

1. *Control Test.*
2. *Risk and reward Test.*
3. *Both control test and risk and reward test.*
4. *Only reward Test*

Question - 13: On which date lessee should recognise Lease asset & Liability?

Answer:

1. *The date of the lease agreement*
2. *The date of a commitment by the parties to the principal provisions of the lease.*
3. *At earlier of A & B*
4. *The date when asset is available for use*

Answer

Q1	***2***	***Q2***	***1***	***Q3***	***2***	***Q4***	***2***
Q5	***2***	***Q6***	***1***	***Q7***	***1***	***Q8***	***2***
Q9	***1***	***Q10***	***3***	***Q11***	***3***	***Q12***	***2***
Q13	***3***						

Accounting Standard 26
Intangible Assets

Question 1

ABC Ltd. developed know-how by incurring expenditure of ₹20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

Answer

Journal Entry

		₹	₹
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	
Amortization A/c	Dr.	2,00,000	
To Know-how A/c*			14,00,000
[Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)]			

Question 2

The company had spent ₹45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1 -20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.

Answer

In the given case, the company spent ₹45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of ₹45 lakhs as an expense in the profit and loss account.

Question 3

A company with a turnover of ₹250 crores and an annual advertising budget of ₹2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

Answer

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of ₹2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹25 crores.

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* As per para 63 of AS 26 "Intangible Assets", there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹2 crores to the Profit and Loss account of the year is correct.

Question 4

What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?

Answer

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- identifiability,
- control over a resource and
- expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
b. The cost of the asset can be measured reliably.

Question 5

What is the measurement criteria at the time of initial recognition of Intangible assets acquired through separate acquisition?

Answer

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and
- any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

Question 6

What is the criteria for recognition and measurement of Internally generated intangible assets. Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the same applies for internally generated goodwill also?

Answer

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. For details, refer para 6.16.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

Question 7

Advise the complete accounting treatment for Research and development phase as per AS 26.

Answer

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Question 8

What is meant by Amortisation of an Intangible asset. What are the different methods for amortisation as per AS 26?

Answer

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

Question 9

Swift Ltd. acquired a patent at a cost of ₹80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years.

Answer

Swift Limited amortised ₹10,00,000 per annum for the first two years i.e. ₹20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

S	Net cash flows ₹	Amortisation Ratio	Amortisation Amount ₹
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

Question 10

AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred ₹20 lakhs towards Research. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

Answer

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting ₹20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

Question 11

During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	***₹***
Completion of detailed program and design (Phase 1)	*50,000*
Coding and Testing (Phase 2)	*40,000*
Other coding costs (Phase 3 & 4)	*63,000*
Testing costs (Phase 3 & 4)	*18,000*
Product masters for training materials (Phase 5)	*19,500*
Packing the products (1,500 units) (Phase 6)	*16,500*

Answer

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design, coding and testing. In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

QUESTION BANK

Question 12

A company acquired a patent at a cost of ₹160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹50 lakhs, ₹30 lakhs, ₹60 lakhs, ₹70 lakhs and ₹40 lakhs. Find out the amortization cost of the patent for each of the years.

(May 2018) (5 Marks)

Answer:

Company amortized ₹16,00,000 per annum for the first two years. Hence, Amortization for the first two years (₹16,00,000 x 2) = ₹32,00,000.

Remaining carrying cost after two years = ₹1,60,00,000 - ₹32,00,000

= ₹1,28,00,000

Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost ₹128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount ₹
I	-	0.1	16,00,000
II	-	0.1	16,00,000
III	50,00,000	0.2	25,60,000
IV	30,00,000	0.12	15,36,000
V	60,00,000	0.24	30,72,000
VI	70,00,000	0.28	35,84,000
VII	40,00,000	0.16	20,48,000
Total	250,00,000	1.000	160,00,000

Question 13

K Ltd. launched a project for producing product X in October, 2016. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2017. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

You are required to advise the Company as per the applicable Accounting Standard.

(*RTP May 2018*)

Answer

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2017.

Question 14

A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in lakhs)	Net operating cash flow (₹ in lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method.

You are required to determine the amortization method in line with AS 26.

(*MTP April 2018/2019 & October 2019*) (*5 Marks*)

Answer

As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-a-vis production is determined reliably. A Ltd. should amortize the license fee of ₹200 lakhs as under:

Year	Net operating Cash inflow (₹)	Ratio	Amortize amount (₹ in lakhs)
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200	0.11 (bal.)	22
	27,400	1.00	200

Question 15

Desire Ltd. acquired a patent at a cost of ₹1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹45,00,000, ₹42,00,000, ₹40,00,000, ₹38,00,000 and ₹35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows).

You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

(*RTP November 2018*)

Answer

Desire Limited amortised ₹20,00,000 per annum for the first two years i.e. ₹40,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows ₹	Amortization Ratio	Amortization Amount ₹
I	-	0.200	20,00,000
II	-	0.200	20,00,000
III	45,00,000	0.225	13,50,000
IV	42,00,000	0.21	12,60,000
V	40,00,000	0.20	12,00,000
VI	38,00,000	0.19	11,40,000
VII	35,00,000	0.175	10,50,000
Total	2,00,00,000	1.000	1,00,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortized in the ratio of net cash flows arising from the product of Desire Ltd.

Question 16

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 croes from the new product. The company had debited to its

Profit and Loss account the total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct?

(*RTP May, 2019*)

Answer

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset'.

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

Question 17

K Ltd. launched a project for producing product X in October, 2016. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2018. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard.

(MTP-March 2019/ RTP November 2019) (5 Marks)

Answer

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.

Question 18

As per provision of AS-26, how would you deal to the following situations:

(1) ₹23,00,000 paid by a manufacturing company to the legal advisor defending the patent of a product is treated as a capital expenditure.

(2) During the year 2018-19, a company spent ₹7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹200 crores and an annual advertising budget of ₹50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹50,00,000 incurred on extensive special initial advertisement campaign for the new product.

(*November 2019, 5 Marks*)

Answer

As per AS 26 “Intangible Assets”, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(ii) The company is required to expense the entire amount of ₹7,00,000 in the Profit and Loss account for the year ended 31 st March, 2019 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹25,00,000 and it should be recognized as expense

(iv) Expenditure of ₹50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the corre ct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

Question 19

A company acquired patent right for ₹1200 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year	1	2	3	4	5
Estimated future cash flows (₹ in lakhs)	600	600	600	300	300

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹150 lakhs. You are required to determine the amortization pattern under Accounting Standard 26.

(*May 2020*)

Answer

Amortization of cost of patent as per AS 26

Year	*Estimated future cash flow (₹ in lakhs)*	*Amortization Ratio*	*Amortized Amount (₹ in lakhs)*
1	600	.25	300
2	600	.25	300
3	600	.25	300
4	300	.40 (Revised)	120
5	300	.40 (Revised)	120
6	150	.20 (Revised)	60
			1,200

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be ₹300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Question 20

Sudesh Ltd. acquired a patent at a cost of ₹2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at ₹48,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years.

(*MTP, October, 2020*) (*5 marks*)

Answer

The entity amortised ₹48,00,000 per annum for the first two years i.e. ₹96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows ₹	Amortization Ratio	Amortization Amount ₹
I	-	0.20	48,00,000
II	-	0.20	48,00,000
III	36,00,000	0.180	25,92,000
IV	46,00,000	0.230	33,12,000
V	44,00,000	0.220	31,68,000
VI	40,00,000	0.200	28,80,000
VII	34,00,000	0.170	24,48,000
Total	2,00,00,000	1.000	2,40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

Question 21

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark “Sun” and strong case in regard to trademark “Surya”'. X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks?

(*RTP, November, 2020*)

Answer

As per AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs incurred for both trademarks must be recognized as an expense.

Question 22

RC Ltd. is showing an intangible asset at ₹72 lakhs as on 31 -3-2020. This asset was acquired for ₹120 lakhs as on 01-04-2014 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis.

You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books.

(*MTP, March, 2021*) (*5 marks*)

Answer

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2020 at ₹48 lakhs i.e. ₹120 lakhs less ₹72 lakhs (₹120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of ₹24 Lakhs (₹72 lakhs – ₹48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹48 lakhs will be amortized over remaining 4 years by amortizing ₹12 lakhs per year**.**

The necessary journal entry (for rectification) will be

Revenue Reserves	Dr. ₹24 Lakhs	
To Intangible Assets		₹24 Lakhs

(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

Question 23

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹10 lakh on research during first 5 months of the financial year 2020-21. The development of the process began on 1st September, 2020 and upto 31st March, 2021, a sum of ₹8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹2 lakh per annum for next five years. The cost of capital is 10%. The present value of annuity factor of ₹1 for 5 years @ 10% is 3.7908.

Decide the treatment of Research and Development Cost of the project as per AS 26.

(*MTP, April, 2021*) (*5 marks*)

Answer

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2020-21. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹8 lakhs incurred upto 31st March, 2021 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	₹2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹2 lakhs x 3.7908)	₹7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹8 lakhs or present value of future net cash flows ₹7.582 lakhs.

Hence, cost of an internally generated intangible asset will be ₹7.582 lakhs.

The difference of ₹0.418 lakhs (i.e. ₹8 lakhs – ₹7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21.

Amortisation - The company can amortise ₹7.582 lakhs over a period of five years by charging ₹1.516 lakhs per annum from the financial year 2021-2022 onwards.

Question 24

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

(*Suggested, November, 2020*)

Answer

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	300	.25	150
2	300	.25	150

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	600

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).The unamortized amount of the patent after third year will be ₹150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

Question 25

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹42 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?

(2) What is the carrying amount of the intangible asset as on 31st March, 2019?

(3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020 ?

What is the carrying amount of the intangible asset as on 31st March, 2020?

(*Suggested, November, 2020*) (*5 marks*)

Answer

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019

₹42 lakhs is recognized as an expense because the recognition criteria were not met until 1st November, 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2019

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

	(*₹ in lacs*)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and loss account	46

₹46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

(iv) Carrying value of intangible asset as on 31.03.2020

	(*₹ in lacs*)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

Question 26

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%

(ii) Additional Import Duty 5%

(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses ₹1,50,000.

(v) Professional fees for clearance from customs ₹50,000.

Compute the cost of software to be Capitalized as per relevant AS.

(*Suggested, January, 2021*) (*5 marks*)

Answer

Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in ₹(UK £1,46,250 x ₹100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	170,91,875

Note: Since entry tax has been mentioned as a recoverable/refundable tax, it is not included as part of the cost of the asset.

Question 27

During 2020-21, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above cost to be recognized in the books of accounts as per AS 26.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model.

In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria).

Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

Question 28

A company is showing an intangible asset at ₹88 lakhs as on 01.04.2021. This asset was acquired for ₹120 lakhs on 01.04.2017 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard.

(*RTP November 2021*)

Answer

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2021 at ₹72 lakhs i.e. ₹120 lakhs less ₹48 lakhs $\left(\frac{₹120\text{ Lakhs}}{10\text{ years}} \times ₹4\text{ years} = 48\text{ Lakhs}\right)$

The difference of ₹16 Lakhs (₹88 lakhs – ₹72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹72 lakhs will be amortized over remaining 6 years by amortizing ₹12 lakhs per year.

Question 29

(a) PQR Ltd. has acquired a Brand from another company for ₹100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.

(b) X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of Accounting Standards.

(*RTP May, 2022*)

Answer

(a) AS 26 'Intangible Assets" provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

(b) As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

Question 30

Surgical Ltd. is developing a new production process of surgical equipment. During the financial year ended 31st March, 2020 the total expenditure incurred on the process was ₹67 lakhs. The production process met the criteria. for recognition as an intangible assets on 1st January, 2020. Expenditure incurred till this date was ₹35 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2021 was ₹105 lakhs. As on 31st March, 2021, the recoverable amount of technique embodied in the process is estimated to be ₹89 lakhs. This includes estimates of future cash outflows and inflows.

Under the provisions of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020;

(ii) Carrying amount of the intangible asset as on 31st March, 2020;

(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2021;

(iv) Carrying amount of the intangible asset as on 31st March, 2021.

(*Question Paper of December 2021*) *(5 Marks)*

Answer

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

₹35 lakhs is recognized as an expense because the recognition criteria were not met until 1stJanuary 2020. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2020

At the end of financial year, on 31st March 2020, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹32 (67-35) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1stJanuary 2020).

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2021

	(₹ in lacs)
Carrying Amount as on 31.03.2020	32
Expenditure during 2020 – 2021	105
Book Value	137
Recoverable Amount	(89)
Impairment loss	48

₹48 lakhs to be charged to Profit and loss account for the year ending 31.03.2021.

(iv) Carrying value of intangible asset as on 31.03.2021

	(₹ in lacs)
Book Value	137
Less: Impairment loss	(48)
Carrying amount as on 31.03.2021	89

Question 31

M/s. Mahesh Ltd. is developing a new production process. During the Financial Year ended 31st March, 2013, the total expenditure incurred on the process was ₹60 lacs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012. Expenditure incurred till this date was ₹32 lacs.

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹90 lacs. As on 31.03.2014, the recoverable amount of know-how embodied in the process is estimated to be ₹82 lacs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2013?
(ii) What is the carrying amount of the intangible asset as on 31st March, 2013?
(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2014?
(iv) What is the carrying amount of the intangible asset as on 31st March, 2014?

(*May, 2015, 5 Marks*)

Answer

As per AS 26 'Intangible Assets'

(i) **Expenditure to be charged to Profit and Loss account for the year ending 31.03.2013**

₹32 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2012. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) **Carrying value of intangible asset as on 31.03.2013**

At the end of financial year, on 31st March 2013, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹28 (60-32) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2012).

(iii) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2014**

	(₹ in lacs)
Carrying Amount as on 31.03.2013	28
Expenditure during 2013-2014	90
Book Value	118
Recoverable Amount	(82)
Impairment loss	36

₹36 lakhs to be charged to Profit and loss account for the year ending 31.03.2014.

(iv) **Carrying value of intangible asset as on 31.03.2014**

	(₹ in lacs)
Book Value	118
Less: Impairment loss	(36)
Carrying amount as on 31.03.2014	82

Question 32

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 crores from the new product. The Company had debited to its Profit and Loss account and total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct? (*November, 2016, 5 Marks*)

Answer

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

Question 33

K Ltd. launched a project for producing product X in October, 2021. The Company incurred ₹ 40 lakhs towards Research and Development expenses upto 31st March, 2022. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

(*RTP November, 2022*)

Answer

As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case.

Hence, the expenses amounting ₹ 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2022.

Question 34

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of 600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	*1*	*2*	*3*	*4*	*5*
Cash Flows (*in lacs*)	*300*	*300*	*300*	*150*	*150*

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be 75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

(*RTP November, 2023*) (*Advance Accounts*) (*5 Marks*)

Answer

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	300	.25	150
2	300	.25	150
3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	600

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).The unamortized amount of the patent after third year will be ₹ 150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

Question 35

Panna Limited purchased software from Agate Limited for a period of 5 years and capitalized the cost. It provided you the following information:

Cost of software ₹ 57,60,000.

Expected Life cycle of the software 5 years

The software was amortised at ₹ 6,40,000 per annum in first three years based on economic benefits derived from the software. After three years, it was found that the software may be used for another 5 years from then. So, Panna Limited got it renewed after expiry of five years for 3 more years.

The net cash flows from the software during these 5 years were expected to be as follows:

Year 1 ₹ 23,04,000

Year 2 ₹ 29,44,000

Year 3 ₹ 28,16,000

Year 4 ₹ 25,60,000

Year 5 ₹ 21,76,000

You are required to calculate the amortization cost of the software for each of the years.

(November Exam., 2023) (Advance Accounts) (5 Marks)

Question 36

K Ltd. launched a project for producing product X in October, 2023. The Company incurred ₹ 40 lakhs towards Research and Development expenses upto 31st March, 2024. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

(*MTP Advanced Accounting April, 2024*) (*5 Marks*)

Answer

As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case.

Hence, the expenses amounting ₹ 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2024.

MCQs

Question - 1: Which of the following is not covered within the scope of AS 26?

Answer:

1. *Intangible assets held-for-sale in the ordinary course of business*
2. *Assets arising from employee benefits*
3. *(a) & (b) both*
4. *Research and development activities*

Question - 2: Intangible asset is recognised if it:

Answer:

1. *meets the definition of an intangible asset*
2. *is probable that future economic benefits will flow*
3. *the cost can be measured reliably*
4. *meets all of the above parameters*

Question - 3: Sun Limited has purchased a computer with various additional software. These are integral part of the computer. Which of the following are true in the context of AS 26:

Answer:

1. *Recognise Computer and software as tangible asset*
2. *Recognise tangible and intangible separately*
3. *Recognise computer and software as intangible asset*
4. *Does not recognize the software as an asset.*

Question - 4: Hexa Ltd developed a technology to enhance the battery life of mobile devices. Hexa has capitalised development expenditure of ₹5,00,000. Hexa estimates the life of the technology developed to be 3 years but the company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in the second year of the product's life?

Answer:

1. *₹2,50,000*
2. *₹1,75,000*
3. *₹1,66,667*
4. *₹1,85,000*

Question - 5: An entity prepares quarterly interim financial reports in accordance with AS 25. The entity is engaged in sale of mobile phones and normally 5% of customers claim on their warranty. The provision in the first quarter was calculated as 5% of sales to date, which was ₹10 million. However, in the second quarter, a fault was found and warranty claims were expected to be 10% for the whole of the year. Sales in the second quarter were ₹15 million. What would be the provision charged in the second quarter's interim financial statements?

Answer:

1. *₹1 million*
2. *₹2 million*
3. *₹1.25 million*
4. *₹1.5 million*

Question - 6: Which of the following items qualify as an intangible asset under AS 26?

Answer:

1. *Advertising and promotion on the launch of a huge product*
2. *Operating losses incurred during the initial stages of the project*
3. *Legal costs paid to intellectual property lawyers to register a patent*
4. *expenditure on research*

Question - 7: Gain or loss arising from the disposal of an intangible asset is

Answer:

1. *recognised as income or expense in the Statement of Profit and Loss in the year of disposal.*
2. *deferred over a period of five years*
3. *capitalized.*
4. *not recognized at all*

Question - 8: Computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and is treated as _____

Answer:

1. *Intangible asset*
2. *Inventory*
3. *Property, plant and equipment*
4. *Current asset other than inventory*

Question - 9: Which of the following is not covered within the scope of AS 26?

Answer:

1. *Intangible assets held-for-sale in the ordinary course of business*
2. *Assets arising from employee benefits*
3. *(a) & (b) both*
4. *Research and development activities*

Question - 10: Intangible asset is recognised if it:

Answer:

1. *meets the definition of an intangible asset*
2. *is probable that future economic benefits will flow*
3. *the cost can be measured reliably*
4. *meets all of the above parameters*

Question - 11: Sun Limited has purchased a computer with various additional software. These are integral part of the computer. Which of the following are true in the context of AS 26:

Answer:

1. *Recognise Computer and software as tangible asset*
2. *Recognise tangible and intangible separately*
3. *Recognise computer and software as intangible asset*
4. *Does not recognize the software as an asset.*

Question - 12: Hexa Ltd developed a technology to enhance the battery life of mobile devices. Hexa has capitalised development expenditure of ₹5,00,000. Hexa estimates the life of the technology developed to be 3 years but the company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in the second year of the product's life?

Answer:

1. *₹2,50,000*
2. *₹1,75,000*
3. *₹1,66,667*
4. *₹1,85,000*

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts.

Answer

Q1	**3**	**Q2**	**4**	**Q3**	**1**	**Q4**	**2**
Q5	**2**	**Q6**	**3**	**Q7**	**1**	**Q8**	**3**
Q9	**3**	**Q10**	**4**	**Q11**	**1**	**Q12**	**2**

Accounting Standard 28
Impairment of Assets

Question 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property,

Plant and Equipment on 31-12-20X1.	*The discount rate is 15%.*	
Year	***Cash Flow (₹ in lakhs)***	
20X2	*4000*	
20X3	*6000*	
20X4	*6000*	
20X5	*8000*	
20X6	*4000*	
Residual value at the end of 20X6	*=*	*₹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.*

(*Source: Illustration 1, Study Material*)

Answer

Calculation of value in use

Year	*Cash Flow*	*Discount as per 15%*	*Discounted cash flow*
20X2	4,000	0.870	3,480
20X3	6,000	0.756	4,536
20X4	6,000	0.658	3,948
20X5	8,000	0.572	4,576
20X6	4,000	0.497	1,988
20X6	(residual) 1,000	0.497	497
			19,025

(a) Calculation of carrying amount:

Original cost = ₹40,000 lakhs

Depreciation for 3 years = [(40,000-1000) ×3/8] = ₹14,625 lakhs

Carrying amount on 31-12-20X1 = [40,000-14,625] = ₹25,375 lakhs

(b) Value in use = ₹19,025 lakhs

(c) Recoverable amount = higher of value in use and net selling price i.e. ₹20,000 lakhs.

Recoverable amount = ₹20,000 lakhs

(d) **Impairment Loss** = ₹(25,375-20,000) = ₹5,375 lakhs

(e) **Revised carrying amount** = ₹(25,375-5,375) = ₹20,000 lakhs

(f) **Depreciation charge for 20X2** = (20,000-1000)/5 = ₹3,800 lakhs

Question 2

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.

(*Source: Illustration 2, Study Material*)

Answer

Present value of future cash flow

Year ended	*Future Cash Flow*	*Discount @ 10% Rate*	*Discounted cash flow*
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53
31.3.20X5	20	0.683	13.66
31.3.20X6	20	0.620	12.40
			118.82
Present value of residual price on 31.3.20X6 = 5 × 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 31.3.20X1 is ₹60 lakhs, the recoverable amount will be higher of ₹121.92 lakhs (value in use) and ₹60 lakhs (net selling price), hence recoverable amount is ₹121.92 lakhs.

Question 3

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.

(*Source: Illustration 3, Study Material*)

Answer

Statement Showing Impairment Loss

	(₹ in crores)
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\frac{7 \text{ crores}}{7 \text{ years}} \times 4 years$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10
Less: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\frac{5.10 \text{ crores}}{3 \text{ years}} \times 3 \text{ years}$	(3.40)
Carrying amount as on 31.03.20X6	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve 20X4-20 X 5 & 20X5-20 X 6 = [(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

Question 4

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?

(*Source: Illustration 4, Study Material*)

Answer

Treatment of Impairment Loss

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹64.50 lakhs (₹67.50 lakhs – ₹3 lakhs) and value in use is ₹60 lakhs. Therefore, recoverable amount will be ₹64.50 lakhs. Impairment loss will be calculated as ₹10.50 lakhs [₹75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

	(₹ in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

Question 5

Write short note on impairment of asset and its application to inventory.

(*Source: Question 5, Study Material*)

Answer

The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss.

- If carrying amount < = Recoverable amount : Asset is not impaired
- If carrying amount > Recoverable amount : Asset is impaired Impairment Loss = Carrying Amount – Recoverable Amount

Recoverable amount is the higher of net selling price and its value in use This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

Question 6

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?

(*Source: Question 6, Study Material*)

Answer

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 7

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?

(*Source: Question 7, Study Material*)

Answer

As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where recoverable amount is the higher of an asset's net selling price* and its value in use**. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (negative ₹70,000)]. Thus impairment loss will be calculated as ₹6,00,000 [carrying amount (₹6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

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* *Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹70,000 = (₹70,000)*

** *Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.*

Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹70,000 as per AS 10 & 29.

Question 8

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.

(*Source: Question 8, Study Material*)

Answer

(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 9

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹54 crore per annum and has a carrying amount of ₹3.46 crore. All such machines put together could fetch a sum of ₹4.44 crore if disposed. Discuss the applicability of Impairment loss.

(*Source: Question 9, Study Material*)

Answer

As per provisions of AS 28 “Impairment of Assets”, impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Question 10

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

(*Source: Question 10, Study Material*)

Answer

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	₹
Current carrying amount (including revaluation amount of ₹14 lakhs)	27,30,000
Less: Current recoverable amount	(12,00,000)
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to

₹12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹4,00,000.

Question 11

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?

(*Source: Question 11, Study Material*)

Answer

As per AS 28 "Impairment of Assets", if the recoverable amount[2] of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognized as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 20X2	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹60 lakhs – ₹24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account (₹35.50 lakhs – ₹12 lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-)2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss) (₹60 lakhs – Nil)	60.00
	Entire book value of plant will be written off and charged to profit and loss account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 20X2

	(₹ in lakhs)
Opening book value as on 1.4.20X1 (₹500 lakhs – ₹415 lakhs)	85
Less: Depreciation for financial year 20X1–20X2	(25)
Closing book value as on 31.3.20X2	60
Estimated net selling price as on 1.4.20X1	30
Less: Estimated decrease during the year (20% of ₹30 lakhs)	(6)
Estimated net selling price as on 31.3.20X2	24
Estimated value in use as on 1.4.20X1	35.0
Less: Estimated decrease during the year (30% of ₹35 lakhs)	(10.5)
Estimated value in use as on 31.3.20X2	24.5

2 Recoverable amount is the higher of an asset's net selling price and its value in use.

QUESTION BANK

Question 12

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?.

(*MTP Advanced Accounting March, 2024*) (*4 Marks*)

Answer

Treatment of Impairment Loss

As per AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹ 64.50 lakhs (₹ 67.50 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs. Therefore, recoverable amount will be ₹ 64.50 lakhs. Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹ 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

	(₹ in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs /10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

MCQs

Question - 1: Read the statements given below: 1. Goodwill cannot be tested for impairment without allocation to CGU. 2. Corporate assets cannot be tested for impairment without allocation to CGU.

Answer:

1. *1 Both statements (1) and (2) are correct.*
2. *2 Both statements (1) and (2) are incorrect.*
3. *3 Only 1is correct.*
4. *4 Statements (1) correct and (2) is incorrect.*

Question - 2: If there is indication that an asset may be impaired but the recoverable amount of the asset is more than the carrying amount of the asset, the following are true:

Answer:

1. *No further action is required and the company can continue the asset in the books at the book value itself.*
2. *The entity should review the remaining useful life, scrap value and method of depreciation and amortization for the purposes of AS 10.*
3. *The entity can follow either (a) or (b).*
4. *The entity should review the scrap value and method of depreciation and amortization for the purposes of AS 10.*

Question - 3: In case Goodwill appears in the Balance Sheet of an entity, the following is true:

Answer:

1. *Apply Bottom up test if goodwill cannot be allocated to CGU (cash generating unit) under review.*
2. *Apply Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.*
3. *Apply both Bottom up test and Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.*
4. *Apply either Bottom up test or Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.*

Question - 4: In case of Corporate assets in the Balance Sheet of an entity, the following is true:

Answer:

1. *Apply Bottom up test if corporate assets cannot be allocated to CGU (cash generating unit) under review.*
2. *Apply Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.*
3. *Apply both Bottom up test and Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.*
4. *Apply either Bottom up test or Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.*

Question - 5: In case of reversal of impairment loss, which statement is true:

Answer:

1. *Goodwill written off can never be reversed.*
2. *Goodwill written off can be reversed without any conditions to be met.*
3. *Goodwill written off can be reversed only if certain conditions are met.*
4. *Goodwill written off can be reversed.*

Answer

Q1	**2**	**Q2**	**2**	**Q3**	**3**	**Q4**	**3**
Q5	**3**						

Accounting Standard 15
Employee Benefits

Question 1

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?

(*Source: Illustration 1, Study Material*)

Answer

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 2

Whether an enterprise is required to provide for employee benefits arising from informal practices?

(*Source: Illustration 2, Study Material*)

Answer

Paragraph 3(c) of the Standard defines employee benefits to include those informal practices that give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. The historical pattern of granting such benefits, the expectation created and the impact on the relationship with employees in the event such benefit is withdrawn should be considered in determining whether the informal practice gives rise to a benefit covered by the Standard. For example, where an employer has a practice of making a lumpsum payment on occasion of a festival or regularly grants advances against informal benefits to employees it would be necessary to provide for such benefits.

Careful judgement should be applied in assessing whether an obligation has arisen particularly in instances where an enterprise's practice is to provide improvements only during the collective bargaining process and not during any informal process. If the employer has not set a pattern of benefits that can be projected reliably to give rise to an obligation there is no requirement to provide for the benefits.

However, if the practice established by an employer was that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of the benefit obligation.

Employee benefits include:

(a) Short-term employee benefits (e.g., wages, salaries, paid annual leave and sick leave, profit sharing bonuses etc. (payable within 12 months of the year-end) and non-monetary benefits for current employees.

(b) Post-employment benefits (e.g., gratuity, pension, provident fund, post- employment medical care etc.).

(c) long-term employee benefits (e.g., long-service leave, long-term disability benefits, bonuses not wholly payable within 12 months of the year end etc.), and

(d) termination benefits (e.g. VRS payments)

The Standard lays down recognition and measurement criteria and disclosure requirements for the above four types of employee benefits separately.

Question 3

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.

(*Source: Illustration 3, Study Material*)

Answer

Total expense for the year (20X1-X2)	₹ 2 crore
Amount to be shown under liability (unpaid)	₹ 2 crore – 1.90 ₹crore
	= ₹ 10 lakhs

Question 4

Whether an entitlement to earned leave which can be carried forward to future periods is a short -term employee benefit or a long-term employee benefit.

(*Source: Illustration 4, Study Material*)

Answer

Paragraph 7.2 of the Standard defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service. Paragraph 8(b) of the Standard illustrates the term 'Short -term benefits' to include "short term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service".

Paragraph 7.2 of the Standard uses "falls due" as the basis, paragraph 8(b) of the Standard uses "expected to occur" as the basis to illustrate classification of short term compensated absences. A reading of paragraph 8(b) together with paragraph 7.2 would imply that the classification of short -term compensated absences should be only when absences have "fallen due" and are also "expected to occur". In other words, where employees are entitled to earned leave which can be carried forward to future periods, the benefit would be a 'short-term benefit' provided the employee is entitled to either encash or utilise the benefit during the twelve months after the end of the period when the employee became entitled to the leave and is also expected to utilise the leave.

Where there are restrictions on encashment and/or availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long-term benefit. For example, where an employee has 100 days of earned leave which he is entitled to an unlimited carry forward, but the rules of the enterprise allow him to encash/utilise only 30 days during the next twelve months, the benefit would be considered as a 'long-term' benefit. In some situations, where there is no restriction but the absence is not expected to wholly occur in the next twelve months, the benefit should be considered as 'long-term'. For example, where an employee has 400 days carry forward earned leave and the past pattern indicates that the employees are unlikely to avail / encash the entire carry forward during the next twelve months, the benefit would not be 'short-term'.

Whilst it is necessary to consider the earned leave which "falls due", the pattern of actual utilisation/ encashment by employees, although reflective of the behavioural pattern of employees, does determine the status of the benefit, i.e., whether 'short-term' or 'long-term'. The value of short-term benefits should be determined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordance with paragraph 129 of the Standard.

The categorisation in 'short-term' or 'long-term' employee benefits should be done on the basis of the overall behavioural pattern of all the employees of the enterprise and not on individual basis.

Question 5

In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be carried forward, whether it is required to recognise a provision in respect of carried forward benefits.

(*Source: Illustration 5, Study Material*)

Answer

A provision should be recognised for all benefits (conditional or unconditional) which an employee becomes entitled to as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In estimating the cost of such benefit the probability of the employee availing such benefit should be considered.

Question 6

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.

(*Source: Illustration 6, Study Material*)

Answer

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.

Question 7

As on 1st April, 20X1 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of

₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 20X2 the fair value of plan assets was ₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,47,920. Actuarial losses on the obligations for the year 20X1- 20X2 were ₹ 600.

On 1st April, 20X1, 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 and unrealised 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 plan assets.

(*Source: Illustration 7, Study Material*)

Answer

Computation of Expected and Actual Returns on Plan Assets

		₹
Return on ₹ 1,00,000 held for 12 months at 10.25%		10,250
Return on ₹ 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)		1,500
Expected return on plan assets for 20X1-20X2		11,750
Fair value of plan assets as on 31 March, 20X2		1,50,000
Less: Fair value of plan assets as on 1 April,20X1 1,00,000		
Contributions received	49,000	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		20,000

Alternatively, the above question may be solved without giving compound effect to rate of return.

Question 8

Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:

(a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.

(b) The fair value of plan assets on the date is estimated at ₹ 5,100.

(c) The unamortized past service cost is ₹ 180.

(d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

(*Source: Illustration 8, Study Material*)

Answer

Gain from curtailment is estimated as under:

	₹
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	₹
Reduced gross obligation (90% of ₹ 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of ₹ 180)	(162)
Liability to be recognised in the balance sheet	138

Question 9

An employee Roshan has joined a company XYZ Ltd. in the year 20X1. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring. Thus he will get 5 yearly increment.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

(*Source: Illustration 9, Study Material*)

Answer

Calculation of Defined Benefit Obligation (DBO)

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	*Opening balance*	*Interest cost*	*Current service cost*	*Closing balance*
a	**b**	**c = b x 8%**	**d**	**e = b + c + d**
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

Question 10

What are the types of Employees benefits and what is the objective of Introduction of this Standard i.e. AS 15?

Answer

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

(a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Question 11

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.

Answer

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 12

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.20X2 calculate the actual return on plan assets:

- Benefits paid	*2,00,000*
- Employer contribution	*2,80,000*
- Fair market value of plan assets on 31.03.20X2	*11,40,000*
- Fair market value of plan assets as on 31.03.20X1	*8,00,000*

Answer

	₹
Fair value of plan assets on 31.3.20X1	8,00,000
Add: Employer contribution	2,80,000
Less: Benefits paid	(2,00,000)
(A)	8,80,000
Fair market value of plan assets at 31.3.20X2 (B)	11,40,000
Actual return on plan assets (B-A)	2,60,000

Question 13

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was ₹ 3,00,000. On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	*10.25*
Realized gains on plan assets (after tax)	*3.00*
Fund administrative costs	*(3.00)*
Expected rate of return	*10.25*

Calculate the expected and actual returns on plan assets as on 31 st March, 20X2, as per AS 15.

Answer

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 20X2	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 20X2		3,00,000
Less: Fair value of Plan Assets 1st April, 20X1 as on	(2,00,000)	
Add: Contribution received as 30th September, 20X1 on	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 20X1		25,000
Actual returns on Plan Assets an on 31st March, 20X2		70,000

QUESTION BANK

Question 14

Hello Limited belongs to the manufacturing industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 12 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 4 lakhs instead of ₹ 10 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.

(*RTP May, 2024*)

Answer

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 ₹ 12 lakhs is required to be credited to the profit and loss statement of the current year.

MCQs

Question - 1: AS-15 is not applicable to:

Answer:

1. *Salary and Wages*
2. *Long-term service award*
3. *Employee Stock Options.*
4. *Termination benefits.*

Question - 2: Cost arising out of increase in the present value of the defined benefit obligation resulting from employee service in the current period is called:

Answer:

1. *Interest cost*
2. *Contribution to the plan*
3. *Current Service Cost*
4. *Past service cost*

Question - 3: Under which plan employers and employees contribute a fixed sum to the plan and some are invested in a separate entity?

Answer:

1. *Defined Benefit Plan*
2. *Defined Contribution plan*
3. *Multi-employers plan*
4. *Actuarial Assumptions*

Question - 4: Gratuity and Pension would be examples of:

Answer:

1. *Short-term employee benefits*
2. *Long-term employee benefits*
3. *Post-employment benefits.*
4. *None of the above.*

Question - 5: Non-accumulating compensating absence is commonly referred to as:

Answer:

1. *Earned Leave*
2. *Sick Leave*
3. *Casual leave*
4. *All of the above*

Question - 6: The plans that are established by legislation to cover all enterprises and are operated by Governments include:

Answer:

1. *Multi-Employer plans*
2. *State plans*
3. *Insured Benefits*
4. *Employee benefit plan*

Question - 7: Best estimates of the variable to determine the eventual cost of post- employment benefits is referred to as:

Answer:

1. *Employer's contribution*
2. *Actuarial assumptions*
3. *Cost to Company*
4. *Employee's contribution*

Question - 8: Actuarial gains/losses should be:

Answer:

1. *Recognised through reserves*
2. *Charged over the expected life of employees*
3. *Charged immediately to Profit and Loss Statement*
4. *Do not charged to Profit and Loss Statement*

Answer

Q1	***3***	***Q2***	***3***	***Q3***	***3***	***Q4***	***3***
Q5	***3***	***Q6***	***2***	***Q7***	***2***	***Q8***	***3***

Accounting Standard 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets

Question 1

At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	*Loss (₹)*
In respect of five cases (Win)	*100%*	□
Next ten cases (Win)	*50%*	□
Lose (Low damages)	*40%*	*1,20,000*
Lose (High damages)	*10%*	*2,00,000*
Remaining five cases		
Win	*50%*	□
Lose (Low damages)	*30%*	*1,00,000*
Lose (High damages)	*20%*	*2,10,000*

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

Answer

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 × 10 + ₹ 72,000 × 5) as contingent liability.

Question 2

EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following:

(i) The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(ii) The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 20X2.

Answer

(i) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed as a contingent liability of ₹ 2.10 crore.

(ii) The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

Question 3

When should provision be recognized as per provisions of AS 29? Explain in brief.

Answer

A provision should be recognised only when: (a) An enterprise has a present obligation as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation.

Question 4

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?

Answer

(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 5

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

Answer

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 BANK

Question 6

The company has not made provision for warrantee in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to examine in line with the provisions of AS 29.

(*RTP May 2018*)

Answer:

As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 7

Sun Ltd. has entered into a sale contract of ₹5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is ₹1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29? Explain.

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

(*MTP March 2018*) (*5 Marks*)

Answer:

(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 recognised. 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, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting ₹1.50 crores.

Question 8

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? You are required to explain in brief giving reasons for your answer.

(*RTP November 2018*)

Answer:

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Question 9

An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.

(*MTP August 2018*) (*5 Marks*)

Answer:

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

Question 10

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

(*RTP November 2019*)

Answer

As per para 46 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

Question 11

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: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	**Amount (₹)**
11th February 2017	60,000
25th December, 2017	40,000
04th October, 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.

(*November 2019, New Course, 5 Marks*)

Answer

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 12

With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

(ii) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31st December, 2019, it goes into liquidation. (Balance Sheet date 31-3-19).

(*May 2020*)

Answer

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date.

Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March, 2019.Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March, 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

Question 13

With reference to AS29 “Provisions, Contingent Liabilities and Contingent Assets”, define:

(i) A Provision

(ii) A Liability

(iii) A Contingent Asset

(iv) Present Obligation

(*May 2016, 4 Marks*)

Answer

(i) ***A Provision*** is a liability which can be measured only by using a substantial degree of estimation.

(ii) **A *Liability*** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

(iii) **A *Contingent asset*** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

(iv) ***Present obligation -*** An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Question 14

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS-29? Explain in brief giving reasons for your answer.

(*November, 2016, 4 Marks*)

Answer

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets’, a provision should be recognized when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Question 15

(a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.

(b) Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 2018-19 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2019-20 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2018-19 financial year. As on balance sheet date (31.3.2019), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement o f provision for contingency in the financial statements for the year ended 31st March, 2019, in line with provisions of AS 29?

(*RTP, November, 2020*)

Answer

(a) **A Contingent liability is a** possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

A present obligation that arises from past events but is not recognized because:

(i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

(b) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting ₹ 2 crores as per AS 29.

Question 16

(i) XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29 ? Explain in brief giving reasons for your answer.

(ii) What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard?

(*MTP, April, 2021*) (*5 marks*)

Answer

(i) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

(ii) As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

Question 17

(a) The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to **examine** in line with the provisions of AS 29.

(b) Explain whether provision is required in the following situations in li ne with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

(*RTP, May, 2021*)

Answer

(a) As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

(b) (i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognised. Disclosures are required for the provision.

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

Question 18

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.

(*Suggested, November, 2020*) (*5 marks*)

Answer

(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 24

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March.

(July, 2021 Suggested) (5 Marks)

Answer

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(*₹ in lacs*)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80

Question 25

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues in line with the provisions of AS 29:

(i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

(ii) The company had committed to supply a consignment worth ₹ 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth ₹ 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth ₹ 30 lakhs which was in transit.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

(i) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

(ii) Loss due to accident ₹ 30,00,000

Insurance claim receivable by company = ₹ 30,00,000 x 90%	=	₹ 27,00,000
Loss to be recognised in the books for 2019-2020		₹ 3,00,000
Insurance claim receivable to be recorded in the books		₹ 27,00,000

Compensation claim by dealer against company to be provided for in the books = ₹ 30,00,000 x 15% = ₹ 4,50,000.

Question 26

(a) A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

(b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29?

(*RTP November 2021*)

Answer

(a) As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

From the above, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts and circumstances of the case.

(b) As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

Question 27

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

(i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(ii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

(iii) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair/replacement is estimated at 10% of such sale value. During the year, the company has made a sale of ₹ 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(*RTP May, 2022*)

Answer

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

(i) an entity has a present obligation (legal or constructive) as a result of a past event;

(ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(ii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

(iii) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty cases for the entity where repair/replacement may be required as per past experience = 1% of ₹ 5,00,00,000 = ₹ 5,00,000

Estimated cost of repair/replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

Question 28

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.

(*Suggested November, 2022*) (*4 Marks*)

Answer

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 × 10 + ₹ 7,20,000 × 5) as contingent liability.

Question 29

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

(i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of ₹ 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.

(ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(iii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(*RTP November, 2022*)

Answer

Principles for recognition of provisions:

As per AS 29, "a provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

(ii) On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

Question 30

A Limited sells goods with unlimited right of return from its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	*% of Cumulative Sales*
Between 0-1 month	*6%*
Between 1-2 months	*7%*
Between 2-3 months	*8%*

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized for the year ended 31st March.

(*MTP September, 2023*) (*Advance Accounts*) (*5 Marks*)

Answer

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value(cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assuming that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for ₹ 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(₹ in lacs)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80
Profit mark up on sales (80/400) x 100 = 20%	

Question 31

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

(*MTP Advanced Accounting April, 2024*) (*4 Marks*)

Answer

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

MCQs

Question - 1: Which of the following best describes a provision?

Answer:

1. *A provision is a liability of uncertain timing or amount.*
2. *A provision is a possible obligation of uncertain timing.*
3. *A provision is a credit balance set up to offset a contingent asset so that the effect on the statement of financial position is nil.*
4. *A provision is a possible obligation of uncertain amount.*

Question - 2: XYZ limited has likely liability of ₹10 Crore for which it is considering to create provision in books of accounts. However, if liability materialises, then XYZ limited is entitled to sell an asset of ₹1 Crore. What should be the accounting treatment of ₹1 Crore while recognizing provision in books?

Answer:

1. *₹1 crore should be ignored*
2. *Provision should be reduced by ₹1 Crore*
3. *Gain should be recorded separately for ₹1 Cr.*
4. *Present value of ₹1 Cr should be recorded as income.*

Question - 3: A company had made a provision for rent liability of ₹10 Cr & interest provision of ₹1 Cr. However, Court made order to the company to pay ₹8 Cr Rent & ₹1.5 Cr interest. What should be the correct accounting treatment?

Answer:

1. *Provision for Rent of ₹2 Cr shall be written back and provision for interest shall be increased by ₹0.5 Cr.*
2. *Provision for Rent of ₹1.5 Cr shall be written back and remaining rent provision shall be adjusted with additional interest by ₹0.5 Cr.*
3. *Total provision of ₹11 Cr shall be written back and fresh rent & interest expense shall be booked by ₹8 Cr & ₹1.5 Cr respectively.*
4. *Provision for Rent of ₹10 Cr shall be written back and provision for interest shall be increased by ₹0.5 Cr.*

Question - 4: As per AS 29, Provisions, Contingent Liabilities and Contingent Assets warranty claims normally generate

Answer:

1. *A contingent liability.*
2. *A provision.*
3. *A contingent asset.*
4. *An onerous contract.*

Question - 5: When should a company dealing in hazardous goods make provision for social welfare expenditure if it is to be made mandatory as per new Law? Till 31.03.2022, it was not mandatory On 10.05.2022, minister made an announcement of developing the new law On 12.09.2022, Both houses of parliament approved it pending for Presidential approval On 29.09.2022, President approved the new law On 02.10.2022, gazette notification is issued for the new law.

Answer:

1. *On 10.05.2022*
2. *On 29.09.2022*
3. *On 02.10.2022*
4. *Since incorporation of the company as per moral duty*

Question - 6: AS 29 is applicable in making provision from which of the following case?

Answer:

1. *Onerous Contract*
2. *Executory Contract*
3. *Provision for employee benefit*
4. *Income tax provision*

Question - 7: An entity has made a provision for insurance liability of ₹5 Cr. Company has a policy to recover its insurance expenses from its dealers. What will be the accounting treatment if the recovery amount will be ₹6 Cr or ₹4 Cr?

Answer:

1. *Make provision of ₹5 Cr & Show receivable of ₹6 Cr or 4 Cr.*
2. *Make provision of ₹5 Cr & Show receivable of ₹5 Cr or 4 Cr.*
3. *Make provision of NIL or 1 Cr & show receivable of ₹1 Cr or NIL.*
4. *Make provision of NIL or 1 Cr & show receivable of NIL.*

Question - 8: What should be the accounting treatment of Income which is Virtually certain?
Answer:

1. *Recognised in P&L*
2. *Disclosed in notes to accounts*
3. *Considered as Remote*
4. *No Action is required*

Question - 9: In line with AS 29 Provisions, Contingent Liabilities and Contingent Assets, a provision shall be recognized when
Answer:

1. *An entity has a present obligation that is a result of a past event.*
2. *It is probable that an outflow of resources embodying economic benefits will be required.*
3. *A reliable estimate can be made of the amount of the obligation*
4. *All the three*

Question - 10: Which of the following best describes a provision?
Answer:

1. *A provision is a liability of uncertain timing or amount.*
2. *A provision is a possible obligation of uncertain timing.*
3. *A provision is a credit balance set up to offset a contingent asset so that the effect on the statement of financial position is nil.*
4. *A provision is a possible obligation of uncertain amount.*

Question - 11: X Co is a business that sells second hand cars. If a car develops a fault within 30 days of the sale, X Co will repair it free of charge. At 1st March 20X1, X Co had made a provision for repairs of ₹25,000. At 31st March 20X1, X Co calculated that the provision should be ₹20,000. What entry should be made for the provision in X Co's income statement for the month 31st March 20X1?
Answer:

1. *A charge of ₹5,000*
2. *A credit of ₹5,000*
3. *A charge of ₹20,000*
4. *A credit of ₹25,000*

Question - 12: Which of the following item does the statement below describe?
"A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity's control"
Answer:

1. *A provision*
2. *A current liability*
3. *A contingent liability*
4. *Deferred tax liability*

Question - 13: Z Ltd has commenced a legal action against Y Ltd claiming substantial damages for supply of a faulty product. The lawyers of Y Ltd have advised that the company is likely to lose the case, although the chances of paying the claim is not remote. The estimated potential liability estimated by the lawyers are: Legal cost (to be incurred irrespective of the outcome of the case) ₹50,000 Settlement if the claim is required to be paid ₹5,00,000
What is the appropriate accounting treatment in the books of Z Ltd.?
Answer:

1. *Create a Provision of ₹5,50,000*
2. *Make a Disclosure of a contingent liability of ₹5,50,000*
3. *Create a Provision of ₹50,000 and make a disclosure of contingent liability of ₹5,00,000*
4. *Create a Provision of ₹5,00,000*

Answer

Q1	**1**	**Q2**	**1**	**Q3**	**1**	**Q4**	**2**
Q5	**2**	**Q6**	**1**	**Q7**	**2**	**Q8**	**1**
Q9	**4**	**Q10**	**1**	**Q11**	**2**	**Q12**	**3**
Q13	**3**						

Accounting Standard 4
Contingencies and Events Occurring after the Balance Sheet Date

Question 1

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.

Decide whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1.

(*Source: Illustration 1, Study Material*)

Answer

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 amounts of assets, liabilities, expenses or incomes. If conditions were existing on balance sheet date.

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 2

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.

(*Source: Illustration 2, Study Material*)

Answer

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.

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 earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the report of the approving authority for financial year 20X1-X2 to enable users of financial statements to make proper evaluations and decisions.

Question 3

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.

(*Source: Illustration 3, Study Material*)

Answer

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 4

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.

(*Source: Illustration 4, Study Material*)

Answer

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 5

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.

(*Source: Illustration 5, Study Material*)

Answer

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 6

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?

(*Source: Illustration 6, Study Material*)

Answer

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 7

Y Ltd. has book debts and has a doubt over recoverability of some of the book debts. The amount that cannot be recovered is not quantifiable. Thus, Y Ltd. is of the opinion that provision for doubtful debts should not be created. Y Ltd. creates provision for certain other expenses on estimated basis.

Whether contention of Y Ltd. is correct?

(*Source: Illustration 7, Study Material*)

Answer

As per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date" if it is likely that a contingency will result in a loss to an entity then it should create provision for that contingency on the estimated basis.

Based on the above, the contention that provision for doubtful debt is not be created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books on the basis of estimation.

Question 8

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?

Answer

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 9

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.

Answer

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 BANK

Question 10

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 finalized 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?

(*November 2005, 4 Marks*)

Answer

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 11

X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at ₹ 10 lacs to another company for ₹ 15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.

(*November 2006, 4 Marks*)

Answer

According to para 13 of 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 additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February, 2009 *i.e.* before the balance sheet date.

Registration of the sale deed on 30th April, 2009, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2009.

Question 12

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2007 was detected only in May, 2007. 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 31.3.2007. Decide.

(*May 2007, 2 Marks*)

Answer

As per paragraph 13 of 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 recognize the loss amounting ₹5,00,000 and adjust the accounts of the company for the year ended 31st March, 2007.

Question 13

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. 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?

(*November 2009, 2 Marks*)

Answer

Para 8.3 of AS 4 "Contingencies and Events Occuring 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.* 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to para 8.6 of the standard, unusual changes affecting the existence or sub-stratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of ₹30 lakhs should be disclosed in the Report of the Directors for the financial year 2008-2009.

Question 14

A Company follows April to March as its Financial Year. The Company recognizes cheques dated 31st March or before, received from customers after balance sheet date, but before approval of Financial statement by debiting cheques in hand A/c and crediting Debtors A/c. The cheques in hand is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company?

(*May, 2010, 2 Marks*)

Answer

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on the balance sheet date *i.e.* 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date". Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

Question 15

While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad-debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 2010 a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by an insurance policy. In April 2010 the debtor become a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March 2010.

(*November, 2010 & November 2011, 5 Marks*)

Answer

As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the Balance Sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the Balance Sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March, 2010.

Question 16

Cashier of A-One Limited embezzled cash amounting to ₹6,00,000 during March, 2012. However same comes to the notice of the company management during April, 2012 only. Financial Statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions AS 4 "Contingencies and events occurring after the Balance Sheet Date" decide whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012?

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Board of Directors of the company?

(*May 2012, 4 Marks*)

Answer

As per AS-4 'Contingencies and Events Occurring after the Balance Sheet Date' issued by the Council of the Institute of Chartered Accountants of India, 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.

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 cash of ₹6,00,000 of A-One limited was embezzled during March 2012. However it came to the notice of management during April 2012 only. As the financial statements are not yet approved by the Board of directors of the company, embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012.

If embezzlement of cash comes to the notice of the management only after approval of financial statement by the board of directors, then it should not be adjusted or disclosed in the financial statements or books of accounts for the year ending March, 2012.

Question 17

Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2013.

(*May 2013, 4 Marks*)

Answer

Nature of Transaction on the date of Balance Sheet (31st March, 2013	*Treatment in the Books of Accounts*
Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.	In this case, the company has collected the amount before 31st March through its Marketing Personnel. Marketing Personnel being employees of the company, the collection of cheques constitutes a *"receipt"* by the company, before the Balance Sheet date. Subsequent realization in April provides additional evidence of the matter, and hence the Company can consider this as an "*Adjusting Event"* and account for such items as "*Cheques in Hand".*
Cheques sent by the stockists through courier on or before 31st March, 2013.	In this case, the Company has not *"received"* the Cheques before 31st March, 2013. Hence, mere sending of the cheques by the Stockists through Courier can not be treated as receipt on the Balance Sheet date. Therefore, this amount should not be adjusted in the accounts.

Question 18

State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013:

(i) An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹ 20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on 15th April, 2013.

(ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2013. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2013.

(*November 2013, 5 Marks*)

Answer

As per 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 additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the instant case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2013 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2013, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013.

As per AS 4 (Revised) "Events occurring after the balance sheet date" are the significant events (both favorable and unfavorable) that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. 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, 2013.

Applying provisions of this standard clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Question 19

With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.

(iii) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.

(iv) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.

(v) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

(*May 2016, 5 Marks*)

Answer

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. "Contingencies" used in the Standard is restricted to conditions or

situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is **non-adjusting** in nature.

(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a **non-adjusting** event.

(iii) In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a **non-adjusting** event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.

(iv) As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an **adjusting event** occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.

(v) Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a **non-adjusting** event and no disclosure is required in the report of the Approving Authority.

Question 20

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?

Comment with reference to relevant Accounting Standard. (*November, 2016, 5 Marks*)

Answer

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date. However, bankruptcy of debtors is an adjusting event.

Accordingly, full provision for bad debts amounting ₹ 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹ 19,00,000 shall be made (20,00,000 x 95%).

Question 21

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again.

State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised).

(*November 2018*) (*5 Marks*)

Answer

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner:

"Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

Question 22

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of ₹2 per equity share (on 2 crore fully paid up equity shares of ₹10 each) for the year ended31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements.

(*RTP May 2019*)

Answer:

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members/shareholders.

Question 23

While preparing its final accounts for the year ended 31st March, 2017, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2017 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2017 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2017? You are required to advise the company in line with AS 4.

(*RTP November 2018*)

Answer:

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹20,00,000 suffered heavy loss due to earthquake in the last week of February, 2017 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2017 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2017. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹19,00,000 shall be made (20,00,000 × 95%) for the year ended 31st March, 2017.

Question 24

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", identify whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet date in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹20 lakhs.

(*RTP May 2018*)

Answer:

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. "Contingencies" used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is non-adjusting in nature.

(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

Question 25

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?

Comment with reference to relevant Accounting Standard.

(*MTP March 2019*) (*5 Marks*)

Answer:

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the

determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹19,00,000 shall be made (20,00,000 x 95%).

Question 26

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events/transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15 April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020.

(*MTP*, *October 2021*) (*5 Marks*)

Answer

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30 June 2020.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020 -2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

(iii) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(iv) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019 -2020 because the violation of the conditions took place in the financial year 2019 -2020 and the company must be aware of it.

Question 27

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

(a) A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 26,50,000.

(b) On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.

(c) A claim for damage amounting to ₹ 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020.

(*RTP November 2021*)

Answer

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'

(a) The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property ₹ 1,50,000 would be considered.

(b) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

(c) On the basis of evidence provided, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

Question 28

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

(*RTP May, 2022*)

Answer

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, the financial statements for the year 2019-2020 should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.

(iii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

Question 29

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 23.05.2021. Loss was estimated to be ₹ 81,00,000.

(*Question Paper of December 2021*) (*5 Marks*)

Answer

(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 31st 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 30

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

(*RTP November, 2022*)

Answer

Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

Question 31

AS 4 "Contingencies and Events occurring after the balance sheet date"

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 5th April, 2023, claiming damages of ₹ 5 lakhs.

(ii) Company sends a proposal to sell an immovable property for ₹ 45 lakhs in March 2023. The book value of the property is ₹ 30 lakhs as on year end date. However, the Deed was registered on 15th April, 2023.

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.

(*RTP May, 2024*)

Answer

Accordingly, the treatment as per AS -4 "Events occurring after the balance sheet date" is:

(i) 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 5th 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.

However, it may be disclosed with the nature of contingency, being a contingent liability.

This event does not pertain to conditions on the balance sheet date. Hence, it will have no effect on financial statement and will be a non-adjusting event.

(ii) In this case, 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, 2023. There was just a proposal before 31st March, 2023 and hence sale cannot be shown in the financial statements for the year ended 31st March, 2023.

Sale of immovable property is an event occurring after the balance sheet date is a non-adjusting event.

MCQs

Question - 1: A company had made a provision for rent liability of ₹ 10 Cr & interest provision of ₹ 1 Cr. However, Court made order to the company to pay ₹ 8 Cr Rent & ₹ 1.5 Cr interest. What should be the correct accounting treatment?

Answer:

1. *Provision for Rent of ₹ 2 Cr shall be written back and provision for interest shall be increased by ₹ 0.5 Cr.*
2. *Provision for Rent of ₹ 1.5 Cr shall be written back and remaining rent provision shall be adjusted with additional interest by ₹ 0.5 Cr.*
3. *Total provision of ₹ 11 Cr shall be written back and fresh rent & interest expense shall be booked by ₹ 8 Cr & ₹ 1.5 Cr respectively.*
4. *Provision for Rent of ₹ 10 Cr shall be written back and provision for interest shall be increased by ₹ 0.5 Cr*

Question - 2: Which is adjusting event as per AS 4.

Answer:

1. *Decline in market value of investments between the balance sheet date and the date on which the financial statements are approved*
2. *Dividend declared after the balance sheet date but before the financial statements are approved for issue.*
3. *Filing of Bankruptcy by a major customer between the balance sheet date and the date on which the financial statements are approved*
4. *Loss from fire which took place between the balance sheet date and the date on which the financial statements are approved*

Question - 3: Cash amounting to ₹4 lakhs, stolen by the cashier in the month of March 20X1, was detected in April, 20X1. The financial statements for the year ended 31st March, 20X1 were approved by the Board of Directors on 15th May, 20X1. As per Accounting Standards, this is _____for the financial statements year ended on 31st March, 20X1.

Answer:

1. *An Adjusting event.*
2. *Non-adjusting event.*
3. *Contingency.*
4. *Provision*

Question - 4: As per Accounting Standards, events occurring after the balance sheet date are

Answer:

1. *Only favourable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.*
2. *Only unfavourable events that occur between the balance sheet date and the date when the 4:financial statements are approved by the Board of directors.*
3. *Those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of directors.*
4. *Those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are not approved by the Board of directors.*

Question - 5: AS 4 does not apply to

Answer:

1. *Obligation under retirement benefit plans.*
2. *Commitments arising from long term lease contracts.*
3. *liabilities of life assurance and general insurance enterprises arising from policies issued*
4. *Both (a) & (b).*

Answer

Q1	**1**	**Q2**	**3**	**Q3**	**1**	**Q4**	**3**	**Q5**	**4**

Accounting Standard 5
Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

Question 1

From the past 5 financial years, an old outstanding balance of ₹50,000 was still appearing as sundry creditor in the current year balance sheet of People Ltd. The company is certain that this amount is not payable due to one or more reasons. Therefore, it decided to write off the said amount in its current year's books of accounts and recognize it as income. The company treated the amount of ₹ 50,000 written off as a prior period item and made the adjustments accordingly.

The company is of the view that since sundry balances were recognized in the prior period(s), its related written-off amount should be treated as a prior period item.

(*Source: Illustration 1, Study Material*)

Answer

No, the company is not correct in treating the amount written off as a prior period item. As per AS 5, prior period items are income or expenses which arise in a current year due to errors or omissions in the preparation of the financial statements of one or more prior period(s).

Writing off an old outstanding balance in the current year which is appearing in its books of accounts from the past 5 financial years does not mean that there has been an error or omission in the preparation of financial statements of prior period(s). It is just a practice adopted by the company to write off the old outstanding balances of more than 5 years in its current year books of accounts. Therefore, the amount written off is not treated as a prior period item.

Hence, adjusting the amount ₹50,000 written off as a prior period item on the basis that sundry balances were recognized in prior period(s) is not in line with AS 5.

Question 2

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.

(*Source: Illustration 2, Study Material*)

Answer

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 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore, it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

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. For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

Question 3

(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 1.9.20 X2 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?

(*Source: Illustration 3, Study Material*)

Answer

(i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

(ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. 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 4

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.

(*Source: Illustration 4, Study Material*)

Answer

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 5

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.

(*Source: Illustration 5, Study Material*)

Answer

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 6

In the current year, A Ltd. changed the depreciation method from the Straight Line Method (SLM) to Written Down Value (WDV) method. When A Ltd. recomputed depreciation retrospectively as per the new method, deficiency arose in depreciation in respect of past years. Therefore, it reduced the carrying amount of the asset by the amount of deficiency and such change in carrying amount (deficiency amount) has been debited to the statement of profit and loss as an extraordinary expense.

Whether the change in the carrying amount of assets due to the change in depreciation method should be treated as an extraordinary item?

(*Source: Illustration 6, Study Material*)

Answer

No.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense.

A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

Question 7

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 Rs. 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?

Answer

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 BANK

Question 8

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

(*May 2019*) (*1 Marks*)

Answer

False: The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 9

PQR Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

(i) Goods worth ₹5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ₹3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31st March, 2018.

(ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra ordinary item or prior period item?

(*May 2018*) (*5 Marks*)

Answer:

(i) As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", *prior period items* are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given instance, it is clearly a case of error/omission in preparation of financial statements for the year 2015-16. Hence, claim received in the financial year 2017-18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

(ii) In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision.

As per AS 5, the revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

The effect of such change should be shown in the profit and loss account for the year ending 31st March, 2018.

Question 10

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. You are required to advise him in the following situations in accordance with the provisions of AS 5

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

(*RTP November 2018*)

Answer:

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction

of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 11

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets.

You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5.

(*RTP May 2018*)

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

Question 12

Examine 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.

(*MTP March 2019*) (*5 Marks*)

Answer:

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 13

The Accountant of a company has sought your opinion with relevant reasons, whether the following will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019-2020, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2020, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories.

(*MTP, May, 2020*) (*5 marks*)

Answer

(i) In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 14

A company created a provision of ₹ 7,50,000 for staff welfare while preparing the financial statements for the year *2020-21*. On 31st March 2021, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 10,00,000. The accounts were approved by Board of Directors on 15th April, 2021.

You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5?

(*MTP, March, 2021*) (*5 marks*)

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹ 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020-21.

As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

Question 15

S.T.B. Ltd. makes provision for expenses amounting ₹ 7,00,000 as on March 31, 2020, but the actual expenses during the year ending March 31, 2021 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 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

(*MTP, April, 2021*) (*5 marks*)

Answer

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of ₹ 2 lakhs, is not a prior period item. Therefore, in the given case expenses amounting ₹ 2,00,000 (i.e. ₹ 9,00,000 – ₹ 7,00,000) recorded in the current year, should not be regarded as prior period item.

Question 16

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.

(*Suggested, January, 2021*) (*5 marks*)

Answer

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra-ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long-term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra-ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

Question 17

(a) There was a major theft of stores valued at ₹ 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021.

(b) 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 organization. Explain whether this will constitute a change in accounting policy or not as per AS 5.

(*RTP November 2021*)

Answer

(a) Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

(b) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

Question 18

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 3%.

(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 the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2021, there was change in cost formula in measuring the cost of inventories.

(*RTP May, 2022*)

Answer

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2020. Subsequently in 2020-21, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in accounting estimate and is not a change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in accounting policy.

(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 not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 19

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.

(*Suggested November, 2022*) (*5 Marks*)

Answer

(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.

Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 20

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹ 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets. Do you agree with the treatment and disclosure? If not, state your views.

(*RTP November, 2022*)

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

Question 21

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.

(*RTP May, 2023*)

Answer

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

Question 22

ABC Ltd. was making provision for non-moving inventories based on issues for the last 12 months up to 31.3.2022.
The company wants to provide during the year ending 31.3.2023 based on technical evaluation:

Total value of Inventory	*₹ 100 lakhs*
Provision required based on 12 months issue	*₹3.5 lakhs*
Provision required based on technical evaluation	*₹ 2.5 lakhs*

Does this amount to change in Accounting Policy? Can the company change the method of provision?

(4 Marks) (RTP November, 2023) (Accounts)

Answer

Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy.

In the above case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material.

The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2022 -23:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year-end net assets would have been lower by ₹ 1 lakh."

MCQs

Question - 1: An entity wishes to accelerate its depreciation policy because of changes in the useful life of the asset. How should the change be dealt with?

Answer:

1. *By retrospective restatement*
2. *By retrospective application*
3. *By prospective application*
4. *By disclosure of an error*

Question - 2: There was an omission of ₹23,000 purchases from last year books and this error is traced in current year. This will be called as

Answer:

1. *(a) Exceptional item.*
2. *(b) Prior period item*
3. *(c) Event occurring after balance sheet date.*
4. *(d) Change in accounting estimates*

Question - 3: Which of the following may not be considered as an extra ordinary item?

Answer:

1. *Attachment of property of the enterprise*
2. *Losses sustained as a result of an earthquake*
3. *Claims from policyholders arising from an earthquake for an insurance enterprise that insures against such risks*
4. *Loss due to major fire in an important plant of the company*

Question - 4: There was an omission of ₹20,000 sales in last year books and this error is traced in current year. This will be called as

Answer:

1. *Exceptional item*
2. *Prior period item*
3. *Event occurring after balance sheet date*
4. *Change in accounting estimates*

Question - 5: Which of the following is a Prior Period item?

Answer:

1. *Arrears payable to workers as a result of revision of wages with retrospective effect during the current period*
2. *Change in the useful life of the asset in current year based on 3 years old technical estimate.*
3. *Income or expense recognised on the outcome of a contingency which previously could not be estimated reliably*
4. *Change in the estimate of the amount of bad debts based on court order in current year*

Question - 6: Following is not required to be disclosed separately in the statement of P&L?

Answer:

1. *Profit or loss from ordinary activities*
2. *Profit or loss from extraordinary activities*
3. *The nature and amount of prior period items*
4. *Impact of change in estimate in the normal course of transaction.*

Question - 7: Which of the following circumstances may not give rise to the separate disclosure of items of income and expense

Answer:

1. *The write-down of inventories to net realisable value*
2. *Legislative changes having retrospective application*
3. *Litigation settlements*
4. *Separation cost paid to CEO of the company*

Question - 8: A Ltd. 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. For the financial year ended 31st March, 20X1

Answer:

1. *The company should record the sale.*
2. *The company should recognise the profit of ₹20 lakhs in its profit and loss account.*
3. *Both (a) and (b).*
4. *The company should disclose the profit of ₹20 lakhs in notes to accounts.*

Question - 9: A change in the estimated life of the asset, which necessitates adjustment in the depreciation is an example of

Answer:

1. *Prior period item.*
2. *Ordinary item.*
3. *Extraordinary item.*
4. *Change in accounting estimate.*

Question - 10: Which of the following is considered as an extraordinary item as per AS 5?

Answer:

1. *Write down or write-off of receivables, inventory and intangible assets.*
2. *Gains and losses from sale or abandonment of equipment used in a business.*
3. *Effects of a strike, including those against competitors and major suppliers.*
4. *Flood damage from unusually heavy rain or a normally dry environment.*

Question - 11: Which one of the following is an example of extraordinary item?

Answer:

1. *The write down of inventories to their net realisable value*
2. *Reversal of write down of inventories*
3. *Government grants become refundable*
4. *Reversal of provisions.*

Question - 12: Extraordinary items are income or expenses

Answer:

1. *That arise from events clearly distinct from the ordinary activities of the enterprise.*
2. *That are not expected to recur frequently or regularly.*
3. *Both (a) and (b).*
4. *None of the three.*

Question - 13: An audit stock verification during the year ended 31st March, 20X1 revealed that opening stock of the year was understated by ₹5 lakhs due to wrong counting. While finalizing accounts, your opinion will be

Answer:

1. *It is not a prior period item and no separate disclosure is required*
2. *It should be treated as a prior period adjustment and should be separately disclosed in the current year's financial statement*
3. *The adjustment of ₹5 lakhs in both opening stock of current year and profit brought forward from previous year should be made*
4. *Both (b) and (c).*

Answer

Q1	**2**	**Q2**	**2**	**Q3**	**3**	**Q4**	**2**
Q5	**2**	**Q6**	**4**	**Q7**	**4**	**Q8**	**3**
Q9	**4**	**Q10**	**4**	**Q11**	**3**	**Q12**	**3**
Q13	**4**						

CHAPTER 19

Accounting Standards 22
Accounting for Taxes on Income

Question 1

Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	*= 2,00,000*
Depreciation as per income tax records	*= 5,00,000*
Unamortised preliminary expenses as per tax record	*= 30,000*

There is adequate evidence of future profit sufficiency. How much net deferred tax asset/liability should be recognised as transition adjustment? Tax rate 50%.

(*Source: Illustration 1, Study Material*)

Answer

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 50%
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

Question 2

From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	₹
Accounting Profit	*6,00,000*
Book Profit as per MAT	*3,50,000*
Profit as per Income Tax Act	*60,000*
Tax rate	*20%*
MAT rate	*7.50%*

(*Source: Illustration 2, Study Material*)

Answer

Tax as per accounting profit 6,00,000 × 20% = ₹ 1,20,000 Tax as per Income-tax Profit 60,000 × 20% = ₹ 12,000

Tax as per MAT 3,50,000 × 7.50% = ₹ 26,250

Tax expense= Current Tax +Deferred Tax

₹ 1,20,000 = ₹ 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-20X1

= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31 -03-20X1 Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000) = ₹ 1,34,250

Question 3

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

(*Source: Illustration 3, Study Material*)

Answer

Statement of Profit and Loss

	31.3.20X1 ₹	**31.3.20X2** ₹	**31.3.20X3** ₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year (2,00,000 x 40%)	80,000		
Tax effect of timing differences reversed/adjusted during the year (1,00,000 x 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

Question 4

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

(*Source: Illustration 4, Study Material*)

Answer

Calculation of Deferred Tax Asset/Liability in Omega Limited

Year	**Accounting Income**	**Taxable Income**	**Timing Difference**	**Timing Difference (balance)**	**Deferred Tax**	**Deferred Tax Liability (balance)**
20X0-20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1-20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2-20X3	21,00,000	23,00,000	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

Question 5

Write short note on Timing differences and Permanent differences as per AS 22.

Answer

In current practices, companies, in general, prepare books of accounts as per Companies Act, 2013 generating Accounting Profit/Loss and Income-tax Act, 1961 generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same. Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is not allowable as a deduction for tax purposes. Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation etc.

Question 6

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference is INR 200 lakhs and INR 400 lakhs respectively which will result in a tax liability in year 1 and 2. From the third year it is expected that the timing difference would reverse each year by INR 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

Answer

As per AS 22, 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income- tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of 200 lakhs timing difference due to depreciation, difference amounting 80 lakhs (10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for 120 lakhs (200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for 48 lakhs (40% of 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting 160 lakhs (40% of 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be 208 lakhs (48 lakhs + 160 lakhs).

Question 7

Ultra Ltd. has provided the following information: Depreciation as per accounting records =INR 4,00,000 Depreciation as per tax records =INR 10,00,000

Unamortized preliminary expenses as per tax record = INR 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%?

Answer

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 8

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.

Answer

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

Question 9

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".

Answer

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 BANK

Question 10

Write short not on Timing difference and permanent Difference as per AS 22.

(*May 2019*) (*5 Marks*)

Answer:

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income maybe different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as Permanent Difference. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income, known as Timing Difference.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

Question 11

Rohit Ltd. has provided the following information

Particulars	₹
Depreciation as per accounting records	2,50,000
Depreciation as per tax records	5,50,000
Unamortised preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax assets/liability should be recognized as transition adjustment when the tax rate is 50%?

(*May 2018*) (*5 Marks*)

Answer:

Table showing calculation of deferred tax asset/liability

Particulars	Amount ₹	Timing difference	Deferred tax	Amount @ 50% ₹
Excess depreciation as per tax records (₹5,50,000 - ₹2,50,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred tax asset	(20,000)
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹1,30,000 should be recognized as transition adjustment.

Question 12

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advise to the company.

(*RTP May 2019*)

Answer:

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

Question 13

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹1,000 lakhs and ₹2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹50 lakhs. Assuming tax rate of 40%, you are required to compute to the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

(*RTP November 2018*)

Answer:

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per

the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹1,000 lakhs depreciation, timing difference amounting ₹400 lakhs (₹50 lakhs × 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for ₹600 lakhs (₹1,000 lakhs - ₹400 lakhs), deferred tax liability will be recognized for ₹240 lakhs (40% of ₹600 lakhs) in first year. In the second year, the entire amount of timing difference of ₹2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting ₹800 lakhs (40% of ₹2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹1,040 lakhs (240 lakhs + 800 lakhs).

Question 14

Gamma Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2014-2015, 2015-2016 and 2016-2017 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 recognized revenue of ₹7,00,000, ₹18,00,000 and ₹23,00,000 for the years 2014-2015, 2015-2016 and 2016-2017 respectively. Income-tax rate is 35%.

You are required to compute the amount of deferred tax asset/liability for the years 2014-2015, 2015-2016 and 2016-2017. Also describe how this amount of deferred tax asset/liability will be disclosed in the balance sheet of Omega Limited as per provisions of AS 22.

(*MTP March 2018 & 2019*) (*5 Marks*)

Answer:

Gamma Limited
Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2014-2015	11,00,000	7,00,000	4,00,000	1,40,000
2015-2016	16,00,000	18,00,000	2,00,000	70,000
2016-2017	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

As per AS 22, deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

Question 15

The following particulars are stated in the Balance Sheet of PQR Ltd. as on 31.03.2018:

	(₹ in lakh)
Deferred Tax Liability (Cr.)	30.00
Deferred Tax Assets (Dr.)	15.00

The following transactions were reported during the year 2018-2019:

(i)	Tax Rate	30%
		(₹ in lakh)
(ii)	Depreciation as per books	80.00
	Depreciation for tax purposes	70.00
(iii)	Items disallowed in 2017-2018 and allowed for tax purposes in 2018-2019.	10.00
(iv)	Donations to Private Trust made in 2018-2019.	10.00

There were no additions to Fixed Assets during the year.

You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31.03.2019.

Answer

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

Transactions	*Analysis*	*Nature of difference*	*Effect*	*Amount*
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	₹ (80-70) lakh × 30% = ₹3 lakh

Transactions	*Analysis*	*Nature of difference*	*Effect*	*Amount*
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakh × 30% = ₹ 3 lakh
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 16

(a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books ₹ 2,80,000
Depreciation for tax purpose ₹ 1,90,000
The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing ₹ 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.

(iii) The company has made a profit of ₹ 6,40,000 before depreciation and taxes.

(iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22?

(*RTP, May, 2021*)

Answer

(a) Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)

			₹
Profit before depreciation and taxes			6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)			(3,10,000)
Profit before taxes	(A)		3,30,000
Less: Tax expense	(B)		
Current tax (W.N.1) (3,30,000 x 40%)		1,32,000	
Deferred tax (W.N.2)		NIL	(1,32,000)
Profit after tax	(A-B)		1,98,000

Working Notes:

1. Computation of taxable income

	Amount (₹)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2. Impact of various items in terms of deferred tax liability / deferred tax asset

S. No.	*Transactions*	*Analysis*	*Nature of difference*	*Effect*	*Amount (₹)*
(i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery Net impact	Due to Allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000 NIL

(b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Question 17

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.

(*Suggested, November, 2020) (5 marks)*

Answer

Tax as per accounting profit 15,00,000×20%= ₹ 3,00,000 Tax as per
Income-tax Profit 2,50,000×20% =₹ 50,000
Tax as per MAT 7,50,000×7.50%= ₹ 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 18

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.

(*Suggested, January, 2021*) (*5 marks*)

Answer

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 19

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020 -2021:

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21. Tax Rate to be taken at 40%.

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021.

*(*July, 2021 Suggested*) (*5 Marks*)*

Answer

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs × 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs × 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs × 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs × 40% =28 lakhs

Question 20

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22.

(*RTP November 2021*)

Answer

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

Question 21

The following transactions were reported by PQR Ltd. during the year 2020-2021:

(i)	Tax Rate	30%
(ii)	Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	(₹ in lakh) 20.00
(iii)	Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
(iv)	Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

(*RTP May, 2022*)

Answer

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	*Analysis*	*Nature of difference*	*Effect*	*Amount*
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	₹ 20 lakh × 30% = ₹ 6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 22

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.*

(iii) 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 31st March, 2022. Also show the effect of the above items on Deferred Tax Liability/Assets as per AS 22.

(Suggested November, 2022) (5 Marks)

Answer

Statement of profit and Loss for the year ended 31st March, 2022 (An Extract)

	₹
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

Question 23

Define followings as per AS 22:

(i) Accounting income (loss)

(ii) Taxable income (tax loss)

(iii) Tax expense (tax saving)

(*RTP November, 2022*)

Answer

Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.

Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Question 24

From the following details of Aditya Limited for accounting year ended on 31st March, 2023:

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.

(5 Marks) (RTP November, 2023) (Advance Accounts)

Answer

Tax as per accounting profit 15,00,000 x 20%= ₹ 3,00,000

Tax as per Income-tax Profit 2,50,000 x 20% =₹ 50,000

Tax as per MAT 7,50,000 x 7.50%= ₹ 56,250

Tax expense= Current Tax +Deferred Tax

₹ 3,00,000 = ₹ 50,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2023

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2023 Current Tax + Deferred Tax liability + Excess of MAT over current tax

MCQs

Question - 1: As per AS 22 on 'Accounting for Taxes on Income', tax expense is:

Answer:

1. *Current tax + deferred tax charged to profit and loss account*
2. *Current tax-deferred tax credited to profit and loss account*
3. *Either (a) or (b)*
4. *Deferred tax charged to profit and loss account*

Question - 2: G Ltd. has provided the following information: Depreciation as per accounting records = ₹2,00,000 Depreciation as per tax records = ₹5,00,000

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%?

Answer:

1. *Deferred Tax asset = ₹2,70,000.*
2. *Deferred Tax asset = ₹1,35,000.*
3. *Deferred Tax Liability = ₹2,70,000*
4. *Deferred Tax Liability = ₹1,35,000.*

Question - 3: State which of the followings statements are correct:

Answer:

(1) There are no pre-conditions required to recognize deferred tax liability,

(2) Deferred tax asset under all circumstances can only be created if and only if there is reasonable certainty that future taxable income will arise.

1. *Both are correct.*
2. *Only (1) is correct.*
3. *Only (2) is correct.*
4. *None of the statements are correct.*

Question - 4: Which of the following statement are incorrect:

Answer:

1. *Only timing differences result in creation of deferred tax.*
2. *Permanent differences do not result in recognition of deferred tax.*
3. *The tax rate used for measurement of deferred tax is substantively enacted tax rate.*
4. *The entity has to recognize deferred tax liability/asset arising out of timing difference. There are no conditions which are required to evaluated for their recognition.*

Answer

Q1	**3**	**Q2**	**4**	**Q3**	**1**	**Q4**	**4**

Accounting Standard 21
Consolidated Financial Statements

Question 1

From the following data, determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

Case	***Subsidiary Company***	***% shares owned***	***Cost***	***Date of acquisition***		***Consolidation Date***	
				1.1.20X1		***31.12.20X1***	
			₹	***Share Capital ₹***	***Profit & Loss Account ₹***	***Share Capital ₹***	***Profit & Loss Account ₹***
Case 1	*A*	*90%*	*1,40,000*	*1,00,000*	*50,000*	*1,00,000*	*70,000*
Case 2	*B*	*85%*	*1,04,000*	*1,00,000*	*30,000*	*1,00,000*	*20,000*
Case 3	*C*	*80%*	*56,000*	*50,000*	*20,000*	*50,000*	*20,000*
Case 4	*D*	*100%*	*1,00,000*	*50,000*	*40,000*	*50,000*	*55,000*

(*Source: Illustration 1, Study Material*)

Answer

(1) *Minority Interest = Equity attributable to minorities*

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c

	Minority % Shares Owned [E]	**Minority interest as at the date of acquisition [E] x [A + B] ₹**	**Minority interest as at the date of consolidation [E] X [C + D] ₹**
Case 1 [100-90]	10 %	15,000	17,000
Case 2 [100-85]	15 %	19,500	18,000
Case 3 [100-80]	20 %	14,000	14,000
Case 4 [100-100]	NIL	Nil	Nil

A = *Share capital on 1.1.20X1*

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

(2) *Calculation of Goodwill or Capital Reserve*

	Shareholding % [F]	Cost [G]	Total Equity [A] + [B] = [C]	Parent's Portion of equity [F] x [C] = H	Goodwill ₹ [G] - [H]	Capital Reserve ₹ [H] - [G]
Case 1	90 %	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85 %	1,04,000	1,30,000	1,10,500	—	6,500
Case 3	80 %	56,000	70,000	56,000	Nil	Nil
Case 4	100 %	1,00,000	90,000	90,000	10,000	—

(3) *The balance in the Profit & Loss Account on the date of acquisition (1.1.20X1) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.*

On 31.12.20X1 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 1.1.20X1 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added / (deducted) from holding's P & L [O] = [K] x [N]
1	90 %	50,000	70,000	20,000	18,000
2	85 %	30,000	20,000	(10,000)	(8,500)
3	80 %	20,000	20,000	NIL	NIL
4	100 %	40,000	55,000	15,000	15,000

Question 2

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st January, 20X1 was ₹1,00,000 and the balance in the Profit & Loss Account was ₹60,000.

During the year ended 31st December, 20X1, ABC Ltd. earned a profit of ₹20,000 and at year end, declared and paid a dividend of ₹ 15,000.

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, 20X1 and 31st December, 20X1? Also please check whether there should be any goodwill/ capital reserve at the date of acquisition.

(*Source: Illustration 2, Study Material*)

Answer

Total dividend paid is ₹ 15,000 (assumed to be out of post-acquisition profits), hence dividend received by XYZ will be credited to P & L.

XYZ Ltd.'s share of dividend = ₹ 15,000 X 80% = ₹ 12,000

In the books of XYZ Ltd.

		₹	₹
Bank A/c	Dr.	12,000	12,000
To Profit & Loss A/c			
(Dividend received from ABC Ltd credited to P&L A/c being out of post-acquisition profits - as explained above)			
Goodwill on consolidation (at the date of acquisition):		₹	₹
Cost of shares			1,40,000
Less: Face value of capital i.e. 80% of capital		80,000	
Add: Share of capital profits [60,000X 80 %]		48,000	(1,28,000)
Goodwill			12,000

	₹	₹
Minority interest on:		
- **1st January, 20X1:**		
20% of ₹ 1,60,000 [1,00,000 + 60,000]		32,000
- **31st December, 20X1:**		
20% of ₹ 1,65,000 [1,00,000 + 60,000 + 20,000 - 15,000]		33,000

Question 3

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 20X1 at a cost of ₹70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	*120*
Investments	*55*
Current Assets	*70*
Loans & Advances	*15*
15% Debentures	*90*
Current Liabilities	*50*

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment	Up by 20%
Investments	Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1 (Face value - ₹10 per share). 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.

(*Source: Illustration 3, Study Material*)

Answer

Revalued net assets of Zed Ltd. as on 31st March, 20X1

	₹ in lakhs	**₹ in lakhs**
Property, plant and equipment [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 share of net assets (70% of 138.5)		96.95
Exe Ltd.'s 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 % i.e. ₹ 2 per share	₹ 7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company**.**

Question 4

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹2,50,000, ₹4,00,000, ₹5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5- X6, B Ltd. experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 20X6-X7 and 20X7-X8, B Ltd. 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.

(*Source: Illustration 4, Study Material*)

Answer

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. In such cases, AS 21 prescribes that the excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Where the minority interest has a binding obligation (say by way of a shareholders₹ agreement), then the share of losses will be attributed to the minority interest even if it exceeds the minority interest in the equity (i.e., debit balance in minority interest). Since information on the existence of a binding obligation is not given in the question, we solve as if such obligation does not exist, and hence the minority interests will be computed as follows:

Year	***Profit/(Loss)***	***Minority Interest (30%)***	***Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)***	***Minority's Share of losses borne by A Ltd.***		***Cost of Control***
				₹	***Balance***	
At the time of acquisition in 20X1		3,24,000 - (W.N.)	-			
20X1-X2	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
Balance		2,49,000				
20X2-X3	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
20X3-X4	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		Nil	(3,71,000)			
20X4-X5	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of minority borne by Holding Co.	36,000	(36,000)	36,000	57,000	
Balance		Nil	(1,20,000)			

Year	***Profit/(Loss)***	***Minority Interest (30%)***	***Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)***	***Minority's Share of losses borne by A Ltd.***		***Cost of Control***
				₹	***Balance***	
20X5-X6	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(15,000)	15,000	(15,000)	42,000	
Balance		Nil	50,000			
20X6-X7	1,00,000	30,000	70,000	(30,000)	12,000	2,44,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000			
Balance		Nil	100,000			
20X7-X8	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.20X1

		Share of Holding Co.	**Minority Interest**
	100%	70%	30%
	(₹)	(₹)	(₹)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 5

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.

(*Source: Illustration 5, Study Material*)

Answer

1. Computation of Purchase Consideration

(a) Yield of VR Ltd.: $\left[\frac{40}{100} \times \frac{30+40+65}{3}\right]$ ₹ 18 lakhs

(b) <u>Price per share of VR Ltd.:</u>

Capitalized Yield: $\left[\frac{18 \text{ lakhs}}{0.15}\right]$ ₹ 120 lakhs

No. of shares 2 lakhs

Therefore, price per share ₹ 60

(c) Purchase Consideration for 54% shares in VR Ltd.

2 lakh shares x 54% x ₹ 60 per shares ₹ 64.80 lakhs

(d) Discharge of Purchase Consideration:

Tax at source (₹ 64.80 lakhs - ₹ 5.40 lakhs) x $\frac{30}{100}$ ₹ 17.82 lakhs

50% of purchase consideration (net of tax) in cash [₹ (64.80 - 17.82) x 50%] ₹ 23.49 lakhs

Balance - Unsecured Loan ₹ 23.49 lakhs

2. Goodwill / Capital Reserve to Variety Ltd.

	₹ in lakhs	
Total Assets	100.00	78.25
Less: Reduction in Value of Property, Plant and Equipment	(1.75)	
	98.25	
Less: Current Liabilities	(20.00)	
Net Assets of VR Ltd. on Date of Acquisition		
Purchase Consideration: 54% purchased from Foreign Co.	64.80	(80.44)
Investment: 46% existing stake	15.64	**2.19**
Goodwill on Date of Acquisition		

Question 6

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.

(*Source: Illustration 6, Study Material*)

Answer

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., preacquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

	₹	₹
Assets		
Property, Plant and Equipment	70,00,000	
Less: Value written off (₹ 70 lakhs x 10%)	(7,00,000)	
	63,00,000	
Investments at Market Value	60,00,000	
Current Assets	68,00,000	
Loans and Advances	22,00,000	2,13,00,000
Less: Liabilities		
Trade Payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x ₹ 20 per share	1,20,00,000	
Less: Pre-acquisition dividend: 6,00,000 shares x ₹ 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		**19,20,000**

Question 7

H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed an 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 the profit is accruing evenly and calendar year as financial year.

(*Source: Illustration 7, Study Material*)

Answer

The profits of S Ltd., have to be divided between capital and revenue profits from the point of view of the holding company:

	Capital Profit (Preacquisition) ₹		***Revenue Profit (Postacquisition)*** ₹
Balance on 1.1.20X1	1,25,000	—	
Profit for 20X1 (3,00,000 x 7/12)	1,75,000	(3,00,000x5/12)	1,25,000
Total	3,00,000		1,25,000
Proportionate share of H Ltd. (3/5)	1,80,000		75,000

Total dividend declared = ₹ 5,00,000 X 40 % = ₹ 2,00,000

H Ltd.'s share in the dividend = ₹ 2,00,000 X 3/5 = ₹ 1,20,000

There can be two situations as regards the treatment of dividend of ₹ 1,20,000:

(1) The profit for 20X1 has been utilised to pay the dividend.

The share of H Ltd in profit for the first seven months of S Ltd = ₹ 1,05,000 (i.e. ₹ 1,75,000 x 3/5)

Profit for the remaining five months = ₹ 75,000 (i.e.₹ 1,25,000 x 3/5).

The dividend of ₹ 1,20,000 will be adjusted in this ratio of 1,05,000: 75,000 = ₹ 70,000 out of profits up to 31.7.20X1 and ₹ 50,000 out of profits after that date.

The dividend out of profits subsequent to 31.7.20X1 will be revenue income and that out of earlier profits will be capital receipt. Hence the entry will be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			70,000
To Profit and Loss Account			50,000

(2) Later profits have been utilised first and then pre- acquisition profits.

In such a case, the whole of ₹ 75,000 (share of H Ltd. in profits of S Ltd., after 31.7.20X1) would be received and treated as revenue income; the remaining dividend, ₹45,000 (₹1,20,000 less ₹ 75,000) would be capital receipt. The entry would be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			45,000
To Profit & Loss Account			75,000

Note: Point (2) discussed above can arise only if there is definite information about the profits utilized. In practice, such treatment is rare.

Question 8

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 f 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.

From the above information calculate Pre-and Post-acquisition Profits, Minority Interest and Cost of Control.

(*Source: Illustration 8, Study Material*)

Answer

Calculation of Pre- and Post-Acquisition Profits:

	Pre-Acquisition Profits (?)	**Post-Acquisition Profits (?)**
Profit & Loss Account	10,00,000	7,90,000
General Reserve	8,00,000	NIL
	18,00,000	7,90,000

	Pre-Acquisition Profits (?)	**Post-Acquisition Profits (?)**
Less: Share of Minority Interest: (%)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500
	(Cost of Control)	(Post-acquisition Profits)

Calculation of Minority Interest:

Particulars	**₹**
Paid-up Equity Share Capital (^ 50,00,000 x %)	12,50,000
Paid-up Preference Share Capital	10,00,000
Share in Reserves:	
Profit & Loss Account: ^ 17,90,000 x %	4,47,500
General Reserve: ^ 8,00,000 x %	2,00,000
Minority Interest	**28,97,500**

Calculation of Goodwill/Capital Reserve

	₹	**₹**
Cost of Investment in Subsidiary: ^50,00,000 x 75% x 125% (cost + 25% premium)	46,87,500	
Less: Pre-acquisition dividend	(3,75,000)	43,12,500
Less: Net Worth of B Ltd. on Date of Acquisition (attributable to A Ltd.):		
Paid-up Capital	37,50,000	
Pre-acquisition Reserves	13,50,000	(51,00,000)
Capital Reserve		7,87,500

Question 9

On 31s 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*

	P Ltd. ₹	***Q Ltd.*** ₹
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.

(*Source: Illustration 9, Study Material*)

Answer

Shareholding pattern

Particulars	**Number of Shares**	**% of holding**
(a) P Ltd.		
(i) Purchased on 31.03.20X1	**1,05,000**	
(ii) Bonus Issue (1,05,000/2)	**52,500**	
Total	**1,57,500**	**70%**
(b) Minority Interest	**67,500**	**30%**

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 20X3:

(a) Before issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (Share Capital)	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control (i.e., Goodwill)		87,000
(ii)	**Minority Interest**		₹
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account - P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd.		15,85,500
	(W.N.)		31,60,500

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Face value of investments (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000

(ii)	**Minority Interest**		₹
	Share Capital (₹ 4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account - P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition)	**Revenue Profits (Post-acquisition)**	
	(Before and after issue of bonus shares) ₹	**Before Bonus Issue** ₹	**After Bonus Issue** ₹
Pre-incorporation profits	30,000		
Profit and loss account on	60,000		
31.3.20X1	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 20X1 to 31st March, 20X3		3,60,000	3,60,000
(₹ 4,20,000 - ₹ 60,000)		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

Question 10

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.

(*Source: Illustration 10, Study Material*)

Answer

Percentage of holding:

		No. of Shares	Percentage
Holding Co	:	20,000	(80%)
Minority shareholders	:	5,000	(20%)
TOTAL SHARES	:	25,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

		Note No	Amount (₹)
	I EQUITY AND LIABILITIES		
1	**Shareholder's Fund**		
	(a) Share Capital	1	5,00,000
	(b) Reserve and Surplus	2	2,60,000
2	**Minority interest**	3	
3	**Current Liabilities**		70,000
	(a) Trade payables	4	2,25,000
	Total		10,55,000
	II ASSETS		
1.	**Non-Current Assets**		
	PPE	5	8,00,000
2.	**Current Assets**	6	2,55,000
	Total		10,55,000

Notes to Accounts

			Amounts (₹)
1	**Share capital**		
	50,000 Equity Shares @ ₹10 each		5,00,000
2	**Reserve and Surplus**		
	Capital Reserve (W.N.)		60,000
	Profit and loss account		2,00,000
			2,60,000
3	**Minority Interest**		
	Paid up value of shares	50,000	
	Add: Share in Profit and loss account 20,000		70,000
4	**Trade payables**		
	H Ltd.		1,75,000
	S Ltd.		50,000
			2,25,000
5	**PPE**		
	H Ltd.		5,00,000
	S Ltd.		3,00,000
			8,00,000
6	**Current Assets**		
	H Ltd.		1,55,000
	S Ltd.		1,00,000
			2,55,000

Working Note:

Determination of Goodwill/(*Capital Reserve*)		**(₹)**
Cost of investment		2,20,000
Less: Paid up value of shares (80% of 2,50,000)	2,00,000	
Share in pre-acquisition profits (80% of 1,00,000)	80,000	(2,80,000)
Capital Reserve		(60,000)

Question 11

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.

(*Source: Illustration 11, Study Material*)

Answer

Percentage of holding:

		No. of Shares	**Percentage**
Holding Co.	:	8,000	(80%)
Minority shareholders	:	2,000	(20%)
TOTAL SHARES	:	10,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.
as at 31st March, 20X2

		Note No	**Amount (₹)**
	I EQUITY AND LIABILITYES		
1	Shareholder's Fund		
	(a) Share Capital	1	1,50,000
	(b) Reserve and Surplus	2	56,000
2	Minority interest	3	28,000
3	Current Liabilities		
	(a) Trade payables	4	1,60,000
	Total		**3,94,000**

Notes to Accounts

	II ASSETS		
1	Non-Current Assets:		
	PPE	5	2,30,000

	Intangible Asset		6	20,000
2	Current Assets		7	1,44,000
	Total			**3,94,000**
1	**Share capital**			1,50,000
	15,000 Equity Shares @ ₹10 each			
2	**Reserve and Surplus**			
	Profit and loss account (₹ 50,000+ 80% of 9/12 x 10,000)			56,000
3	**Minority Interest**			
	Share capital (20% of ₹ 1,00,000)	20,000		
	Share in Profit and loss account (₹ 40,000 X 20%)	8,000		28,000
4	**Trade payables**			
	H Ltd.			1,00,000
	S Ltd.			60,000
				1,60,000
5	**PPE**			
	H Ltd.			1,00,000
	S Ltd.			1,30,000
				2,30,000
6	Intangible Asset			
	Cost of Investment			1,26,000
	Less: Paid up value of shares (80% of ₹ 1,00,000)			
	Share in pre-acquisition profits			(80,000)
	80% of [30,000 + 3/12(40,000-30,000)]			(26,000)
	Goodwill			20,000
7	**Current Assets**			
	H Ltd.			74,000
	S Ltd.			70,000
				1,44,000

Question 12

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

Particulars	***Note No.***	***Virat Ltd. (₹)***	***Anushka Ltd. (₹)***
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*6,00,000*	*4,00,000*
(b) Reserves 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*

Particulars	***Note No.***	***Virat Ltd. (₹)***	***Anushka Ltd. (₹)***
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*	*—*

(*Source: Illustration 12, Study Material*)

Answer

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 20X1

	Particulars	**Note**	**Amount (₹)**
I	**EQUITY AND LIABILITIES:**		
(1)	**Shareholders₹ Funds:**		
	(a) Share Capital	1	6,00,000
	(b) Reserve and Surplus	2	1,80,000
(2)	**Minority Interest**	3	1,00,000
(3)	**Non-Current Liabilities:**		
	Long Term Borrowings	4	3,00,000
(4)	**Current Liabilities:**		
	Trade Payables	5	2,00,000
	Total		**13,80,000**
II	**ASSETS:**		
(1)	**Non-Current Assets**		
	Property, Plant & Equipment	6	7,00,000
(2)	**Current Assets:**		
	(a) Inventories		
	(b) Trade receivables	7	3,60,000
	(c) Cash and Cash Equivalents	8	2,20,000
		9	1,00,000
	Total		**13,80,000**

Notes to Accounts

	Particulars	₹	₹
1.	**Share capital**		
	60,000 equity shares of ₹10 each fully paid up		6,00,000
2.	**Reserves and Surplus**		
	General Reserve	1,00,000	
	Add: General reserve of Anushka Ltd (80%)	80,000	
	Total		1,80,000
3.	**Minority interest**		
	20% share in Anushka Ltd (WN 3)		1,00,000
4	**Long term borrowings**		
	Long term borrowings of Virat	2,00,000	
	Add: Long term borrowings of Anushka	1,00,000	
	Total		3,00,000
5.	**Trade payables**		
	Trade payables of Virat	1,00,000	
	Add: Trade payables of Anushka	1,00,000	
	Total		2,00,000
6.	**Property, Plant and Equipment (PPE)**		
	PPE of Virat Ltd	4,00,000	
	Add: PPE of Anushka Ltd	3,00,000	
	Total		7,00,000
7.	**Inventories**		
	Inventories of Virat Ltd	1,60,000	
	Add: Inventories of Anushka Ltd	2,00,000	
	Total		3,60,000
8.	**Trade receivables**		
	Trade receivables of Virat Ltd	80,000	
	Add: Trade receivables of Anushka Ltd	1,40,000	
	Total		2,20,000
9	**Cash and cash equivalents**		
	Cash and cash equivalents of Virat Ltd	40,000	
	Add: Cash and cash equivalents of Anushka Ltd	60,000	
	Total		1,00,000

1. Basic Information

Company Status	Dates	Holding Status
Holding Co. = Virat Ltd. Subsidiary = Anushka Ltd.	Acquisition: Anushka's Incorporation Consolidation: 31st March, 20X1	Holding Company = 80% Minority Interest = 20%

2. Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of ₹1,00,000 will be Revenue.

3. Consolidation of Balances

Holding- 80%, Minority - 20%	Total	Minority Interest	Holding Company	
Equity Capital	4,00,000	80,000	3,20,000	-
General Reserves	1,00,000	20,000	Nil (pre-acq)	80,000 (post-acq)
Total		1,00,000	3,20,000	80,000
Cost of Investment Goodwill/capital reserve			(3,20,000) NIL	-
Parent's Balance				1,00,000
Amount for Consolidated Balance Sheet				1,80,000

Question 13

From the following balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 20X1, 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, 20X0.

(ii) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 respectively on 1st April, 20X0 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Balance Sheet of H Ltd. and S Ltd. as at 31st March, 20X1

Particulars	Note No.	H Ltd. (₹)	S Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*6,00,000*	*1,00,000*
(b) Reserves and Surplus	*2*	*3,00,000*	*1,00,000*
(2) Current Liabilities			
(a) Trade Payables		*1,50,000*	*57,000*
Total		*10,50,000*	*2,57,000*
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	*3*	*4,50,000*	*1,07,000*
(b) Other non-current investments	*4*	*6,00,000*	*1,50,000*
Total		*10,50,000*	*2,57,000*

Notes to Accounts

		₹	*H Ltd. (₹)*	*S Ltd. (₹)*
1.	***Share capital***			
	6,000 equity shares of ₹ 100 each, fully paid up		*6,00,000*	—
	1,000 equity shares of ₹ 100 each, fully paid up		*- -*	*1,00,000*
	Total		*6,00,000*	*1,00,000*
2.	***Reserves and Surplus***			
	General reserves		*2,00,000*	*75,000*
	Profit and loss account		*1,00,000*	*25,000*
	Total		*3,00,000*	*1,00,000*

		₹	***H Ltd.*** ***(₹)***	***S Ltd.*** ***(₹)***
3.	***Property, Plant and Equipment***			
	Machinery		*3,00,000*	*90,000*
	Furniture		*1,50,000*	*17,000*
	Total		*4,50,000*	*1,07,000*
4.	***Other Non-current investments***			
	Non-current Investments		*4,40,000*	*1,50,000*
	Shares in S Ltd. *(800 shares at ₹200 each)*		*1,60,000*	—
	Total		*6,00,000*	*1,50,000*

(*Source: Illustration 13, Study Material*)

Answer

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 20X1

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	3,44,600
(2) Minority Interest	3	48,150
(3) Current Liabilities		
(a) Trade Payables		2,07,000
Total		**11,99,750**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	5,97,750
(b) Intangible assets	5	12,000
(c) Other non-current investments	6	5,90,000
Total		**11,99,750**

Notes to Accounts

				₹
1.	**Share capital**			
	6,000 equity shares of ₹ 100 each, fully paid up			6,00,000
	Total			6,00,000
2.	**Reserves and Surplus**			
	Reserves		2,00,000	
	Add: 4/5th share of S Ltd.'s post acquisition reserves (W.N.3)		40,000	2,40,000
	Profit and Loss Account		1,00,000	
	Add: 4/5th share of S Ltd.'s post acquisition profits (W.N.4)		4,600	1,04,600
	Total			3,44,600
3.	**Minority interest in S Ltd.** (WN 5)			48,150

				₹
4.	**Property, plant and equipment**			
	Machinery			
	H. Ltd.		3,00,000	
	S Ltd.	1,00,000		
	Add: Appreciation	50,000		
		1,50,000		
	Less: Depreciation (1,50,000 X 10%)*	(15,000)	1,35,000	
	Furniture			
	H. Ltd.		1,50,000	
	S Ltd.	20,000		
	Less: Decrease in value	(5,000)		
		15,000		
	Less: Depreciation (15,000 X 15%)*	(2,250)	12,750	5,97,750
5.	**Intangible assets**			
	Goodwill [WN 6]			12,000
6.	Other non-current investments			
	H Ltd.		4,40,000	
	S Ltd.		1,50,000	
	Total			5,90,000

* As an alternative manner of presentation, the solution contains only the ₹additional depreciation₹.

	₹
1. Pre-acquisition profits and reserves of S Ltd.	
Reserves	25,000
Profit and Loss Account	15,000
	40,000
H Ltd.'*s* = 4/5 (or 80%) x 40,000	32,000
Minority Interest= 1/5 (or 20%) x 40,000	8,000
2. Profit on revaluation of assets of S Ltd.	
Profit on Machinery ₹ (1,50,000 - 1,00,000)	50,000
Less: Loss on Furniture ₹ (20,000 - 15,000)	5,000
Net Profit on revaluation	45,000
H Ltd.'*s* share 4/5 x 45,000	36,000
Minority Interest 1/5 x 45,000	9,000
3. Post-acquisition reserves of S Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 75,000 25,000)	50,000
H Ltd.'*s* share 4/5 x 50,000	40,000
Minority interest 1/5 x 50,000	10,000
4. Post -acquisition profits of S Ltd.	
Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 25,000 - 15,000)	10,000
Add: Excess depreciation charged on furniture @ 15%	
on ₹ 5,000 i.e. (20,000 - 15,000)	750
	10,750

	₹
Less: Under depreciation on machinery @ 10% on ₹ 50,000 i.e. (1,50,000 - 1,00,000)	(5,000)
Adjusted post-acquisition profits	5,750
H Ltd.'s share 4/5 x 5,750	4,600
Minority Interest 1/5 x 5,750	1,150
5. Minority Interest	
Paid-up value of (1,000 - 800) = 200 shares held by outsiders i.e. 200 x ₹ 100 (or 1,00,000 X 20%)	20,000
Add: 1/5th share of pre-acquisition profits and reserves	8,000
1/5th share of profit on revaluation	9,000
1/5th share of post-acquisition reserves	10,000
1/5th share of post-acquisition profit	1,150
	48,150
6. Cost of Control or Goodwill	
Price paid by H Ltd. for 800 shares(A)	1,60,000
Intrinsic value of the shares-	
Paid-up value of 800 shares held by H Ltd. i.e. 800 x ₹ 100 (or 1,00,000 X 80%)	80,000
Add: 4/5th share of pre-acquisition profits and reserves	32,000
4/5th share of profit on the revaluation	36,000
Intrinsic value of shares on the date of acquisition (B)	1,48,000
Cost of control or Goodwill (A - B)	12,000

Question 14

(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.

(*Source: Illustration 14, Study Material*)

Answer

As per para 16 and 17 of AS 21, intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealized profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealized losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

Using above mentioned guidance, following adjustments would be required:

(a) *This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).*

Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs - ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 20X1, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 20X1.

(b) *This would be the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs - ₹ 150 lacs),*

would be eliminated in the consolidated financial statements for financial year ended 31 March 20X1, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 20X1. In the consolidated balance sheet as of 31 March 20X1, A Ltd.'s share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).

Question 15

H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:

	H Ltd. (₹ in lacs)	***S Ltd. (₹ in lacs)***
Sales and other income	*5,000*	*1,000*
Increase in Inventory (closing less opening)	*1,000*	*200*
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*

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. prior to 20X1-20X2. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.

Prepare a consolidated statement of profit and loss.

(*Source: Illustration 15, Study Material*)

Answer

Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 20X3

Particulars	**Note No.**	**₹ in Lacs**
I. Revenue from operations	1	5,865
II. Total Income		**5,865**
III. Expenses		
Cost of material purchased/consumed	2	1,180

Particulars	Note No.	₹ in Lacs
Changes of inventories of finished goods	3	(1,196)
Employee benefit expense	4	950
Finance cost	5	150
Depreciation and amortization expense	6	150
Other expenses	7	535
Total expenses		**1,769**
IV. Profit before tax (II-III)		**4,096**

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	Revenue from operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	1,000	
		6,000	
	Less: Inter-company sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Cost of material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct expenses (Production)		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
3.	Changes of inventories of finished goods		
	H Ltd.	1,000	
	S Ltd.	200	
	20 *Less:* Unrealized profits ₹ 24 lacs x 120	(4)	1,196
4.	Employee benefits and expenses Wages and salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Finance cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150
6.	Depreciation		
	H Ltd.	100	
	S Ltd.	50	150

		₹ in Lacs	₹ in Lacs
7.	Other expenses		
	Administrative expenses		
	H Ltd.	200	
	S Ltd.	100	
	Less: Consultancy fees received by H Ltd. from S Ltd. Selling and distribution Expenses:	(5)	295
	H Ltd.	200	
	S Ltd.	50	
	Less: Commission received by S Ltd. from H Ltd.	(10)	240
			535

Question 16

Subsidiary B Ltd. provides the following balance sheet:

Particulars	***Note No.***	***20X0 (₹)***	***20X1 (₹)***
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*5,00,000*	*5,00,000*
(b) Reserves and Surplus	*2*	*2,86,000*	*7,14,000*
(2) Current Liabilities			
(a) Short term borrowings	*3*	*--*	*1,70,000*
(b) Trade Payables		*4,90,000*	*4,94,000*
(c) Short-term provisions	*4*	*3,10,000*	*4,30,000*
Total		*15,86,000*	*23,08,000*
II. Assets			
(1) Non-current assets			
(a) Property, Plant Equipment and	*5*	*2,72,000*	*2,24,000*
(b) Non-current Investment			*4,00,000*
(2) Current assets			
(a) Inventories			
(b) Trade Receivables		*5,97,000*	*7,42,000*
(c) Cash & Cash Equivalents		*5,94,000*	*8,91,000*
(d) Other current assets		*51,000*	*3,000*
	6	*72,000*	*48,000*
Total		*15,86,000*	*23,08,000*

		20X0 (₹)	***20X1 (₹)***
1.	***Share capital***		
	5,000 equity shares of ₹10 each, fully paid up	*5,00,000*	*5,00,000*
2.	***Reserves and Surplus***		
	General Reserves	*2,86,000*	*7,14,000*
3.	***Short term borrowings***		
	Bank overdraft	*--*	*1,70,000*

Particulars		***Note No.***	***20X0 (₹)***	***20X1 (₹)***
4.	***Short term provisions***			
	Provision for taxation		*3,10,000*	*4,30,000*
5.	***Property, plant and equipment***			
	Cost		*3,20,000*	*3,20,000*
	Less: Depreciation		*(48,000)*	*(96,000)*
	Total		*2,72,000*	*2,24,000*
6.	***Other current Assets***			
	Prepaid expenses		*72,000*	*48,000*

Also consider the following information:

(a) B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accounting year.

(b) A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by ₹12,000 at the end of 20X0 and ₹34,000 at the end of 20X1.

(c) B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

(d) Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 20X0 and ₹ 30,000 in 20X1, being part of initial advertising expenditure of ₹ 90,000 in 20X0 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 20X0.

Restate the balance sheet of B Ltd. as at 31st December, 20X1 after considering the above information, for the purpose of consolidation. Would restatement be necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

(*Source: Illustration 16, Study Material*)

Answer

As per para 20 and 21 of AS 21, Consolidated financial statements:

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

Adjusted reserves of B Ltd.:

	₹	₹
Reserves as given		7,14,000
Add: Provision for doubtful debts		
{[8,91,000/99 X 100]-8,91,000}		9,000
		7,23,000
Less: Reduction in value of Inventory	34,000	
Advertising expenditure to be written off	30,000	(64,000)
Adjusted reserves		6,59,000

Note: No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

Restated Balance Sheet of B Ltd. as at 31st December, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	6,59,000
(2) Current Liabilities		
(a) Short term borrowings	3	1,70,000
(b) Trade Payables		4,94,000
(c) Short-term provision	4	4,30,000
Total		22,53,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	2,24,000
(b) Non-current Investment		4,00,000
(2) Current assets		
(a) Inventories	6	7,08,000
(b) Trade Receivables	7	9,00,000
(c) Cash & Cash Equivalents		3,000
(d) Other current assets	8	18,000
Total		22,53,000

Notes to Accounts

			20X1 (₹)
1.	**Share capital**		
	5,000 equity shares of Rs 10 each, fully paid up		5,00,000
2.	**Reserves and Surplus**		
	General Reserves (refer to WN)		6,59,000
3.	**Short term borrowings**		
	Bank overdraft		1,70,000
4.	**Short term provisions**		
	Provision for taxation		4,30,000
5.	**Property, plant and equipment**		
	Cost		3,20,000
	Less: Depreciation		(96,000)
	Total		2,24,000
6.	**Inventory**		
	Actual inventory		7,42,000
	Less: Change in method of valuation		(34,000)
	Total		7,08,000
7.	**Trade receivables**		
	Actual trade receivables		8,91,000
	Add: Adjustment for provision		9,000
	Total		9,00,000
8.	**Other current Assets**		
	Prepaid expenses		48,000

Question 17

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 20X1 for ₹2,10,000. The issued capital of Power Ltd., on 1st January, 20X1 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹90,000. During the year ended 31st December, 20X1, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500. What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also compute goodwill/ capital reserve at the date of acquisition.

(*Source: Practical Question 6, Study Material*)

Answer

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

Goodwill on consolidation (at the date of acquisition):	₹	₹
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on:		
- **1st January, 20X1:**		
20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 20X1:**		
20% of ₹ 2,47,500 [1,50,000 + 90,000 + 30,000 - 22,500]		49,500

Question 18

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.

(*Source: Practical Question 7, Study Material*)

Answer

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	(280)
Current Liabilities	100.0	
Equity / Net Worth		277

	₹ *in lakhs*	₹ *in lakhs*
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 19

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 Acquisition of 01-01-20X1*		*Consolidation date 31-12-20X1*	
				Share Capital	*Profits and Loss*	*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*

(*Source: Practical Question 8, Study Material*)

Answer

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 20

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 Funds			
(a) Share Capital	*1*	*5,00,000*	*2,00,000*
(b) Reserves and Surplus	*2*	*2,97,200*	*1,82,000*

Particulars	***Note No.***	***A Ltd. (₹)***	***B Ltd. (₹)***
(2) Current Liabilities			
(a) Trade Payables		*47,100*	*17,400*
(b) Short term borrowings	*3*	*80,000*	
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 Investments	*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 Total	*2,40,000*	*1,35,000*
		3,90,000	*3,15,000*
5.	***Non-current Investments***	*3,40,000*	*--*
	Investment in B Ltd (at cost)		
6.	***Cash & Cash equivalents***	*14,500*	*8,000*
	Cash		

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.

(*Source: Practical Question 9, Study Material*)

Answer

Consolidated Balance Sheet of A Ltd. and its subsidiary, B Ltd.
as at 31st December, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	3,08,800
(2) Minority Interest		83,600
(3) Current Liabilities		
(a) Trade Payables	3	64,500
(b) Short term borrowings	4	80,000
Total		10,36,900
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	7,41,000
(b) Intangible assets	6	17,200
(2) Current assets		
(a) Inventories	7	1,56,400
(b) Trade receivables	8	99,800
(c) Cash & Cash equivalents	9	22,500
Total		10,36,900

Notes to Accounts

				₹
1.	**Share Capital**			
	5,000 shares of ₹ 100 each			5,00,000
2.	**Reserves and Surplus**			
	Reserves		2,40,000	
	Profit & loss (Refer to W.N 8)		68,800	
	Total			3,08,800
3.	**Trade Payables**			
	A Ltd.	47,100		
	Add: B Ltd	17,400		
	Total			64,500
4.	**Short term borrowings**			
	Bank overdraft			80,000
5.	**Property, plant and equipment**			
	Land and building- A Ltd	1,50,000		
	Add: Land and building- B Ltd	1,80,000	3,30,000	
	Plant & Machinery (Refer to W.N 7)		4,11,000	
	Total			7,41,000

			₹
6.	**Intangible assets**		
	Goodwill (refer to W.N 6)		17,200
7.	**Inventories**		
	A Ltd.	1,20,000	
	B Ltd.	36,400	
	Total		1,56,400
8	**Trade Receivables**		
	A Ltd. 59,800		
	B Ltd. 40,000		
	Total		99,800
9	**Cash & Cash equivalents**		
	Cash of A Ltd	*14,500*	
	Add: cash of B Ltd.	8,000	
	Total		22,500

Share holding Pattern

Total Shares of B Ltd	2,000 shares
Shares held by A Ltd	1,600 shares i.e. 80 %
Minority Shareholding	400 shares i.e. 20 %

Working Notes:

1. The dividend @ 10% on 1,600 shares - ₹ 16,000 received by A Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. A Ltd., must pass a rectification entry, viz.

Profit & Loss Account	Dr. ₹ 16,000
To Investment	₹ 16,000

2. The Plant & Machinery of B Ltd. would stand in the books at ₹ 1,42,500 on 1st July, 20X1, considering only six months' depreciation on ₹ 1,50,000 total depreciation being ₹ 15,000. The value put on the assets being ₹ 1,80,000, there is an appreciation to the extent of ₹ 37,500 (1,80,000 - 1,42,500).

3. Capital profits of B Ltd.

	₹	₹
Reserve on 1st January, 20X1 (Assumed there is no movement in reserves during the year and hence balance as on 1st January 20X1 is same as of 31st December 20X1)		1,00,000
Profit & Loss Account Balance on 1st January, 20X1	30,000	
Less: Dividend paid	(20,000)	10,000
Profit for 20X1:		
Total ₹ 82,000		
Less: ₹10,000		
₹ 72,000		
Proportionate upto 1st July, 20X1 on time basis (₹ 72,000/2)		36,000
Appreciation in value of Plant & Machinery		37,500
		1,83,500
Less: 20% due to outsiders		(36,700)
Holding company's share		**1,46,800**

4. Revenue profits of B Ltd.:

Profit after 1st July, 20X1 [(82,000 - 10,000) x ½]		36,000
Less: Depreciation		
10% depreciation on ₹1,80,000 for 6 months	9,000	
Less: Depreciation already charged for 2nd half year on 1,50,000	(7,500)	(1,500)
		34,500
Less: 1/5 due to outsiders		(6,900)
Share of A Ltd.		**27,600**

5. Minority interest:

Par value of 400 shares (2,00,000 X 20%)	40,000
Add: 1/5Capital Profits [WN 3]	36,700
1/5 Revenue Profits [WN 4]	6,900
	83,600

6. Cost of Control:

Amount paid for 1,600 shares	3,40,000	
Less: Dividend out of pre-acquisition profits	(16,000)	3,24,000
Par value of shares	1,60,000	
Capital Profits -share of A Ltd. [WN 3]	1,46,800	(3,06,800)
Cost of Control or Goodwill		17,200

7. *Value of plant & Machinery:*

		2,40,000
B Ltd.	1,35,000	
Add: Appreciation on 1st July, 20X1 [1,80,000 - (1,50,000 - 7,500)]	37,500	
	1,72,500	
Add: Deprecation for 2nd half charged on prerevalued value	7,500	
Less: Depreciation on ₹1,80,000 for 6 months	(9,000)	1,71,000
		4,11,000

8. *Profit & Loss Account (Consolidated):*

A Ltd. as given	57,200	
Less: Dividend transferred to Investment A/c	(16,000)	41,200
Share of A Ltd. in revenue profits of B Ltd. (WN 4)		27,600
		68,800

Question 21

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 Funds***			
(a) Share Capital	*1*	*12,000*	*4,800*

Particulars	***Note No.***	***H Ltd. (₹ in Lacs)***	***S Ltd. (₹in Lacs)***
(b) Reserves 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		*1,200*	*-*
(Dividend payable)			
Total		*21,387*	*9,208*
II. Assets			
(1) ***Non-current assets***			
Property, Plant and Equipment	*5*	*9,468*	*5,486*
Non-current Investments		*3,000*	
(Shares in S Ltd.)			
(2) ***Current assets***			
(a) Inventories		*3,949*	*1,956*
(b) Trade receivables	*6*	*2,960*	*1,562*
(c) Cash and cash equivalents		*1,490*	*204*
(d) Short term loans and	*7*	*520*	
advances			
Total		*21,387*	*9,208*

Notes to Accounts

		H Ltd. (₹ in lacs)	***S Ltd. (₹ in lacs)***
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 Reserve	*2,784*	*1,380*
	Profit and Loss Account:	*2,715*	*1,620*
	Total	*5,499*	*3,000*
3.	***Trade Payables***		
	Creditors	*1,461*	*854*
	Bills Payable	*372*	*160*
		1,833	*1,014*
4.	***Short term provisions***		
	Provision for Taxation	*855*	*394*
5.	***Property, plant and equipment***		
	Land and Buildings	*2,718*	*-*
	Plant and Machinery	*4,905*	*4,900*
	Furniture and Fittings	*1,845*	*586*
	Total	*9,468*	*5,486*

		H Ltd. (₹ in lacs)	***S Ltd. (₹ in lacs)***
6.	***Trade receivables***		
	Debtors	*2,600*	*1,363*
	Bills Receivable	*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.

(*Source: Practical Question 10, Study Material*)

Answer

Consolidated Balance Sheet of H Ltd.
and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	**Note No.**	**(₹ in Lacs)**
I. Equity and Liabilities		
(1) **Shareholder's Funds**		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) **Minority Interest [W.N.6]**		3,120
(3) **Current Liabilities**		
(a) Trade payables	3	2,802
(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		27,530
II. Assets		
(1) **Non-current assets**		
Property, Plant and Equipment	6	14,954
(2) **Current assets**		
(a) Inventories	7	5,885
(b) Trade receivables	8	4,477
(c) Short term loans and advances	9	520
(d) Cash and cash equivalents	10	1,694
Total		27,530

Notes to Accounts

				(₹ in lacs)	(₹ in lacs)
1.	**Share Capital**				
	Authorized share capital				15,000
	Equity shares of ₹10 each, fully paid up				
	Issued and Subscribed:				
	Equity shares of ₹ 10 each, fully paid up				12,000
	Total				12,000
2.	**Reserves and surplus**				
	Capital Reserve (Note 5)			1,320	
	General Reserve (2,784 + 108) Profit and Loss Account:			2,892	
	H Ltd.		2,715		
	Less: Dividend wrongly credited 360				
	Unrealized Profit	20	(380)		
			2,335		
	Add: Share in S Ltd.'s Revenue profits		612	2,947	
	Total				7,159
3.	**Trade payables**				
	Creditors				
	H Ltd.		1,461		
	S Ltd.		854	2,315	
	Bills Payable H Ltd.		₹ 372		
	S Ltd.		₹ 160		
			₹ 532		
	Less: Mutual owing		₹ (45)	487	2,802
4.	**Short term provisions**				
	Provision for Taxation				
	H Ltd.			855	
	S Ltd.			394	
	Total				1,249
5.	**Other current liabilities**				
	Dividend payable H Ltd.				1,200
6.	**Property, plant and equipment**				
	Land and Buildings				
	H Ltd.			2,718	
	Plant and Machinery H Ltd.		₹ 4,905		
	S Ltd.		₹ 4,900	9,805	
	Furniture and Fittings H Ltd.		₹ 1,845		
	S Ltd.		₹ 586	2,431	
	Total				14,954
7.	**Inventories**				
	Stock				
	H Ltd.			3,949	
	S Ltd.			1,956	
				5,905	

			(₹ in lacs)	(₹ in lacs)
	Less: Unrealized profit		J20)	5,885
8.	**Trade receivables**			
	Debtors			
	H Ltd.	₹ 2,600		
	S Ltd.	₹ 1,363	3,963	
	Bills Receivable			
	H Ltd.	₹ 360		
	S Ltd.	₹ 199		
	₹ 559			
	Less: Mutual Owing	₹ (45)	514	4,477
9.	**Short term loans and advances**			
	Sundry Advances			520
10.	**Cash and cash equivalents**			
	Cash and Bank Balances			1,694

Share holding pattern of S Ltd.

Shares as on 31st March, 20X1 (Includes bonus shares issued on 1st January, 20X1)	480 lakh shares (4,800 lakhs/ ₹ 10)
H Ltd.'s holding as on 1st April, 20X0	180 lakhs
Add: Bonus received on 1st January, 20X1	108 lakhs (180 / 5 x 3)
Total H Ltd.'s holding as on 31st March, 20X1	288 lakhs i.e. 60 %
Minority Shareholding	[288/480x100] 40%

Working Notes:

1. S Ltd.'s General Reserve Account

	₹ in lakhs		₹ in lakhs
To Bonus to equity		By Balance b/d	3,000
shareholders (WN-8)	1,800	By Profit and Loss A/c	180
To Balance c/d	1,380	(Balancing figure)	—
	3,180		3,180

***2.* S Ltd.'s Profit and Loss Account**

	₹ in lakhs		₹ in lakhs
To General Reserve		By Balance b/d	1,200
[WN 1]	180	By Net Profit for the year*	1,200
To Dividend paid			
(20% on ₹3,000 lakhs)	600	(Balancing figure)	
To Balance c/d	1,620		—
	2,400		2,400

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60%	(720)
(General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	—
Share of Minority Shareholders (40%)	480

Note: *The question can also be solved by taking ₹ 1,020 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.*

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 - ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less	600
dividend paid (₹ 1,200 - ₹ 600)	1,800

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

Minority interest = ₹ 1,800 - ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

₹ in lakhs	
Paid up value of shares held (60% of ₹4,800)	2,880
Add: Share in capital profits [WN 4]	1,080
	3,960
Less: Cost of shares less dividend received (₹ 3,000 - ₹ 360)	(2,640)
Capital reserve	1,320

6. Calculation of Minority Interest

	II ₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	720
	3,120

7. ***Unrealized profit in respect of inventory***

₹ 100 lakhs $\frac{25}{125}$ *= ₹ 20 lakhs*

8. ***Computation of bonus to equity shareholders***

	₹ In lakhs
Shares as on 31 March 20X1 including bonus share issued on 1 January 20X1	4800
Or we can say these are 1 + $\frac{3}{5}$ or $\frac{8}{5}$	
i.e. Shares before bonus issue should have been $\frac{4800}{8/5}$	=3000
Accordingly, bonus issue would be (4,800–3,000)	1,800

QUESTION BANK

Question 22

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	6,00,000	2,00,000
Reserves and surplus	1,00,000	1,50,000
Non-Current Liabilities	2,00,000	2,00,000
Current Liabilities	4,00,000	3,00,000
Total	**13,00,000**	**8,50,000**
Non-Current Assets		
Fixed Assets	3,00,000	3,00,000
Investment in 100% Share of S Ltd. Purchased on 31-03-2015	3,50,000	
Current Assets	6,50,000	5,50,000
Total	**13,00,000**	**8,50,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 0 Minority Interest 0 Balance sheet 18,00,000

Question 23

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	10,00,000	5,00,000
Reserves and surplus	5,00,000	4,00,000
Current Liabilities	2,00,000	1,00,000
Total	**17,00,000**	**10,00,000**
Investment in 90% Share of S Ltd.	9,50,000	
Other Assets	7,50,000	10,00,000
Total	**17,00,000**	**10,00,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 1,40,000 Minority Interest 90,000 Balance sheet 18,90,000

Question 24

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	20,00,000	12,00,000
Reserves and surplus	9,00,000	6,00,000
Current Liabilities	3,00,000	2,00,000
Total	**32,00,000**	**20,00,000**
Investment in 90% Share of S Ltd.	10,00,000	
Other Assets	22,00,000	20,00,000
Total	**32,00,000**	**20,00,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 6,20,000 Minority Interest 1,80,000 Balance sheet 42,00,000

Question 25

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Equity Share Capital	7,00,000	8,00,000
Reserves and surplus	15,00,000	2,00,000
Current Liabilities	3,00,000	1,00,000
Total	**25,00,000**	**11,00,000**

	H Ltd.	*S Ltd.*
Investment in 80% Share of S Ltd.	8,20,000	
Current Assets	16,80,000	11,00,000
Total	**25,00,000**	**11,00,000**

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

Answer:

Goodwill 20,000 Minority Interest 2,00,000 Balance sheet 28,00,000

Question 26

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	15,00,000	10,00,000
Reserves and surplus	2,00,000	1,00,000
Current Liabilities	3,00,000	1,00,000
Total	**20,00,000**	**12,00,000**
Investment in 70% Share of S Ltd.	7,50,000	
Current Assets	12,50,000	12,00,000
Total	**20,00,000**	**12,00,000**

H Ltd. had purchased share in S Ltd. on 01.04.2014 when Balance in Reserve & Surplus of S Ltd. Were ₹4,000/-. Prepare Consolidated Balance Sheet of group on 31.03.2015

Answer:

Goodwill 47,200 Minority Interest 3,30,000 Balance sheet 24,97,200

Question 27

Balance Sheet 31.3.2012

Equity & Liabilities	H	S
Shareholder Funds		
Share capital	2,00,000	1,00,000
Profit & Loss a/c	70,000	30,000
Current Liabilities		
Creditors	60,000	20,000
	3,30,000	**1,50,000**
	H	S
Non Current Assets		
Fixed Assets	1,00,000	1,20,000
Investment 60%	1,90,000	—
Current Assets	40,000	30,000
	3,30,000	**1,50,000**

H Ltd. Purchase Investment on 1-4-2011 when Balance in Profit & Loss a/c of S Ltd. was ₹18,000.
Prepare consolidated Balance Sheet

Answer:

Goodwill 1,19,200 Minority Interest 52,000 Balance sheet 4,09,200

Question 28

Balance Sheet as on 31.3.2015

Equity & Liabilities	*H Ltd.*	*S Ltd.*
Shareholder Funds		
Equity Share Capital (₹10)	100,000	50,000
Profit & Loss A/c	80,000	50,000
Current Liabilities		
Creditors	85,000	140,000
	265000	**240,000**
Non Current Assets	*H Ltd.*	*S Ltd.*
Fixed Assets	100,000	80,000
Investment in S 70%	75,000	—
Current Assets	90,000	160,000
	265000	**240,000**

Investments were purchased on 1.10.2014 balance as 1.4.2014 in P & L A/cs was ₹40,000. Prepare Consolidated Balance sheet.

Answer:

Goodwill 85,000 Minority Interest 30,000 Balance sheet 4,38,500

Question 29

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	10,00,000	8,00,000
Reserves and Surplus	6,00,000	4,00,000
Creditors	2,00,000	1,00,000
Total	**18,00,000**	**13,00,000**
Fixed Assets	5,00,000	6,00,000
Investment 80% Share of S Ltd.	11,00,000	
Current Assets	2,00,000	7,00,000
Total	**18,00,000**	**13,00,000**

H Ltd. had purchased share in S Ltd. on 01.04.2014 when Balance in Profit & Loss of S Ltd. was ₹ 2,50,000/- S Ltd. distributed Dividend on 01/10/2014 @ 10%. H Ltd. credited dividend to its Profit & Loss Account. Prepare Consolidated Balance Sheet.

Question 30

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital	20,00,000	16,00,000
Profit & Loss	3,00,000	2,00,000
General Reserves	1,00,000	2,00,000
Creditors	6,00,000	5,00,000
Total	**30,00,000**	**25,00,000**
Fixed Assets	5,00,000	8,00,000
Goodwill	1,00,000	50,000
Investment in S Ltd. 60%	11,00,000	
Current Assets	13,00,000	16,50,000
Total	**30,00,000**	**25,00,000**

H Ltd. had purchased shares in S Ltd. on 01.01.2013. for ₹11,00,000/-. Balance in Profit & Loss and General Reserve on 01.04.2012 was ₹ 1,20,000/- each in S Ltd.

S Ltd. Paid	**Date**	**Type**	**Rate**
	01-10-2012	Final	10%

Prepare Consolidated Balance Sheet.

Question 31

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital (₹ 10)	10,00,000	9,00,000
Reserves and Surplus:		
General Reserves	2,00,000	1,00,000
Profit & Loss	3,00,000	2,00,000
Non-Current Liabilities	3,00,000	3,00,000
Current Liabilities	1,00,000	1,00,000
Total	**19,00,000**	**16,00,000**
Non-Current Assets		
Fixed Assets	4,00,000	6,00,000
Investment in share of S Ltd.	3,00,000	
Current Assets	12,00,000	10,00,000
Total	**19,00,000**	**16,00,000**

H Ltd. had purchased 50,000 shares of S Ltd. on 01.10.2013. Balance in Profit & Loss and General Reserve of S Ltd. was ₹ 1,50,000/- and ₹ 90,000/- respectively on 01.04.2013.

S Ltd. had distributed Bonus @ 1 shares for 8 held on 31.03.2014.

S Ltd. paid Dividend

Date	**Rate**
01-11-2013	10%
01-10-2014	12%

All dividends were credited to Profit & Loss of H Ltd. Prepare Consolidated Balance Sheet.

Question 32

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

Balance Sheet

as on 31st March 2015

	H Ltd.	*S Ltd.*
Share Capital (₹ 10)	7,00,000	5,00,000
Reserves and Surplus	6,00,000	4,00,000
Current Liabilities	3,00,000	3,00,000
Total	**16,00,000**	**12,00,000**
Fixed Assets	7,50,000	8,00,000
Investment in share of S Ltd.	5,00,000	
Current Assets	3,50,000	4,00,000
Total	**16,00,000**	**12,00,000**

H Ltd. held 30,000 shares of S Ltd. H Ltd. had purchased share of S Ltd. on 01-10-2014. Balance in Reserve & Surplus of S Ltd. on 01-04-2014 was ₹ 3,00,000/-

1. Bonus declared (distributed) ratio 1 : 4 by S Ltd. on 31-03-2015
2. Dividend paid by S Ltd. on 01-01-2015 @ 10%
3. Market Value of Fixed Assets of S Ltd. was increased by ₹ 50,000 on 01-10-2014. Depreciation rate @ 10% p.a. This Adjustment is yet to made in Balance Sheet.

Prepare Consolidated Balance Sheet.

Question 33

On 31st March, 2015, the abridged Balance Sheets of H Ltd. and S Ltd. stood as follows:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Liabilities		
Equity Share Capital - Authorised	5,000	3,000
Issued and subscribed in Equity Shares or 10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
	7,129	4,604
Assets:		
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	260	190
	7,129	4,604

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2014 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, 2014 S Ltd. declared a dividend of 20% out of pre-acquisition profits and H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2014, 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, 2015, the Inventory of S Ltd. included goods purchased for ₹50 thousand from H Ltd., which had made a profit of 25% on Cost.

(e) Details of Trade payables and Trade receivables:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Trade payables		
Bills Payable	124	80
Sundry creditors	487	427
Trade receivables		
Debtors	700	683
Bills Receivables	120	95
	820	778

Prepare a consolidated Balance Sheet as on 31st March, 2015.

(*Practice Manual*)

Answer

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as on 31st March, 2012

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**		
Fixed assets		
Tangible assets	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)			
	General Reserve (₹ 928+₹ 54)		982	
	Profit and Loss Account:			
	H Ltd.	₹ 1,305		
	Add: Share in S Ltd	₹ 306		
		₹ 1,611		
	Less: Dividend wrongly credited	₹ (180)		
		₹ 1,431		
	Less: Unrealised profit	₹ (10)	1,421	3,063

			(₹ in 000's)	(₹ in 000's)
3.	Trade payables			
	Sundry Creditors H Ltd.	₹ 487		
	S Ltd.	₹ 427	914	
	Bills payable H Ltd.	₹ 124		
	S Ltd.	₹ 80	204	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.	Tangible Assets			
	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			
	Stock H Ltd.	₹ 983		
	S Ltd.	₹ 786		
	Less: Unrealised profit (₹ 50 x 1/5)		(10)	1,759
7	Trade receivable			
	Debtors H Ltd.	₹ 700		
	S Ltd.	₹ 683	1,383	
	Bills Receivables H Ltd.	₹120		
	S Ltd.	₹ 95	215	1,598
8	Cash and cash equivalents			
	Cash and Bank Balances H Ltd		410	
	S Ltd.		102	512
9	Short term loans and advances			
	Sundry Advances H Ltd.		260	
	S Ltd.		190	450

Working Notes:

1. S Ltd. General Reserve

		(₹ in 000)			(₹ in000)
To	Bonus to equity shareholders $\left(\frac{2,400\times 3}{8}\right)$	900	By	Balance b/d	1,500
			By	Profit and Loss A/c	90
To	Balance c/d	690		(Balancing figure)	
		1,590			1,590

2. S Ltd. Profit and Loss Account

		(₹in 000)			(₹in 000)
To	General Reserve	90	By	Balance b/d	633
To	Dividend paid on 14.7.2009 ₹ 1,500 × 20/100	300	By	Net Profit for the year (Balancing figure)	600*
To	Corporate Dividend Tax (11% of ₹ 300)	33			
To	Balance c/d	810			
		1,233			1,233

* Out of ₹ 6,00,000 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	600
Share of H Ltd. (60%)	360
Share of Minority shareholders (₹ 600 – ₹ 360)	240

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		
Corporate tax paid	₹ 33	(333)	300
			900
Share of H Ltd. (60%)			540
Share of Minority shareholders			360

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)		540
		1,980
Less: Investments in S Ltd.	1,500	
Less: Dividends received out of pre- acquisition profits ₹ 300 × ₹ 60/100	(180)	(1,320)
		660

6. **Calculation of Minority Interest**

		₹ in '000
40% of share capital of S Ltd.		960
Add: Share of Revenue Profits		240
(Note 3) Share of Capital		360
Profits (Note 4)		1,560

Question 34

On 31st March, 2015 the summarized Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Liabilities	**H Ltd. (₹ in lakhs)**	**S Ltd. (₹ in lakhs)**
Share Capital:		
Authorised	15,000	6,000
Issued and Subscribed:		
Equity Shares of ₹ 10 each, fully paid up	12,000	4,800
General Reserve	2,784	1,380
Profit and Loss Account	2,715	1,620
Trade payables	1,833	1,014
Provision for Taxation	855	394
Payable Dividend	1,200	
	21,387	9,208
Assets	**H Ltd. (in lakhs)**	**S Ltd. (in lakhs)**
Land and Buildings	2,718	—
Plant and Machinery	4,905	4,900
Furniture and Fittings	1,845	586
Investments in shares in S Ltd.	3,000	—
Inventory	3,949	1,956
Trade receivables	2,960	1,562
Cash and Bank Balances	1,490	204
Sundry Advances	520	—
	21,387	9,208

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 1st April, 2014 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

(b) On 31st May, 2014, S Ltd. declared a dividend @ 20% for the year ended 31st March, 2014. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 2015 S Ltd. issued 3 fully paid-up shares for every 5 shares held as bonus shares out of balances to its general reserve as on 31st March, 2014.

(d) Details of Trade payables and Trade receivables:

	H Ltd.	**S Ltd.**
	(₹ in lakhs)	**(₹ in lakhs)**
Trade payables		
Bills Payable	372	160
Sundry creditors	1,461	854
	1,833	1,014
Trade receivables		
Debtors	2,600	1,363
Bills Receivables	360	199
	2,960	1,562

(e) On 31st March, 2015 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.

(f) On 31st March, 2015, 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, 2015 bearing in mind the requirements of AS 21.

(*Practice Manual*)

Question 35

The following are the balance sheets of a Holding Company and Subsidiary Company as at 31.3.1996 and 1997:

Holding Company's Balance Sheet as on 31 March ….

Liabilities	*1996* ₹	*1997* ₹	*Assets*	*1996* ₹	*1997* ₹
Paid-up capital:			Bank Balance	12,000	30,000
35,000 Shares of ₹ 10 each	3,50,000	3,50,000	Goodwill	50,000	50,000
Sundry Creditors	39,000	35,000	Land and Building at cost	1,10,000	1,10,000
Reserve	41,000	57,000	Machinery *less* deprecation	80,000	75,000
Profit and Loss Account	67,000	80,000	Stock	40,000	47,000
			Sundry Debtors	55,000	60,000
			Investment:		
			9,000 Shares of ₹ 10 each at cost	1,50,000	1,50,000
	4,97,000	5,22,000		4,97,000	5,22,000

Subsidiary Company's Balance Sheet as on 31 March …

Liabilities	*1996* ₹	*1997* ₹	*Assets*	*1996* ₹	*1997* ₹
Paid-up Capital:			Goodwill	40,000	40,000
10,000 shares of ₹10 each	1,00,000	1,00,000	Machinery less depreciation	45,000	42,500
Sundry Creditors	10,000	10,000	Stock	25,000	30,000
Reserve	17,500	20,500	Sundry Debtors	22,000	32,000
Profit and Loss Account	12,000	28,500	Bank Balance	7,500	12,500
	1,39,500	1,57,000		1,39,500	1,57,000

The shares in the subsidiary company were acquired on 31 March 1996. No dividend has been declared. Prepare consolidated balance sheet as at 31 March 1997.

Question 36

From the balance sheets given below, prepare a consolidated balance sheet of X Ltd. and its subsidiary company Y Ltd. The interest of minority shareholders in Y Ltd. is to be shown as a separate item in the consolidated balance sheet.

Balance Sheet of X Ltd. as on 31 March 1995

Liabilities	*₹*	*Assets*	*₹*
12,000 Shares of ₹ 10 each	1,20,000	Freehold Building at cost	80,000
General Reserve	25,000	Plant and machinery at cost (40,000) *less* depreciation	30,000
Profit and Loss Account	12,000	Shares (2000) in subsidiary company at cost	25,000
Trade Creditors	15,000	Stock at cost	10,000
		Trade Debtors	22,000
		Bank	5,000
	1,72,000		1,72,000

Balance Sheet of Y Ltd. as on 31 March 1995

Liabilities	*₹*	*Assets*	*₹*
3,000 Shares of ₹ each	30,000	Leasehold property at cost (₹ 30,000) *less* deprecation	25,000
General Reserve as on 1-4-1994	6,000	Plant and Machinery at cost (₹ 15,000) *less* depreciation	10,000
Profit and Loss Account	9,000	Stock at cost	3,000
Trade Creditors	5,000	Trade Debtors	7,000
		Bank	5,000
	50,000		50,000

At the date of acquisition by X Ltd. of its holding of 2,000 shares in Y Ltd. the latter company had a credit balance of ₹ 6,000 in its profit and loss account.

Question 37

The balance sheets of Hindustan Ltd. and Sundram Ltd. as on 31 March 1997 were as under:

Liabilities	*Hindustan Ltd.* *₹*	*Sundram Ltd.* *₹*	*Assets*	*Hindustan Ltd.* *₹*	*Sundram Ltd.* *₹*
Shares of ₹ 100 each	2,00,000	50,000	Land and Building	60,000	—
General Reserve	30,000	10,000	Plant and Machinery	2,00,000	—
Profit and Loss Account:			Stock	40,000	85,000
Balance on 1.4.1996	40,000	20,000	Sundry Debtors	10,000	30,000
Profit for 1996-97	50,000	25,000	Bank	10,000	10,000
Creditors	30,000	30,000	300 Shares in Sundram Ltd. at cost	65,000	—
Bank overdraft	20,000	—	Bills Receivable	—	10,000
Bills payable	15,000	—			
	3,85,000	1,35,000		3,85,000	1,35,000

Shares were acquired by Hindstan Ltd. as 1 October 1996. Bills receivable held by Sundram Ltd. are all accepted by Hindustan Ltd. Included in the debtors of Sundram Ltd. are ₹ 6,000 owing by Hindustan Ltd. in respect of goods supplied. Prepare consolidated balance sheet.

Question 38

From the following information you are required to prepare a consolidated balance sheet of Karnataka Co. Ltd., and its subsidiary Bangalore Co. Ltd., as on 31.3.1998:

Balance Sheet as on 31.3.1998

Liabilities	*Karnataka* *₹*	*Bangalore* *₹*	*Assets*	*Karnataka* *₹*	*Bangalore* *₹*
Share Capital:			Fixed Assets		
Shares of ₹ 10	5,00,000	2,00,000	Goodwill	1,000,000	—
Reserve & Surplus:			Plant & Machinery	2,00,000	1,20,000
General Reserves	2,00,000	60,000	Buildings	2,00,000	1,30,000

Liabilities	*Karnataka* ₹	*Bangalore* ₹	*Assets*	*Karnataka* ₹	*Bangalore* ₹
Surplus	1,50,000	40,000	Investments in 16,000 Shares of ₹ 10 each at Bangalore Ltd.	2,00,000	—
Secured Loans			Govt. Securities	—	50,000
Against Buildings	—	80,000	Current Assets:		
Unsecured Loans	—	40,000	Stock	80,000	50,000
Current Liabilities & Provisions:			Debtors	1,00,000	40,000
Creditors	1,00,000	60,000	Bills Receivable	50,000	—
Bills Payable	50,000	20,000	Bank	20,000	80,000
			Cash	50,000	30,000
	10,00,000	5,00,000		10,00,000	5,00,000

(i) Bills Payable of Bangalore Ltd., include ₹ 10,000 due to Karnataka Ltd., which has discounted bills worth ₹ 5,000 with its Banker.

(ii) Sundry Creditors of Karnataka Co. Ltd. include ₹ 20,000 due to Bangalore Co Ltd.

(iii) The closing stock of Karnataka Ltd., include stock worth ₹ 60,000 supplied by Bangalore Ltd., which had invoiced to Karnataka Ltd., at cost *plus* 20% profit on cost.

(iv) On the date of purchase (1.1.1998) of 16,000 shares in Bangalore Ltd., by Karnataka Ltd., the balance sheet of Bangalore Ltd., showed general reserves of ₹ 20,000 and surplus of ₹ 10,000.

Question 39

Jupiter Ltd. purchased control of Neptune Ltd. on 1.10.1997. Following are the balance sheets of two companies as at 31 March 1998:

Liabilities	*Jupiter Ltd.* ₹	*Neptune Ltd.* ₹	*Assets*	*Jupiter Ltd.* ₹	*Neptune Ltd.* ₹
Equity Share Capital of ₹ 10 Share	3,60,00	1,80,000	Goodwill	6,000	24,000
General Reserve	36,000	30,000	Land & Building	60,000	60,000
Profit & Loss Account	60,000	60,000	Plant & Machinery	1,20,000	1,08,000
Creditors	60,000	42,000	Stock in trade	70,500	60,000
Bills Payable to Jupiter Ltd.	—	6,000	Debtors	30,000	54,000
Contingent Liability of Jupiter Ltd. for ₹ 9,000 for bills discounted			Investments in 13,500 Shares of Neptune Ltd.	2,02,500	—
			Cash at Bank	27,000	12,000
	5,16,000	3,18,000		5,16,000	3,18,000

Neptune Ltd. had on 1.4.1997 ₹ 30,000 in general reserve and ₹ 36,000 (Cr.) in profit and loss account. 10% dividend was received by Jupiter Ltd. in November from Neptune Ltd. for 1996-97 and this amount was credited to profit and loss Neptune Ltd. dad plant on 1.4.1997 at ₹ 1,20,000 on the date of purchase which was revalued at ₹ 1,44,000. Stock of Neptune Ltd. includes ₹ 9,600 received from Jupiter Ltd. on which it made a profit of 25% on cost. Prepare the consolidated balance sheet.

Question 40

On 1 October 1998, H. Ltd. acquired 24,000 shares of ₹ 10 each in S. Ltd. at cost of ₹ 3,40,000. The balance sheets of two companies as on 30 June 1999 were as follows:

Liabilities	*H. Ltd.* ₹	*S. Ltd.* ₹	*Assets*	*H. Ltd.* ₹	*S. Ltd.* ₹
Share Capital (₹ 10)	15,00,000	4,00,000	Goodwill	5,00,000	1,40,000
General Reserve (as per last year's account)	6,00,000	3,00,000	Land & Building	6,50,00	2,00,000
Profit & Loss Account	4,00,000	1,70,000	Machineries	6,00,000	2,00,000
Sundry Creditors	3,60,000	84,000	Stock	3,00,000	80,000
Bills Payable	1,40,000	1,20,000	Debtors	3,50,000	2,70,000

Liabilities	*H. Ltd.* ₹	*S. Ltd.* ₹	*Assets*	*H. Ltd.* ₹	*S. Ltd.* ₹
			Investments	3,40,000	—
			Bills Receivable	1,20,000	60,000
			Cash at Bank	1,40,000	1,24,000
	30,00,000	10,74,000		30,00,000	10,74,000

On 1 July 1998, the profit and loss account of S. Ltd. showed a credit balance of ₹ 80,000 out of which a dividend of 15% was paid in December 1998. The bills payable of S. Ltd. represent bills issued in favour of H. Ltd. which company still held ₹ 80,000 of the bills accepted of S. Ltd. The entire closing stock of S. Ltd. represents goods supplied by H. Ltd. at cost *plus* 20%. Prepare as consolidated balance sheet of two companies as on 30 June 1999.

Question 41

The balance sheets of Ashish Ltd. and its subsidiary Anubhav Ltd. as on 31.3.1995 are as follows:

Liabilities	*Ashish Ltd.* ₹	*Anubhav Ltd.* ₹		*Assets*	*Ashish Ltd.* ₹	*Anubhav Ltd.* ₹
Share Capital:				Building	2,80,000	58,000
Equity Shares of ₹ 10 each	4,00,000	1,00,000		Plant & Machinery	2,00,000	52,000
General Reserve (1-4-1994)	2,80,000	4,000		Furniture & Fixtures	15,000	7,000
Profit & Loss account	1,70,000	72,000		Stock in trade	75,000	42,000
Sundry Creditors	70,000	35,000		Sundry Debtors	80,000	32,000
				Investments	2,00,000	—
				Cash & Bank balances	70,000	20,000
	9,20,000	2,11,000			9,20,000	2,11,000

Prepare a consolidated balance sheet together with a work sheet, having regard to the following:

(i) Ashish Ltd. had acquired in Anubhav Ltd. 8,000 shares as at 1 July 1994 at a cost of ₹2,00,000.

(ii) Stock-in-trade of Ashish Ltd. includes ₹ 6,000 relating to stock in tade at cost purchased from Anubhav Ltd. which follows the practice of charging 25% extra on the cost for determining the sale price.

(iii) Sundry creditors of Ashish Ltd. includes ₹ 10,000 on account of purchases from Anubhav Ltd. who follows the practice of charging 25% extra on the cost for detrermining the sale price.

(iv) Profit and loss account of Ashish Ltd. includes interim dividend declared after 1 July 1994 at the rate of 10% from Anubhav Ltd.

(v) Balance in profit and loss account as at 1 April 1994 of Anubhav Ltd. was ₹ 56,000, an interim dividend having been paid during the year out of the said undistributed profits.

(vi) Profits during the year 1994-95 have been earned on uniform basis throughout the year.

Question 42

Prepare a consolidated balance sheet in the books of H Company Ltd. from the following balance sheets of H. Co. Ltd. and S. Co. Ltd. and given informations:

Balance Sheets as on 31 March 1995

Liabilities	*H. Co. Ltd.* ₹	*S. Co. Ltd.* ₹
Preference Share Capital	2,00,000	40,000
Equity Share Capital of ₹ 100 each	8,00,000	4,00,000
General Reserve as on 1-4-94	2,00,000	1,20,000
Profit and Loss Account	2,80,000	1,80,000
Creditors	1,60,000	1,00,000
Bills Payable	—	40,000
	16,40,000	8,80,000
Assets		
Goodwill	80,000	60,000
Land and Building	4,00,000	2,60,000
Plant and Machinery	3,20,00	1,80,000

Liabilities	*H. Co. Ltd.* ₹	*S. Co. Ltd.* ₹
Debtors	40,000	1,50,000
Stock	2,00,000	1,80,000
3,000 Shares in S Co. Ltd. purchased on 30-9-94	4,80,000	—
Cash/Bank	1,20,000	40,000
Preliminary Expenses	—	10,000
	16,40,00	8,80,000

Informations

(1)Profit and loss Account of S Co. Ltd showed a credit balance of ₹ 1,00,000 on 1 April 1994.

(2)A dividend of 15% was paid by S Co. Ltd. in October 1994 for the year ended 31 March 1994 which was credit to profit and loss account of H Co. Ltd.

(3)Included in creditors of S Co. Ltd. ₹ 40,000 for goods supplied by H Co. Ltd. Also included in the stock of S Co. Ltd. are goods to the value of ₹ 16,000 which were supplied by H Co. Ltd. at a profit of 25% on sales.

(4)Plant and Machinery were revalued at ₹ 3,00,000 which stood in the books at ₹ 2,00,000 in the beginning.

(5)There is contingent liability of ₹ 2,000 for a pending suit in the court in the books of H Co. Ltd.

Question 43

A. Ltd. acquired 16,000 equity shares of ₹ 10 each in B. Ltd. on 1 October 1996 for ₹ 3,22,800. The balance sheets of the two companies as on 31 March 1997 were as follows:

Liabilities	*A Ltd.* ₹	*B Ltd.* ₹	*Assets*	*A Ltd.* ₹	*B Ltd.* ₹
Share capital of ₹ 10 Shares	5,00,000	2,00,000	Land & Buildings	1,80,000	1,90,000
Reserves	2,40,000	1,00,000	Plant & Machinery	2,40,000	1,35,000
Profit & Loss Account	57,200	82,000	Investments	3,60,000	—
Bank Overdraft	1,00,000	—	Stock	1,14,000	42,000
Bills Payable	—	13,000	Debtors	44,000	40,000
Sundry Creditors	69,800	20,000	Bills Receivable	14,800	—
			Cash	14,200	8,000
	9,67,000	41,5,000		9,67,000	41,5,000

Additional Information

(i) The profit and loss account of B. ltd. showed a balance of ₹ 30,000 on 1 April 1996 out of which a dividend of 10% was paid on 1 November 1996. The dividend was correctly recorded by A Ltd.

(ii) The plant and machinery of B. Ltd. which stood at ₹ 1,50,000 on 1 April 1996 was considered worth ₹1,80,000 on the date of acquisition by A Ltd.

(iii) Profits may be assumed to have accrued evenly throughout the year. Prepare a consolidated balance sheet.

Question 44

A Ltd. acquired 3,200 equity shares of ₹ 100 each on 31 March 1998. The balance sheet of two companies as on that date were:

Liabilities	*A Ltd.* ₹	*B Ltd.* ₹	*Assets*	*A Ltd.* ₹	*B Ltd.* ₹
Equity Shares of ₹ 100	10,00,000	4,00,000	Land & Buildings	3,00,000	3,60,000
Capital Reserves	—	2,40,000	Plant & Machinery	4,80,000	2,18,800
General Reserve	4,80,000	—	Investments in B Ltd. at cost	6,80,000	—
Profit & Loss Account	1,14,400	72,000	Stocks	2,40,000	72,000
Bank Overdraft	1,60,000	—	Sundry Debtors	88,000	80,000
Bills Payable (including ₹ 8,000 to A. Ltd.)	—	16,800	Bills Receivable (including ₹ 6,000 from B. Ltd.)	31,600	—
Sundry Creditors	94,200	18,000	Cash and Bank	29,000	16,000
	18,48,600	7,46,800		18,48,600	7,46,800

The following additional information is available:

(i) B Ltd. ahs made a bonus issue on 31 March 1998 of one equity share for every two shares held by its shareholders. This issue has not yet been taken into account.

(ii) Land buildings of B Ltd. are undervalued by ₹ 40,000 and plant and machinery of B Ltd. overvalued by ₹ 20,000. Values of these assets have to be adjusted accordingly.

(iii) Sundry Creditors of A Ltd. include ₹ 24,000 due to B Ltd. Prepare the consolidated balance sheet as at 31 March 1998.

Question 45

The balance-sheets of H. Co. Ltd. and its subsidiary S. Co. Ltd. as on 31st March 1993 are as follows:

Liabilities	*H Ltd.* ₹	*S Ltd.* ₹	*Assets*	*H Ltd.* ₹	*S Ltd.* ₹
Preference Share capital	1,00,000	—	Land	3,56,000	70,000
Equity Share Capital ₹ 100 fully paid	5,00,000	1,50,000	Properties	3,76,000	40,000
General Reserve	3,40,000	6,000	Plant and Machines	1,40,000	91,300
Profit and Loss Account	3,60,000	1,08,000	Investments in 1,200 shares of S. Co. on 1-4-1992	1,80,000	
Creditors	1,00,000	44,150	Stock	1,36,000	50,600
Bills Payable		24,150	Debtors and cash	2,12,000	80,400
	14,00,000	3,32,300		14,00,000	3,32,300

The other informations given are:

(a) Profit and loss account of H Co. includes an interim dividend of 10% received from S. Company.

(b) On 1-4-1992 profit and loss account of S. Co. stood at ₹ 77,500 and general reserve at ₹3,000. Also H. Co. revalued plant and machines of S. Co. at the time of purchase of shares by ₹ 20,000 more than its book value.

(c) Stock of H. Co. includes ₹ 8,000 of stock at cost purchased from S. Co. Further Debtors of S. Co. includes ₹ 24,000 for sales to H. Co. on which S. Co. made a profit of ₹ 6,000.

(d) S. Co. made a bonus issue during the year out of pre-acquisition profits for ₹ 60,000 not recorded in the books. Prepare consolidated balance sheet

Question 46

Following are the balance sheets of H. Ltd. and S. Ltd. as at 31 March, 1997:

Liabilities	*H Ltd.* ₹	*S Ltd.* ₹
Share capital:		
Shares of ₹ 100 each	5,00,000	2,00,000
General reserve as on 1.4.1996	1,00,000	60,000
Profit & loss account	1,40,000	90,000
Bills payable	—	40,000
Creditors	80,000	50,000
	8,20,000	4,40,000
Assets		
Goodwill	40,000	30,000
Other fixed assets	3,60,000	2,20,000
1,500 shares in S Ltd. at cost	2,40,000	—
Stock	1,00,000	90,000
Debtors	20,000	75,000
Cash at bank	60,000	25,000
	8,20,000	4,40,000

The profit and loss account of S Ltd. showed a balance of ₹ 50,000 on 1 April, 1996. A dividend of 15% was paid on 15 October, 1996 for the year 1995-96. The dividend was credited by H Ltd. to its profit and loss account. H Ltd. acquired the shares on 1 October, 1996. The bills payable of S Ltd. were all issued in favour of H Ltd., which company got the bills discounted. Included in the creditors of S Ltd. are ₹ 20,000 for goods supplied by H Ltd. the stock of S Ltd. includes goods to the value of ₹ 8,000 which were supplied by H Ltd. at a profit of 33-1/3% on cost. Prepare consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as on 31 March. 1997. Give all your working notes clearly.

Question 47

The balance sheets of H Co. and S. Co. as on 31 March 1998 are as follows:

Liabilities	*H Co.* ₹	*S Co.* ₹	*Assets*	*H Co.* ₹	*S Co.* ₹
Preference Share Capital	3,00,000	40,000	Goodwill	70,000	60,000
Equity Share Capital of ₹ 100 each	9,00,000	4,00,000	Land & Buildings	6,00,000	2,60,000

Liabilities	*H Co.* ₹	*S Co.* ₹	*Assets*	*H Co.* ₹	*S Co.* ₹
General Reserve as on 1-4-97	2,00,000	1,20,000	Plant & Machinery	3,30,000	1,80,000
P & L Account	2,80,000	1,80,000	Investments :		
Creditors	1,60,000	1,00,000	3,000 shares in S. Co. (on 30.9.97)	4,80,000	—
Bills Payable	—	40,000	Debtors	40,000	1,50,00
			Stocks	2,00,000	1,80,000
			Cash	1,20,000	40,000
			Preliminary Exp.	—	10,000
	18,40,000	8,80,000		18,40,000	8,80,000

Informations: **1.** A dividend of 15% was paid by S Co. in October, 1997 for the year ended 31 March, 1997; **2.** Plant & Machinery of S. Co. in the beginning was ₹ 2,00,000. H. Co. revalued it by ₹ 1,00,000 more tat the time of purchase of shares; **3.** There was a bonus issue of ₹ 40,000 out of post-acquisition profits by S. Co.; **4.** Credit balance of P & L Account of S. Co on 1 April 1997 was ₹ 1,00,000; **5.** Included in stock of S. Co. are goods to the value of ₹ 16,000 which were supplied by H Co. at profit of 25% on sales. Prepare consolidated balance sheet giving working notes.

Question 48

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 reserve and surplus of ₹40,000.

Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. fared badly and suffered losses of ₹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.

(*May 2019*) (*10 Marks*)

Answer:

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.)	-			1,22,000 (W.N.)
2011	(1,25,000)	(37,500)	(87,500)			
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	

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*	
Balance		Nil	(1,85,500)			
2014	(60,000)	(18,000)	(42,000)			1,22,000
	Loss of Minority borne by Holding Co.	18,000	(18,000)	18,000	28,500	
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 49

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for ₹2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was ₹2,00,000 and the balance in the Profit & Loss Account was ₹1,20,000.

During the year ended 31st December, 2016, ABC Ltd. earned a profit of ₹40,000 and at year end, declared and paid a dividend of ₹60,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

You are required to compute amount of minority interest as on 1st January, 2016 and 31st December, 2016?

(*MTP March 2018*) (*5 Marks*)

Answer

Total dividend paid = ₹60,000

Out of post-acquisition profit = ₹40,000

Out of pre-acquisition profit = ₹20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = ₹60,000 × 80% = ₹48,000

In the books of XYZ Ltd.

	₹	₹
Bank A/c Dr.	48,000	
To Profit & Loss A/c		32,000
To Investments in ABC Ltd.		16,000
(Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits - as explained above)		
Goodwill on Consolidation:		₹
Cost of shares less dividend out of capital profits		2,64,000
Less: Face value of capital i.e. 80% of capital	1,60,000	
Share of capital profits [1,20,000 - 20,000 (dividend portion out of pre-acquisition profits)] X 80 %	80,000	2,40,000
Goodwill		24,000
Minority interest on:		64,000
1st January, 2016: 20% of ₹3,20,000 [2,00,000 + 1,20,000]		
31st December, 2016: 20% of ₹3,00,000 [2,00,000 + 1,20,000 + 40,000 - 60,000]		60,000

Question 50

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2010 at cost of ₹10,00,000 when B Ltd. had an equity share capital of ₹10,00,000 and reserves and surplus of ₹80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹2,50,000, ₹4,00,000, ₹5,00,000 and ₹1,20,000 respectively. Thereafter in 2014-15, B Ltd. experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 2015-16 and 2016-17, B Ltd. recorded annual profits of ₹1,00,000 and ₹1,50,000 respectively.

You are required to compute the minority interests and cost of control at the end of each year for the purpose of consolidation.

(*MTP April 2018*) (*10 Marks*)

Answer:

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.) Cr.	Minority's Share of losses borne by A Ltd.		Cost of Control
				₹	Balance	
At the time of acquisition in 2010		3,24,000 (W.N.)	—			
2010-11	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
Balance		2,49,000				
2011-12	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
2012-13	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		Nil	(3,71,000)			
2013-14	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of minority borne by Holding Co.	36,000	(36,000)	36,000	57,000	
Balance		Nil	(1,20,000)			
2014-15	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority	(15,000)	15,000	(15,000)	42,000	

Year	Profit/ (Loss)	Minority Interest (30%)	Additional Consolidated P & L (Dr.) Cr.	Minority's Share of losses borne by A Ltd.		Cost of Control
				₹	Balance	
Balance	absorbed by Holding Co.	Nil	50,000			
2015-16	1,00,000	—	1,00,000	(30,000)	12,000	2,44,000
Balance		Nil				
2016-17	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.2010

	100% (₹)	Share of Holding Co. 70% (₹)	Minority Interest 30% (₹)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Question 51

From the following data, determine the amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition		Consolidation Date	
				1.1.2016		31.12.2016	
				Share Capital	Profit & Loss Account	Share Capital	Profit & Loss Account
			₹	₹	₹	₹	₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

(*MTP April 2018*) (*5 Marks*)

Answer

The balance in the Profit & Loss Account on the date of acquisition (1.1.2016) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2016 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 31.12.2016 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added/ (deducted) from holding's P&L [O] = [K] x [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	20,000	Nil	Nil
4	100 %	40,000	55,000	15,000	15,000

Question 52

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 been 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.

(*MTP October 2018*) (*5 Marks*)

Answer

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 share of net assets (70% of 138.5)		96.95
Exe Ltd.'s 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 % i.e. ₹2 per share	₹7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Question 53

The following data is provided to you:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition		Consolidation Date	
				1.1.2018		31.12.2018	
				Share Capital	Profits Loss Account	Share Capital	Profits Loss Account
			₹	₹	₹	₹	₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

Determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(*RTP May, 2019*)

Answer

(1) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c.

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] × [A+B] ₹	Minority interest as at the date of consideration [E] × [C + D] ₹
Case 1 [100-90]	10%	15,000	*17,000*
Case 2 [100-85]	15%	*19,500*	18,000
Case 3 [100-80]	20%	*14,00*	14,000
Case 4 [100-100]	Nil	*Nil*	Nil

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 1.1.2018

(2) Calculation of Goodwill or Capital Reserve

	Shareholding % [F]	Cost [G]	Total Equity [A]+[B] = [H]	Parent's Portion of equity [F]x[H]	Goodwill ₹[G]-[H]	Capital Reserve ₹[H] - [G]
Case I	90%	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85%	1,04,000	1,30,000	1,10,500	—	6,500
Case 3	80%	56,000	70,000	56,000	Nil	Nil
Case 4	100%	1,00,000	90,000	90,000	10,000	—

Question 54

From the following data, determine the amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

Case	Subsidiary Company	% shares owned	Cost ₹	Date of acquisition		Consolidation Date	
				1.1.2018		31.12.2018	
				Share Capital ₹	Profit & Loss Account ₹	Share Capital ₹	Profit & Loss Account ₹
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	55,000

(MTP-March 2019) (5 Marks)

Answer*:*

The balance in the Profit & Loss Account on the date of acquisition (1.1.2018) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2018 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 31.12.2018 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added/ (deducted) from holding's P & L [O] = [K] x [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	20,000	Nil	Nil
4	100%	40,000	55,000	15,000	15,000

Question 55

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for ₹2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was ₹2,00,000 and the balance in the Profit & Loss Account was ₹1,20,000.

During the year ended 31st December, 2016, ABC Ltd. earned a profit of ₹40,000 and at year end, declared and paid a dividend of ₹60,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 2016 and 31st December, 2016?

(*MTP-April 2019*) (*5 Marks*)

Answer

Total dividend paid = ₹60,000

Out of post-acquisition profit = ₹40,000

Out of pre-acquisition profit = ₹20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = ₹60,000 X 80% = ₹48,000

In the books of XYZ Ltd.

		₹	₹
Bank A/c	Dr.	48,000	
To Profit & Loss A/c			32,000
To Investments in ABC Ltd.			16,000
(Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits - as explained above)			
Goodwill on Consolidation:			₹
Cost of shares less dividend out of capital profits			2,64,000
Less: Face value of capital i.e.80% of capital		1,60,000	
		80,000	2,40,000
Add: Share of capital profits [1,20,000-20,000 (dividend portion out of pre-acquisition profits)] × 80%			24,000
Goodwill			
Minority interest on:			64,000
1st January, 2016: 20% of ₹3,20,000 [2,00,000 + 1,20,000]			
31st December, 2016: 20% of ₹3,00,000 [2,00,000 + 1,20,000 + 40,000-60,000]			60,000

Question 56

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2017:

	H Ltd. (₹)	S Ltd. (₹)
Equity and Liabilities		
Shareholders' Funds		
Equity Share Capita! (fully paid up shares of ₹10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
Total	22,37,000	5,43,000

	H Ltd. (₹)	S Ltd. (₹)
Assets		
Non-Current Assets		
Fixed Assets		
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
Total	22,37,000	5,43,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2016. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹50,000 and ₹30,000 respectively.

Machinery (hook 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,2016 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: 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 purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet as at 31st March, 2017.

(May 2018) (20 Marks)

Answer:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as at 31st March, 2017

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		12,00,000
(1,20,000 equity shares of ₹10each)		
(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		
(a) Fixed assets		
(i) Tangible assets	3	13,10,500
(ii) Intangible assets	4	24,000
(b) 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.	Tangible Assets			
	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 1.4.2016

	₹
Machinery	
Revaluation as on 1.4.2016	3,00,000
Less: Book value as on 1.4.2016	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2016	30,000
Less: Book value as on 1.4.2016	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	**Furniture**
Upward/(Downward) Revaluation (W.N. 4)	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 31.03.2017

	Pre-acquisition profit upto 1.4.2016	**Post-acquisition profits (1.4.2016-31.3.2017)**	
	(Capital profits)	**General Reserve**	**Profit and loss account**
General reserve as on 31.3.2017	50,000	1,05,000	
Profit and loss account as on 31.3.2017	30,000		35,000
Upward Revaluation of machinery as on 1.4.2016	1,00,000		
Downward Revaluation of Furniture as on 1.4.2016	(10,000)		
Short depreciation on machinery (W.N. 5)			(10,000)
Excess depreciation on furniture (W.N. 5)			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 (55,000x 10/110)* × 20%	(1,000)
	99,300

* considered that ₹55,000 is cost to H Ltd. Alternative solution considering it as cost to S Ltd. is also possible

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 57

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 areas follows:

Particulars	**Amounts as at 31st March, 2017**	
	X Ltd. (₹ in lakhs)	**Y Ltd. (₹ in lakhs)**
LIABILITIES		
Share Capital:		
Authorised	20,000	8,000
Issues and subscribed:		
Equity share of ₹10 each, fully paid up	15,000	6,000
15% preference shares of ₹10 each, fully paid up	4,000	1,000
General Reserves	2,500	1,450
Profit & Loss Account	2,750	1,250
Trade payables	1,646	1,027
	25,896	10,727
ASSETS		
Land & Building	3,550	1,510
Plants Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd.:		
450 Lakh Equity share in Y Ltd. purchased on 1st April, 2016	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	1,174	560
	25,896	10,727

The following information is also given to you

(a) 10% dividend on Equity shares was declared by Y Ltd. on 31st March, 2016 for the year ended 31st March, 2016. X Ltd. credited the dividend received to its Profit & Loss Account.

(b) Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2016 was ₹650 Lakhs.

(c) General Reserve of Y Ltd. stood at same ₹1,450 Lakhs as on 1st April, 2016.

(d) Y Ltd.'s Plant & machinery showed a balance of ₹4,000 Lakh on 1st April 2016. At the time of purchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by ₹1,000 Lakh.

(e) Included in Trade Payables of Y Ltd. are ₹50 Lakh for goods supplied by X Ltd.

(f) On 31st March, 2017, Y's ltd. inventory included goods for ₹150 lakhs which it had purchased from X Ltd. X Ltd. sold goods to Y Ltd. at cost plus 25%.

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 giving working notes. (Ignoring dividend on preference shares).

(*RTP November 2018*)

Answer:

Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017

	Particulars	Note No.	₹ in lakhs
I	**Equity and Liabilities**		
1	**Shareholders' Funds**		
	(a) Share Capital	1	19,000
	(b) Reserves and Surplus	2	5,620
2.	**Minority interest**	3	3,400
3.	**Current Liabilities**		
	(a) Trade payables	4	2,623
	Total		30,643
II	**Assets**		
1	**Non Current Assets**		
	Fixed Assets		
	(i) Tangible Assets	5	17,435
2	**Current Assets**		
	(a) Inventories	6	6,632
	(b) Trade Receivables	7	4,842
	(c) Cash and Cash equivalents	8	1,734
			30,643

Notes to Accounts

			₹ in lakhs
1.	Share Capital		
	Issued, Subscribed and Paid up (1,500 lakh Equity Shares of ₹10 each fully paid up)		15,000
	400 lakh Preference Shares of ₹10 each fully paid up		4,000
			19,000
2.	Reserves and Surplus		
	Credit Balance of Profit & Loss Account	2,750	
	Less: Capital Receipt wrongly credited (Dividend @ 10% on ₹4500 Lakh Equity Shares)	450	
		2,300	
	Add: Share in Y Ltd. Revenue Profit (Working Note i)	825	
		3,125	
	Less: Unrealised Profit (Working Note iv)	30	3,095
	Capital Reserve (Working Note iii)	25	
	General Reserve	2,500	2,525
			5,620
3.	**Minority interest**		
	100 Lakh Preference Shares of ₹10 fully paid up	1,000	
	150 Lakh Equity Shares of ₹10 each fully paid up	1,500	2,500
	Share in Revenue Profits (Working Note i)	275	
	Share in Capital Profit (working Note ii)	625	900
			3,400
4.	**Trade payables**		
	X Ltd.	1,646	
	Y Ltd.	1,027	
		2,673	
	Less: Mutual owing	50	2,623

			₹ in lakhs
5.	**Tangible Assets**		
	Land & Building		
	X Ltd.	3,550	
	Y Ltd	1,510	5,060
	Plants Machinery		
	X Ltd.	5,275	
	Y Ltd (Working note v)	4,500	9,775
	Furniture & Fixtures		
	X Ltd.	1,945	
	Y Ltd	655	2,600
			17,435
6.	**Inventories**		
	X Ltd.	4,142	
	Y Ltd	2,520	
		6,662	
	Less: Unrealized Profit	1301	6,632
7.	**Trade Receivables**		
	X Ltd.	3,010	
	Y Ltd	1,882	
		4,892	
	Less: Mutual Owing	50	4,842
8.	**Cash & cash Equivalents**		
	X Ltd.	1,174	
	Y Ltd	560	1,734

Working Notes

(i) Calculation of Revenue Profits

Y's Ltd Profit & Loss Account

	₹ in lakh		₹ in lakh
To Equity Dividend		By Balance b/d	650
10% of 6,000 lakh	600	By Net profit for the year (Bal Fig.)	1,200
To balance c/d	1,250		
	1,850		1,850

Depreciation provided on Plant & Machinery

Balance as on 1st April, 2016	4,000
Less Balance as 31st March 2017	3,600
	400
Hence rate of Depreciation = 400/4000 × 100	10%
Net Profit for the year ended 31st March 2017	1,200
Less: Additional Depreciation	100
Revenue Profit	1,100
X Ltd's share- 1100 × 450/600	825
Y Ltd's share = 1100 × 150/600	275

(ii) Calculation of Capital Profits

Profit & Loss Balance as on 1st April, 2016	650
Less: Dividend Paid	600
	50
Add: General Reserve as on 1st April, 2016	1,450
Add: Profit on Revaluation of Plant & machinery	1,000
Capital Profit	2,500
X Ltd's Share in Capital Profit = 2,500 × 450/600	1,875
Y Ltd's Share in Capital Profit = 2,500 × 150/600	625

(iii) Calculation of Capital Reserve

Paid up value of 450 Lakh equity shares	4,500
Add: Share in Capital Profits	1,875
	6,375
Amount Paid to acquire the 450 Lakh Equity Shares	6,800
Less: Dividend received out of Pre acquisition profits	450
	6,350
Capital Reserve = 6,375 - 6,350	25

(iv) Unrealised Profit

₹150 Lakh × 25/125* = 30 lakh

(v) Plant & Machinery of Y Ltd.

Balance as on 31st March, 2017		3,600
Add: Addition due to revaluation	1,000	
Less: Depreciation on additional Value of Plant & Machinery @ 10 %	100	900
		4,500

* ₹150 lakh considered as cost to Y Ltd.

Question 58

Consider the following summarized balance sheets of subsidiary Neel Ltd.:

	2015 ₹	2016 ₹		2015 ₹	2016 ₹
Share-Capital Issued & subscribed 2,500 equity shares of ₹100 each	2,50,000	2,50,000	Fixed Assets Cost	1,60,000	1,60,000
Reserves & Surplus			Less: Accumulated depreciation	(24,000)	(48,000)
				1,36,000	**1,12,000**
Revenue reserves	1,43,000	3,57,000	Investments at cost		
Current Liabilities & Provisions:			Current Assets:	—	2,00,000
Trade Payables	2,45,000	2,47,000	Inventory	2,98,500	3,71,000
Bank overdraft	—	85,000	Trade Receivables	2,97,000	4,45,500
Provision for taxation	1,55,000	2,15,000	Prepaid Expenses	36,000	24,000
			Cash at Bank	25,500	1,500
	7,93,000	**11,54,000**		**7,93,000**	**11,54,000**

Also consider the following information:

(i) Neel Ltd. is a subsidiary of Sky Ltd. Both the companies follow calendar year as the accounting year.

(ii) Sky Ltd. values inventory on LIFO basis while Neel Ltd. used FIFO basis. To bring Neel Ltd.'s values in line with those of Sky Ltd. its value of inventory is required to be reduced by ₹6,000 at the end of 2015 and ₹17,000 at the end of 2016.

(iii) Neel Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

(iv) Prepaid expenses in Neel Ltd. include advertising expenditure carried forward of ₹30,000 in 2015 and ₹15,000 in 2016, being part of initial advertising expenditure of ₹45,000 in 2015 which is being written off over three years. Similar amount of advertising expenditure of Sky Ltd. has been fully written off in 2015.

You are required to restate the balance sheet of Neel Ltd. as on 31st December, 2016 after considering the above information, for the purpose of consolidation. Make the necessary restatement which is necessary to make the accounting policies adopted by Sky Ltd. and Neel Ltd. uniform.

(*MTP-April 2019*) (*12 Marks*)

Answer*:*

(*a*) Adjusted revenue reserves of Neel Ltd.

	₹	₹
Revenue reserves as given		3,57,000
Add: Provision for doubtful debts [4,45,500/99 × 1]		4,500
		3,61,500
Less: Reduction in value of Inventory	17,000	
Advertising expenditure to be written off	15,000	(32,000)
Adjusted revenue reserve		3,29,500

Therefore, reduction in inventory would have been taken care of by sale value. Hence no adjustment has been made for the same.

Restated Balance Sheet of Neel Ltd.
as at 31st December, 2016

	Particulars	Note No.	(₹)
I.	**Equity and Liabilities**		
	(1) Shareholder's Funds		2,50,000
	(a) Share Capital	1	3,29,500
	(b) Reserves and Surplus		
	(2) Current Liabilities		
	(a) Short term borrowings	2	85,000
	(b) Trade Payables		2,47,000
	(c) Short-term provision	3	2,15,000
	Total		**11,26,500**
II.	**Assets**		
	(1) Non-current assets		
	(a) Fixed assets		
	Tangible assets	4	1,12,000
	(b) Non-current Investment		2,00,000
	(2) Current assets		
	(a) Inventories		3,54,000
	(b) Trade Receivables		4,50,000
	(c) Cash & Cash Equivalents		1,500
	(d) Other current assets		9,000
	Total		**11,26,500**

Notes to Accounts

			₹
1.	**Reserves and Surplus**		
	Revenue Reserve (refer computation of adjusted revenue reserves of Neel Ltd)		3,29,500
2.	**Short term borrowings**		85,000
	Bank overdraft		
3.	**Short-term provision**		2,15,000
	Provision for taxation		
4.	**Tangible Assets**		
	Cost	1,60,000	
	Less: Depreciation to date	(48,000)	1,12,000
5.	**Other current assets**		
	Prepaid expenses (After adjusting advertising expenditure to be written off each year)		9,000

Question 59

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2019:

	H Ltd. (₹)	S Ltd. (₹)
Equity and Liabilities		
Shareholders' Funds		
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
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,25,000	1,25,000
Total	22,40,000	5,45,000

	H Ltd. (₹)	S Ltd. (₹)
Assets		
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	4,73,000	2,37,000
Cash and Bank	1,64,000	32,000
Total	22,40,000	5,45,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2018. 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,2018 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹40,000 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 S Ltd. as at 31st March, 2019.

(*RTP November 2019*)

Answer:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2019

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		
(a) Property, Plant and Equipment		
(i) Tangible assets	3	13,10,500
(ii) Intangible assets	4	24,000
(b) 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.		3,25,000	
	S Ltd.		1,25,000	
	Less: Mutual transaction		(40,000)	4,10,000
3.	Tangible Assets			
	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.		4,73,000	
	S Ltd.		2,37,000	7,10,000
	Less: Mutual transaction			(40,000)
				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 1.4.2018

	₹
Machinery	
Revaluation as on 1.4.2018	3,00,000
Less: Book value as on 1.4.2018	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2018	30,000
Less: Book value as on 1.4.2018	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	***Furniture***
Upward/(Downward) Revaluation (W.N. 4)	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 31.03.2019

	Pre-acquisition profit upto 1.4.2018	***Post-acquisition profits (1.4.2018 – 31.3.2019)***	
	(Capital profits)	***General Reserve***	***Profit and loss account***
General reserve as on 31.3.2019	50,000	1,05,000	
Profit and loss account as on 31.3.2019	30,000		35,000
Upward Revaluation of machinery as on 1.4.2018	1,00,000		
Downward Revaluation of Furniture as on 1.4.2018	(10,000)		
Short depreciation on machinery (W.N. 5)			(10,000)
Excess depreciation on furniture (W.N. 5)			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 60

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.:

Liabilities	**2017-18 Amount in ₹**	**2018-19 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
	15,88,000	23,08,000
Assets		
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.

(*November 2019, New Course, 10 Marks*)

Answer

Restated Balance Sheet of MNT Ltd. as at 31st December, 2019

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables		3,50,000
(c) Cash & Cash Equivalents		
(d) Other current assets	6	42,500
		52,500
Total		23,14,500

Notes to Accounts

			₹
1.	**Reserves and Surplus**		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	**Short term borrowings**		
	Bank overdraft		1,70,000
3.	**Short-term provision**		
	Provision for taxation		4,30,000
4.	**Property, Plant and Equipment**		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 61

From the following summarized balance sheets of Kedar Ltd. and its subsidiary Vijay Ltd. drawn up at 31st March, 2019, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of Vijay Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Kedar Ltd. on 1st April, 2018.

(ii) Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Vijay Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2018 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 Kedar Ltd. and Vijay Ltd. as on 31st March, 2019

Liabilities	Kedar Ltd.	Vijay Ltd.	Assets	Kedar Ltd.	Vijay Ltd.
Equity and Liabilities	₹	₹	Non-current assets	₹	₹
Shareholders' funds			Fixed assets		
Share Capital			Machinery	7,50,000	2,25,000
Shares of ₹ 100 each	15,00,000	2,50,000	Furniture	3,75,000	42,500
Reserves	5,00,000	1,87,500	Other non-current assets	11,00,000	3,75,000
Profit and Loss			Non-current Investments		
Account	2,50,000	62,500	Shares in Vijay Ltd.:		
Trade Payables	3,75,000	1,42,500	2,000 shares at ₹ 200 each	4,00,000	—
	26,25,000	6,42,500		26,25,000	6,42,500

(*May 2020*)

Answer

Consolidated Balance Sheet of Kedar Ltd. and its Subsidiary Vijay Ltd. as at 31st March, 2019

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 Vijay 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 Vijay Ltd.'s post- acquisition profits (W.N.4)		11,500	2,61,500
				8,61,500
2.	**Trade Payables**			
	Kedar Ltd.		3,75,000	
	Vijay Ltd.		1,42,500	5,17,500
3.	**Property, Plant & Equipment**			
	Machinery			
	Kedar Ltd.		7,50,000	

				₹
	Vijay Ltd.	2,50,000		
	Add: Appreciation	1,25,000		
		3,75,000		
	Less: Depreciation	(37,500)	3,37,500	
	Furniture	-		
	Kedar Ltd.	-	3,75,000	
	Vijay Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,375
4.	**Intangible assets**			
	Goodwill [WN 6]			30,000
5.	**Other non-current assets**			
	Kedar Ltd.		11,00,000	
	Vijay Ltd.		3,75,000	14,75,000

Working Notes:

		₹
1.	**Pre-acquisition profits and reserves of Vijay Ltd.**	
	Reserves	62,500
	Profit and Loss Account	37,500
		1,00,000
	Kedar 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 Vijay 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
	Kedar Ltd.'s share 4/5 × 1,12,500	90,000
	Minority Interest 1/5 × 1,12,500	22,500
3.	**Post-acquisition reserves of Vijay Ltd.**	-
	Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500)	1,25,000
	Kedar Ltd.'s share 4/5 × 1,25,000	1,00,000
	Minority interest 1/5 × 25,000	25,000
4.	**Post -acquisition profits of Vijay 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
	Kedar 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
6.	**Cost of Control or Goodwill**	1,20,375
	Paid-up value of 2,000 shares held by Kedar 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 Kedar 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 62

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

	Hello Ltd. (₹ in lacs)	Sun Ltd. (₹ in lacs)
Incomes:		
Sales and other income	10,000	2,000
Increase in Inventory	2,000	400
	12,000	2,400
Expenses:		
Raw material consumed	1,600	400
Wages and Salaries	1,600	300
Production expenses	400	200
Administrative Expenses	400	200
Selling and Distribution Expenses	400	100
Interest	200	100
Depreciation	200	100
	4,800	1,400
Profit before tax	7,200	1,000
Provision for tax	2,400	400
Profit after tax	4,800	600
Dividend paid	2,400	300
Balance of Profit	2,400	300

Other Information:

Hello Ltd. sold goods to Sun Ltd. of ₹240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing ₹48 lacs. Administrative expenses of Sun Ltd. include ₹10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include ₹20 lacs paid to Sun Ltd. as commission.

Hello Ltd. holds 80% of equity share capital of ₹2,000 lacs in Sun Ltd. prior to 2015-2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017.

(*RTP May 2018*)

Answer:

Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd.
for the year ended on 31st March, 2017

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	11,730
II. Total revenue		11,730
III. Expenses		
Cost of Material purchased/Consumed	3	2,360
Changes of Inventories of finished goods	2	(2,392)
Employee benefit expense	4	1,900
Finance cost	6	300
Depreciation and amortization expense	7	300
Other expenses	5	1,070
Total expenses		3,538
IV. Profit before Tax (II - III)		8,192
V. Tax Expenses	8	2,800
VI. Profit After Tax		5,392
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		5,392
Dividend paid		
Hello Ltd.	2,400	
Sun Ltd.	300	
	2,700	
Less: Share of Hello Ltd. in dividend of Sun Ltd.		
80% of ₹300 lacs	(240)	(2,460)
Profit to be transferred to consolidated balance sheet		2,932

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	Revenue from Operations		
	Sales and other income		
	Hello Ltd.	10,000	
	Sun Ltd.	2,000	
		12,000	
	Less: Inter-company Sales	(240)	
	Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	
	Commission received by Sun Ltd. from Hello Ltd.	(20)	11,730
2.	Increase in Inventory		
	Hello Ltd.	2,000	
	Sun Ltd.	400	
		2,400	
	Less: Unrealized profits ₹48 lacs × $\frac{20}{120}$	(8)	2,392
			14,122
3.	Cost of Material purchased/consumed		
	Hello Ltd.	1,600	
	Sun Ltd.	400	
		2,000	
	Less: Purchases by Sun Ltd. from Hello Ltd.	(240)	1,760
	Direct Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	600
			2,360
4.	Employee benefits and expenses		
	Wages and Salaries:		
	Hello Ltd.	1,600	
	Sun Ltd.	300	1,900
5.	Other Expenses		
	Administrative Expenses		
	Hello Ltd.	400	
	Sun Ltd.	200	
		600	
	Less: Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	590
	Selling and Distribution Expenses:		
	Hello Ltd.	400	
	Sun Ltd.	100	
		500	
	Less: Commission received from Sun Ltd. from Hello Ltd.	(20)	480
			1,070
6.	Finance Cost		
	Interest:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
7.	Depreciation and Amortization Depreciation:		
	Hello Ltd.	200	
	Sun Ltd.	100	300
8.	Provision for tax		
	Hello Ltd.	2,400	
	Sun Ltd.	400	2,800

Note: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not added to consolidated opening retained earnings (which is also not given).

Question 63

Given below are the Profit & Loss Accounts of H Ltd. and its subsidiary Ltd. for the year ended 31st March, 2017:

	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
Dividend paid	1,200	150
Balance of Profit	1,200	150

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. prior to 2015-2016. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 2017.

(*MTP March 2018*) (*12 Marks*)

Answer

Consolidated Profit & Loss Account of H Ltd. and its subsidiary S Ltd.
for the year ended on 31st March, 2017

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	5,865
II. Total revenue		5,865
III. Expenses		
Cost of Material purchased/Consumed	3	1,180
Changes of Inventories of finished goods	2	(1,196)
Employee benefit expense	4	950
Finance cost	6	150
Depreciation and amortization expense	7	150
Other expenses	5	535
Total expenses		1,769
IV. Profit before Tax (II-III)		4,096
V. Tax Expenses	8	1,400
VI. Profit After Tax		2,696
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		2,696
Dividend paid		
H Ltd.	1,200	
S Ltd.	150	
	1,350	
Less: Share of H Ltd. in dividend of S Ltd.		
80% of ₹150 lacs	(120)	(1,230)
Profit to be transferred to consolidated balance sheet		1,466

Notes to Accounts

		₹ in lacs	₹ in lacs
1.	Revenue from Operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	1,000	
		6,000	
	Less: Inter-company Sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Increase in Inventory		
	H Ltd.	1,000	
	S Ltd.	200	
		1,200	
	Less: Unrealized profits ₹24 lacs × 20/120	(4)	1,196
			7,061
3.	Cost of Material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct Expenses		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
4.	Employee benefits and expenses		
	Wages and Salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Other Expenses		
	Administrative Expenses		
	H Ltd.	200	
	S Ltd.	100	
		300	
	Less: Consultancy fees received by H Ltd. from S Ltd.	(5)	295
	Selling and Distribution Expenses:		
	H Ltd.	200	
	S Ltd.	50	
		250	
	Less: Commission received from S Ltd. from H Ltd.	(10)	240
			535
6.	Finance Cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150
7.	Depreciation and Amortisation		
	Depreciation:		
	H Ltd.	100	
	S Ltd.	50	150
8.	Provision for tax		
	H Ltd.	1,200	
	S. Ltd.	200	1,400

Question 64

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	11
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.

(November 2018) (10 marks)

Answer*:*

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

		₹ in Lacs	₹ in Lacs
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealised profits ₹180x1/6x25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and 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 65

(a) 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 2019. Suggest the accounting treatment for this transaction in the consolidated financial statements of A Ltd giving reference of the relevant accounting standard.

(b) 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	
				01-01-2019		31-12-2019	
				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

(*RTP, November, 2020*)

Answer

(a) As per para provisions of AS 21, Intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

The case given in the question is the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 2019 , entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs – ₹ 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 2019, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 2019. In the consolidated balance sheet as of 31 March 2019, A Ltd's share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).

(b) 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 1.1.2019

B = Profit & loss account balance on 1.1.2019

C = Share capital on 31.12.2019

D = Profit & loss account balance on 31.12.2019

	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 66

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 2019 for ₹ 2,10,000. The issued capital of Power Ltd., on 1st January, 2019 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 2019, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500.

What is the amount of minority interest as on 1st January, 2019 and 31st December, 2019? Also compute goodwill/ capital reserve at the date of acquisition.

(*MTP, October, 2020*) (*6 marks*)

Answer

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

***Goodwill on consolidation* (*at the date of acquisition*):**	₹	₹
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on:		
- **1st January, 2019:**		
20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 2019:**		49,500
20% of ₹2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		

Question 67

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 2020. What will be the accounting treatment for this transaction in the consolidated financial statements of A Ltd?

(*MTP, October, 2020*) (*4 marks*)

Answer

This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 2020, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs – ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 2020, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 2020.

Question 68

A Ltd. and its subsidiary B Ltd. give the following information for the year ended 31st March, 2020:

₹ in Lakhs

	A Ltd.	**B Ltd.**
Sales and other income	7,500	1,500
Increase in Inventory	1,500	300
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

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) A Ltd. holds 72% of the Equity Capital of B Ltd and the Equity Capital of B Ltd is ₹1,500 Lakhs on 1.4.2019 (date of acquisition of shares).

(iii) Administrative expenses of B Ltd include ₹ 8 Lakhs paid to A Ltd as consultancy fees. Moreover, selling and distribution expenses of A Ltd include ₹15 Lakhs paid to B Ltd as commission.

You are required to prepare a consolidated Statement of Profit and Loss Account of A Ltd. with its subsidiary B Ltd. for the year ended 31st March, 2020.

(*MTP, March, 2021*) (*15 marks*)

Answer

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.
for the year ended on 31st March, 2020

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

Particulars	***Note No.***	***₹ in Lacs***
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

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)	8,797
	Commission received by B Ltd. from A Ltd.	(15)	
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	300	
		1,800	
	Less: Unrealized profits ₹ 180×1/6 x 25/125	(6)	1,794
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	300	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	(180)	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	150	450
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	225	1,425
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	150	
		450	
	Less: Consultancy fees received by A Ltd. from B Ltd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	75	
		375	
	Less: Commission received from B Ltd. from A Ltd.	(15)	360
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	75	225
7.	Depreciation and Amortization		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	75	225

Question 69

(a) 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.

(*MTP, April, 2021*) (*16 marks*)

Answer

(a) 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		
(2) Minority Interest (W.N.4)		
(3) Current Liabilities	1	8,16,200
(a) Trade Payables		99,300
II. Assets Total	2	4,10,000
(1) Non-current assets		25,25,500
(i) Property, plant and equipment		
(ii) Intangible assets	3	13,10,500
	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
	Trade Payables			
2.	H Ltd.			
	S Ltd.		3,22,000	
	Less: Mutual transaction		1,23,000	
			(35,000)	4,10,000
3.	Property, plant and equipment			
	Machinery		6,40,000	
	H Ltd.	2,00,000		
	S Ltd.	1,00,000		
	Add: Appreciation	3,00,000		
	Less: Depreciation	(30,000)	2,70,000	9,10,000
	Furniture		3,75,000	
	H. Ltd.			
	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.			
	S Ltd.		1,64,000	
			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 70

A Ltd. acquired 70% equity shares of B Ltd. @ ₹20 per share (Face value - ₹10) on 31st March, 2021 at a cost of ₹ 140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021:

	₹ in lakhs
Property, plant and equipment	360
Investments	90
Current Assets	140
Loans & Advances	30
15% Debentures	180
Current Liabilities	100

(*RTP, May, 2021*)

Answer

Net assets of B Ltd. as on 31st March, 2021

	₹ in lakhs	*₹ in lakhs*
Property, plant and equipment		360
Investments		90
Current Assets		140
Loans and Advances		30
Total Assets		620
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		340
Share of Minority Interest in net assets (30% of 340)		102
A Ltd.'s share in net assets (70% of 340)		238
A Ltd.'s cost of acquisition of shares of B Ltd.		
(₹140 lakhs)		(140)
Capital reserve		98

Question 71

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.

(*Suggested, November, 2020*) (*15 marks*)

Answer

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

Particulars	Note No.	(₹)
(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.			
	S Ltd.		4,56,000	
			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 72

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

	H Ltd.	S Ltd.
	₹	₹
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.

(*Suggested, January, 2021) (20 marks*)

Answer

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	13,40,000
(b) Reserves and Surplus	2	8,27,040
(2) Minority Interest		1,15,560
(3) Non- Current Liabilities		1,00,000
(a) 12% Debentures		
(4) Current Liabilities	3	3,84,800
(a) Trade Payables		1,00,000
(b) Short term Borrowings (Bank overdraft)		
Total		28,67,400
II. Assets		
(1) Non-current assets		
(a)		
(i) Property, Plant and Equipment	4	14,34,600
(ii) Intangible assets	5	28,800
(2) Current assets		
(a) Inventory (6,00,000+2,00,000)		8,00,000
(b) Trade Receivables	6	5,08,000
(c) Cash and Cash equivalents		96,000
Total		28,67,400

Notes to Accounts

				₹
1.	Share Capital			
	Equity share capital			13,40,000
	1,34,000 shares of ₹ 10 each fully paid up Reserves and Surplus			
2.	Reserves		4,80,000	
	Add: 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3)		96,000	5,76,000
	Profit and Loss Account		2,40,000	
	Add: 4/5th share of S Ltd.'s post- acquisition profits (W.N.4)		11,040	2,51,040
				8,27,040
3.	Trade Payables			
	H Ltd.	2,00,000		
	S Ltd.	1,22,000	3,22,000	
	Bills Payables			
		60,000		
	H Ltd.	14,800	74,800	
	S Ltd.		3,96,800	
			(12,000)	3,84,800
	Less: Mutual Owings			
4.			7,20,000	
	Property Plant and Equipment			
	Machinery	2,40,000		
	H. Ltd.			
	S Ltd.	1,20,000		
	Add: Appreciation	3,60,000		
		(36,000)	3,24,000	
	Less: Depreciation (3,60,000 X 10%)			
	Furniture			
	H. Ltd.		3,60,000	
	S Ltd.	48,000		
	Less: Decrease in value	(12,000)		
		36,000		
		5,400	30,600	14,34,600
	Less: Depreciation (36,000 X 15%)			
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.				
	Trade receivables	3,00,000		
	H Ltd.	90,000	3,90,000	
	S Ltd.	1,00,000		
	Bills Receivables	30,000	1,30,000	
	H Ltd.		5,20,000	
	S Ltd.			
	Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

		₹
1.	Pre-acquisition profits and reserves of S Ltd.	
	Reserves	60,000
	Profit and Loss Account	36,000
		96,000
	H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
	Minority Interest= 1/5 (or 20%) × 96,000	19,200
2.	Profit on revaluation of assets of S Ltd.	
	Profit on Machinery ₹ (3,60,000 – 2,40,000)	1,20,000
	Less: Loss on Furniture ₹(48,000 –36,000)	(12,000)
	Net Profit on revaluation	1,08,000
	H Ltd.'s share 4/5 × 1,08,000	86,400
	Minority Interest 1/5 × 1,08,000	21,600

3.	Post-acquisition reserves of S Ltd.	
	Total reserves	1,80,000
	Less: Pre- acquisition reserves	(60,000)
	Post-acquisition reserves	1,20,000
	H Ltd.'s share 4/5 × 1,20,000	96,000
	Minority interest 1/5 × 1,20,000	24,000
4.	Post -acquisition profits of S Ltd.	
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 60,000 – 36,000)	24,000
	Add: Excess depreciation charged on furniture @ 15% on ₹ 12,000 i.e. (48,000 – 36,000)	1,800
		25,800
	Less: Under depreciation on machinery @ 10% on ₹ 1,20,000 i.e. (3,60,000 – 2,40,000)	(12,000)
	Adjusted post-acquisition profits	13,800
	H Ltd.'s share 4/5 × 13,800	11,040
	Minority Interest 1/5 × 13,800	2,760
5.	Minority Interest	
	Paid-up value of (24,000 – 19,200) = 4,800 shares held by outsiders i.e. 2,40,000 X 20%	48,000
	Add: 1/5th share of pre-acquisition profits and reserves	19,200
	1/5th share of profit on revaluation	21,600
	1/5th share of post-acquisition reserves	24,000
	1/5th share of post-acquisition profit	2,760
		1,15,560
6.	Cost of Control or Goodwill	
	Price paid by H Ltd. for 19,200 shares (A)	3,84,000
	Less: Intrinsic value of the shares	
	Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%	1,92,000
	Add: 4/5th share of pre-acquisition profits and reserves	76,800
	4/5th share of profit on the revaluation	86,400
	Intrinsic value of shares on the date of acquisition (B)	3,55,200
	Cost of control or Goodwill (A – B)	28,800

Question 73

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.

(*Wrong solution of ICAI*) (*July, 2021 Suggested*) (*15 Marks*)

Answer

Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, 2021

Particulars	Note No.	₹
I. Revenue from operations	1	35,80,000
II. Total revenue		35,80,000
III. Expenses		
Cost of Material purchased/Consumed	2	20,80,000
Changes of Inventories of finished goods		-
Employee benefit expense	3	5,00,000
Finance cost	4	48,000
Depreciation and amortization expense	5	4,57,000
Other expenses	6	2,80,000
Total expenses		33,65,000
IV. Profit before Tax (II-III)		2,15,000
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		2,15,000
Preference dividend	7,000	
Preference dividend payable	7,000	(14,000)
		2,01,000
Share in pre-acquisition loss (WN 3)		1,800
Share of Minority interest in losses (WN 1)		1,800
Less: Investment Account- dividend for 3 months (prior to acquisition)		(3,500)
Inventory reserve (WN 2)		(6,000)
Profit to be transferred to consolidated balance sheet		1,95,100

Notes to Accounts

		₹	₹
1	Revenue from Operations		
	X Ltd.	18,00,000	
	Y Ltd.	19,00,000	
	Total	37,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	35,80,000
2	Cost of Materials Purchased/Consumed		
	X Ltd.	10,00,000	
	Y Ltd.	12,00,000	
	Total	22,00,000	
	Less: Intra-group sales (X sold to Y)	(1,20,000)	20,80,000
3	Employee benefit and expenses		
	Wages and salaries		
	H Ltd.	2,00,000	
	S Ltd.	3,00,000	5,00,000
4	Finance cost		
	Interest		
	H Ltd.	24,000	
	S Ltd.	24,000	48,000
5	Depreciation		
	H Ltd.	2,20,000	
	S Ltd.	2,37,000	4,57,000

		₹	₹
6	Other expenses		
	H Ltd.	1,60,000	
	S Ltd.	1,20,000	2,80,000

Working Note

1. Profit of Subsidiary ₹

Revenue from Operations		19,00,000
Less: Expenses		
Cost of Material purchased/Consumed	12,00,000	
Changes of Inventories of finished goods	-	
Employee benefit expense	3,00,000	
Finance cost	24,000	
Depreciation and amortization expense	2,37,000	
Other expenses	1,20,000	
Total expenses		(18,81,000)
Profit Before Tax		19,000
Less: Preference Dividend	14,000	
Less: Preference Dividend Payable	14,000	(28,000)
Profit available for shareholders		(9,000)
Minority Share (20% of loss ₹ 9,000)		(1,800)

2. **Inventory reserve** $= \left[\frac{120,000}{4} \times \frac{25}{125}\right] = ₹\ 6,000$

3. **Pre-acquisition loss** = 80% of 3 month's profit up to 30th June,2020 i.e. 80 % of ¼ of loss ₹ 9,000. Hence, pre-acquisition loss = ₹ 1,800

4. Investment account includes Preference dividend for 3 months prior to acquisition i.e. ₹ 4,00,000 X 50% X 7% X1/4 = ₹ 3,500

Question 74

Long Limited acquired 60% stake in Short Limited for a consideration of ₹ 112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was ₹ 100 lakhs, Revenue Reserve was ₹ 40 lakhs and balance in Profit & Loss Account was ₹ 30 lakhs. From the above information you are required to calculate Goodwill / Capital Reserve in the following situations:

(i) On consolidation of Balance Sheet.

(ii) If Long Limited showed the investment in subsidiary at a carrying amount of ₹ 104 lakhs.

(iii) If the consideration paid for acquiring the 60% stake was ₹ 92 lakhs.

(*July, 2021 Suggested*) (*5 Marks*)

Answer

	₹
60% of the Equity Share Capital ₹ 100 Lakhs	60
60% of Accumulated Reserve ₹ 70 Lakhs (40+30) Lakhs	42
Book value of shares of Short Ltd.	102

(i) Goodwill/Capital Reserve computation on consolidation of balance sheet
Long Ltd. paid a positive differential of ₹ 10 Lakhs (112 - 102). This differential ₹ 10 Lakhs is called goodwill and is shown in the balance sheet under the head intangibles

(ii) If Long Ltd. showed the investment in Short Ltd. at carrying amount of ₹ 104 Lakhs, then the goodwill will be ₹ 2 Lakhs.

If the consideration paid is ₹ 92 lakhs, then there would have been capital reserve amounting ₹ 10 Lakhs (102- 92).

Question 75

Consider the following information of subsidiary MNT Ltd.-

Liabilities	2019-20 Amount in ₹	2020-21 Amount in ₹
Issued and subscribed: 7,500 Equity Shares of ₹ 100 each	7,50,000	7,50,000
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000

Liabilities	2019-20	2020-21
Provision for Taxation	2,62,000	4,30,000
Property, plant and equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment (at cost)	-	5,30,000
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500

Other Information:

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2019-2020 and increased by ₹ 12,000 at the end of 2020- 2021. (Inventory of 2019-20 has been sold out during the year 2020-21)

(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 2019-20 and ₹ 12,500 in 2020-21 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2019-20, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2019-20.

Restate the balance sheet of MNT Ltd. as on 31st March, 2021 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

(*MTP*, *October 2021*) (*16 Marks*)

Answer

Restated Balance Sheet of MNT Ltd. as at 31st March 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\left(\frac{3,43,000}{98}\times 100\right)$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		23,14,500

Notes to Accounts

			₹
1.	Reserves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	**Short term borrowings**		
	Bank overdraft		1,70,000
3.	Short-term provision		
	Provision for taxation		4,30,000

			₹
4.	Property, Plant and Equipment		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Question 76

A Ltd. had acquired 80% shares of B Ltd. for ₹ 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

(*MTP*, *October 2021*) (*4 Marks*)

Answer

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd.	(28,00,000)
	2,00,000

Working Note:

A Ltd.'s share in net assets of B Ltd.

	₹
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ₹ 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

Question 77

On 31st March, 2020 H Ltd. and its subsidiary S Ltd. give the following information:

	H Ltd.	S Ltd.
	₹	₹
Shareholders' Fund:		
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:		
Creditors	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Property, Plant & Equipment:		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
Investments:		
Investments in S Ltd.	3,84,000	-
(19,200 shares at ₹ 20 each)		

	H Ltd.	S Ltd.
	₹	₹
Current Assets:		
Inventories	6,00,000	2,00,000
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000

The following information is also provided to you:

(a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹ 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.

(*MTP, November, 2021*) (*20 Marks*)

Answer

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	13,40,000
(b) Reserves and Surplus	2	8,27,040
(2) Minority Interest		1,15,560
(3) Non- Current Liabilities		
(a) 12% Debentures		1,00,000
(4) Current Liabilities		
(a) Trade Payables	3	3,84,800
(b) Short term Borrowings (Bank overdraft)		1,00,000
Total		28,67,400
II. Assets		
(1) Non-current assets		
(a)		
(i) Property, Plant and Equipment	4	14,34,600
(ii) Intangible assets	5	28,800
(2) Current assets		
(a) Inventory (6,00,000+2,00,000)		8,00,000
(b) Trade Receivables	6	5,08,000
(c) Cash and Cash equivalents		96,000
Total		28,67,400

Notes to Accounts

		₹		
1.	Share Capital Equity share capital 1,34,000 shares of ₹ 10 each fully paid up			13,40,000
2.	Reserves and Surplus			
	Reserves		4,80,000	
	Add: 4/5th share of S Ltd.'s post- acquisition reserves (W.N.3)		96,000	5,76,000
	Profit and Loss Account		2,40,000	
	Add: 4/5th share of S Ltd.'s post- acquisition profits (W.N.4)		11,040	2,51,040
				8,27,040
3.	Trade Payables			
	Creditors			

		₹		
	H Ltd.	2,00,000		
	S Ltd.	1,22,000	3,22,000	
	Bills Payables			
	H Ltd.	60,000		
	S Ltd.	14,800	74,800	
			3,96,800	
	Less: Mutual Owings		(12,000)	3,84,800
4.	Property Plant and Equipment			
	Machinery			
	H. Ltd.		7,20,000	
	S Ltd.	2,40,000		
	Add: Appreciation	1,20,000		
		3,60,000		
	Less: Depreciation (3,60,000 X 10%)	(36,000)	3,24,000	
	Furniture			
	H. Ltd.		3,60,000	
	S Ltd.	48,000		
	Less: Decrease in value	(12,000)		
		36,000		
	Less: Depreciation (36,000 X 15%)	5,400	30,600	14,34,600
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.	Trade receivables			
	H Ltd.	3,00,000		
	S Ltd.	90,000	3,90,000	
	Bills Receivables			
	H Ltd.	1,00,000		
	S Ltd.	30,000	1,30,000	
			5,20,000	
	Less: Mutual Owings		(12,000)	5,08,000

Working Notes:

		₹
1.	Pre-acquisition profits and reserves of S Ltd.	
	Reserves	60,000
	Profit and Loss Account	36,000
		96,000
	H Ltd.'s = 4/5 (or 80%) × 96,000	76,800
	Minority Interest= 1/5 (or 20%) × 96,000	19,200
2.	Profit on revaluation of assets of S Ltd.	
	Profit on Machinery ₹ (3,60,000 – 2,40,000)	1,20,000
	Less: Loss on Furniture ₹(48,000 –36,000)	
		(12,000)
	Net Profit on revaluation	1,08,000
	H Ltd.'s share 4/5 × 1,08,000	86,400
	Minority Interest 1/5 × 1,08,000	21,600
3.	Post-acquisition reserves of S Ltd.	
	Total reserves	1,80,000
	Less: Pre-acquisition reserves	(60,000)
	Post-acquisition reserves	1,20,000
	H Ltd.'s share 4/5 × 1,20,000	96,000
	Minority interest 1/5 × 1,20,000	24,000
4.	Post -acquisition profits of S Ltd.	
	Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 60,000 – 36,000)	24,000

Add: Excess depreciation charged on furniture @ 15%		
on ₹ 12,000 i.e. (48,000 – 36,000)		1,800
Less: Under depreciation on machinery @ 10%		25,800
on ₹ 1,20,000 i.e. (3,60,000 – 2,40,000)		(12,000)
Adjusted post-acquisition profits		13,800
H Ltd.'s share 4/5 × 13,800		11,040
Minority Interest 1/5 × 13,800		2,760
5. Minority Interest		
Paid-up value of (24,000 – 19,200) = 4,800 shares		
held by outsiders i.e. 2,40,000 X 20%		48,000
Add: 1/5th share of pre-acquisition profits and reserves		19,200
1/5th share of profit on revaluation		21,600
1/5th share of post-acquisition reserves		24,000
1/5th share of post-acquisition profit		2,760
		1,15,560
6. Cost of Control or Goodwill		
Price paid by H Ltd. for 19,200 shares	(A)	3,84,000
Less: Intrinsic value of the shares		1,92,000
Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%		
Add: 4/5th share of pre-acquisition profits and reserves		76,800
4/5th share of profit on the revaluation		86,400
Intrinsic value of shares on the date of acquisition	(B)	3,55,200
Cost of control or Goodwill	(B-A)	28,800

Question 78

On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of ₹ 10 each fully paid	15,00,000
Pre-incorporation profits	30,000
Profit and Loss Account	60,000
Trade payables	1,05,000

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

	P Ltd. ₹	**Q Ltd.** ₹
Equity shares of ₹ 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	–
Pre-incorporation profits	–	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (ii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares.

(b) Immediately after issue of bonus shares.

(*RTP November 2021*)

Answer

Shareholding pattern

Particulars	Number of Shares	% of holding
(a) P Ltd.		
(i) Purchased on 31.03.2015	1,05,000	
(ii) Bonus Issue (1,05,000/2)	52,500	
Total	1,57,500	70%
(b) Minority Interest	67,500	30%

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 2021:

(a) Before issue of bonus shares

(i)	**Cost of control/capital reserve**	**₹**	**₹**
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control		87,000
(ii)	**Minority Interest**		**₹**
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account – P Ltd.**		**₹**
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	**₹**	**₹**
	Face value of investments (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		**₹**
	Share Capital (₹ 4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		**₹**
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits	Revenue Profits	
	(Before and after issue of bonus shares)	Before Bonus Issue	After Bonus Issue
	₹	₹	₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.2015	60,000		
General reserve*	90,000		19,05,000
Less: Bonus shares		19,05,000	(7,50,000)
			11,55,000

Profit for period of 1st April, 2015 to 31st March, 2021 (₹ 4,20,000 – ₹ 60,000)		3,60,000	3,60,000
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

Question 79

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%.]

(*RTP May, 2022*)

Answer

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
	Less: Under depreciation on machinery @ 10%	26,875
	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 80

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 31.03.2021 as per schedule III of the Companies Act, 2013.

(*Question Paper of December 2021*) *(15 Marks)*

Answer

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 revenues[1]			
	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)	5,00,32,500
	Brokage received by Moon Ltd. from Star Ltd.		(2,12,500)	
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	

1 *Consultancy fees, Royalty and brokerage received are considered as operating revenues in the given answer.*

			₹	₹
	Royalty:			
	Star Ltd.	50,000		
	Less: Received by Moon Ltd.	(50,000)	Nil	
	Selling and distribution Expenses:			
	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

Question 81

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Equity Share Capital – Authorised	5,000	3,000
Issued and subscribed in Equity Shares of ₹ 10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account (Cr. Balance)	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
Plant and Machinery	2,541	2,450
Furniture and Fittings	615	298
Investment in the Equity Shares of S Ltd.	1,500	—
Inventory	983	786
Trade receivables	820	778
Cash and Bank Balances	410	102
Sundry Advances (Dr. balances)	260	190

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the following balances stood in the books of S Ltd.:
General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 633 thousand.

(b) On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of ₹ 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.

(d) On 31st March, 2021, the Inventory of S Ltd. included goods purchased for ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

(e) Details of Trade payables and Trade receivables:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Trade payables		
Bills Payable	124	80
Sundry creditors	487	427
	611	507
Trade receivables		
Debtors	700	683
Bills Receivables	120	95
	820	778

Prepare a consolidated Balance Sheet as on 31st March, 2022.

(*RTP November, 2022*)

Answer

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

Particulars	Note No.	(₹ in 000's)
(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.		82	482
5.	PPE			
	Plant and Machinery			
	H Ltd.	₹ 2,541		
	S Ltd.	₹ 2,450	4,991	
	Furniture and fittings			
	H Ltd.	₹615		
	S Ltd.	₹298	913	5,904
6.	Inventories			
	Inventory H Ltd.	₹983		
	S Ltd.	₹786	1,769	
	Less: Unrealised profit (₹ 50 x 1/5)		(10)	1,759
7.	Trade receivables			
	H Ltd.		820	
	S Ltd.		778	1,598

		(₹ in 000's)	(₹ in 000's)
8.	Cash and cash equivalents		
	Cash and Bank Balances	410	
	H Ltd		
	S Ltd.	102	512
9.	Short term loans and advances		
	Sundry Advances	260	
	H Ltd.		
	S Ltd.	190	450

Working Notes:

Share holding pattern

Particulars	Number of Shares	% of holding
(a) S Ltd.		
(i) Purchased on 01.04.2021	90,000	
(ii) Bonus Issue (90,000/5 x 3)	54,000	
Total	1,44,000	60% (1,44,000 /2,40,000*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 shareholders $\left(\frac{2,400 \times 3}{8}\right)$	900	By	Balance b/d	1,500
			By	Profit and Loss A/c	
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 $\frac{1,500 \times 20}{100}$	300	By	Net Profit for the year (Balancing figure)	567*
To	Balance c/d	810			
		1,200			1,200

* Out of ₹ 5,67,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

3. Distribution of Revenue Profits

	₹ in '000
Revenue Profit as above	567.00
Share of H Ltd. (60%)	340.20
Share of Minority shareholders (567– 340.20)	226.80

4. Computation of Capital Profits

	₹ in 000	₹ in 000
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		(900)
		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 $\frac{`300 \times 60}{100}$	(180)	(1,320)
		679.80

6. Calculation of Minority Interest

	₹ in '000
40% of share capital of S Ltd.	960.00
Add: Share of Revenue Profits (Note 3)	226.80
Share of Capital Profits (Note 4)	373.20
	1,560.00

Question 82

G Ltd. and its subsidiary K Ltd. give the following information for the year ended 31st March, 2023 :

(₹ in crores)

Particulars		G Ltd.	K Ltd.
Sales and other Income		3000	750
Increase in Inventory		750	100
Raw material consumed'		600	100
Wages and Salaries		600	75
Production expenses		100	50
Administrative expenses		75	50
Selling-and Distribution expenses		100	25
Interest		75	30
Depreciation		75	30

The following information is also given:

(i) G Ltd. sold goods of ₹200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventory of K Ltd. at the end of the year)

(ii) G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is ₹ 800 crores on 01.04.2022 (date of acquisition of shares)

(iii) Administrative expenses of K Ltd. include ₹ 5 crore paid to G Ltd. as consultancy fees. Also, selling and distribution expenses of G Ltd. include ₹ 20 crores paid to K Ltd. as commission.

Prepare it consolidated statement of Profit and Loss of G Ltd. with its subsidiary K Ltd. for the year ended 31st March, 2023.

(*G-II, May, 2023*) (*10 Marks*)

Question 83

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 ₹10each)		
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	-

	H Ltd. ₹	S Ltd. ₹
Stock-in-Trade	1,00,000	50,000
Trade Debtors	60,000	35,000
Bills Receivable	25,000	20,000
Cash at 'Bank	90,000	40,000
Total	**12,30,000**	**3,65,000**

The following additional information is provided to you :

(i) General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March, 2022.

(ii) Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to ₹20,000.

(iii) H Ltd. sold goods to S Ltd. costing ₹ 8,000 for ₹ 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.

(iv) Creditors of S Ltd. include ₹4000 due to H Ltd. on account of these goods.

(v) Out of Bills payable issued by S Ltd. ₹15,000 are those which, have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, ₹ 8000 worth of bills receivable in favour of its creditors.

You are required' to draw a consolidated Balance Sheet as on 31st March, 2023.

(*G-II, May, 2023*) (*10 Marks*)

Question 84

GB Limited acquired 80% of equity shares of TB Limited on 1 April, 2016 at a cost of ₹ 58,00,000 when TB Limited had an Equity share capital of ₹ 50,00,000 and Reserves and Surplus of ₹ 4,64,000.

The following information is provided

Year	*Profit/(Loss) of TB Limited (₹)*
2016-17	(*14,50,000*)
2017-18	(*23,20,000*)
2018-19	(*29,00,000*)
2019-20	(*6,96,000*)
2020-21	*1,90,000*
2021-22	*6,80,000*
2022-23	*12,70,000*

You are required to calculate the minority interests and cost of control at the end of each year for the purpose of consolidation.

(*14 Marks*) (*Exam. November, 2023*) (*Advance Accounts*)

Question 85

AS 21 "Consolidated Financial Statements"

Zoom Ltd. acquired 70% shares of Star Ltd. @ ₹ 30 per share. Following is the extract of Balance Sheet of Star Ltd.:

	₹
15,00,000 Equity Shares of ₹ 10 each	1,50,00,000
15% Debentures	15,00,000
Trade Payables	82,50,000
Property, Plant and Equipment	1,05,00,000
Investments	67,50,000
Current Assets	1,02,00,000
Loans and Advances	33,00,000

On the same day Star 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 ₹ 90,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.

(*RTP May, 2024*)

Answer

As per para 13 of AS 21 any excess of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, should be described as goodwill to be recognised as an asset in the consolidated financial statements. When the cost to the parent of its investment in a subsidiary is less than the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, the difference should be treated as a capital reserve in the consolidated financial statements.

Since dividend is declared by Star Ltd. on the date of acquisition itself, it would be out of the divisible profits of Star Ltd. existing on the date of acquisition i.e., pre-acquisition profits from the perspective of Zoom Ltd. Accordingly, as per para 12 of AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

Calculation of Goodwill or Capital Reserve	**₹**	**₹**
Cost of Investment in Star Ltd. (70% stake):		
15,00,000 Equity Shares x 70% x ₹ 30 per share	3,15,00,000	
Less: Pre-acquisition dividend:		
10,50,000 shares x ₹ 2	(21,00,000)	2,94,00,000
Less: Share of Zoom Ltd. in Net Assets of Star Ltd (W.N)		(1,55,40,000)
Goodwill on Date of Acquisition		1,38,60,000

Working Note:

Calculation of net asset	**₹**	**₹**
Assets		
Property, Plant and Equipment	1,05,00,000	
Less: Value written off (₹ 105 lakhs x 10%)	(10,50,000)	
	94,50,000	
Investments at Market Value	90,00,000	
Current Assets	1,02,00,000	
Loans and Advances	33,00,000	3,19,50,000
Less: Liabilities		
Trade Payables	82,50,000	
15% Debentures	15,00,000	(97,50,000)
Net Assets of Star Ltd.		2,22,00,000
Share of Zoom Ltd. in Net Assets of Star Ltd.: 70%		1,55,40,000

Note: In the absence of information about the reserves, it is presumed that the given extract of the Balance Sheet of Star Ltd. is after considering the effects of the dividend declared on the date of acquisition.

Question 86

The Balance Sheets of Art Limited and Craft Limited as on 31st March 2024 are as below.:

Particulars	**Note No**	**Art Limited (₹)**	**Craft Limited (₹)**
I. Equity and Liabilities			
(a) Shareholder's Fund			
(i) Share Capital	1	6,50,000	4,00,000
(ii) Reserve & Surplus	2	3,12,000	2,48,000
(b) Current Liabilities			
(i) Trade Payables		1,45,000	92,000
(ii) Short term borrowings	3	70,000	-
		11,77,000	**7,40,000**
II. Assets			
(a) Non-current Assets			
(i) Property, Plant & Equipment	4	4,21,000	3,60,00
(ii) Non-current investment	5	4,32,000	-
(b) Current Assets			
(i) Inventories		1,66,000	2,05,000
(ii) Trade Receivables		1,33,500	1,68,300
(iii) Cash & Cash equivalent	6	24,500	6,700
		11,77,000	**7,40,000**

Notes to Accounts:

		Art Limited (₹)	Craft Limited (₹)
1.	Share capital		
	6,500 shares of ₹ 100 each	6,50,000	-
	4,000 shares of ₹ 100 each fully paid-up	-	4,00,000
	Total	6,50,000	4,00,000
2.	Reserves and Surplus		
	General Reserve	1,20,000	40,000
	Profit and Loss account	1,92,000	2,08,000
	Total	3,12,000	2,48,000
3.	Short term borrowings		
	Bank Overdraft	70,000	-
4.	Property Plant & Equipment		
	Land & Building	1,90,000	1,35,000
	Plant & Machinery	2,31,000	2,25,000
	Total	4,21,000	3,60,000
5.	Non-current investments		
	Investment in Craft Limited (Cost)	4,32,000	-
6.	Cash & Cash equivalents		
	Cash	24,500	6,700

Additional information:

(i) Art Limited acquired 3,200 ordinary shares of Craft Limited on 1st October, 2023. The Reserve & Surplus and Profit & Loss Account of Craft Limited showed a credit balance of ₹40,000 and respectively as on 1st April, 2023. ₹58,700

(ii) The Plant & Machinery of Craft Limited which stood at ₹2,50,000 as on 1 April, 2023 was considered worth ₹2,20,000 on the date of acquisition. The depreciation on Plant & Machinery is calculated @ 10% p.a. on the basis of useful life. The revaluation of Plant & Machinery is to be considered at the time of consolidation.

(iii) Craft Limited deducts 1% from Trade Receivables as a general provision against doubtful debts. This policy is not followed by Art Limited.

(iv) On 31st March 2024, Craft Limited's inventory includes goods which it had purchased from Art Limited for ₹1,03,500 which made a profit of 15% on cost price.

You are required to prepare a consolidated Balance Sheet as on 31st March 2024.

(*Question Paper May, 2024) (14 Marks*)

Question 87

Star Ltd. acquires 70% of equity shares of Moon Ltd.as on 31st March, 2024 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Moon Ltd.as *on* 31st March, 2024:

	₹ 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%
Investments	Down by 10%

Moon Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 2024 (Face value - ₹ 10 per share). Star Ltd. purchased the shares of Moon Ltd.@ ₹ 20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Moon Ltd. 31st March, 2024.

(*MTP Advanced Accounting April, 2024*) (*7 Marks*)

Answer

Revalued net assets of Moon Ltd.as on 31st March, 2024

	₹ in lakhs	₹ in lakhs
Property, plant and equipment [240 x 120%]		288.0
Investments [110 X 90%]		99
Current Assets		140.0
Loans and Advances		30.0
Total Assets after revaluation		557
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280.0)
Equity / Net Worth		277
Star Ltd.'s share of net assets (70% of 277)		193.9
Star Ltd.'s cost of acquisition of shares of Moon Ltd.		
(₹ 140 lakhs – ₹ 14 lakhs*)		126.00
Capital reserve		67.9

* Total Cost of 70 % Equity of Moon Ltd.	₹ 140 lakhs
Purchase Price of each share	₹ 20
Number of shares purchased [140 lakhs /₹ 20]	7 lakhs
Dividend @ 20 % i.e. ₹ 2 per share	₹ 14 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Question 88

Gamma Ltd. acquired 24,000 equity shares of ₹ 10 each, in Beta Ltd. on October 1, 2023 for₹ 4,60,200. The profit and loss account of Beta Ltd. showed a balance of ₹ 15,000 on April 1,2023. The plant and machinery of Beta Ltd. which stood in the books at ₹ 2,25,000 on April 1,2023 was considered worth ₹ 2,70,000 on the date of acquisition.

The information of the two companies as at 31-3-2024 was as follows:

	Gamma Ltd. (₹)	Beta Ltd. (₹)
Shares capital (fully paid equity shares of ₹ 10 each)	7,50,000	3,00,000
General reserve	3,60,000	1,50,000
Profit and loss account	85,800	1,23,000
Current Liabilities	2,54,700	49,500
Land and building	2,70,000	2,85,000
Plant and machinery	3,60,000	2,02,500
Investments	4,60,200	
Current assets	3,60,300	1,35,000

You are required to compute impact of revaluation of Plant and Machinery.

(*MTP Advanced Accounting April, 2024*) (*7 Marks*)

Answer

Impact of Revaluation of Plant and Machinery will be as -

	₹
Book value of Plant and Machinery as on 01-04-2023	2,25,000
(2,25,000-2,02,500)	10%
Depreciation Rate 2,25,000 = 22,500/2,25000 x100	
Book value of Plant and Machinery as on 01-10-2023 after six months depreciation @10% (2,25,000-11,250)	2,13,750
Revalued at	2,70,000
Revaluation profit (2,70,000-2,13,750)	56,250
Share of Gamma Limited in Revaluation Profit (80%)	45,000
Share of Minority in Revaluation profit (20%)	11,250
Additional Depreciation on appreciated value to be charged from post-acquisition profits	

	₹
(10% of ₹ 22,5,000 for 6 months) + (10% of ₹ 2,70,000 for 6 months) less ₹ 22500 (as already charged)	2,250
Share of Gamma Limited in additional depreciation that will reduce its share (80%) in post-acquisition profit by	1,800
Share of Minority Interest in additional depreciation	450

Working note:

Percentage of holding:

		No. of Shares	Percentage
Holding Co.	:	24,000	(80%)
Minority shareholders :		6,000	(20%)
TOTAL SHARES	:	30,000	

Question 89

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, 2023

Particulars	Note No.	Virat Ltd. (₹)	Anushka Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	6,00,000	4,00,000
(b) Reserves 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	--

(*MTP Advanced Accounting March, 2024*) (*14 Marks*)

Answer

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 2023

Particulars		Note	Amount (₹)
I	**EQUITY AND LIABILITIES:**		
(1)	**Shareholders' Funds:**		
	(a) Share Capital	1	6,00,000
	(b) Reserve and Surplus	2	1,80,000
(2)	**Minority Interest**	3	1,00,000
(3)	**Non-Current Liabilities:**		
	Long Term Borrowings	4	3,00,000
(4)	**Current Liabilities:**		
	Trade Payables	5	2,00,000
	Total		**13,80,000**
II	**ASSETS:**		
(1)	**Non-Current Assets**		
	Property, Plant & Equipment	6	7,00,000
(2)	**Current Assets:**		
	(a) Inventories	7	3,60,000
	(b) Trade receivables	8	2,20,000
	(c) Cash and Cash Equivalents	9	1,00,000
	Total		**13,80,000**

Notes to Accounts

	Particulars	₹	₹
1.	**Share capital**		
	60,000 equity shares of ₹ 10 each fully paid up		6,00,000
2.	**Reserves and Surplus**		
	General Reserve	1,00,000	
	Add: General reserve of Anushka Ltd (80%)	80,000	
	Total		1,80,000
3.	**Minority interest**		
	20% share in Anushka Ltd (WN 3)		1,00,000
4	**Long term borrowings**		
	Long term borrowings of Virat	2,00,000	
	Add: Long term borrowings of Anushka	1,00,000	
	Total		3,00,000
5.	**Trade payables**		
	Trade payables of Virat	1,00,000	
	Add: Trade payables of Anushka	1,00,000	
	Total		2,00,000
6.	**Property, Plant and Equipment (PPE)**		
	PPE of Virat Ltd	4,00,000	
	Add: PPE of Anushka Ltd	3,00,000	
	Total		7,00,000
7.	**Inventories**		
	Inventories of Virat Ltd	1,60,000	
	Add: Inventories of Anushka Ltd	2,00,000	
	Total		3,60,000
8.	**Trade receivables**		
	Trade receivables of Virat Ltd	80,000	
	Add: Trade receivables of Anushka Ltd	1,40,000	

	Particulars	₹	₹
	Total		2,20,000
9	**Cash and cash equivalents**		
	Cash and cash equivalents of Virat Ltd	40,000	
	Add: Cash and cash equivalents of Anushka Ltd	60,000	
	Total		1,00,000

Working Notes:

1. Basic Information

Company Status	Dates	Holding Status
Holding Co. = Virat Ltd. Subsidiary = Anushka Ltd.	Acquisition: Anushka's Incorporation Consolidation: 31st March, 2023	Holding Company = 80% Minority Interest = 20%

2. Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of ₹1,00,000 will be Revenue.

3. Consolidation of Balances

Holding- 80%, Minority - 20%	Total	Minority Interest	Holding Company	
Equity Capital General Reserves	4,00,000	80,000	3,20,000	-
	1,00,000	20,000	Nil (pre-acq)	80,000 (post-acq)
Total		1,00,000	3,20,000	80,000
Cost of Investment Goodwill/ capital reserve			(3,20,000) NIL	-
Parent's Balance				1,00,000
Amount for Consolidated Balance Sheet				1,80,000

MCQs

Question 1 - : Dividend paid by subsidiary to its parent, out of capital profits, should be credited by the parent company in its

Answer:

1. *Profit and loss account.*
2. *Dividend account.*
3. *Shares invested in subsidiary account.*
4. *Capital reserve.*

Question 2 - : Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of

Answer:

1. *Current liability.*
2. *Revenue profit.*
3. *Capital profit.*
4. *Current assets.*

Question 3 - : If the purchase consideration is more than net assets (at agreed values) of the transferor company, difference shall be recorded as _____ in the books of the transferee company.

Answer:

1. *Goodwill.*
2. *Capital Reserve.*
3. *Profit.*
4. *Loss*

Question - 4: Dividend paid by subsidiary to its parent, out of capital profits, should be credited by the parent company in its

Answer:

1. *Profit and loss account.*
2. *Dividend account.*
3. *Shares invested in subsidiary account.*
4. *Capital reserve.*

Question - 5: Minority interest should be presented in the consolidated balance sheet of Holding Company (with its subsidiary)

Answer:

1. *As a part of liabilities*
2. *As a part of equity of the parents shareholders*
3. *Separately from liabilities and the equity of the parents shareholders*
4. *As a part of assets*

Question - 6: Issue of bonus shares by the subsidiary company out of capital profits will

Answer:

1. *Decrease Goodwill or increase capital reserve.*
2. *Increase Goodwill or decrease capital reserve.*
3. *Have no effect on Goodwill or capital reserve.*
4. *Have no effect on Goodwill.*

Question - 7: If the subsidiary company follows weighted average method for valuation of inventories and the holding company follows FIFO method, then while consolidating,

Answer:

1. *Financial statements of subsidiary company should be restated by adjusting the value of inventories to bring the same in line with the valuation procedure adopted by the holding company.*
2. *Financial statements of holding company should be restated by adjusting the value of inventories to bring the same in line with the valuation procedure adopted by the subsidiary company.*

3. *Financial statements of both companies may continue as per the basis followed by them.*
4. *No changes are required to be done for consolidation purposes.*

Question - 8: Goodwill is equal to

Answer:

1. *Cost of Investment less Parents share in the equity of the subsidiary on date of investment.*
2. *Cost of investment less Parents share in the debentures of subsidiary on date of investment.*
3. *Parents share in the equity of subsidiary on date of investment less Cost of investment.*
4. *Parents share in the debentures of subsidiary on date of investment*

Question - 9: If there remains any unrealized profit in the inventory, of any of the Group Company,

Answer:

1. *Unrealized profit is added to value of inventory to compute consolidated profit.*
2. *Unrealized profit is reduced from value of inventory to compute consolidated profit.*
3. *No adjustment needs to be done.*
4. *Unrealized profit is added to revenue profit.*

Question - 10: If there remains any unrealized profit in the inventory, of any of the Group Company,

Answer:

1. *Unrealized profit is added to value of inventory to compute consolidated profit.*
2. *Unrealized profit is reduced from value of inventory to compute consolidated profit.*
3. *No adjustment needs to be done.*
4. *Unrealized profit is added to revenue profit.*

Question - 11: Dividend paid by subsidiary to its parent, out of capital profits, should be credited by the parent company in its

Answer:

1. *Profit and loss account.*
2. *Dividend account.*
3. *Shares invested in subsidiary account.*
4. *Capital reserve.*

Question - 12: Issue of bonus shares by the subsidiary company out of capital profits will

Answer:

1. *Decrease Goodwill or increase capital reserve.*
2. *Increase Goodwill or decrease capital reserve.*
3. *Have no effect on Goodwill or capital reserve.*
4. *Have no effect on Goodwill.*

Question - 13: In consolidation of accounts of holding and subsidiary company _____ is eliminated in full.

Answer:

1. *Current liabilities of subsidiary company*
2. *Reserves and surplus of both holding and subsidiary company*
3. *Mutual indebtedness.*
4. *Current assets of subsidiary company.*

Question - 14: Minority interest should be presented in the consolidated balance sheet of Holding Company (with its subsidiary)

Answer:

1. *As a part of liabilities*
2. *As a part of equity of the parents shareholders*
3. *Separately from liabilities and the equity of the parents shareholders*
4. *As a part of assets*

Question - 15: If the subsidiary company follows weighted average method for valuation of inventories and the holding company follows FIFO method, then while consolidating,

Answer:

1. *Financial statements of subsidiary company should be restated by adjusting the value of inventories to bring the same in line with the valuation procedure adopted by the holding company.*
2. *Financial statements of holding company should be restated by adjusting the value of inventories to bring the same in line with the valuation procedure adopted by the subsidiary company.*
3. *Financial statements of both companies may continue as per the basis followed by them.*
4. *No changes are required to be done for consolidation purposes.*

Question - 16: Goodwill is equal to

Answer:

1. *Cost of Investment less Parents share in the equity of the subsidiary on date of investment.*
2. *Cost of investment less Parents share in the debentures of subsidiary on date of investment.*
3. *Parents share in the equity of subsidiary on date of investment less Cost of investment.*
4. *Parents share in the debentures of subsidiary on date of investment*

Question - 17: Minority interest should be presented in the consolidated balance sheet

Answer:

1. *As a part of liabilities.*
2. *As a part of equity of the parent's shareholders.*
3. *Separately from liabilities and the equity of the parent's shareholders.*
4. *As a part of assets.*

Question - 18: Minority of the subsidiary is entitled to

Answer:

1. *Capital profits of the subsidiary company.*
2. *Revenue profits of the subsidiary company.*
3. *Both capital and revenue profits of the subsidiary company.*
4. *Neither capital nor revenue profits of the subsidiary.*

Question - 19: In consolidation of accounts of holding and subsidiary company is eliminated in full.

Answer:

1. *Current liabilities of subsidiary company.*
2. *Reserves and surplus of both holding and subsidiary company.*
3. *Mutual indebtedness.*
4. *Nothing.*

Question - 20: In consolidated balance sheet, the share of the outsiders in the net assets of the subsidiary must be shown as

Answer:

1. *Minority interest.*
2. *Capital reserve.*
3. *Current liability.*
4. *Current assets.*

Question - 21: Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of

Answer:

1. *Current liability.*
2. *Revenue profit.*
3. *Capital profit.*
4. *Current assets*

Answers

Q1	***3***	***Q2***	***3***	***Q3***	***1***	***Q4***	***3***	***Q5***	***3***	***Q6***	***3***
Q7	***1***	***Q8***	***1***	***Q9***	***2***	***Q10***	***2***	***Q11***	***3***	***Q12***	***2***
Q13	***3***	***Q14***	***3***	***Q15***	***1***	***Q16***	***1***	***Q17***	***3***	***Q18***	***3***
Q19	***3***	***Q20***	***1***	***Q21***	***1***						

Accounting Standard 23
Accounting for Investments in Associates in Consolidated Financial Statements

Question 1

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.

(*Source: Illustration 1, Study Material*)

Answer

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 2

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.

(*Source: Illustration 2, Study Material*)

Answer

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April 1	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 x 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹4,00,000 +₹ 5,00,000)	(4,20,000)	
Add: Goodwill		1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) - refer note below	
Carrying Amount of Investment	

Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS

Investment in Associate as per AS 23	₹
Investment in B Ltd.	-

Question 3

Describe the cases when AS 23 does not allow the use of equity method of accounting?

Answer

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

(a) Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. The term 'Near Future' is explained with AS 21.

Or;

(b) It operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor. In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

Question 4

When is an investor required to discontinue the use of the equity method of accounting?

Answer

An investor should discontinue the use of the equity method from the date that:

(a) It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

(b) The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Question 5

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?

Answer

(i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2

	₹
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of 10-month profit of	
Investee as per equity method (30% of ₹ 3,00,000 x 10/12)	75,000
Carrying amount as on 31.3.20X2	2,60,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2 as per AS 23

	₹
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (₹ 60,000 x 30%)	(18,000)
Carrying amount as on 30.6.20X2	2,42,000

Question 6

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?

Answer

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill (*₹ in lakhs)*

Amount paid towards acquisition of stake in B Ltd.	3.00
Less: Pre-acquisition dividend (₹ 5,00,000 x 40% x 25%)	0.50
Cost of Investment in B Ltd.	2.50
Less: Share in the value of Equity of B Ltd. as at the date of investment [25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs)]	(2.50)
Goodwill	NIL

(ii) A Ltd.

Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd.		1.75
Pre-acquisition Dividend received from B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd.		
Cost of Investment in B Ltd.	2.50	
Share of profit for year 20X1 – 20X2	1.75	
	4.25	
Add: Goodwill	NIL	4.25

Working Notes:

1. Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.

Question 7

A Ltd. had acquired 80% shares of B Ltd. for ₹ 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

(*4 Marks*) (*MTP October, 2023*) (*Accounts*)

Answer

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	***₹***
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd.	(28,00,000)
	2,00,000

Working Note:

A Ltd.'s share in net assets of B Ltd.

	₹
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ₹ 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

MCQs

Question - 1: Identity which of the statements are correct.

An enterprise can influence the significant economic decision making by many ways like:

Answer:

(i) Representation on the board of directors or governing body of the investee.

(ii) Participation in policy-making processes.

(iii) Interchange of managerial personnel.

(iv) Provision of essential technical information.

1. *Statement (i) and (ii) are correct.*
2. *Statement (i), (ii) and (iii) are correct.*
3. *Statement (i), (ii), (iii) and (iv) are correct.*
4. *Statement (ii) and (iii) are correct.*

Question - 2: A Ltd. is holding 90% share in B Ltd. and 10% shares in C Ltd., and B Ltd. is holding 11% shares in C Ltd. Identity which of the statements are incorrect.

Answer:

(i) In this case, A Ltd. is parent of B Ltd.

(ii) As far as the relationship between A Ltd. and C Ltd. is concerned; A Ltd. has a total of direct and indirect holding of (10% + 90% of 11%) 19.9 % in C Ltd.

(iii) C Ltd. is an associate of A Ltd.

1. *Statement (ii) is incorrect.*
2. *Statement (iii) is incorrect.*
3. *Statement (ii) and (iii) both are incorrect.*
4. *All statements are incorrect.*

Question - 3: A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 of the same year. Other information is as follows:

Cost of Investment for 10% ₹1,00,000 and for 15% ₹1,55,000

Net asset on April 01 ₹8,50,000 and on October 01 ₹10,00,000.

What is the amount of goodwill or capital reserve arising on significant influence?

Answer:

1. *Goodwill = ₹10,000.*
2. *Goodwill = ₹20,000.*
3. *Capital Reserve = ₹10,000.*
4. *Capital Reserve = ₹20,000.*

Question - 4: A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:

Answer:

Cost of Investment for 10% ₹1,00,000 and for 15% ₹1,45,000

Net asset on April 01 ₹8,50,000 and on October 01 ₹10,00,000.

What is the amount of goodwill or capital reserve arising on significant influence?

1. *Goodwill = ₹10,000.*
2. *Goodwill = ₹20,000.*
3. *Capital Reserve = ₹10,000.*
4. *Capital Reserve = ₹20,000.*

Question - 5: Identity which of the statements are correct.

Answer:

(i) In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.

(ii) In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed after taking into consideration the proposed dividend.

(iii) The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor.

(iv) The potential equity shares of the investee held by the investor should be taken into account for determining the voting power of the investor.

1. *Statement (i) and (iii).*
2. *Statement (ii) and (iv).*
3. *Statement (i) only.*
4. *Statement (iii) only.*

Answer

Q1	***3***	***Q2***	***1***	***Q3***	***2***	***Q4***	***1***
Q5	***1***						

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.

(*Source: Illustration 1, Study Material*)

Answer

Draft Consolidated Profit & Loss Account

Particulars	₹	₹	Particulars	₹	₹
To Purchase of Land:			By Sale of Flats:		
Mr. A		60,00,000	Mr. A	40,00,000	
To Registration Fees:			Mr. B	20,00,000	
Mr. A		60,000	Mr. C	10,00,000	70,00,000
To Materials:			By Flats taken by Venturers:		
Mr. B		9,50,000	Mr. A	10,00,000	
To Other Expenses:			Mr. B	10,00,000	
Mr. C		9,00,000	Mr. C	10,00,000	30,00,000
To Bank Interest:					
Mr. A		2,00,000			
To Profits:					
Mr. A	6,30,000				
Mr. B	6,30,000				
Mr. C	6,30,000	18,90,000			—
		1,00,00,000			1,00,00,000

In the Books of Mr. A Joint Venture Account

Particulars	₹	Particulars	₹
To Bank Loan (Purchase of Land)	50,00,000	By Bank (Sale of Flats)	40,00,000
To Bank:(Purchase of Land)	10,00,000	By Land & Building	10,00,000
To Bank (Registration Fees)	60,000	By Bank (Received from Mr. B)	14,20,000
To Bank (Bank Interest)	2,00,000	By Bank (Received from Mr. C)	4,70,000
To Profit on JV	6,30,000		
	68,90,000		68,90,000

In the Books of Mr. B Joint Venture Account

Particulars	₹	Particulars	₹
To Purchases (Material Supplied)	4,50,000	By Bank (Sale of Flats)	20,00,000
To Bank (Materials)	5,00,000	By Land & Building	10,00,000
To Profit on JV	6,30,000		
To Bank (Paid to Mr. A)	14,20,000		___
	30,00,000		30,00,000

In the Books of Mr. C Joint Venture Account

Particulars	₹	*Particulars*	₹
To Bank (Misc. Expenses)	9,00,000	By Bank (Sale of Flats)	10,00,000
To Profit on JV	6,30,000	By Land & Building	10,00,000
To Bank (Paid to Mr. A)	4,70,000		____
	20,00,000		20,00,000

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.

(*Source: Illustration 2, Study Material*)

Answer

Consolidated Balance Sheet

		Note	(₹)
I	**Equity and liabilities**		
	Shareholders ₹ funds: Share Capital	1	71,40,000
	Assets		71,40,000
II	Non-current Assets		71,40,000
	Property, Plant and Equipment:	2	
			71,40,000

Notes to Accounts

			(₹)
1.	Share capital		
	A Ltd.	23,80,000	
	B Ltd.	23,80,000	
	C Ltd.	23,80,000	71,40,000

			(₹)
2.	Property, Plant and Equipment		
	Land & Building:		
	A Ltd.	3,80,000	
	B Ltd.	3,80,000	
	C Ltd.	3,80,000	11,40,000
	Plant & Machinery:		
	A Ltd.	17,00,000	
	B Ltd.	17,00,000	
	C Ltd.	17,00,000	51,00,000
	Computers:		
	A Ltd.	60,000	
	B Ltd.	60,000	
	C Ltd.	60,000	1,80,000
	Vehicles:		
	A Ltd.	2,40,000	
	B Ltd.	2,40,000	
	C Ltd.	2,40,000	7,20,000

In the Books of A Ltd.

Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	*Depreciation and amortisation expense*		
	Land & Building	*20,000*	
	Plant & Machinery	*3,00,000*	
	Computers	*40,000*	
	Vehicles	*60,000*	*4,20,000*
2.	*Land & Building*	*4,00,000*	
	Less*: Depreciation*	*(20,000)*	*3,80,000*
	Plant & Machinery	*20,00,000*	
	Less*: Depreciation Computers*	*(3,00,000)*	*17,00,000*
		1,00,000	
	Less*: Depreciation*	*(40,000)*	*60,000*
	Vehicles	*3,00,000*	
	Less*: Depreciation*	*(60,000)*	*2,40,000*
			23,80,000

In the Books of B Ltd.

Extract of draft Profit & Loss Account

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	*Depreciation and amortisation expense*		
	Land & Building	*20,000*	
	Plant & Machinery	*3,00,000*	
	Computers	*40,000*	
	Vehicles	*60,000*	*4,20,000*
2.	*Land & Building*	*4,00,000*	
	Less*: Depreciation*	*(20,000)*	*3,80,000*
	Plant & Machinery	*20,00,000*	
	Less*: Depreciation*	*(3,00,000)*	*17,00,000*
	Computers	*1,00,000*	
	Less*: Depreciation*	*(40,000)*	*60,000*
	Vehicles	*3,00,000*	
	Less*: Depreciation*	*(60,000)*	*2,40,000*
			23,80,000

In the Books of C Ltd.

Extract of Draft Profit & Loss Account	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation		17,00,000
		(3,00,000)	

		₹	₹
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

Question 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.

(*Source: Illustration 3, Study Material*)

Answer

Consolidated Profit & Loss Account

Particulars	***Note No.***	***(₹)***
Revenue from operations	1	13,05,000
Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000
Other expenses	3	3,06,000
Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

		Note No.	**(₹)**
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital	5	4,01,000
	Reserves and Surplus	6	1,99,000
	2. Non-current liabilities		
	Long term borrowings	7	2,00,000
	3. Current Liabilities	8	1,00,000
			9,00,000

		Note No.	(₹)
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment	9	6,00,000
	Current Assets		
	Inventories	10	1,00,000
	Other current assets	11	2,00,000
			9,00,000

Notes to Accounts

	Particulars		(₹)
1.	**Revenue from operations**		
	Sales:		
	A Ltd.	7,25,000	
	B Ltd.	5,80,000	13,05,000
2.	**Purchases**		
	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	**Other expenses**		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	**Closing Inventory**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	**Share Capital**		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	**Reserves and Surplus**		
	Profit & Loss Account:		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	**Long Term Borrowings**		
	Unsecured Loans:		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	**Current Liabilities**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
9.	**Property, Plant and Equipment**		
	A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000
10.	**Inventories**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000

	Particulars		(₹)
11.	**Other Current Assets**		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

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.

(*Source: Illustration 4, Study Material*)

Answer

Balance Sheet of A Ltd.

		Note No.	*(₹)*
I	***Equity and liabilities***		
	1. Shareholders ₹ funds:		
	Share Capital		*10,00,000*
	Reserves and Surplus	*1*	*24,00,000*
	2. Non-current liabilities	*2*	*4,00,000*
	3. Current Liabilities	*3*	*4,50,000*
	TOTAL		*42,50,000*
II	***Assets***		
	Non-current Assets		
	Property, Plant and Equipment:	*4*	*40,25,000*
	Current Assets	*5*	*2,25,000*
			42,50,000

Notes to Accounts

Balance Sheet of B Ltd.

		₹	₹
1.	*Reserves and Surplus*		
	A Ltd.	*18,00,000*	
	C Ltd.	*6,00,000*	*24,00,000*
2.	*Long Term Borrowings*		
	Loans:		
	A Ltd.	*3,00,000*	
	C Ltd.	*1,00,000*	*4,00,000*

		₹	₹
3.	Current Liabilities:		
	A Ltd.	4,00,000	
	C Ltd.	50,000	4,50,000
4.	Property, Plant and Equipment:		
	A Ltd.	30,50,000	
	C Ltd.	9,75,000	40,25,000
5.	Current Assets:		
	A Ltd.	2,00,000	
	C Ltd.	25,000	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders ₹ funds:		
	Share Capital		7,50,000
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	
			3,00,000
			37,50,000
II	**Assets**		
	1. Non-current Assets		
	Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	
			1,50,000
			37,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	16,00,000	
	C Ltd.	6,00,000	22,00,000
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	4,00,000	
	C Ltd.	1,00,000	5,00,000
3.	Current Liabilities:		
	A Ltd.	2,50,000	
	C Ltd.	50,000	3,00,000
4.	Property, Plant and Equipment:		
	A Ltd.	26,25,000	
	C Ltd.	9,75,000	36,00,000
5.	Current Assets:		
	A Ltd.	1,25,000	
	C Ltd.	25,000	1,50,000

Question 5

A and B established a separate vehicle i.e. entity J, wherein each operator has a 50% ownership interest and each takes 50% of the output. On formation of the joint venture, A contributed a property with fair value of ₹ 110 crore and agreed to contribute his experience over the years towards this venture; and B contributed equipment with a fair value of ₹ 120 crore. The carrying values of the contributed assets were ₹ 100 crore and ₹ 80 crore, respectively.

Answer

A – Gain in consolidated financial statements

A's share in the fair value of assets contributed by entity

B (50% x 120)	60
A's share in the carrying value of asset contributed by	
A to the joint venture (50% x 100)	(50)
Gain recognised by A	10

Question 6

Describe the cases when AS 27 does not allow the use of Proportionate consolidation method of accounting?

Answer

Proportionate consolidation method of accounting is to be followed except in the following cases:

(a) Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or

(b) joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investee is treated as investment according to AS 13.

Question 7

When is a venturer required to discontinue the use of the proportionate consolidation method?

Answer

A venturer should discontinue the use of the proportionate consolidation method from the date that:

(a) It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.

(b) The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe long- term restrictions that significantly impair its ability to transfer funds to the venturers.

From the date of discontinuing the use of the proportionate consolidation method,

(a) If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.

(b) If interest is 20% or more but up to 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statement.

(c) For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

(d) For this purpose, the carrying amount of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost thereafter.

Question 8

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 years. 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 years. 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.

Answer

As per para 26 of AS 27 “Financial Reporting of Interests in Joint Ventures”, in a venturer’s separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 ‘Accounting for Investments’.

As per para 17 of AS 13 “Accounting for Investments”, long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee’s assets and results and the expected cash flows from the investment. The type and extent of the investor’s stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1-20X2 i.e., more than a year, it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. ‘losses incurred to the company’ may lead to diminution in the value of the shares while the other indicator that ‘the company has positive expected cash flows from its business plans’ does not lead to decline in the value of shares.

Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

MCQs

Question 1- : Which item will form part of Share capital as per Schedule III to the Companies Act, 2013?

Answer:

1. *Share options outstanding account*
2. *Forfeited Shares*
3. *Share application money pending allotment*
4. *Capital work-in-progress.*

Question - 2: State which of the following statements are incorrect.

Answer:

(i) *The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, applies only when consolidated financial statements are prepared by venturer.*

(ii) *The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, applies irrespective whether consolidated financial statements are prepared by venturer or not.*

(iii) *An investor in joint venture, which does not have joint control, should report its interest in a joint venture in its consolidated financial statements in accordance with AS 13, AS 21 and AS 23as the case may be.*

1. *Point (i) is incorrect.*
2. *Point (ii) is incorrect.*
3. *Point (iii) is incorrect.*
4. *None of the above.*

Question - 3: Identify which of the following is not a feature of a Jointly controlled operations (JCO):

Answer:

1. *Each venturer has his own separate business.*
2. *There is a separate entity for joint venture business.*
3. *Each venturer record only his own transactions without any separately set of books maintained for the joint venture business.*
4. *There is a common agreement between all of them.*

Question - 4: Identify which of the following is/are not a feature of a Jointly controlled assets (JCA):

Answer:

(i) *There is a separate legal identity.*

(ii) *There is a common control over the joint assets.*

(iii) *Expenses on jointly held assets are shared by the venturers as per the contract.*

(iv) *In their financial statement, venturer shows only their share of the asset and total income earned by them along with total expenses incurred by them.*

1. *Point no. (i) only.*
2. *Point no. (i) and (iii).*
3. *Point no. (iii) and (iv).*
4. *Point (i) and (ii).*

Question - 5: Identify which is/ are features of a Jointly controlled entity (JCE):

Answer:

(i) *Venturer creates a new entity for their joint venture business.*

(ii) *All the venturers pool their resources under new banner and this entity purchases its own assets, create its own liabilities, expenses are incurred by the entity itself and sales are also made by this entity.*

(iii) *The revenues and expenses of the entity is shared by the venturers in the ratio agreed upon in the contractual agreement.*

1. *Point no. (i) only.*
2. *Point no. (i) and (ii).*
3. *Point no. (iii).*
4. *Point no. (iii).*

Question - 6: Identify the correct statements.

From the date of discontinuing the use of the proportionate consolidation method:

Answer:

(i) If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statements.

(ii) If interest is 20% or more but upto 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statements.

(iii) For all other cases investment in joint venture is treated as per AS 13, Accounting for Investments.

(iv) For this purpose, the fair value of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost thereafter.

1. *Point no. 1 and 2.*
2. *Point no. 1, 2 and 3.*
3. *Point no. 1, 2, 3 and 4.*
4. *None of the above.*

Answer

Q1	***2***	***Q2***	***2***	***Q3***	***2***	***Q4***	***1***
Q5	***3***	***Q6***	***2***				

Case Study 1

Question 1

RTS Ltd, ("RTS" or the "Company"), is engaged in the business of manufacturing of equipments/components. The Company has a contract with the Indian Railways for a brake component which is structured such that:

- The Company's obligation is to deliver the component to the Railways' stockyard, while the delivery terms are ex-works, the Company is responsible for engaging a transporter for delivery.
- Railways sends an order for a defined quantity.
- The Company manufactures the required quantity and informs Railways for carrying out the inspection.
- Railways representatives visit the Company's factory and inspect the components, and mark each component with a quality check sticker.
- Goods once inspected by Railways, are marked with a hologram sticker to earmark for delivery identification by the customer when they are delivered to the customer's location.
- The Company raises an invoice once it dispatches the goods.

The management of RTS is under discussion with the auditors of the Company in respect of accounting of a critical matter as regards its accounting with respect subsequent events i.e. events after the reporting period. They have been checking as to which one of the following events after the reporting period provide evidence of conditions that existed at the end of the reporting period?

(i) Nationalisation or privatization by government

(ii) Out of court settlement of a legal claim

(iii) Rights issue of equity shares

(iv) Strike by workforce

(v) Announcing a plan to discontinue an operation

The Company has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the Company distributed ₹ 2 crores as dividend. The Company also received land, free of cost, from the State Government but it has not recorded this at all in the books as no money has been spent.

RTS has a subsidiary, A Ltd, which is evaluating its production process wherein normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input was ₹ 1,000. The entire quantity of waste was on stock at the end of the financial year.

(i) When should RTS Ltd recognize revenue as per the Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006? Would your answer be different if inspection is normally known to lead to no quality rejections?

   (a) Revenue should be recognized on dispatch of components. The assessment would not change even in case where inspection is normally known to lead to no quality rejections.

   (b) Revenue should be recognized on completion of inspection of components. The assessment would not change even in case where inspection is normally known to lead to no quality rejections.

   (c) Revenue should be recognized on dispatch of components. The assessment would change where inspection is normally known to lead to no quality rejections.

   (d) Revenue should be recognized on delivery of the component to the Railways' stockyard. The assessment would change where inspection is normally known to lead to no quality rejections.

(ii) In respect of A Ltd, state with reference to Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, what would be value of the inventory to be recorded in the books of accounts?

   (a) ₹ 4,700,000.

   (b) ₹ 5,000,000.

   (c) ₹ 4,950,000.

   (d) ₹ 4,947,368.

(iii) Please guide regarding the accounting treatment of both the grants mentioned above in line with the requirements of Accounting Standard 12.

(a) Distribution of dividend out of grant is correct. In the second case also not recording land in the books of accounts is correct.

(b) Distribution of dividend out of grant is incorrect. In the second case, not recording land in the books of accounts is correct.

(c) Distribution of dividend out of grant is correct. In the second case, land should be recorded in the books of accounts at a nominal value.

(d) Distribution of dividend out of grant is incorrect. In the second case, land should be recorded in the books of accounts at a nominal value.

(*Ad. Accounting May, 2024*)

Answer

1.	(i)	(b)
	(ii)	(d)
	(iii)	(d)

Case Study 2

Case Scenario

1. SEAS Ltd., the "Company", is in the business of tours and travels. It sells holiday packages to the customers. The Company negotiates upfront with the Airlines for specified number of seats in flight. The Company agrees to buy a specific number of tickets and pay for those tickets regardless of whether it is able to resell all of those in package.

   The rate paid by the Company for each ticket purchased is negotiated and agreed in advance. The Company also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

   The Company bought a forward contract for three months of US$ 1,00,000 on 1 March 2024 at 1 US$ = INR 83.10 when exchange rate was US$ 1 = INR 83.02. On 31 March 2024, when the Company closed its books, exchange rate was US$ 1 = INR 83.15. On 1 April 2024, the Company decided for premature settlement of the contract due to some exceptional circumstances.

   The Company is evaluating below mentioned schemes:

   (i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex - gratia payments to employees on retirement.

   (ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

   SEAS Ltd. has a subsidiary, ADI Ltd., which is in the business of construction having turnover of ₹ 200 crores. SEAS Ltd. and ADI Ltd. hold 9% and 23% respectively in an associate company, ASOC Ltd. Both SEAS Ltd. and ADI Ltd. prepare consolidated financial statements as per Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006.

   (i) What would be the basis of revenue recognition for SEAS Ltd. as per the requirements of Accounting Standards?

      (a) Gross basis.

      (b) Net basis.

      (c) Depends on the accounting policy of the Company.

      (d) Indian GAAP allows a choice to the Company to recognize revenue on gross basis or net basis.

   (ii) Please suggest accounting treatment of forward contract for the year ended 31 March 2024 as per Accounting Standard 11.

      (a) MTM (marked to market value) of contract will be recorded on 31 March 2024.

      (b) MTM (marked to market value) of contract will be computed as at 31 March 2024 and only if there is loss, it will be recorded during the year ended 31 March 2024.

      (c) No accounting will be done during the year ended 31 March 2024.

      (d) Premium on contract will be amortized over the life of the contract.

   (iii) You are requested to advise the Company in respect of the accounting requirements of above schemes related to employee benefits as to which one of those schemes should be considered as a change in accounting policy during the year.

      (a) 1 – Change in accounting policy. 2 – Change in accounting policy.

      (b) 1– Not a change in accounting policy. 2 – Change in accounting policy.

      (c) 1 – Not a change in accounting policy. 2 – Not a change in accounting policy.

      (d) 1– Change in accounting policy. 2 – Not a change in accounting policy.

   (iv) Please comment regarding consolidation requirements for SEAS Ltd. and ADI Ltd. using the below mentioned options as to which one should be correct.

      (a) ADI Ltd. would using equity method of accounting for 23% in ASOC Ltd. SEAS Ltd. would consolidate ADI Ltd. and consequently automatically equity account 23% and separately account for the balance 9% as per AS 13.

(b) ADI Ltd. would account for 23% in ASOC Ltd. as per AS 13. SEAS Ltd. would consolidate ADI Ltd. and consequently automatically account 23% and separately account for the balance 9%.

(c) ADI Ltd. would account for 23% share in ASOC Ltd using equity method of accounting. SEAS Ltd. would consolidate ADI Ltd. and consequently, automatically account for ASOC Ltd 23% share and separately account for 9% share in ASOC Ltd. using equity method of accounting in consolidated financial statements.

(d) ADI Ltd. would account for 23% in ASOC Ltd. as per AS 13. SEAS Ltd. would consolidate ADI Ltd. and using equity method of accounting 23% in ASOC Ltd. and separately account for the balance 9% as per AS 13.

Answer

1.	**(i)**	**(a)**
	(ii)	**(d)**
	(iii)	**(c)**
	(iv)	**(c)**

Case Study 3

Accounting Standard 10
Property, Plant and Equipment

1. On 1st April, 2022, Shubham Limited purchased some land for ₹ 30 lakhs for the purpose of constructing a new factory. This cost of 30 lakhs included legal cost of ₹ 2 lakhs incurred for the purpose of acquisition of this land. Construction work could start on 1st May, 2022 and Shubham Limited provides you the details of the following costs incurred in relation to its construction:

	₹
Preparation and levelling of the land	80,000
Employment costs of the construction workers (per month)	29,000
Purchase of materials for the construction	21,24,000
Cost of relocating employees to new factory for work	60,000
Costs of inauguration ceremony on 1st January, 2023	80,000
Overhead costs incurred directly on the construction of the factory (per month)	25,000
General overhead costs allocated to construction project by the Manager is ₹ 30,000. However, as per company's normal overhead allocation policy, it should be ₹ 24,000. The auditor of the company has support documentation for the cost of ₹ 15,000 only) and raised objection for the balance amount.	

The construction of the factory was completed on 31st December, 2022 and production could begin on 1st February, 2023. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it was estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 25% of the total cost of the building.

The construction of the factory was partly financed by a loan of ₹ 28 lakhs borrowed on 1st April, 2022. The loan was taken at an annual rate of interest of 9%. During the period when the loan proceeds had been fully utilized to finance the construction, Shubham Limited received investment income of ₹ 25,000 on the temporary investment of the proceeds.

You are required to assume that all of the net finance costs to be allocated to the cost of factory (not land) and interest cost to be capitalized based on nine months' period.

Based on the information given in the above scenario, answer the following multiple choice questions:

(i) Which of the following cost (incurred directly on construction) will be capitalized to the cost of factory building?

(a) ₹ 2,00,000 incurred as legal cost

(b) ₹ 60,000 – costs of relocating employees

(c) ₹ 80,000 costs of inauguration ceremony

(d) ₹ 24,000 – allocated general overhead cost

(ii) What amount of employment cost of construction workers will be capitalized to the cost of factory building?

(a) ₹ 2,90,000

(b) ₹ 3,48,000

(c) ₹ 2,32,000

(d) ₹ 29,000

(iii) What is the amount of net borrowing cost capitalized to the cost of the factory?

(a) ₹ 1,89,000

(b) ₹ 1,68,000

(c) ₹ 1,44,000

(d) ₹ 1,64,000

(iv) What will be the carrying amount (i.e. value after charging depreciation) of the factory in the Balance Sheet of Shubham Limited as at 31st March, 2023?

(a) ₹ 30,00,000

(b) ₹ 57,78,125

(c) ₹ 27,78,125

(d) ₹ 58,00,000

Case Scenario

2. Mars Ltd. is a manufacturing enterprise which is starting a new manufacturing plant at X Village. It has commenced construction of the plant on April 1, 2023 and has incurred following expenses:

- It has acquired land for installing Plant for ₹ 50,00,000
- It incurred ₹ 35,00,000 for material and direct labour cost for developing the Plant.
- The Company incurred ₹ 10,00,000 for head office expenses at New Delhi which included rent, employee cost and maintenance expenditure.
- The Company borrowed ₹ 25,00,000 for construction work of Plant @12% per annum on April 1, 2023. Director finance of the Company incurred travel and meeting expenses amounting to ₹ 5,00,000 during the year for arranging this loan.
- On November 1, 2023, the construction activities of the plant were interrupted as the local people alongwith the activists have raised issues relating to environmental impact of plant being constructed. Due to agitation the construction activities came to standstill for 3 months.
- With the help of Government and NGOs, the agitation was over by February 28, 2024 and the work resumed. However, to balance the impact on environment, government ordered the company to install certain devices for which the Company had to incur ₹ 6,00,000 in March 2024.
- The rate of depreciation on Plant is 10%.

Based on the above information, answer the following questions.

(i) Which of the following expenses cannot be included in the cost of plant:

(a) Cost of Land

(b) Construction material and labour cost

(c) Head office expenses

(d) Borrowing cost

(ii) How much amount of borrowing cost can be capitalised with the plant:

(a) ₹ 300,000

(b) ₹ 2,00,000

(c) ₹ 7,00,000

(d) ₹ 6,00,000

(iii) The total cost of plant as on march 31, 2024 will be:

(a) ₹ 85,00,000

(b) ₹ 98,00,000

(c) ₹ 93,00,000

(d) ₹ 95,00,000

(iv) The amount of depreciation to be charged for the year end March 31, 2024

(a) ₹ 4,30,000

(b) ₹ 9,30,000

(c) ₹ 9,80,000

(d) Nil

Multiple Choice Questions [4 MCQs of 2 Marks each: Total 8 Marks]

Answer

1.	**(i)**	**(a)**
	(ii)	**(c)**
	(iii)	**(d)**
	(iv)	**(b)**
2.	**(i)**	**(c)**
	(ii)	**(b)**
	(iii)	**(c)**
	(iv)	**(d)**

Case Study 4

Buy-Back of Securities

1. Kesar Ltd., a company engaged in various business activities, has decided to initiate a share buy-back on 1st April, 2023. The company plans to repurchase 25,000 equity shares of ₹ 10 each at a price of ₹ 20 per share. This buy-back initiative is in compliance with the company's articles of association, and the necessary resolution has been duly passed by the company. As part of the financial arrangement for the share buy-back, Kesar Ltd. intends to utilize its current assets, particularly the bank balance, to make the payment for the repurchased shares.

   Here is a snapshot of Kesar Ltd.'s Balance Sheet as of 31st March, 2023:

   A. Share Capital: Equity share capital (fully paid up shares of ₹ 10 each) - ₹ 12,50,000

   B. Reserves and Surplus: Securities premium ₹ 2,50,000; Profit and loss account ₹ 1,25,000; Revenue reserve ₹ 15,00,000;

   C. Long term borrowings: 14% Debentures- ₹ 28,75,000, Unsecured Loans - ₹ 16,50,000

   D. Land and Building ₹ 19,30,000; Plant and machinery ₹ 18,00,000; Furniture and fitting ₹ 9,20,000 and Other Current Assets - ₹ 30,00,000

   Authorized, issued and subscribed capital: Equity share capital (fully paid up shares of 10 each) - 12,50,000.

   (i) By using the Shares Outstanding Test the number of shares that can be bought back
      (a) 1,25,000
      (b) 31,250
      (c) 25,000
      (d) 30,000

   (ii) By using the Resources Test determine the number of shares that can be bought back:
      (a) 25,000
      (b) 31,250
      (c) 28,750
      (d) 39,062

   (iii) By using the Debt Equity Ratio Test determine the number of shares that can be bought back:
      (a) 25,000
      (b) 31,250
      (c) 28,750
      (d) 39,062

   (iv) On the basis of all three tests determine Maximum number of shares that can be bought back:
      (a) 25,000
      (b) 31,250
      (c) 28,750
      (d) 39,062

Multiple Choice Questions [4 MCQs of 2 Marks each: Total 8 Marks]

2. Kumar Ltd., a privately-held company, operates in the manufacturing industry. Founded in 2008, the company has steadily grown its operations and established a strong presence in the market. As of 31st March, 2023, the company's capital structure reflects a blend of equity and debt financing.

   Capital Structure Overview:

   - Equity Share Capital: The company has a total of ₹ 30,00,000 invested in equity shares, each valued at ₹ 10 and fully paid.
   - Reserves & Surplus: Kumar Ltd. has accumulated reserves and surplus totaling ₹49,00,000, comprising contributions from various sources including General Reserve (₹ 32,50,000), Security

Premium Account (₹ 6,00,000), Profit & Loss Account (₹ 4,30,000), and Revaluation Reserve (₹ 6,20,000).

- Loan Funds: The company has acquired loan funds amounting to ₹ 42,00,000 to support its operational and growth initiatives.

Buy-Back Decision:

Considering its financial position and market conditions, Kumar Ltd. has decided to initiate a share buy-back program. The company intends to repurchase its shares at a price of ₹30 per share.

In accordance with financial regulations and internal policies, Kumar Ltd. aims to assess the maximum number of shares it can repurchase while maintaining a prudent debt-equity ratio. By utilizing the Debt Equity Ratio Test, the company seeks to strike a balance between its equity base and debt obligations.

Based on the above information, answer the following questions.

(i) What is the minimum equity Kumar Ltd. needs to maintain after buy- back, according to the Debt Equity Ratio Test?
   (a) ₹ 12,95,000
   (b) ₹ 21,00,000
   (c) ₹ 32,50,000
   (d) ₹ 6,00,000

(ii) What is the maximum permitted buy-back of equity for Kumar Ltd.?
   (a) ₹ 38,85,000
   (b) ₹ 42,00,000
   (c) ₹ 12,95,000
   (d) ₹ 59,85,000

(iii) How many shares of Kumar Ltd. can be bought back at ₹ 30 per share according to the Debt Equity Ratio Test?
   (a) 43,000
   (b) 1,29,500
   (c) 2,00,000
   (d) 78,000

Multiple Choice Questions [3 MCQs of 2 Marks each: Total 6 Marks]

Answer

1.	**(i)**	**(b)**
	(ii)	**(d)**
	(iii)	**(c)**
	(iv)	**(c)**
2.	**(i)**	**(b)**
	(ii)	**(a)**
	(iii)	**(b)**

Case Study 5

AS 3: Cash Flow Statement

1. Beloved Finance Ltd. is a financial enterprise which is in the business of lending loan to small businesses and earn interest on loans.
   - During the year the Company has lend 50 crores and earned ₹ 1.5 crore as interest on loans.
   - The Company had surplus funds during the year and invested then in Fixed Deposits with bank and earned interest on fixed deposits of ₹ 20 lacs.
   - The Company also acquired a gold loan unit for ₹ 10 crore during the year and the Company provided interest free loan of ₹ 15 crore to its wholly-owned subsidiary.
   - The Company paid a total income tax of ₹ 75 lacs for the year.

   Based on the above information, answer the following questions.

   (i) In the Cash Flow Statement as per AS 3, the interest income of ₹ 1.5 crore earned on earned on loans given by the Company will be disclosed as:
   (a) Cash Flow from Operating Activities
   (b) Cash Flow from Investing Activities
   (c) Cash Flow from Financing Activities
   (d) Non-cash Items

   (ii) In the Cash Flow Statement as per AS 3, the interest income of ₹ 20 Lacs earned fixed deposits with bank will be disclosed as:
   (a) Cash Flow from Operating Activities
   (b) Cash Flow from Investing Activities
   (c) Cash Flow from Financing Activities
   (d) Non-cash Items

   (iii) In the Cash Flow Statement as per AS 3, amount paid for acquiring gold loan unit will be disclosed as:
   (a) Cash Flow from Operating Activities
   (b) Cash Flow from Investing Activities
   (c) Cash Flow from Financing Activities
   (d) Non-cash Items

   (iv) In the Cash Flow Statement as per AS 3, total income tax of ₹ 75 lacs paid for the year will be disclosed as:
   (a) Cash Flow from Operating Activities
   (b) Cash Flow from Investing Activities
   (c) Cash Flow from Financing Activities
   (d) Non-cash Items

   (v) Is any specific disclosures required to made in relation to the interest free loan of ₹ 15 crore provided by the Company to its wholly-owned subsidiary, if yes, as per which Accounting Standard:
   (a) Yes, disclosure is required to be made as per AS 3, Cash Flow Statements.
   (b) Yes, disclosure is required to be made as per AS 18, Related Party Disclosures
   (c) Yes, disclosure is required to be made as per AS 13, Accounting for Investments
   (d) No specific disclosures are required.

Multiple Choice Questions [5 MCQs of 2 Marks each: Total 10 Marks]

Answer

1.	**(i)**	**(a)**
	(ii)	**(a)**
	(iii)	**(b)**
	(iv)	**(a)**
	(v)	**(b)**

Time Allowed – 3 Hours ***Maximum Marks: 100***

CA Inter: Advanced Accounts

GENERAL INSTRUCTIONS TO CANDIDATES
QUESTION PAPER COMPRISES OF MCQ AND DESCRIPTIVE QUESTIONS
MCQ WEIGHED 30 MARKS AND REMAINING DESCRIPTIVE WEIGHTED 70 MARKS
Question No. 1 is compulsory

*Candidates are also required to answer any **Four** questions from the remaining **Five** questions*
Working Note should form part of the respective answers.

Question 1:

Answer the following Questions

(a) *RTS Ltd, ("RTS" or the "Company"), is engaged in the business of manufacturing of equipments/ components. The Company has a contract with the Indian Railways for a brake component which is structured such that:*

- *The Company's obligation is to deliver the component to the Railways' stockyard, while the delivery terms are ex -works, the Company is responsible for engaging a transporter for delivery.*
- *Railways sends an order for a defined quantity.*
- *The Company manufactures the required quantity and informs Railways for carrying out the inspection.*
- *Railways representatives visit the Company's factory and inspect the components, and mark each component with a quality check sticker.*
- *Goods once inspected by Railways, are marked with a hologram sticker to earmark for delivery identification by the customer when they are delivered to the customer's location.*
- *The Company raises an invoice once it dispatches the goods.*

The management of RTS is under discussion with the auditors of the Company in respect of accounting of a critical matter as regards its accounting with respect subsequent events i.e. events after the reporting period. They have been checking as to which one of the following events after the reporting period provide evidence of conditions that existed at the end of the reporting period?

(i) Nationalisation or privatization by government
(ii) Out of court settlement of a legal claim
(iii) Rights issue of equity shares
(iv) Strike by workforce
(v) Announcing a plan to discontinue an operation

The Company has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the Company distributed ₹ 2 crores as dividend. The Company also received land, free of cost, from the State Government but it has not recorded this at all in the books as no money has been spent.

RTS has a subsidiary, A Ltd, which is evaluating its production process wherein normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input was ₹ 1,000. The entire quantity of waste was on stock at the end of the financial year.

(i) *When should RTS Ltd recognize revenue as per the Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006? Would your answer be different if inspection is normally known to lead to no quality rejections?*

(a) Revenue should be recognized on dispatch of components.
The assessment would not change even in case where inspection is normally known to lead to no quality rejections.

(b) Revenue should be recognized on completion of inspection of components. The assessment would not change even in case where inspection is normally known to lead to no quality rejections.

(c) Revenue should be recognized on dispatch of components.
The assessment would change where inspection is normally known to lead to no quality rejections.

(d) Revenue should be recognized on delivery of the component to the Railways' stockyard. The assessment would change where inspection is normally known to lead to no quality rejections.

(*3 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(ii) *In respect of A Ltd, state with reference to Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, what would be value of the inventory to be recorded in the books of accounts?*

(a) ₹4,700,000.

(b) ₹5,000,000.

(c) ₹4,950,000.

(d) ₹4,947,368.

(*2 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(iii) *Please guide regarding the accounting treatment of both the grants mentioned above in line with the requirements of Accounting Standard 12.*

(a) Distribution of dividend out of grant is correct. In the second case also not recording land in the books of accounts is correct.

(b) Distribution of dividend out of grant is incorrect. In the second case, not recording land in the books of accounts is correct.

(c) Distribution of dividend out of grant is correct. In the second case, land should be recorded in the books of accounts at a nominal value.

(d) Distribution of dividend out of grant is incorrect. In the second case, land should be recorded in the books of accounts at a nominal value.

(*3 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(b) *Gyan Ltd. borrowed ₹10 crore for construction of a plant at the rate of 10% per annum (interest paid annually ₹1 crore). The construction was being carried on and out of the borrowings, ₹4 crore was temporarily placed in a fixed deposit at the rate of 6% per annum (interest earned ₹24 lakh). At the year end, how much cost of borrowing Gyan Limited will capitalise?*

(a) Interest paid on ₹10 crore i.e. ₹1 crore

(b) Interest paid on ₹6 crore as only this amount was utilized i.e. ₹60 Lakh.

(c) Interest paid less income on temporary investment i.e. ₹76 lakh

(d) Nothing will be capitalized

(*2 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(*c*) *On 1st April, 2022 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2022 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2023 was ₹21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹3,40,000.*

You are required to compute Basic EPS for the year ended 31st March, 2023 as per Accounting Standard 20 "Earnings Per Share".

(*4 Marks*) (*MTP October, 2023*) (*Advance Accounts*)

Question 2:

Consider the following information of subsidiary MNT Ltd.-

Liabilities	***2021-22***	***2022-23***
	Amount in ₹	***Amount in ₹***
Issued and subscribed: 7,500 Equity Shares of ₹100 each	*7,50,000*	*7,50,000*
Revenue Reserve	*2,14,000*	*5,05,000*
Securities Premium	*72,000*	*2,07,000*
Trade Payables	*2,90,000*	*2,46,000*
Bank Overdraft	*-*	*1,70,000*
Provision for Taxation	*2,62,000*	*4,30,000*
Property, plant and equipment (Cost)	*9,20,000*	*9,20,000*

Liabilities	***2021-22***	***2022-23***
	Amount in ₹	***Amount in ₹***
Less: Accumulated Depreciation	(*1,70,000*)	(*2,82,500*)
	7,50,000	*6,37,500*
Investment (*at cost*)	-	*5,30,000*
Inventory	*4,12,300*	*6,90,000*
Trade Receivable	*2,95,000*	*3,43,000*
Prepaid expenses	*78,000*	*65,000*
Cash at Bank	*52,700*	*42,500*

Other Information:

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹5,000 at the end of 2021-2022 and increased by ₹12,000 at the end of 2022-2023. (*Inventory of 2021-22 has been sold out during the year 2022-23*)

(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 2021-22 and ₹12,500 in 2022-23 being part of initial Sales Promotion expenditure of ₹37,500 in 2021-22, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2021-22.

Restate the balance sheet of MNT Ltd. as on 31st March, 2023 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.

(*14 Marks*) (*MTP October, 2023*) (*Advance Accounts*)

Question 3:

(a) *The accountant of Beryl Limited has asked you to identify the following items as - Change in Accounting Policies/Change in Accounting Estimates/Extraordinary Items/Prior period items/ Ordinary Activity:*

(*i*) *Non-provision for salary already due in earlier year.*
(*ii*) *Attachment of the property of the enterprise.*
(*iii*) *Introduction of new pension scheme for employees.*
(*iv*) *Change in Reserve for obsolete inventory.*
(*v*) *Settlement of litigation case.*
(*vi*) *Actual Bad debts exceed the provision.*
(*vii*) *Legislative changes having long term retrospective application.*
(*viii*) *Capitalisation of working capital loan interest.*
(*ix*) *Change from Cost Model to Revaluation Model for measurement of carrying amount of PPE.*
(*x*) *Government sanctioned grant in current year for expenses incurred in previous accounting year.*

(*5 Marks*) (*November Exam., 2023*) (*Advance Accounts*)

(b) *Based upon criteria for rating of non-corporate entity, categorize the following as Level I, Level II and Level III Level IV entities for the purpose of compliance of Accounting Standards in India.*

(a) Rama Textiles whose turnover (excluding other income) exceeds ten crore but does not exceed rupees fifty crore in the immediately preceding accounting year.
(b) Star Industries is having borrowings (including public deposits) in excess of rupees two crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.
(c) Newman Industries is having borrowings (including public deposits) less than rupees fifty lakh at any time during the immediately preceding accounting year.
(d) SS Finance is a financial institution carrying its business in India since last 10 years.
(e) DD Finance, holding company of SS Finance. (Entity mentioned at Point (v) above)
(f) Reliable Co-op Bank, a co-operative bank, carrying banking operations since last 15 years.

(*5 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(c) *Analyse the disclosure and preparation requirements of AS 24 for the Discontinuing operations* (*any five*)

Question 4:

Answer the following Questions:

(*a*) *Moon Star has a branch at Virginia* (*USA*). *The Branch is a non-integral foreign operation of the Moon Star. The trial balance of the Branch as at 31st March, 2023 is as follows:*

Particulars	***US $***	
	Dr.	***Cr.***
Office equipments	*48,000*	
Furniture and Fixtures	*3,200*	
Stock (*April 1, 2022*)	*22,400*	
Purchases	*96,000*	
Sales	*---*	*1,66,400*
Goods sent from H.O	*32,000*	
Salaries	*3,200*	
Carriage inward	*400*	
Rent, Rates & Taxes	*800*	
Insurance	*400*	
Trade Expenses	*400*	
Head Office Account	*---*	*45,600*
Sundry Debtors	*9,600*	
Sundry Creditors	*---*	*6,800*
Cash at Bank	*2,000*	
Cash in Hand	*400*	
	2,18,800	*2,18,800*

The following further information is given:

(1) Salaries outstanding $ 400.

(2) Depreciate office equipment and furniture & fixtures @10% p.a. at written down value.

(3) The Head Office sent goods to Branch for ₹15,80,000.

(4) The Head Office shows an amount of ₹ 20,50,000 due from Branch.

(5) Stock on 31st March, 2023 -$21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1, 2021 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2022, the rate was 47 per $. On March 31, 2023 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare Trial balance incorporating adjustments given converting dollars into rupees and Trading, Profit and Loss Account for the year ended 31st March, 2023 of the Branch as would appear in the books of Moon Star for the purpose of incorporating in the main Balance Sheet.

(*8 Marks*) (*MTP October, 2023*) (*Accounts*)

(b) *The following data is provided for M/s. Raj Construction Co.*

(i) Contract Price - ₹ 85 lakhs

(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused.at the end of the period.

(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)

(iv) Specific Contract Costs = ₹ 5 Lakhs

(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to Sub-Contractors - ₹ 4 Lakhs

(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

(*6 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

Question 5:

You are required to prepare a Balance Sheet as at 31st March 2023, as per Schedule III of the Companies Act, 2013, from the following information of Mehar Ltd.:

Particulars	***Amount (₹)***	***Particulars***	***Amount (₹)***
Term Loans (Secured)	*40,00,000*	*Investments (Non-current)*	*9,00,000*
Trade payables	*45,80,000*	*Profit for the year*	*32,00,000*
Cash and Bank Balances	*38,40,000*	*Trade receivables*	*49,00,000*
Staff Advances	*2,20,000*	*Miscellaneous Expenses*	*2,32,000*
Other advances (given by Co.)	*14,88,000*	*Loan from other parties*	*8,00,000*
Provision for Taxation	*10,20,000*	*Provision for Doubtful Debts*	*80,000*
Securities Premium	*19,00,000*	*Stores*	*16,00,000*
Loose Tools	*2,00,000*	*Finished Goods*	*30,00,000*
General Reserve	*62,00,000*	*Plant and Machinery (WDV)*	*2,14,00,000*

Additional Information: -

1. *Share Capital consists of-*
   (a) *1,20,000 Equity Shares of ₹100 each fully paid up.*
   (b) *40,000, 10% Redeemable Preference Shares of ₹100 each fully paid up.*
2. *Write off the amount of Miscellaneous Expenses in full, amounting ₹2,32,000.*

(*14 Marks*) (*MTP October, 2023*) (*Accounts*)

Question 6:

Answer the following Questions:

(*a*) *From the following particulars calculate cash flows from Operating activities:*

Particulars	*₹*
Retained earning	*17,000*
Depreciation	*4,000*
Loss on Sale of Machinery	*3,000*
Provision for tax	*7,000*
Interim Dividend paid during the year	*10,000*
Dividend paid during the year	*8,000*
Premium payable on redeemable Preference Shares	*2,000*
Profit on sale of investment	*10,000*
Refund of tax	*1,000*

Additional Information:

	31. 3. 22 *₹*	***31. 3. 23*** *₹*
Trade Receivable	*10,000*	*12,000*
Trade Payable	*7,000*	*15,000*
Provision for Tax	*4,000*	*7,000*
Prepare Expenses	*2,000*	*1,000*
Outstanding Expenses	*1,400*	*1,000*

(*5 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(b) *Naresh Ltd. had the following transactions during the financial year 2022-2023:*

(i) *Naresh Ltd. acquired running business of Sunil Ltd. for ₹10,80,000 on 15th May, 2022. The fair value of Sunil Ltd.'s net assets was ₹5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.*

(ii) *Naresh Ltd. had taken a franchise on July 2022 to operate a restaurant from Sankalp Ltd. for ₹ 1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹60,000 during the financial year 2022-2023.*

(iii) On 20th August, 2022, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition.

Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2023.

(*5 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

(c) *Hello Limited belongs to the manufacturing industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 12 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 4 lakhs instead of ₹ 10 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.*

(*4 Marks*) (*RTP May, 2024*) (*Advance Accounts*)

CA Inter: Advanced Accounts
Answer

Answer 1(a) ADV-2

(i) (b)
(ii) (d)
(iii) (d)

Answer 1(b): (c) ADV-2

Answer 1(c) ADV-2

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	*No. of equity shares*	*Amount paid per share*	*Weighted average no. of equity shares*
	₹	₹	₹
1.4.2023	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2023	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2023	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

Answer 2 ADV-2

Restated Balance Sheet of MNT Ltd. as at 31st March 2023

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000

Particulars	Note No.	(₹)
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables $\left(\frac{3,43,000}{98}\times 100\right)$		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		23,14,500

Notes to Accounts

			₹
1.	Reserves and Surplus		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2.	**Short term borrowings**		
	Bank overdraft		1,70,000
3.	Short-term provision		
	Provision for taxation		4,30,000
4.	Property, Plant and Equipment		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5.	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6.	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)		52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		5,11,500

Answer 3(b) ADV-2

(a) Level III Entity – Rama textiles, whose turnover (excluding other income) exceeds rupees ten crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(b) Level III Entity – Star industries is having borrowings (including public deposits) in excess of rupees two crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(c) Level IV Entity– Newman Industries is having borrowings (including public deposits) less than rupees fifty lakhs at any time during the immediately preceding accounting year.

(d) Level I Entity – SS is a financial institutions carrying its business in India since last 10 years.

(e) Level I Entity – DD finance, Holding company of SS finance (Entity mentioned in point (d) above).

(f) Level I Entity – Reliable co-operative banks carrying on banking business since last 15 years.

Answer 4(a) ADV-2

In the books of Moon Star

Trial Balance (in Rupees) of Virginia (USA) Branch as on 31st March, 2023

	Dr.	*Cr.*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	*₹*	*₹*
Office Equipment	43,200		50	21,60,000	
Depreciation on Office Equipment	4,800		50	2,40,000	
Furniture and fixtures	2,880		50	1,44,000	
Depreciation on furniture and fixtures	320		50	16,000	
Stock (1st April, 2022)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods sent from H.O.	32,000			15,80,000	
Carriage inward	400		45	18,000	
Salaries (3,200+400)	3,600		45	1,62,000	
Outstanding salaries		400	50		20,000
Rent, rates and taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade expenses	400		45	18,000	
Head Office A/c		45,600			20,50,000
Trade debtors	9,600		50	4,80,000	
Trade creditors		6,800	50		3,40,000
Cash at bank	2,000		50	1,00,000	
Cash in hand	400		50	20,000	
Exchange gain (bal. fig.)					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Trading and Profit and Loss Account of Virginia Branch for the year ended 31st March, 2023

	₹		₹
To Opening stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing stock	10,75,000
To Goods from Head Office	15,80,000	(21,500 US $ × 50)	
To Carriage inward	18,000		
To Gross profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross profit b/d	15,92,200
To Rent, rates and taxes	36,000		
To Insurance	18,000		
To Trade expenses	18,000		
To Depreciation on office equipment	2,40,000		
To Depreciation on furniture and fixtures	16,000		
To Net Profit c/d	11,02,200		
	15,92,200		15,92,200

Answer 4(b) ADV-2

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost
= ₹ 45,00,000/₹ 80,00,000
= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

Answer 5 ADV-2

Balance Sheet of Mehar Ltd. as at 31st March, 2023

		Note	₹
I	**EQUITY AND LIABILITIES:**		
(1)	(a) Share Capital	1	1,60,00,000
	(b) Reserves and Surplus	2	110,68,000
(2)	**Non-current Liabilities**		
	Long term Borrowings- Terms Loans (Secured)		40,00,000
(3)	**Current Liabilities**		
	(a) Trade Payables		45,80,000
	(b) Other current liabilities	3	8,00,000
	(c) Short-term Provisions (Provision for taxation)		10,20,000
	Total		**3,74,68,000**
II	**ASSETS**		
(1)	**Non-current Assets**		
	(a) Property, Plant and Equipment	4	214,00,000
	(b) Non- current Investments		9,00,000
(2)	**Current Assets:**		
	(a) Inventories	5	48,00,000
	(b) Trade Receivables	6	48,20,000
	(c) Cash and Cash Equivalents		38,40,000
	(d) Short-term Loans and Advances	7	17,08,000
	Total		**3,74,68,000**

Notes to accounts

			(₹)
1.	**Share Capital**		
	Authorized, issued, subscribed & called up		
	1,20,000, Equity Shares of ₹ 100 each	1,20,00,000	1,60,00,000
	40,000 10% Redeemable Preference Shares of 100 each	40,00,000	

				(₹)
2.	**Reserves and Surplus**			
	Securities Premium Account		19,00,000	
	General reserve		62,00,000	
	Profit & Loss Balance			
	Opening balance	-		
	Profit for the period	32,00,000		
	Less: Miscellaneous Expenditure written off	(2,32,000)	29,68,000	110,68,000
3.	**Other current liabilities**			
	Loan from other parties			8,00,000
4.	**Property, plant and equipment**			
	Plant and Machinery (WDV)			214,00,000
5.	**Inventories**			
	Finished Goods		30,00,000	
	Stores		16,00,000	
	Loose Tools		2,00,000	48,00,000
6.	**Trade Receivables**			
	Trade receivables		49,00,000	
	Less: Provision for Doubtful Debts		(80,000)	48,20,000
7.	**Short term loans & Advances**			
	Staff Advances*		2,20,000	
	Other Advances*		14,88,000	17,08,000

**Considered to be short term.*

Answer 6(a) ADV-2

Calculation of Cash Flow from Operating Activities

Particulars	**Amount ₹**
Retained earnings	17,000
Add: Depreciation	4,000
Add: Loss on sale of Machinery	3,000
Add: Premium Payable on redeemable Preference Shares	2,000
Add: Dividend paid	8,000
Add: Interim dividend paid during the year	10,000
Add: provision for tax made during the current year	7,000
Less: Refund of tax	(1,000)
Less: Profit on Sale of Investment	(10,000)
Operating Profit before Working Capital Changes	40,000
Add: Decrease in Prepaid Expenses	1,000
Less: Increase in Trade receivable	(2,000)
Add: Increase in Trade Payable	8,000
Less: Decrease in Outstanding Expenses	(400)
Cash generated from (Net of refund) operation	46,600
Less: Income tax paid (4,000 – 1,000)	(3,000)
Net Cash flow operating activities	43,600

Answer 6(b) ADV-2

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2023

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 ie. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

Answer 6(c) ADV-2

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 ₹ 12 lakhs is required to be credited to the profit and loss statement of the current year.