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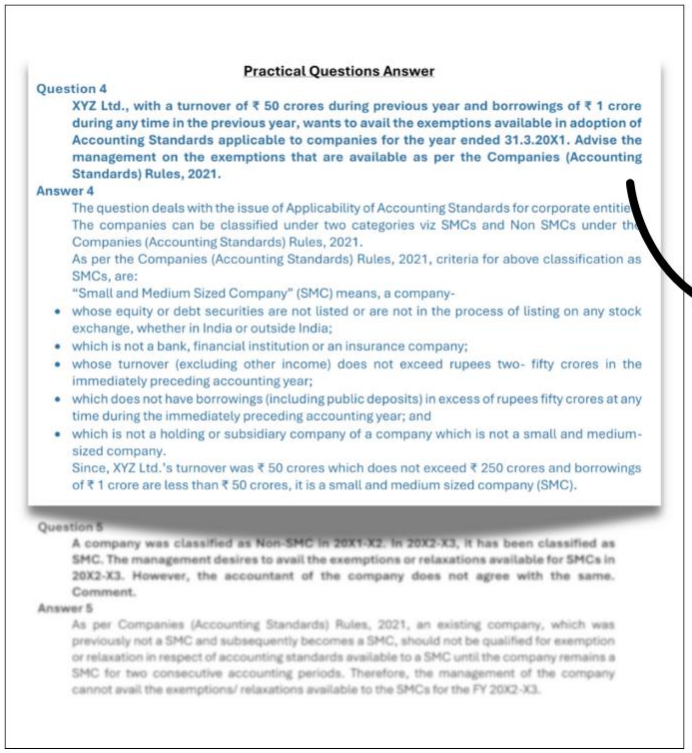

Practical Questions Answer

Question 4

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.

Answer 4

The question deals with the issue of Applicability of Accounting Standards for corporate entiti
The companies can be classified under two categories viz SMCs and Non SMCs under th
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 5

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.

Answer 5

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.

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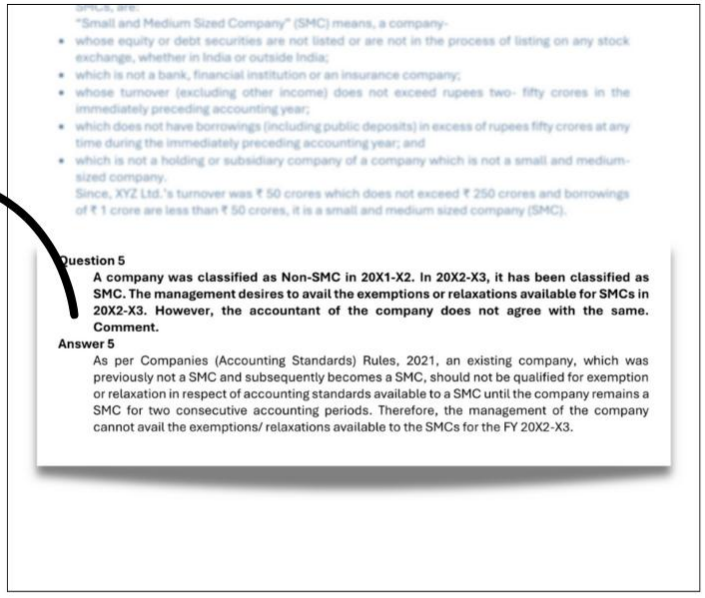

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Answer 5

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.

Test your knowledge

Multiple Choice Questions

1. **Accounting Standards for non-corporate entities in India are issued by**
   (a) Central Govt
   (b) State Govt.
   (c) Institute of Chartered Accountants of India.
   (d) MCA

Ans: (c)

2. **Accounting Standards**
   (a) Harmonies accounting policies and eliminate the non-comparability of financial statements
   (b) Improve the reliability of financial statements
   (c) Both (a) and (b).
   (d) Manipulate the data for the management

Ans: (c)

3. **It is essential to standardize the accounting principles and policies in order to ensure**
   (a) Transparency
   (b) Consistency.
   (c) Comparability
   (d) All the above

Ans: (d)

4. **Which committee is responsible for approval of accounting standards and their modification for the purpose of applicability to companies?**
   (a) NFRA.
   (b) MCA.
   (c) Central Government Advisory Committee
   (d) IASB

Ans: (b)

5. **Global Standards facilitate**
   (a) Cross border flow of money.
   (b) Comparability of financial statements

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(c) Uniformity and Transparency of financial statements
(d) All the three

Ans: (d)

Theoretical Question and Answer

Question 1

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

Answer 1

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 financial statements 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 make the financial statements of different companies comparable, which helps investors in decision making.
b. Accounting Standards prevent any misleading accounting treatment.
c. Accounting Standards prevent manipulation of data by the management.

Question 2

Briefly explain the process of issuance of Indian Accounting Standards.

Answer 2

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 converge and 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. Recognizing 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.

Answer 3

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

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reinstatement of financial statements.

Question 4

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

Answer 4

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 'Carveouts'. Additional guidance given in Ind AS over and above what is given in IFRS, is termed as 'Carve in'.

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Illustrations

Question 1 (Illustration)

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.

Answer 1

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

	Case (i)	Case (ii)		Case (i)	Case (ii)
	₹	₹		₹	₹
To Opening Stock	30,000	30,000	By Sales	4,50,000	4,50,000
To Purchases	4,00,000	4,00,000	By Closing Stock	32,000	40,000
To Expenses	14,900	14,900	By Trade payables	-	600
To Depreciation	13,000	5,000			
To Provision for doubtful debts	2,000	6,000			
To Deferred expenditure	2,500	10,000			

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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 (Illustration)

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 ie. (i) Historical costs, (ii) Current purchasing power and (iii) Physical capital maintenance.

Answer 2

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

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Less: Capital to be maintained		
Opening capital (At closing price)	15,000	
Introduction (At closing price)	Nil	(15,000)
Retained profit/(loss)		(3,000)

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)

Test your knowledge

Multiple Choice Questions

1. The 'going concern' concept assumes that
(a) The business can continue in operational existence for the foreseeable future
(b) The business cannot continue in operational existence for the foreseeable future.
(c) The business is continuing to be profitable.
(d) The business cannot continue if it is not able to earn profits.

Ans: (a)

2. Two principal qualitative characteristics of financial statements are
(a) Understandability and materiality
(b) Relevance and reliability
(c) Relevance and materiality
(d) Comparability and materiality.

Ans: (b)

3. All of the following are components of financial statements except
(a) Balance sheet
(b) Statement of Profit and loss
(c) Human responsibility report
(d) Social responsibility report.

Ans: (c)

4. An accounting policy can be changed if the change is required
(a) By statute or accounting standard
(b) For more appropriate presentation of financial statements
(c) Both (a) and (b)
(d) By statute as well as accounting standards.

Ans: (c)

5. Value of equity may change due to
(a) Contribution from or Distribution to equity participants

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(b) Income earned
(c) expenses incurred
(d) All the three.

Ans: (d)

Theoretical Questions and Answer

Questions 1

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

Answer 1

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Understand ability; Relevance; Reliability; Comparability are the qualitative characteristics of financial statements. For details, refer para 7 of the chapter.

Questions 2

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

Answer 2

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

Practical Questions Answers

Question 3

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.

Answer 3

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 4

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.

Answer 4

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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 5

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.

Answer 5

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		

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	5,38,500		**5,38,500**

Question 6

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.

Answer 6

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)			

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Multiple Choice Questions

1. **Non-corporate entities which are not Level I entities whose turnover (excludingother income) exceeds rupees _____but does not exceed rupees two-fifty crores in the immediately preceding accounting year are classified as Level II entities.**
   (a) five crores.
   (b) two crores.
   (c) fifty crores.
   (d) ten crores.

Ans: (C)

2. **The following Accounting Standard is not applicable to Non-Corporate Entities falling in Level II in its entirety.**
   (a) AS 10.
   (b) AS 17.
   (c) AS 2.
   (d) AS 13.

Ans: (b)

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**
   (a) Level II entities.
   (b) Level I entities.
   (c) Level III entities.
   (d) Level IV entities.

Ans: (b)

4. **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.**
   (a) Level II entities.
   (b) Level IV entities.
   (c) Level III entities.
   (d) Level I entities.

Ans: (C)

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

(a) which may be a bank, financial institution or an insurance company.

(b) whose turnover (excluding other income) does not exceed rupees two-fifty crores in the immediately preceding accounting year;

(c) whose turnover (excluding other income) does not exceed rupees fifty crores in the immediately preceding accounting year;

(d) whose turnover (excluding other income) does not exceed rupees five hundred crores in the immediately preceding accounting year.

Ans: (b)

Theory Questions Answer

Question 1

What are the issues, with which Accounting Standards deal?

Answer 1

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 2

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.

Answer 2

Criteria for classification of Non-company Entities as decided by the Institute of Chartered Accountants of India

Level I Entities

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

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

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

(iii) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees two-fifty crore in the immediately preceding accounting year.

(iv) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees fifty crore at any time during the immediately preceding accounting year.

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

Level II Entities

Non-company entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees fifty crore but does not exceed rupees two-fifty crore in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees ten crore but not in excess of rupees fifty crore at any time during the immediately preceding accounting year.

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

Question 3

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.

Answer 3

Level IV Entities

Non-company entities which are not covered under Level I, Level II and Level III are considered as Level IV entities.

Additional requirements

(1) An MSME which avails the exemptions or relaxations given to it shall disclose (by way of a note to its financial statements) the fact that it is an MSME, the Level of MSME and that it has complied with the Accounting Standards insofar as they are applicable to entities falling in Level II or Level III or Level IV, as the case may be.

(2) Where an entity, being covered in Level II or Level III or Level IV, had qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be covered in Level II or Level III or Level IV, as the case may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities shall be disclosed in the notes to the financial statements. The fact that previous period figures have not been revised shall also be disclosed in the notes to the financial statements.

(3) Where an entity has been covered in Level I and subsequently, ceases to be so covered and gets covered in Level II or Level III or Level IV, the entity will not qualify for exemption/relaxation available to that Level, until the entity ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an entity, which has been covered in Level II or Level III and subsequently, gets covered under Level III or Level IV.

(4) If an entity covered in Level II or Level III or Level IV opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it shall disclose the Standard(s) in respect of which it has availed the exemption or relaxation.

(5) If an entity covered in Level II or Level III or Level IV opts not to avail any one or more of the exemptions or relaxations available to that Level of entities, it shall comply with the relevant requirements of the Accounting Standard.

(6) An entity covered in Level II or Level III or Level IV may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard:
Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

(7) In respect of Accounting Standard (AS) 15, Employee Benefits, exemptions/ relaxations are available to Level II and Level III entities, under two sub- classifications, viz., (i) entities whose average number of persons employed during the year is 50 or more, and (ii) entities whose average number of persons employed during the year is less than 50. The requirements stated in paragraphs (1) to (6) above, mutatis mutandis, apply to these sub- classifications.

Practical Questions Answer

Question 4

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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.

Answer 4

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 5

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.

Answer 5

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.

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Question 1 (Illustration)

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. Realizable 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.

Answer 1

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 (Illustration)

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.

Answer 2

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

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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 (Illustration)

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.

Answer 3

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.

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Multiple Choice Questions

1. **Which of the following is NOT a major consideration in selection and application of accounting policies?**
   (a) Prudence
   (b) Comparability
   (c) Materiality
   (d) Substance over form

Ans: (b)

2. **Adoption of different accounting policies by different companies operating in the same industry affects which of the qualitative characteristics the most?**
   (a) Comparability
   (b) Relevance
   (c) Faithful representation
   (d) Reliability

Ans: (a)

3. **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?**
   (a) Any change in an accounting policy which has a material effect shouldbe disclosed.
   (b) 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.
   (c) 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.
   (d) 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 shouldbe appropriately disclosed only in the later periods i.e. year(s) next to the year in which the change is adopted.

Ans: (d)

Theoretical Questions Answer

Question 1

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

Answer 1

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

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Question 2

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

Answer 2

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 necessarythat 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.

Practical Questions Answer

Question 3

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.

Answer 3

(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 4

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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 an issue?

Answer 4

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 thefinancial 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 5

ABC Ltd. was making provision for non – moving inventories based on issues for the last 12 months up to 31.2.20X1.

The company wants to provide during the year ending 31.3.20X2 based on technical evaluation:

Total value of inventory	**₹100 lakhs**
Provision required based on 12 month 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 ?

Answer 5

Accounting policy of a company may require the provision for non- moving inventories should be made. The method of estimating the amount of provision may be changed in case 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 20X1-X2.

"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.

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Question 1 (Illustration)

Classify the following activities as (a) Operating Activities, (b) Investing Activities, (c) Financing Activities (d) Cash Equivalents.

Sr No.	Particulars	Sr No.	Particulars
1	Purchase of Machinery.	18	Interest paid on Long-term borrowings.
2	Proceeds from issuance of equity share capital	19	Office and Administration Expenses paid
3	Cash Sales.	20	Manufacturing Overheads paid.
4	Proceeds from long-term borrowings.	21	Dividend received on shares held as investments.
5	Cheques collected from Trade receivables.	22	Rent Received on property held as investment.
6	Cash receipts from Trade receivables.	23	Selling and distribution expense paid.
7	Trading Commission received.	24	Income tax paid
8	Purchase of investment.	25	Dividend paid on Preference shares.
9	Redemption of Preference Shares.	26	Underwritings Commission paid.
10	Cash Purchases.	27	Rent paid.
11	Proceeds from sale of investment	28	Brokerage paid on purchase of investments.
12	Purchase of goodwill.	29	Bank Overdraft
13	Cash paid to suppliers.	30	Cash Credit
14	Interim Dividend paid on equity shares.	31	Short term deposits
15	Wages and salaries paid.	32	Highly liquid Marketable Securities (without risk of change in value)
16	Proceed from sale of patents.	33	Refund of Income Tax received.
17	Interest received on debentures held as investment.		

Answer 1

(a) Operating Activities: 3,5,6,7,10,13,15,19,20,23,24,27,33
(b) Investing Activities: 1,8,11,12,16,17,21,22,28,31
(c) Financing Activities: 2,4,9,14,18,25,26,29,30
(d) Cash Equivalent: 32

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Question 2 (Illustration)

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?

Answers 2

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 (Illustration)

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

Answer 3

(i) Interest paid by financial enterprise :

Cash flows from operating activities

*As per AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition and is subject to insignificant risk of change in value.

(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 (Illustration)

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st 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 Trade Receivables	3,50,000	Property, plant and equipment acquired	4,00,000
		Debentures redeemed	50,000

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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.

Answers 4

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 (Illustration)

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**

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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**

Answer 5

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.

Test your knowledge

Multiple Choice Questions

1. 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

(a) Nil
(b) ₹ 8,000
(c) ₹ 68,000
(d) ₹ 60,000

Ans: (a)

2. While preparing cash flows statement, an entity (other than a financial institution) should disclose the dividends received from its investment in shares as

(a) Operating cash inflow
(b) Investing cash inflow
(c) Financing cash inflow
(d) Cash & cash equivalent

Ans: (b)

3. XYZ Co. is a financial enterprise. In its cash flow statement, interest paid and dividends received should be

(a) Classified as operating cash flows
(b) Classified as financing cash flows
(c) Not shown in cash flow statement
(d) Classified as investing cash flows

Ans: (a)

4. In the cash flow statement, 'cash and cash equivalents' do not include

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(a) Bank balances
(b) Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value
(c) Cash balances
(d) Loan from bank

Ans: (d)

5. 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"?

(a) Interest income
(b) Gain on sale of a fixed asset
(c) Depreciation
(d) Gain on sale of inventory

Ans: (d)

Theoretical Questions Answers

Question 1

What are the main features of the Cash Flow Statement?

Answer 1

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 2

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?

Answer 2

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.

Practical Questions Answers

Question 3

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.**

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Answer 3

As per AS 3, the given cash flows shall be recorded as under:

porate Income Tax paid amounting to ₹ 70 lakhs during the reporting period.	) 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 4

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.

Answer 4

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 5

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	50,000
Limited	
Fixed Deposit created on 01-11-20X1 and maturing on 15-04-20X2	75,000
Short Term Investment in highly liquid Sovereign Debt	1,00,000
Mutual fund on 01-03-20X2 (having maturity period of less than 3 months)	
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)	

Answer 5

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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 6

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.

Answer 6

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 7

Following is the Balance Sheet of Fox Ltd. You are required to prepare cash flow statement using Indirect Method.

Particulars	Note No.	31st March,20X2(₹)	31st March,20X1(₹)
(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			

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(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,20X2 (₹)	31st March,20X1 (₹)
1. Share capital		
(a) Equity share capital	4,10,000	2,00,000
(b) Preference share capital	1,50,000	1,00,000
2. Reserve and surplus	5,60,000	3,00,000
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.**

Answer 7

Fox Ltd.

Cash Flow Statement for the year ended 31st March, 20X2

	₹	₹
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		

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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 31.3.20X2	3,50,000
Add back:	
Depreciation for the year	40,000
	3,90,000
Less: W.D.V. at 31.12.20X1	1,80,000
Acquisitions during 20X1-20X2	2,10,000

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Question 1 (Illustration)

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.

Answer 1

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

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

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

- The combined result of all segments in profit; or
- The combined result of all segments in loss,

whichever is greater in absolute amount; or

Its segment assets are 10% or more of the total assets of all segments.

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until at least 75% of total enterprise revenue is included in reportable segments.

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 (Illustration)

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

Answer 2

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

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consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 3 (Illustration)

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.

Answer 3

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 (Illustration)

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**

Answer 4

Diversifiers Ltd. Segmental Report ₹ *('000)*

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forgingshop	Bright Bar	Fitting		
Segment Revenue					

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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					57
liabilities					
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 (Illustration)

Microteach Ltd. produces batteries for scooters, cars, trucks, and specialized batteries for investors and UPS. How many segments should it have and why?

Answer 5

In case of Microteach Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for investors 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 investors and UPS, the risks and returns are affected by power condition, standard of living, etc. Therefore, it can be said that Microteach Ltd. has two business segments viz- 'Automobile batteries' and 'batteries for Invertors and UPS'.

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Test your knowledge

Multiple Choice Questions

1. As per AS 17, reportable segments are those whose total revenue from external sales and inter-segment sales is

(a) 10% or more of the total revenue of all segments
(b) 10% or more of the total revenue of all external segments
(c) 12% or more of the total revenue of all segments
(d) 12% or more of the total revenue of all external segments

Ans: (a)

2. Which of the following statements is correct?

(a) Management has a discretion to include a segment as a reportable segment even if it passes the 10% materiality test.
(b) Management has a discretion to include any segment as a reportable segment if it fails the 12% materiality test.
(c) It is mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.
(d) It is not mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.

Ans: (c)

3. Which of the following statements is correct?

(a) The overall test of 75% considers only external revenue to compute the threshold limit.
(b) The overall test of 75% considers only internal revenue to compute the threshold limit.
(c) The overall test of 75% considers both internal and external revenue to compute the threshold limit.
(d) It is management choice whether they want to include both external and internal revenue for computing threshold limit.

Ans: (a)

4. Which of the following statements is correct?

(a) The 10% test computed on the basis of revenue, considers both internal and external revenue to compute the threshold limit.
(b) The 10% test computed on the basis of revenue, considers only external revenue to compute the threshold limit.
(c) The 10% test computed on the basis of revenue, considers only internal revenue to compute the threshold limit.
(d) It is management choice whether they want to include both external and internal revenue for computing threshold limit.

Ans: (a)

5. Which of the following statements is correct?

(a) 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 netloss respectively of all segments taken together becomes reportable segment.
(b) 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

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reportable segment.

(c) 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.

(d) 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.

Ans: (c)

Practical Questions Answers

Question 1

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.

Answer 1

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 2

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.

Answer 2

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

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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 3

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?

Answer 3

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 4

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)

Answer 4

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	Reportable Segment Yes

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	(₹ In lakhs)	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 5

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.

Answer 5

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 6

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**

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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.

Answer 6

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 7

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**

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Enterprise expenses				**77,000**
(allocated in 5 :4 :2 basis)				
Expenses on transactions with other				
segments				
Transaction from B	**75,000**		**30,000**	
Transaction from C	**6,000**	**40,000**		
Transaction from A		**18,000**	**82,000**	

Answer 7

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 8

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

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'.

Answer 8

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 segment is 10 % or more of the total revenue – external and internal of all segment; or

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

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(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.

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Illustration

Question 1 (Illustration)

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.

Answer 1

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

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Question 2 (Illustration)

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.?

Answer 2

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

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

Question 3 (Illustration)

Consider a scenario wherein:
- **X Ltd. holds 28% voting right in Y Ltd. (and hence Y Ltd. is an associate of X Ltd.)**

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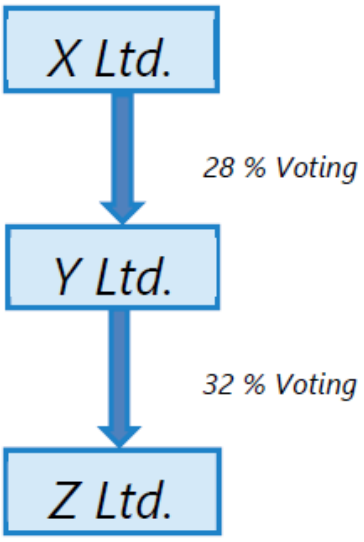
- **Y Ltd. holds 32% voting right in Z Ltd. (and hence Z L td. is an associate of Y Ltd.)**

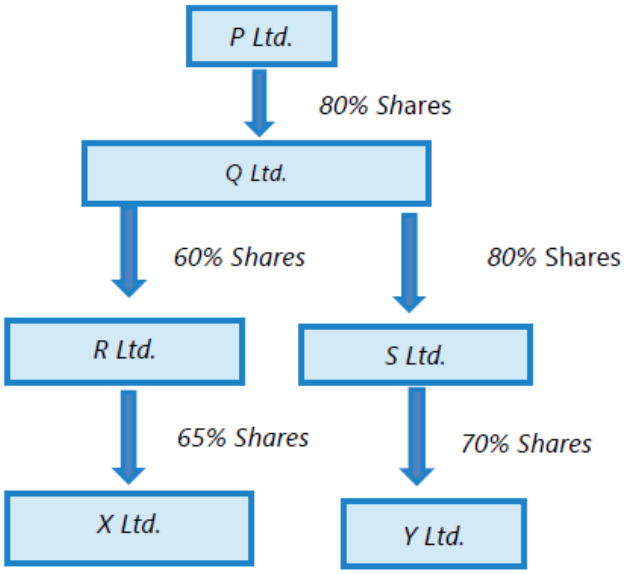


- **In the above case, since Y Ltd. is an associate of X Ltd. – Y Ltd. is a related party to X Ltd.**
- **Likewise, since Z Ltd. is an associate of Y Ltd. - Z Ltd. is a related party to Y Ltd.**
- **The question is: Whether Z Ltd. is to be treated under AS-18 as a party related to X Ltd.?**

Answer 3

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 (Illustration)



Consider the following organization structure related to P Ltd.
Given the above structure: Identify related party relationships, if R Ltd. is the reporting enterprise

Answer 4

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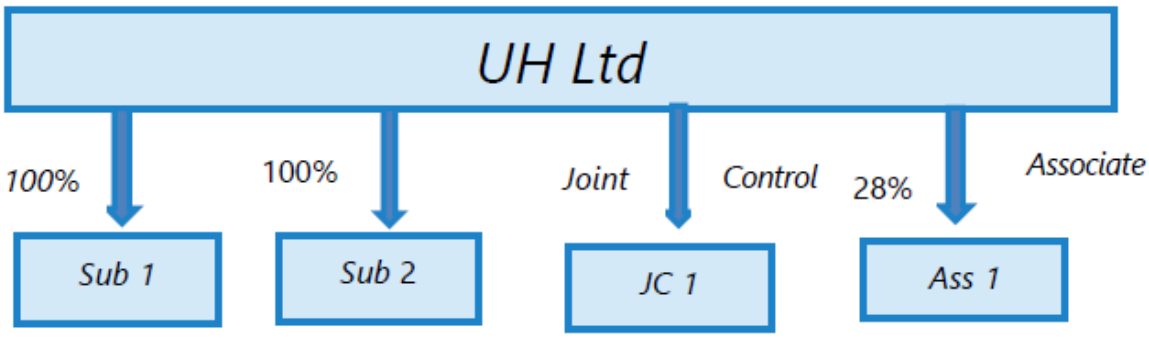
The following table identifies the related party relationships for R Ltd. (being the reporting enterprise):

Party Name	Relationship under AS-18
P Ltd.	P Ltd. has indirect control on R Ltd. (through Q Ltd.) Hence R Ltd. is related to P Ltd.
Q Ltd.	Q Ltd. has direct control of R Ltd. Hence R Ltd. is related to Q Ltd.
S Ltd.	R Ltd. and S Ltd. are under common control of Q Ltd. Hence R Ltd. is related to S Ltd.
X Ltd.	X Ltd. is controlled by R Ltd. Hence R Ltd. is related to X Ltd.
Y Ltd.	Y Ltd. is the sub-subsidiary of Q Ltd. Both R Ltd. and Y Ltd. are under common control of Q Ltd. Hence R Ltd. is related to Y Ltd.

Question 5 (Illustration)

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

Answer 5

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

Reportingenterprise	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 (Illustration)

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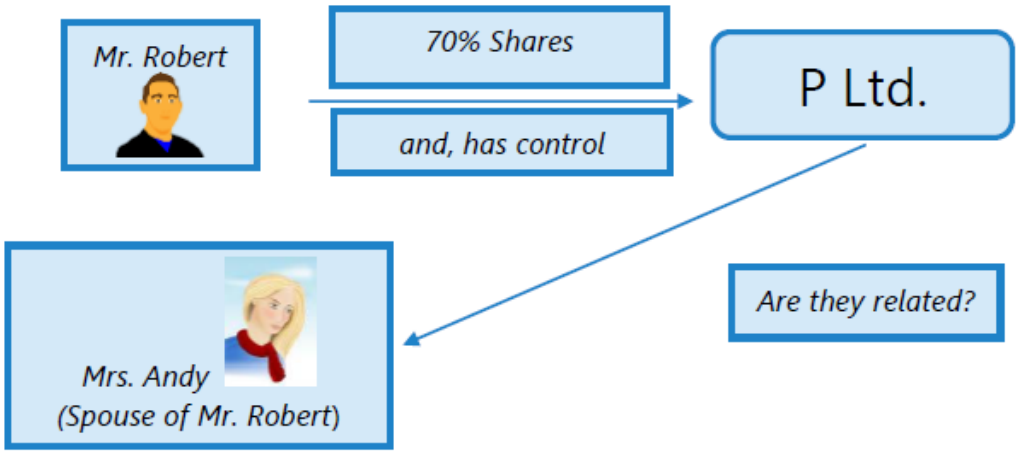
Consider a scenario wherein:

- **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?

Answer 6

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 (Illustration)

Consider a scenario wherein:

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

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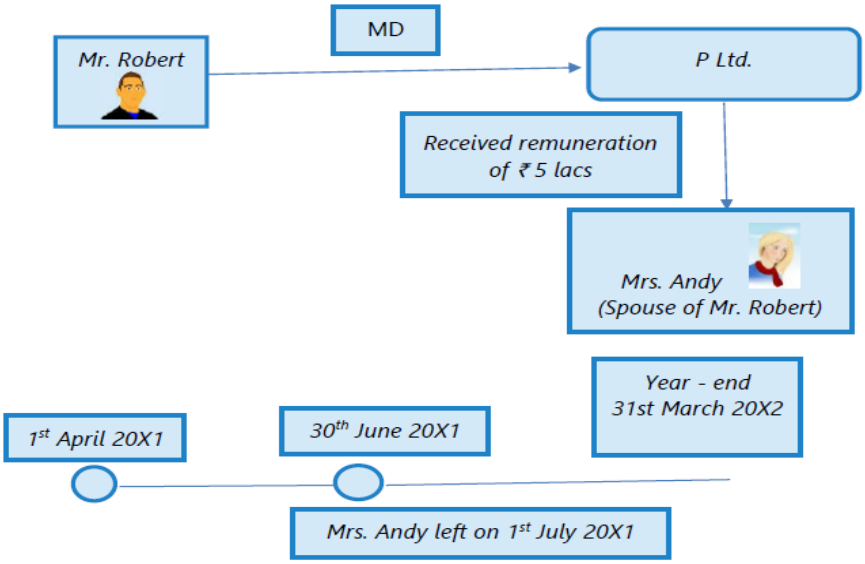


Whether Andy is to be identified as related party at the year-end date (31st March 20X2) for the purposes of AS-18?

Answer 7

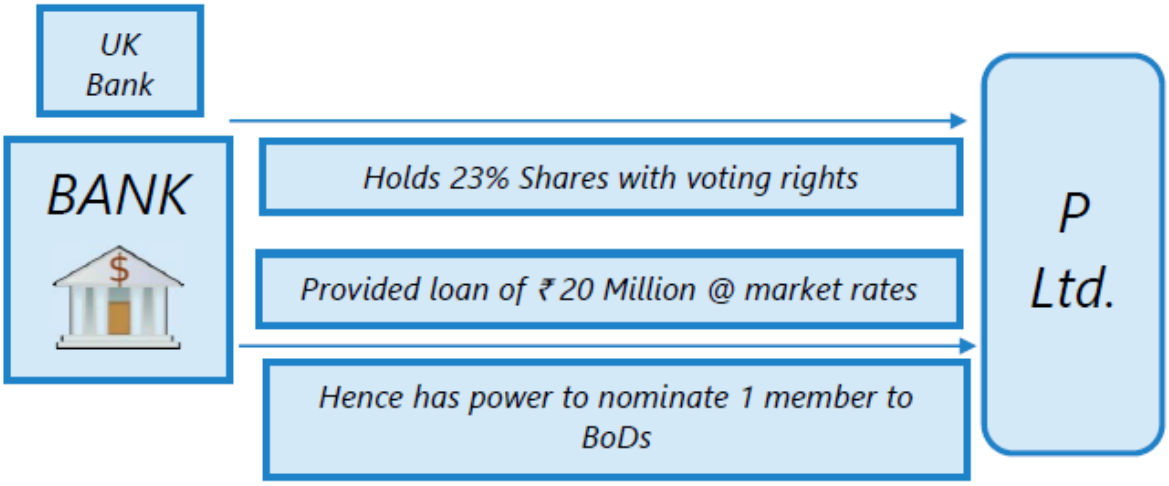
Yes – This is because as per AS-18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

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 (Illustration)

Consider a scenario wherein:

- **UK Bank holds 23% equity shares with voting rights in P Ltd.**
- **The bank has provided a loan of Rs. 20 million to P Ltd. at market interest rate**
- **As per the terms and conditions of the loan agreement, the bank has appointed one person as its**



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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)?

Answer 8

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 (Illustration)

Consider a scenario wherein:

- **P Ltd. hold 22% shares and voting rights in Q Ltd. (and hence Q Ltd. is an associate of P Ltd.)**
- **On 1st April 20X1, P Ltd. sold certain goods to Q Ltd. amounting to Rs. 5 lacs**
- **On 30th June 20X1, P Ltd. sold its entire 22% stake in Q Ltd. (and hence the related party relationship ceased to exist after 30th June 20X1)**
- **However, P Ltd. continued supply goods to Q Ltd. subsequent to 30th June 20X1 (just like any other customer) and sold goods worth Rs. 15 lacs during 9-month period ended 31st March 20X2**
- **Consider 31st March 20X2 as the year-end date for P Ltd.**

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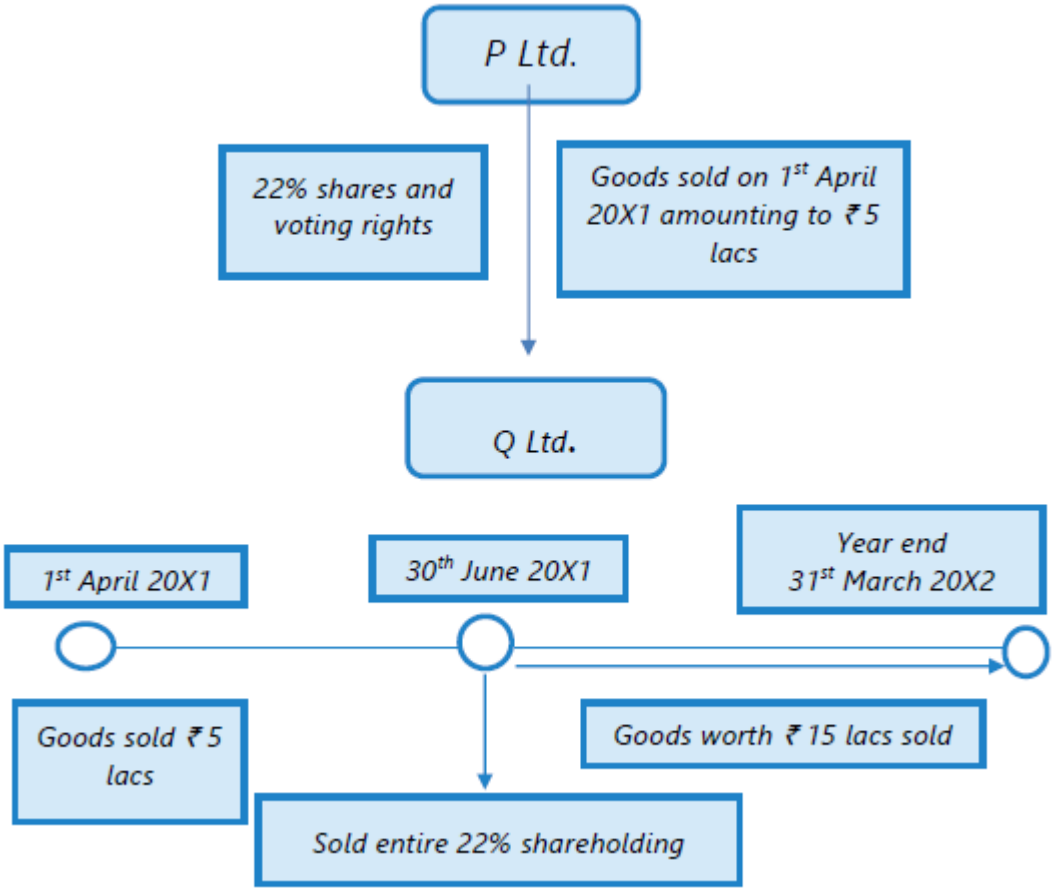

Determine whether the transaction for the entire year (ending on 31st March 20X2) is required to be disclosed under AS-18 as related party transaction

Answer 9

No – This is because as per AS-18, the disclosure requirements under the Standard relate only to the period during related party relationship existed.

Accordingly, only transactions between P Ltd and Q Ltd till 30th June 20X1 (being sale of goods worth Rs. 5 lacs) are required to be reported / disclosed under AS- 18. Transactions entered into after 30th June 20X1 are NOT required to be disclosed under AS-18.

Question 10 (Illustration)

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?

Answer 10

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.

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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.

Test your knowledge

Multiple Choice Questions

1. 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

Ans: (b)

2. Are the following statements in relation to related parties true or false, according to AS-18 Related Party Disclosures?

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)
(a) False	False
(b) False	True
(c) True	False
(d) True	True

Ans: (d)

3. Which of the following is not a related party as envisaged by AS-18 Related Party Disclosures?

(a) A director of the entity
(b) The parent company of the entity
(c) A shareholder of the entity that holds 1% stake in the entity
(d) The spouse of the managing director of the entity

Ans: (c)

4. 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..

(a) True
(b) False

Ans: (b)

5. 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.

(a) True
(b) False

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Ans: (b)

Theoretical Questions Answers

Questions 1

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

Answers 1

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.

Questions 2

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?

Answers 2

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.

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Questions 3

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?

Answers 3

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.

Practical Questions Answers

Question 4

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?

Answer 4

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.

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Question 5

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.

Answer 5

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 6

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.)

Answer 6

Reporting Entity	Related Party
M Ltd.	S Ltd. (subsidiary) F Ltd.(subsidiary)

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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)

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Illustrations:

Question 1 (Illustration)

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.

Answers 1

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
In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

a. Equity shares issued in exchange for cash are included when cash is receivable;
b. Equity shares issued as a result of the conversion of a debt instrument to equity shares are included as of the date of conversion;
c. Equity shares issued in lieu of interest or principal on other financial instruments are included as of the date interest ceases to accrue;
d. Equity shares issued in exchange for the settlement of a liability of the enterprise are included as of the date the settlement becomes effective;
e. Equity shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognized; and
f. Equity shares issued for the rendering of services to the enterprise are included as the services are rendered.

In these and other cases, the timing of the inclusion of equity shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with the issue.

Question 2 (Illustration)

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.

Answers 2

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid,

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number of partly paid equity shares would be taken as 300for 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.

Contingently Issuable Shares

Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

Bonus Issue, Share split and Right issue

Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

a. A bonus issue;
b. A bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;
c. A share split; and
d. A reverse share split (consolidation of shares).

In case of a bonus issue or a share split, 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. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported means along with the impact to current year adjustment, **it will also impact the calculation of EPS of last year retrospectively.**

For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

Question 3 (Illustration)

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.

Answers 3

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

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

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

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.

The issue of equity shares at the time of exercise or conversion of potential equity shares will not usually

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give rise to a bonus element, since the potential equity shares will usually have been issued for full value, resulting in a proportionate change in the resources available to the enterprise. In a rights issue, on the other hand, the exercise price is often less than the fair value of the shares. Therefore, a rights issue usually includes a bonus element.

[Thus, it may be noted that if a company makes a right issue at fair value itself, then there will be no bonus element in the right issue].

The number of equity shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the following adjustment factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex} - \text{rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights.

Question 4 (Illustration)

Net profit for the year 20X1	**₹ 11,00,000**
Net profit for the year 20X2	**₹ 15,00,000**
15,00,000 No. of shares outstanding prior to rights issue	**5,00,000 share**
Rights issue price	**₹ 15.00**
Last date to exercise rights	**1st March 20 X 2**

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.

Answers 4

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

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

Theoretical ex-rights fair value per share = ₹ 20.00

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoreticalex}-\text{rights value per share}} = \frac{(21.00)}{(20.00)} = 1.05$$

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 share EPS = 15,00,000/5,87,500 = 2.55

Question 5 (Illustration)

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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.

Answers 5

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 (Illustration)

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.

Answers 6

Computation of earnings per share

	Earnings ₹	Shares	Earnings/Share ₹
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares duringyear 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would havebeen 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 (Illustration)

X Limited, during the year ended March 31, 20X1, has income from continuing ordinary operations of Rs. 2,40,000, a loss from discontinuing operations of Rs. 3,60,000 and accordingly a net loss of Rs. 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 20X1.

You are required to compute Basic and Diluted EPS?

Answers 7

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

In case there are more than 1 potential equity shares:

In considering whether potential equity shares are dilutive or antidilutive, each issue or series of potential equity shares is considered separately rather than in aggregate. The sequence in which potential equity shares are considered may affect whether or not they are dilutive. Therefore, in order to maximise the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For the purpose of determining the sequence from most dilutive to least dilutive potential equity shares, the earnings per incremental potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

Test your knowledge

Multiple Choice Questions

1. **AB Company Ltd. had 1,00,000 shares of common stock outstanding on January 1. 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**
   (a) 1,40,000 shares
   (b) 1,25,000 shares
   (c) 1,16,667 shares
   (d) 1,20,000 shares

Ans: (c)

2. **As per AS 20, potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would**
   (a) Decrease net profit per share from continuing ordinary operations.
   (b) Increase net profit per share from continuing ordinary operations.
   (c) Make no change in net profit per share from continuing ordinary operations.
   (d) Decrease net loss per share from continuing ordinary operations

Ans: (a)

3. **As per AS 20, equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements are**
   (a) Dilutive potential equity shares
   (b) Contingently issuable shares
   (c) Contractual issued shares
   (d) Potential equity shares

Ans: (b)

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4. **In case potential equity shares have been cancelled during the year, they should be:**
   (a) Ignored for computation of Diluted EPS.
   (b) Considered from the beginning of the year till the date they are cancelled.
   (c) The company needs to make an accounting policy and can follow the treatment in (a) or (b) as it decides.
   (d) Considered for computation of diluted EPS only if the impact of such potential equity shares would be material.

Ans: (b)

5. **Partly paid up equity shares are:**
   (a) Always considered as a part of Basic EPS.
   (b) Always considered as a part of Diluted EPS.
   (c) 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.
   (d) Considered as part of Basic/ Diluted EPS depending on the accounting policy of the company.

Ans: (c)

Theoretical Questions Answers

Questions 1

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.

Answers 1

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.

Questions 2

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

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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.

Answers 2

As per AS 20 "A potential equity share is a financial instrument or othercontract 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, forthe purpose of calculating diluted earnings per share, the net profit or lossfor 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 notin 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. Theoptions 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.

Questions 3

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?

Answers 3

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.

Practical Questions Answers

Questions 4

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 Rs. 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 Rs. 1 each at their full market price of Rs. 7.60 per share.

NAT's shares were trading at Rs. 8.05 per share on 31st March, 20X2.

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Further it has been provided that the basic earnings per share for the year ended 31st March, 20X1 was previously reported at Rs. 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?**

Answers 4

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 +Bonusissue)

= ₹ 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.

Questions 5

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

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		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**

Answers 5

Computation of Basic Earnings Per Share (as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 20X1₹	**Year 20X2 ₹**
EPS for the year 20X1 as originally reported $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity share outstanding during the year}}$ = (₹20,00,000 / 10,00,000 shares) EPS for the year 20X1 restated for rights issue	2.00	
= [₹20,00,000 / (10,00,000 shares × 1.04*)] EPS for the year 20X2 including effects of rights issue	1.91 (approx.)	
$\frac{₹30,00,000}{(10,00,000 \text{ share} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$ $\frac{₹30,00,000}{11,97,500 \text{ shares}}$		2.51 (approx.)

Working Notes:

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

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

$$= \frac{(₹25 \times 10,00,000\ shares) + (₹\ 20 \times 2,50,000\ shares)}{10,000\ share + 2,50,000\ shares} = \frac{₹\ 3,00,00,000}{12,50,000\ shares} = ₹\ 24$$

2. Computation of adjustment factor

$$= \frac{\textit{Fair value per share prior to exercise of rights}}{\textit{Theoretical exrights value per share}}$$

$$= \frac{₹\ 25}{₹\ 24(\textit{Refer Working Note } 1)} = 1.04(\text{approx.})$$

Questions 6

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 31 st March, 20X2 as per Accounting Standard 20 "Earnings Per Share".

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Answers 6

Basic Earnings per share (EPS) =

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

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

Refer working note 2.

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 becalculated 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

Questions 7

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.

Answers 7

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 8

Following information is supplied by K Ltd.

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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 – 20X2.
Fair value of one equity share immediately prior to exercise of right on 30-06-20X2 is ₹102.
Net profit to Equity share holders:
20X1 -20X2 - ₹50,00,000
20X2 – 20X3 - ₹75,00,000
You are required to calculate the basic earning per share as per AS-20 Earning per share.

Answer8

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

$$\frac{102\ X\ 2{,}50{,}000\ Shares + ₹98\ X\ 1{,}00{,}000\ shares}{3{,}50{,}000\ Shares}$$

Theoretical ex-rights fair value per share = ₹100.86

Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex} - \text{rights value per share}} = 102/100.86 = 1.01$$

Computation of earnings per share:

EPS for the year 20X1-X2 as originally reported : ₹50,00,000 /2,50,000 shares = ₹20

EPS for the year 20X1-X2 restated for right issue: = ₹50,00,000 / (2,50,000 shares X1.01)
= ₹19.80

EPS for the year 20X2 -X3 including effect of rights issue:

EPS = 75,00,000 /3,25,625 = ₹23.03

(2,50,000 x 1.01 X 3/12) + (3,50,000 X9/12) = 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.

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Test your knowledge

Multiple Choice Questions

1. AB decided to dispose of its Clothing division as part of its long-term strategy.
(a) Date of Board approval - 1st March 20X1;
(b) Date of formal announcement made to affected parties - 15th March 20X1.
(c) Date of Binding Sale agreement – 1st July 20X1;
(d) 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
Ans: (b)

2. To qualify as a component that can be distinguished operationally and for financial reporting purposes, the condition(s) to be met is (are):
(a) The operating assets and liabilities of the component can be directly attributed to it.
(b) Its revenue can be directly attributed to it.
(c) At least a majority of its operating expenses can be directly attributed to it.
(d) All of the above
Ans: (d)

3. Identify which of the following statements is incorrect?
(a) A discontinuing operation is a component of an enterprise that representsa separate major line of business or geographical area of operations.
(b) A discontinuing operation is a component of an enterprise that can be distinguished operationally and for financial reporting purposes.
(c) A discontinuing operation is a component of an enterprise that may ormay not be distinguished operationally and for financial reporting purposes.
(d) A discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.
Ans: (c)

4. Identify the incorrect statement.
(a) Discontinuing operations are infrequent events, but this does not meanthat all infrequent events are discontinuing operations.

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(b) 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.

(c) For recognising and measuring the effect of discontinuing operations, AS 24 does not provide any guidelines, but for the purpose the relevantAccounting Standards should be referred.

(d) 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.

Ans: (b)

Theoretical Questions Answers

Question 1

(ii) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(iii) 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 1

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

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

(b) Discontinuing, even if relatively abruptly, several products withinan ongoing line of business;

(c) Shifting of some production or marketing activities for a particularline 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 2

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 reportingperiod, and the income tax expense related thereto.

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(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.

Practical Questions Answers

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 tosell the assets of the passenger car division in a phased but time bound manner?

Answer 3

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

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

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

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

iii) terminating through abandonment; and

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

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

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

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

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

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

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

(ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer 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.

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(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 4

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

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

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

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24?

Answer 4

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 discontinuation and made an announcement of the plan.

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Illustrations:

Question 1 (Illustration)

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.

Answers 1

Particulars	**(₹ In crores)**	
Result of first quarter ended 30th June, 20X1		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories		Nil
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

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

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Question 2 (Illustration)

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.

Answers 2

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 (Illustration)

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.

Answers 3

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 (Illustration)

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:

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	₹ 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 4

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.

Test your knowledge

Multiple Choice Questions

1. AS 25 mandates the following in relation to interim financial reports.

(a) which entities should publish interim financial reports.

(b) how frequently it should publish interim financial reports.

(c) how soon it should publish after the end of interim period.

(d) none of the above.

Ans: (d)

2. The standard defines Interim Financial Report as a financial report for an interim period that contains a set of _____ financial statements.

(a) Complete

(b) Condensed

(c) Financial statement similar to annual

(d) Either complete or condensed

Ans: (d)

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3. 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.

(a) ₹ 17,000
(b) ₹ 30,000
(c) ₹ 2,000
(d) AS 25 does not mandate to report tax expenses

Ans: (a)

4. 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?

(a) ₹1 million
(b) ₹ 2 million
(c) ₹ 1.25 million
(d) ₹ 1.5 million

Ans: (b)

Theoretical Questions Answers

Question 1

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.

Answer 1

As per Accounting Standard 25, Interim reports should include interimfinancial statements (condensed or complete) for periods as given below

Statement	Current period	Comparative period
Balance sheet	End of current interimperiod	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).

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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 2

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?

Answer 2

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.

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Question 3

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?

Answer 3

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 asthose that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interimperiod and the estimate changes in a subsequent interim period of that financialyear, the original estimate is changed in the subsequent interim period either byaccrual of an additional amount of loss or by reversal of the previously recognised amount. In light of the same, the impairment loss recognized in onequarter 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.

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Practical Questions Answers

Question 4

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

Answer 4

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 5

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.

Answer 5

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 6

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.

Answer 6

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

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Weighted average annual income tax rate = $\frac{B}{A} = \frac{3,50,000}{10,00,000}$ = 35%

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

Question 7

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.

Answer 7

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 financialyear. 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

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Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹ (3-2) lakhs	1
	9
Less: Sales promotion expenses (80% of ₹ 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	(8)

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Illustrations:

Question 1 (Illustration)

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.

Answer 1

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 2 (Illustration)

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?

Answer 2

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 3 (Illustration)

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.

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Answer 3

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 $\frac{20,00,000}{2,00,000}$	10	70
		270

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

Question 4 (Illustration)

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

Answer 4

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.

Test your knowledge

Multiple Choice Questions

1. **Which item of inventory is under the scope of AS 2 (Revised)?**
   (a) WIP arising under construction contracts
   (b) Raw materials
   (c) Shares
   (d) Debentures held as stock in trade.

Ans: (b)

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2. **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**
   (a) sold at or above cost.
   (b) sold above cost.
   (c) sold less than cost.
   (d) sold at market value(where market value is more than cost).

Ans: (a)

3. **All of the following costs are excluded while computing value of inventories except?**
   (a) Selling and Distribution costs
   (b) Allocated fixed production overheads based on normal capacity.
   (c) Abnormal wastage
   (d) Storage costs (which is not necessary part of the production process)

Ans: (b)

4. **Identify the statement(s) which is/are incorrect.**
   (a) Storage costs which is a necessary part of the production process isincluded in inventory valuation.
   (b) Administration overheads are never included in inventory valuation.
   (c) Full amount of variable production overheads incurred are included in inventory valuation.
   (d) Administration overheads are always included in inventory valuation.

Ans: (b)

Theoretical Questions Answers

Question 1

"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'.

Answer 1

As per AS 2 (Revised) 'Valuation of Inventories', certain costs are excluded fromthe 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.

Practical Questions Answers

Questions 2

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.

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Answer 2

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 3

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.

Answer 3

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 × cost or NRV whichever is less (₹)
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000

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Finished goods X	1,500	320	300	4,50,000
Value of Inventory				6,24,000

Question 4

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

Answer 4

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 5

Alpha Ltd. Sells flavored milk to customers; some of the customers consume the milk in the shop run by Alpha Limited. While leaving the shop, the consumers leave the empty bottles in the shop and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders.

Keeping this in view:

Decide whether the inventory of empty bottles is an asset of the company;

If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to ₹Other Income' ?

Answer 5

As per the ₹Framework on Presentation and Preparation of Financial Statements':

Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets.

Alpha Ltd. sells these empty bottles by calling tenders. It means further befits are accrued on its sale. Therefore, empty bottles are assets for the company.

As per As 2, inventories are assets held for sale in the ordinary course of business.

Inventory of empty bottles existing on the Balance Sheet date is the inventory and Alpha Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality.

Thus, inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

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Illustrations:

Question 1 (Illustration)

(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.

Answer 1

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.

Question 2 (Illustration)

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?

Answer 2

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 (Illustration)

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

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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.

Answer 3

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 (Illustration) (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?

Answer 4

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 (Illustration)

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.

Answer 5

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.

Question 6 (Illustration)

(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)?

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Answer 6

In the given case, Plant & Machinery is valued at ₹25,00,000, which is assumed tobe 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 (Illustration)

(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?

Answer 7

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

Determination of Cost in special cases:

Cost of an item of PPE is the cash price equivalent at the recognition date.

Question 8 (Illustration)

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?

Answer 8

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 (Illustration)

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?

Answer 9

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.

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Question 10 (Illustration)

(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?

Answer 10

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 (Illustration)

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?

Answer 11

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.

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Question 12 (Illustration)

(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.

Answer 12

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).

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Question 13 (Illustration)

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.

Answer 13

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 (Illustration)(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 14

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 (Illustration) (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 15

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.

Question 16 (Illustration)(Gain on replacement of Insured Assets)

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

Answer 16

Entity A should account for a loss in the Statement of Profit and Loss on de- recognition of the carrying value

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of plant and machinery in accordance with AS 10 (Revised).

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

Test your knowledge

Multiple Choice Questions

1. 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

(a) Costs of site preparation
(b) Costs of relocating
(c) Installation and assembly costs.
(d) initial delivery and handling costs

Ans: (b)

2. As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property.

(a) as per fair value
(b) under discounted cash flow model.
(c) under cost model
(d) under cash flow model

Ans: (c)

3. 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?

(a) Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
(b) Initial upward valuation of ₹ 50,000 credited to P/L. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
(c) Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to Revaluation Reserve.
(d) Initial upward valuation of ₹ 50,000 debited to P/L. Subsequent downward revaluation of ₹ 20,000 credited to P/L.

Ans: (c)

4. 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?

(a) Initial downward valuation of ₹ 10,000 debited to Revaluation Reserve. Subsequent upward revaluation of ₹ 15,000 credited to P/L.
(b) Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 15,000 credited to P/L.
(c) Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 10,000

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credited to P/L and ₹ 5,000 credited to Revaluation Reserve.

(d) 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.

Ans: (c)

5. On sale of an asset which was revalued upwards, what would be the treatment of Revaluation Reserve?

(a) The Revaluation Reserve is credited to P/L since the profit on sale of such asset is now realized.

(b) The Revaluation Reserve is credited to Retained Earnings as a movement in reserves without impacting the P/L.

(c) No change in Revaluation Reserve since profit on sale of such asset is already impacting the P/L.

(d) The Revaluation Reserve is reduced from the asset value to compute profit or loss.

Ans: (b)

6. 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

(a) ₹ 10,000.

(b) ₹ 11,800.

(c) ₹ 9,000.

(d) ₹ 10500

Ans: (a)

Theoretical Questions Answers

Question 1

A company changed its method of depreciation from SLM to WDV. How should the change be recognised?

Answer 1

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.

Question 2

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.

Answer 2

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.

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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 3

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.

Answer 3

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 4

Which factors should be considered by a company while determining useful life?

Answer 4

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 5

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.

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Answer 5

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.

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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.

Practical Questions Answers

Question 6

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.

Answer 6

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)

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Question 7

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).

Answer 7

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 8

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.

Answer 8

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 9

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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?

Answer 9

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 10

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.

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Answer 10

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)	3,75,555
5,63,333 ÷ 6 years x 4 years	
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	95,575	5,04,425

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ratio of carrying amount		
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 11

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%.

Answer 11

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 12

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

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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.

Answer 12

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) [₹ 110 lakhs (–)₹ 60 lakhs (₹ 63 lakhs x 100/105)]	50.00
Cost of Land	**3,269.25**

Question 13

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 15.01.20X1 but was used from 01.02.20X1. 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.

Answer 13

1. 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

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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 15.1.20X1 to 1.2.20X1 to be charged to profit and loss A/c as plant was ready for production on 15.1.20X1.

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Illustrations

Question 1 (Illustration)

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?

Answer 1

As stated in the question that financial statements for the year ended 31st March, 20X1 are still under preparation – The answer has been given on the assumption that the financial statements are yet to be completed and approved by the Board of Directors.

Also, the fall in value of investments has been considered on account of conditions existing on the balance sheet date.

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 (Illustration)

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?

Answer 2

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.

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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.

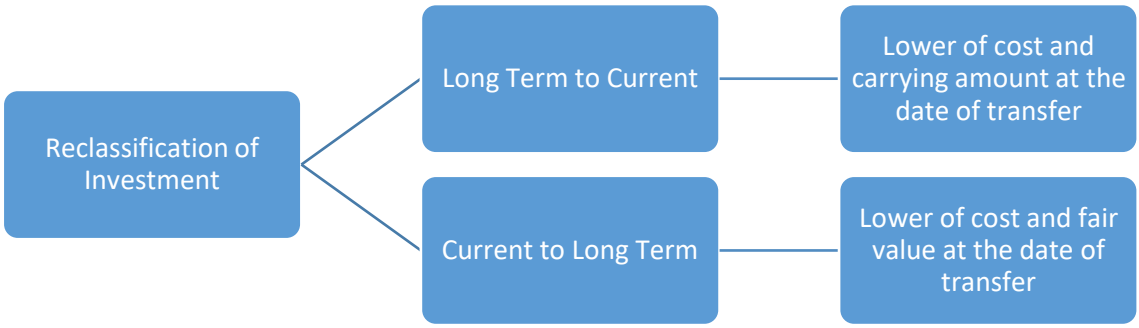
Question 3 (Illustration)

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).



Answer 3

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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 (Illustration)

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"?

Answer 4

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 (Illustration)

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half

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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.

Answer 5

In the books of M/s Bull & Bear Investment Account
for the period from 1st December 20X2 to 1s 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 (Illustration)

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.

Answer 6

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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 (Illustration)

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.

Answer 7

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			

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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 = $\frac{500}{1,000} \times 62,500 = 31,250$
   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 = $\frac{500}{1,000} \times 62,500 = 31,250$

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 (Illustration)

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.

Answer 8

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 $\times \frac{1}{3} \times$ ₹2 = 20,000 to be credited to statement of profit and loss

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4. Rights subscribed = 30,000 shares $\times \frac{2}{3} \times$ ₹15 = 3,00,000

Question 9 (Illustration)

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 31.12.20X1and shares are valued at average cost.

Answer 9

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 on shares acquired on 20/06/20X1) (W.N.4)	—	10,000
20.6.20X1	To Bank	5,000	80,000	15.11.20X1	By Bank (sale of shares)	25,000	3,75,000
16.8.20X1	To Bonus (W.N.1)	5,000		31.12.20X1	By Bal. c/d (W.N.6)	20,000	2,64,444
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				
		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

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	1,04,444		1,04,444

Working Notes:

1. Bonus Shares = $\frac{(25,000+5000)}{6}$ = 5,000 shares
2. Right Shares = $\frac{(25,000+5,000+5,000)}{7}$ × 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 = $\frac{(3,75,000+80,000+1,50,000+10,000)}{45,000}$ × 25,000 = 3,30,556
   Profit = 3,75,000 – 3,30,556 = 44,444
6. Cost of shares on 31.12.20X1 $\frac{(3,75,000+80,000+1,50,000+10,000)}{45,000}$ × 20,000 = 2,64,444

Test your knowledge

Multiple Choice Questions

1. The cost of Right shares is
(a) added to the cost of investments.
(b) subtracted from the cost of investments.
(c) no treatment is required.
(d) added to cost of investments at market value

Ans: (a)

2. Long term investments are carried at
(a) fair value.
(b) cost less 'other than temporary' decline.
(c) Cost and market value whichever is less.
(d) Cost and market value whichever is higher.

Ans: (b)

3. Current investments are carried at
(a) Fair value.
(b) cost.
(c) Cost and fair value, whichever is less.
(d) Cost and fair value, whichever is higher

Ans: (c)

4. 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

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investments at the year- end will be ₹

(a) 2,70,000.
(b) 1,50,000.
(c) 1,20,000.
(d) 1,70,000.

Ans: (a)

5. Cost of investment includes

(a) Purchase costs.
(b) Brokerage and Stamp duty paid.
(c) Both (a) and (b).
(d) none of the above.

Ans: (c)

Theoretical Questions Answers

Question 1

Briefly explain disclosure requirements for Investments as per AS-13.

Answer 1

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 2

How will you classify the investments as per AS 13? Explain in Brief.

Answer 2

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.

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Question 3

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.

Answer 3

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.

Practical Questions Answers

Question 4

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?

Answer 4

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 5

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.

Answer 5

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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

   Bonus Shares = $\frac{15,000\ shares+5,000\ shares}{5} \times 1$ = 4,000 shares

2. Calculation of right shares subscribed

   Right Shares = $\frac{15,000\ shares+5,000\ shares+4,000\ shares}{6}$ = 4,000 shares

   Shares subscribed by XY Ltd. = $\frac{4,000}{2}$ = 2,000 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

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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 6

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.

Answer 6

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						

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		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 7

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.

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Answer 7

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

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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
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 8

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.

Answer 8

Investment Account in Books of Vijay (Scrip: Equity Shares in X Ltd.)

Date	Particulars	No.	Amount ₹	Date	Particulars	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

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2. Right Shares = $\left(\frac{30,000+5,000+5,000}{8}\right) \times 3$ = 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
   Average cost = $\left(\frac{4,,50,000+80,000+1,50,000-10,000}{50,000}\right) \times 20,000$ = ₹ 2,68,000
   Profit = ₹ 3,00,000– ₹ 2,68,000= ₹ 32,000.
7. Cost of shares on 31.3.20X2
   $\left(\frac{4,50,000+80,000+1,50,000-10,000}{50,000}\right) \times 30,000$ = 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 9

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.

Answer 9

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 reclassified 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 10

Gowtham Limited invested in shares of another company (with the intention to hold the shares for short-term period) on 30th November, 2021 at a cost of
₹ 4,25,000. It also earlier purchased Gold of ₹ 8,00,000 and Silver of ₹ 3,50,000 on 31st March, 20X1.

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Market values as on 31st March, 20X4, of the above investments are as follows:

Shares ₹ 3,50,000
Gold ₹ 10,25,000
Silver ₹ 5,10,000

You are required to explain how will the above investments be shown (individually and in total) in the books of account of Gowtham Limited for the year ending 31st March, 20X4 as per the provisions of AS 13.

Answer10

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares

- if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹ 4,25,000) and market value (₹ 3,50,000) as on 31 March 20X4, i.e., ₹ 3,50,000. Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 31st March, 20X1) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 20X4, i.e., ₹ 8,00,000 and ₹3,50,000 respectively, though their market values have been increased.

  Thus the shares, gold and silver will be shown at ₹ 3,50,000, ₹ 8,00,000 and ₹ 3,50,000 respectively and hence, total investment will be valued at ₹ 15,00,000 for the year ending on 31st March, 20X4 as per AS 13.

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Illustrations:

Question 1 (Illustration)

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.

Answer 1

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 (Illustration)

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 1 st 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.

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Answer 2

(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 + 4,50,000 + 1,20,000)	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 (Being amount of cost of building And borrowing cost thereon capitalised)			10,94,189

∗ **(₹ 6,22,500 - ₹ 1,00,000)**

Question 3 (Illustration)

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

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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.

Answer 3

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	** $52.20 \times \frac{406}{580} = 36.54$ ** $52.20 \times \frac{58}{580} = 5.22$	
Advance to supplies for additional assets	Qualifying asset		$52.20 \times \frac{116}{580}$ 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 31 st March, 20X2.

Question 4 (Illustration)

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.

Answer 4

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

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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).

Test your knowledge

Multiple Choice Questions

1. As per AS 16, all the following are qualifying assets except

(a) Manufacturing plants and Power generation facilities
(b) Inventories that require substantial period of time
(c) Assets those are ready for sale.
(d) None of the above

Ans: (c)

2. Which of the following statement is correct:

(a) Entire exchange gain is reduced from the cost of the Qualifying asset.
(b) Entire exchange loss is added to the cost of a Qualifying asset.
(c) No adjustment is done for the exchange loss while computing cost of Qualifying asset.
(d) None of the above

Ans: (c)

3. Capitalization rate considers:

(a) Borrowing costs on general borrowings only.
(b) Borrowing costs on general and specific borrowings both.
(c) Borrowing costs on specific borrowings only
(d) None of the above

Ans: (a)

4. 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.

(a) ₹ 12,000.
(b) ₹ 5,000.
(c) ₹ 7,000.
(d) ₹ 10,000.

Ans: (b)

5. X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

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

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iv) 18th July, 20X1: Construction work commences

Identify the commencement date for capitalisation under AS 16.

(a) 15th May, 20X1	(b) 19th June, 20X1
(c) 18th July, 20X1	(d) 2nd June, 20X1

Ans: (b)

Theoretical Questions Answers

Question 1

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain the provision.

Answer 1

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 2

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.

Answer 2

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 3

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?

Answer 3

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.

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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.

Practical Questions Answers

Question 4

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

	Construction of sealink across two cities:	
(i)	**(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**	**1 crores**
	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.

Answer 4

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 equipment 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)]

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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	

*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 5

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.

Answer 5

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 6

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

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

(₹ in lakhs)

	Phase I	Phase II	Phase III	Phase IV
	₹	₹	₹	₹

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Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phasess				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.

Answer 6

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 = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	13,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment 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 7

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.20X1. 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

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(i) Interest on debentures for the Financial Year 20X1-20X2 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, 20X2 construction of factory building was not completed (it is expected that it will take another 6 months).
(iv) In March 20X2, Machinery was installed and ready for its intended use.
(v) Furniture was put to use at the end of March 20X2.
(vi) Truck is going to be received in April, 20X2.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 20X2 in the Books of Expert Limited.

Answer 7

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

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

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory building	Qualifying Asset	9,50,000x40/100	NIL
		= ₹ 3,80,000	
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

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Illustrations

Question 1 (Illustration)

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

Answer 1

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.

∗ **Minimum Lease Payment of 4th year includes guaranteed residual value amounting ₹ 1,25,000.**

Question 2 (Illustration)

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

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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.

Answer 2

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 (Illustration)

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.

Answer 3

Following will be the treatment in the given cases:

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(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.

Test your knowledge

Multiple Choice Questions

1. 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
(a) A Ltd. should amortise the profit of ₹ 10 lakhs over lease term.
(b) A Ltd. should recognise the profit of ₹ 10 lakhs immediately.
(c) A Ltd. should defer the profit of ₹ 10 lakhs.
(d) B Ltd. should recognise the profit of ₹ 10 lakhs immediately.

Ans: (b)

2. In case of an operating lease – identify which statement is correct:
(a) The lessor continues to show the leased asset in its books of accounts.
(b) The lessor de-recognises the asset from its Balance Sheet.
(c) The lessor discontinues to claim depreciation in its books.
(d) The lessee recognises the asset in its Balance Sheet.

Ans: (a)

3. 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:
(a) Useful life.
(b) Lease term.
(c) Useful life or lease term whichever is less.
(d) Useful life or lease term whichever is higher.

Ans: (c)

4. 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?
(a) Any 1 condition fails.
(b) Majority of the 5 conditions fail.

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(c) All 5 conditions fail.
(d) Any 2 conditions fails.

Ans: (c)

5. The basis of classification of a lease is:

(a) Control Test.
(b) Risk and reward Test.
(c) Both control test and risk and reward test.
(d) Only reward Test

Ans: (b)

Theoretical Questions Answers

Question 1

Explain the types of lease as per AS 19.

Answer 1

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 2

Explain the accounting treatment for a sale and leaseback transaction under Operating lease.

Answer 2

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.

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Question 3

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

Answer 3

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 4

What are the disclosures requirements for operating leases by the lessee as per AS-19?

Answer 4

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.

Practical Questions Answers

Question 5

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".

Answer 5

(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.

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

Question 6

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.

Answer 6

i) Annual lease rent

Total lease rent

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

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

= 1,95,000 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 7

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.

Answer 7

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

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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 8

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.

Answer 8

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

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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 9

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.

Answer 9

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.

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Illustration:

Question 1 (Illustration)

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 amortized 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 1

Journal Entry

		₹	₹
fit and Loss A/c (Prior period item)	Dr.	12,00,000	
ortization A/c	Dr.	2,00,000	
To Know – how A/c*			14,00,000
ing amortization of 7 years t of which amortization of 6 years charged as prior period item)]			

*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.

Question 2 (Illustration)

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 2

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 (Illustration)

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?

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Answer 3

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. 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.

Reference:The students are advised to refer the full text of AS 28 "Intangible Assets" (issued 2002).

Test your knowledge

Multiple Choice Questions

1. Which of the following is not covered within the scope of AS 26?

(a) Intangible assets held-for-sale in the ordinary course of business
(b) Assets arising from employee benefits
(c) (a) & (b) both
(d) Research and development activities

Ans: (c)

2. Intangible asset is recognised if it:

(a) meets the definition of an intangible asset
(b) is probable that future economic benefits will flow
(c) the cost can be measured reliably
(d) meets all of the above parameters

Ans: (d)

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:

(a) Recognise Computer and software as tangible asset
(b) Recognise tangible and intangible separately
(c) Recognise computer and software as intangible asset
(d) Does not recognize the software as an asset.

Ans: (a)

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?

(a) ₹ 2,50,000
(b) ₹ 1,75,000
(c) ₹ 1,66,667
(d) ₹ 1,85,000

Ans: (b)

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Theoretical Questions Answers

Question 1

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 1

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 2

What is the measurement criteria at the time of initial recognition of Intangible assets acquired through separate acquisition?

Answer 2

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 3

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 3

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.

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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 4

Advise the complete accounting treatment for Research and development phase as per AS 26.

Answer 4

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 5

What is meant by Amortization of an Intangible asset. What are the different methods for amortization as per AS 26?

Answer 5

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life. The amortization 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 amortization 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.

Practical Questions Answers

Question 6

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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 6

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 amortized in the ratio of net cash flows arising from the product of Swift Ltd.

Question 7

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 7

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 8

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**

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Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts.

Answer 8

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 harged to P & L A/c.

Question 9

As per provisions of AS-26, how would you deal to the following situations:

(1) ₹ 23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.

(2) During the year 20X1-X2, 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.

Answer 9

As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹ 23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(ii) The company is required to expense the entire amount of ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 20X2 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹ 25,00,000 and it should be recognized as expense

(iv) Expenditure of ₹ 50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

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Illustrations

Question 1 (Illustration)

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.

Answer 1

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 =

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[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 (Illustration)

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.

Answer 2

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 (Illustration)

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.

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Answer 3

Statement Showing Impairment Loss

	(₹in crores)
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\left\lfloor \frac{7\ Crores}{7\ Years} \times 4\ years \right\rfloor$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserveaccount)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10
Less: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\left\lfloor \frac{5.10\ Crores}{3\ Years} \times 4\ years \right\rfloor$	(3.40)
Carrying amount as on 31.03.20X6	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve	
20X4-20X5 & 20X5-20X6=[(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

Question 4 (Illustration)

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?

Answer 4

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

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	(₹ 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

Test your knowledge

Multiple Choice Questions

1. 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:

(a) No further action is required and the company can continue the asset in the books at the book value itself.

(b) The entity should review the remaining useful life, scrap value and method of depreciation and amortization for the purposes of AS 10.

(c) The entity can follow either (a) or (b).

(d) The entity should review the scrap value and method of depreciation and amortization for the purposes of AS 10.

Ans: (b)

2. In case Goodwill appears in the Balance Sheet of an entity, the following is true:

(a) Apply Bottom up test if goodwill cannot be allocated to CGU (cash generating unit) under review.

(b) Apply Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.

(c) Apply both Bottom up test and Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.

(d) Apply either Bottom up test or Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.

Ans: (c)

3. In case of Corporate assets in the Balance Sheet of an entity, the following is true:

(a) Apply Bottom up test if corporate assets cannot be allocated to CGU (cash generating unit) under review.

(b) Apply Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.

(c) Apply both Bottom up test and Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.

(d) Apply either Bottom up test or Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.

Ans: (c)

4. In case of reversal of impairment loss, which statement is true:

(a) Goodwill written off can never be reversed.

(b) Goodwill written off can be reversed without any conditions to be met.

(c) Goodwill written off can be reversed only if certain conditions are met.

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(d) Goodwill written off can be reversed.

Ans: (c)

Theoretical Questions Answers

Question 1

Write short note on impairment of asset and its application to inventory.

Answer 1

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.

Practical Questions Answers

Question 2

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?

Answer 2

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 3

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

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Answer 3

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 impairmentloss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

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

∗ **Net selling price** is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, net selling price = Selling Price - Cost of disposal = Nil - ₹ 70,000 = (₹ 70,000)

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

Question 4

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.

Answer 4

(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	

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Asset less depreciation	500
Less: Impairment loss	(100)
	400

Question 5

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.

Answer 5

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 6

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**

Answer 6

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

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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 7

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?

Answer 7

As per AS 28 "Impairment of Assets", if the recoverable amount 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	

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loss account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value andEstimated 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

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Illustrations

Question 1 (Illustration)

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?

Answer 1

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 tobe considered to determine the nature of a 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 (Illustration)

Whether an enterprise is required to provide for employee benefits arising from informal practices?

Answer 2

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 providefor 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

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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 (Illustration)

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.

Answer 3

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 (Illustration)

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.

Answer 4

Paragraph 7.2 of the Standard defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months afterthe 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 periodin 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 "expectedto 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 duringthe 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

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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 bedetermined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordancewith 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 (Illustration)

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.

Answer 5

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 thecost of such benefit the probability of the employee availing such benefit shouldbe considered.

Question 6 (Illustration)

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.

Answer 6

According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as incomeor expense. Therefore, surplus amount of ₹6 lakhs is required to be credited tothe profit and loss statement of the current year.

Question 7 (Illustration)

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)

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Expected Rate of Return	**10.25**

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

Answer 7

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 effectto rate of return.

Question 8 (Illustration)

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.

Answer 8

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 estimatedas under:

	₹
Reduced gross obligation (90% of ₹6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300

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Less: Unamortised past service cost (90% of ₹180)	(162)
Liability to be recognised in the balance sheet	138

Question 9 (Illustration)

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 get5 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)

Answer 9

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 companyevery year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years]	Discounting @8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interestcost	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.

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Multiple Choice Questions

1. **Gratuity and Pension would be examples of:**
   (a) Short-term employee benefits
   (b) Long-term employee benefits
   (c) Post-employment benefits.
   (d) None of the above.

Ans: (c)

2. **Non-accumulating compensating absence is commonly referred to as:**
   (a) Earned Leave
   (b) Sick Leave
   (c) Casual leave
   (d) All of the above

Ans: (c)

3. **The plans that are established by legislation to cover all enterprises and are operated by Governments include:**
   (a) Multi-Employer plans
   (b) State plans
   (c) Insured Benefits
   (d) Employee benefit plan

Ans: (b)

4. **Best estimates of the variable to determine the eventual cost of post- employment benefits is referred to as:**
   (a) Employer's contribution
   (b) Actuarial assumptions
   (c) Cost to Company
   (d) Employee's contribution

Ans: (b)

5. **Actuarial gains / losses should be:**
   (a) Recognized through reserves
   (b) Charged over the expected life of employees
   (c) Charged immediately to Profit and Loss Statement
   (d) Do not charged to Profit and Loss Statement

Ans: (c)

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Theoretical Questions Answers

Question 1

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

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Answer 1

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 byan employer to pay for medical care of its employees), paid annualleave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medicalcare, 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-employmentmedical 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 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 foremployee benefits.

Practical Questions Answers

Question 2

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

The company's contentions in this matter are:

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

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

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

Answer 2

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 Companythat 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 tobe 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

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(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 accountingfor settlement allowances.

Question 3

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: (New SM)

- 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 3

	₹
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 4

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect ofemployee 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 31st March,20X2, as per AS 15.

Answer 4

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, asper 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

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Less: Fair value of Plan Assets as on 1st April 20X1	(2,00,000)	
Add: Contribution received as on 30th September, 20X1	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 20X1		25,000
Actual returns on Plan Assets as on 31st March, 20X2		70,000

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Illustrations

Question 1 (Illustration)

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 1

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

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To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 X 10 + ₹ 72,000 X 5) as contingent liability.

Question 2 (Illustration)

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 2

(i) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and also disclosed as a contingent liability of ₹ 2.10 crore.

(ii) The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

Test your knowledge

Multiple Choice Questions

1. Which of the following best describes a provision?

(a) A provision is a liability of uncertain timing or amount.
(b) A provision is a possible obligation of uncertain timing.
(c) A provision is a credit balance set up to offset a contingent asset so thatthe effect on the statement of financial position is nil.
(d) A provision is a possible obligation of uncertain amount.

Ans:(a)

2. 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 1 st 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?

(a) A charge of ₹ 5,000
(b) A credit of ₹ 5,000
(c) A charge of ₹ 20,000
(d) A credit of ₹ 25,000

Ans:(b)

3. 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"

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(a) A provision
(b) A current liability
(c) A contingent liability
(d) Deferred tax liability

Ans:(c)

4. 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.?

(a) Create a Provision of ₹ 5,50,000
(b) Make a Disclosure of a contingent liability of ₹ 5,50,000
(c) Create a Provision of ₹ 50,000 and make a disclosure of contingentliability of ₹ 5,00,000
(d) Create a Provision of ₹ 5,00,000

Ans:(c)

Theoretical Questions Answers

Question 1

When should provision be recognized as per provisions of AS 29? Explain in brief.

Answer 1

A provision should be recognized 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.

Practical Questions

Questions 2

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 2

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that SunLtd. 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.

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(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.

Questions 3

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31 st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

Answer 3

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 4

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.

(i) Less than 1 year: 2% provision **(ii) More than 1 year: 3% provision** **(iii) The company has raised invoices as under :**	
Invoice Date	**Amount (₹)**
11th Feb, 20X0	**60,000**
25th Dec, 20X0	**40,000**
04th Oct, 20X1	**1,35,000**

Calculate the provision to be made for warranty under AS-29 as at 31st March, 20X1 and 31st March, 20X2. Also compute amount to be debited to P & L account for the year ended 31st March, 20X2.

Answer 4

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 20X1 = ₹ 60,000 x .02 + ₹ 40,000 x .03
= ₹ 1,200 + ₹ 1,200 = ₹ 2,400

As at 31st March, 20X2 = ₹ 40,000 x .02 + ₹ 1,35,000 x .03
= ₹ 800 + ₹ 4,050 = ₹ 4,850

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Amount debited to Profit and Loss Account for year ended 31st March, 20X2

	₹
Balance of provision required as on 31.03.20X2	4,850
Less: Opening Balance as on 1.4.20X1	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31st March, 20X2 in respect of sales amounting ₹ 60,000 made on 11th February, 20X0 as the warranty period of 2 years has already expired.

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Illustrations

Question 1 (Illustration)

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.

Answer 1

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

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

Question 2 (Illustration)

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.

Answer 2

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 recognized 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.

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Question 3 (Illustration)

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.

Answer 3

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 finalization of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 20X1.

Question 4 (Illustration)

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.

Answer 4

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 (Illustration)

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.

Answer 5

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

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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 (Illustration)

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?

Answer 6

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 (Illustration)

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?

Answer: 7

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.

Test your knowledge

Multiple Choice Questions

1. **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.**
   (a) An Adjusting event.
   (b) Non-adjusting event.
   (c) Contingency.

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(d) Provision

Ans: (a)

2. As per Accounting Standards, events occurring after the balance sheet date are

(a) Only favorable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.

(b) Only unfavorable events that occur between the balance sheet date and the date when the financial statements are approved by the Board of directors.

(c) Those 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.

(d) Those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are not approved by the Board of directors.

Ans: (c)

3. AS 4 does not apply to

(a) Obligation under retirement benefit plans.

(b) Commitments arising from long term lease contracts

(c) liabilities of life assurance and general insurance enterprises arising from policies issued

(d) all of the above

Ans: (d)

4. 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

(a) The company should record the sale.

(b) The company should recognise the profit of ₹ 20 lakhs in its profit and loss account.

(c) Both (a) and (b).

(d) The company should disclose the profit of ₹ 20 lakhs in notes to accounts.

Ans: (c)

Practical Questions

Question 1

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 1

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 2

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

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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 2

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.

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Illustrations

Question 1 (Illustration)

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.

Answer 1

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 (Illustration)

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?

Answer 2

No. payment of tax cannot be recognized as an extraordinary item.

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

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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 3 (Illustration)

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.

Answer 3

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. 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 4 (Illustration)

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

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

Answer 4

(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

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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 1.10.20X1 to 31.3.20X2 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 5 (Illustration)

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.

Answer 5

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 6 (Illustration)

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

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

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

Answer 6

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.

Test your Knowledge

Multiple Choice Questions

1. A change in the estimated life of the asset, which necessitates adjustment in the depreciation is an example of

(a) Prior period item.

(b) Ordinary item.

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(c) Extraordinary item.
(d) Change in accounting estimate.

Ans: (d)

2. Which of the following is considered as an extraordinary item as per AS 5?
(a) Write down or write-off of receivables, inventory and intangible assets.
(b) Gains and losses from sale or abandonment of equipment used in a business.
(c) Effects of a strike, including those against competitors and major suppliers.
(d) Flood damage from unusually heavy rain or a normally dry environment.

Ans: (d)

3. Which one of the following is an example of extraordinary item?
(a) The write down of inventories to their net realisable value
(b) Reversal of write down of inventories
(c) Government grants become refundable
(d) Reversal of provisions.

Ans: (c)

4. Extraordinary items are income or expenses
(a) That arise from events clearly distinct from the ordinary activities of the enterprise.
(b) That are not expected to recur frequently or regularly.
(c) Both (a) and (b).
(d) None of the three.

Ans: (c)

5. 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
(a) It is not a prior period item and no separate disclosure is required
(b) It should be treated as a prior period adjustment and should be separately disclosed in the current year's financial statement
(c) The adjustment of ₹ 5 lakhs in both opening stock of current year and profit brought forward from previous year should be made
(d) Both (b) and (c).

Ans: (d)

Practical Questions

Questions 1

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 1

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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 recurfrequently 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.

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Illustrations:

Question 1 (Illustration)

Classify the following items as monetary or non-monetary item:
Inventories
Trade Receivables
Investment in Equity shares
Property, Plant and Equipment.

Answer 1

Inventories	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Property, Plant and Equipment	Non-monetary

Question 2 (Illustration)

	Exchange Rate per $
Goods purchased on 1.1.20X1 for US $ 15,000	**RS 75**
Exchange rate on 31.3.20X1	**RS 74**
Date of actual payment 7.7.20X1	**RS 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.

Answer 2

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 (Illustration)

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:

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01/01/20X1 1 US$ = ₹ 48.00
31/03/20X1 1 US$ = ₹ 49.00
31/07/20X1 1 US$ = ₹ 49.50

Answer 3

Journal Entries in the Books of Kalim Ltd.

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1			216,00,000	
Jan. 01	Bank Account (4,50,000 x 48)	Dr.		
	To Foreign Loan Account			216,00,000
Mar. 31	Foreign Exchange Difference Account	Dr.	4,50,000	
	To Foreign Loan Account [4,50,000 x (49-48)]			4,50,000
Jul. 01	Foreign Exchange Difference Account (P/L) [4,50,000 x (49.5-49)]	Dr.	2,25,000	
	Foreign Loan Account	Dr.	220,50,000	
	To Bank Account			2,22,75,000

Question 4 (Illustration)

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.?

Answer 4

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 (Illustration)

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.

Answer 5

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

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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 (Illustration)

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.

Answer 6

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 (Illustration)

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**	

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Debtors	**1,600**	
Opening Stock	**400**	
Goods received from Head Office Account	**6,100**	
(Recorded in HO books as ₹ 4,02,000)		
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**

Answer 7

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

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	₹ (Dr.)	₹ (Cr.)
			Transaction date		
Machinery	5,000		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 (Illustration)

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.

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You are required to state, how these transactions would be accounted for.

Answer 8

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 = $\frac{3{,}000\ lakhs}{40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars = (42.50 – 40.00) = ₹187.50 lakhs (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

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 (Illustration)

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.

Answer 9

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

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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	Bank Account (10,000 x 48) Dr.		
Apr. 01	To Foreign Loan Account	4,80,000	
	Finance Cost (USD 10,000 x 5% x ₹ 51)		4,80,000
Mar 31	To Bank Account	25,500	
	Foreign Exchange Difference Account Dr.		25,500
Mar 31	To Foreign Loan Account [10,000 x (51-48)]	30,000	
	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA) Dr.		30,000
Mar 31	To Foreign Exchange Difference Account	30,000	
			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.

Test your knowledge

Multiple Choice Questions

1. As per AS 11 assets and liabilities of non-integral foreign operations shouldbe converted at rate
(a) Opening
(b) Average
(c) Closing
(d) Transaction

Ans: (c)

2. The debit or credit balance of "Foreign Currency Monetary Item Translation Difference Account"
(a) Is shown as "Miscellaneous Expenditure" in the Balance Sheet
(b) Is shown under "Reserves and Surplus" as a separate line item
(c) Is shown as "Other Non-current" in the Balance Sheet

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(d) Is shown as "Current Assets" in the Balance Sheet

Ans: (b)

3. If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset is translated at

(a) Average exchange rate
(b) Closing exchange rate
(c) Exchange rate at the date of purchase of asset
(d) Opening exchange rate

Ans: (c)

4. Which of the following can be classified as an integral foreign operation?

(a) Branch office serving as an extension of the head office in terms of operations
(b) Independent subsidiary of the parent company
(c) Branch office independent of the head office in terms of operational decisions
(d) None of the above

Ans: (a)

5. Which of the following items should be converted to closing rate for the purposes of financial reporting?

(a) Items of Property, Plant and Equipment
(b) Inventory
(c) Trade Payables, Trade Receivables and Foreign Currency Borrowings
(d) All of the above

Ans: (c)

Theoretical Questions Answers

Question 1

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date?

Answer 1

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 2

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Answer 2

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.

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Practical Questions Answers

Question 3

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 3

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)		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.

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Illustrations

Question 1 (Illustration)

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 deferred tax asset/liability should be recognised as transition adjustment? Tax rate 50%.

Answer 1

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
Unamortized preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

Question 2 (Illustration)

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%

Answer 2

Tax as per accounting profit 6,00,000 X 20% = ₹ 1,20,000

Tax as per Income-tax Profit 60,000 X 20% = ₹ 12,000

Tax as per MAT 3,50,000 X 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

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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 (Illustration)

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.

Answer 3

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 (Illustration)

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.

Answer 4

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

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	48,00,000	48,00,000				

Test your knowledge

MCQ'S

1. As per AS 22 on 'Accounting for Taxes on Income', tax expense is

(a) Current tax + deferred tax charged to profit and loss account
(b) Current tax-deferred tax credited to profit and loss account
(c) Either (a) or (b)
(d) Deferred tax charged to profit and loss account

Ans: (c)

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 transitionadjustment when the tax rate is 50%?

(a) Deferred Tax asset = ₹ 2,70,000.
(b) Deferred Tax asset = ₹ 1,35,000.
(c) Deferred Tax Liability = ₹ 2,70,000
(d) Deferred Tax Liability = ₹ 1,35,000.

Ans: (d)

3. State which of the followings statements are correct:

(1) There are no pre-conditions required to recognize deferred tax liability,
(2) Deferred tax asset under all circumstances can only be created if andonly if there is reasonable certainty that future taxable income will arise.

(a) Both are correct.
(b) Only (1) is correct.
(c) Only (2) is correct.
(d) None of the statements are correct.

Ans: (a)

4. Which of the following statement are incorrect:

(a) Only timing differences result in creation of deferred tax.
(b) Permanent differences do not result in recognition of deferred tax.
(c) The tax rate used for measurement of deferred tax is substantively enacted tax rate.
(d) 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.

Ans: (d)

Theoretical Questions Answers

Question 1

Write short note on Timing differences and Permanent differences as per AS 22.

Answer 1

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

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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.

Practical Questions Answers

Question 2

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 resulting in a tax liability in year 1 and 2 is ₹ 200 lakhs and ₹ 400 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 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 2

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 3

Ultra Ltd. has provided the following information:

Depreciation as per accounting records =₹ 4,00,000 Depreciation as per tax records =₹ 10,00,000

Unamortized preliminary expenses as per tax record = ₹ 30,000 There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

Answer 3

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

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Question 4

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 4

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 5

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 5

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:

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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
AccountingIncome	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 canbe realized.

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 recognize DTA of ₹ 0.8 Crores and company should recogniseonly current tax liability of ₹0.8 Crores.

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Illustrations

Questions 1 (Illustration)

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?

Answer 1

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.

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Question 2 (Illustration)

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.

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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.

Answer 2

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%)	0.30 crore
[1.20 crore x 25%]	
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 (Illustration)

(Percentage completion method)

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

Answer 3

Profit & Loss Account

Year		₹000	Year		₹ 000
20X1-X2	To Construction Costs (for 45%work)	81	20X1-X2	By Contract Price (45% of ContractPrice)	90
	To Net profit	9			
	(for 45% work)				
		90			90
20X2-X3	To Construction Costs (for 55% work)	89	20X2-X3	By Contract Price (55% of Contract Price)	110
	To Net Profit	21			
	(for 55% work)				
		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

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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 ifthe outcome of a construction contract cannot be estimated reliably. In such cases:

(a) revenue should be recognized only to the extent of contract costs incurredof which recovery is probable; and

(b) contract costs should be recognized as an expense in the period in whichthey are incurred.

An expected loss on the construction contract should be recognized as an expense immediately in accordance with paragraph 35.

Question 4 (Illustration)

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.

Answer 4

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 (Illustration)

(Stage of completion for a loss-making contract)

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).

Answer 5

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		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)	-	-
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	390	By Contract Price	360
To Provision for loss	20	By Net Loss	50
	410		410

Profit & Loss A/c (Year 2)

	₹		₹
To Construction costs	260	By Contract Price	240
		By Reversal of Provision for loss	20
	260		260

Question 6 (Illustration)

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.

Answer 6

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		(₹ in lakhs)
(a)	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.

		(₹ in lakhs)
(b)	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) 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

Question 7 (Illustration)

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)?

Answer 7

	₹
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)

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Total foreseeable loss	12,00,000

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

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

Proportion of total contract value recognized as turnover:

= 67% of Rs. 85,00,000 = Rs. 56,95,000

The amount of expected will be split as under:

Particular	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 – 8,40,000	3,96,000

Test your knowledge

Multiple Choice Questions (MCQ)

The below information relates to Questions 1 – 3:

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.

1. Revenue to be recognized by XY Ltd. for the year ended 31st March 20X2 is

(a) ₹ 28 lakh
(b) ₹ 42 lakh
(c) ₹ 30 lakh
(d) ₹ 32 lakh

Ans: (a)

2. Total expense to be recognised in Year 1 is

(a) ₹ 30 lakh
(b) ₹ 120 lakh
(c) ₹ 38 lakh
(d) ₹ 36 lakh

Ans: (c)

3. Revenue to be recognised for year 2 is

(a) ₹ 84 lakh
(b) ₹ 42 lakh
(c) ₹ 56 lakh
(d) ₹ 28 lakh

Ans: (c)

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Below information relates to Questions 4 – 5

ddM/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. The revenue to be recognised based on the certified work completed.

4. Revenue to be recognized by M/s AV is

(a) ₹ 320 lakh
(b) ₹ 370 lakh
(c) ₹ 360 lakh
(d) ₹ 400 lakh

Ans: (a)

5. Total expense to be recognized by M/s AV is

(a) ₹ 360 lakh
(b) ₹ 400 lakh
(c) ₹ 320 lakh
(d) ₹ 360 lakh

Ans: (d)

6. 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 ₹ 100lakh. 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:

(a) ₹ 40 lakh
(b) ₹ 10 lakh
(c) ₹ 90 lakh
(d) ₹ 50 lakh

Ans: (b)

Theory Questions

Question 1

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.

Answer 1

Usually, construction contracts are long term nature i.e., the contracts areentered 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

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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 2

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?

Answer 2

The contractor's view is not entirely correct in considering the variation as apart of contract revenue. There is an argument that he has been able tocomplete 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.

Practical Questions

Question 3

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

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

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

****Excludes ₹ 100 lacs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer.**

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

Answer 3

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	Recognized in previous	Recognized in current year

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	date	years	
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8050 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 up-to 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 4

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

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

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

Answer 4

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

	Cost of Construction	₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.20X2	2,00,000	38,00,000

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	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred up-to 31.03.20X2		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 – 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 – 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

Questions 5

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.

Answer 5

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

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Question 6

On 1st December, 20X1, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 20X2, 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, 20X2 as per provisions of AS-7?

Answer 6

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

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) × 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 20X2 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.

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Illustrations

Questions 1 (Illustration)

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 orderswere 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?

Answer 1

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 thefood 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.

Questions 2 (Illustration)

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 collectthe amount from CD due to poor financial conditions. Explain how the recognition of revenue be done by AB?

Answer 2

In the above case, AB should not recognize any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognized by AB on 5th of May 20X1. The

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inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Questions 3 (Illustration)

AB sells goods to CD on 1st January 20X1 for ₹ 2 lakhs. After the sale was made, CDis 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 andhas 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?

Answer 3

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 booka loss in his books.

Accounting in the books of AB

1st January 20X1

CD A/c (Receivables)	Dr.	₹ 2 lakhs	
To Revenue A/c (Being goods sold to CD Ltd)			₹ 2 lakhs

15th March 20X1

Bad Debts A/c	Dr.	₹ 2 lakhs	
To CD A/c (Receivables)A/c (Being receivables from CD written off due to its liquidation)			₹ 2 lakhs

Questions 4 (Illustration)

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 wasproposed on 10th April, 20X1.

Whether the above treatment is as per the relevant Accounting Standard?

Answer 4

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'.

Questions 5 (Illustration)

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20X1-X2. Youare required to state whether and on what basis these revenues can be recognizedby X Ltd.

Answer 5

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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.

Questions 6 (Illustration)

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 for20X1-20X2.Advise.

Answer 6

Price revision was affected 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 7 (Illustration)

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 ended31st March, 20X3.

Answer 7

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 againsta 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 5states 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 amountof such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

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Test your knowledge

Multiple Choice Questions

1. **Which of the conditions mentioned below must be met to recognize revenuefrom the sale of goods?**
   (i) the entity selling does not retain any continuing influence or controlover 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.
   (a) (i), (ii) and (v)
   (b) (ii), (iii) and (iv)
   (c) (i), (iii) and (v)
   (d) (i), (iv) and (v)

Ans: (a)

2. **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?**
   (a) Manufacturer cannot require the dealer to return the inventory
   (b) Dealer has the right to return the inventory
   (c) Manufacture is responsible for the pricing of goods and any changes inthe pricing can only be approved by the manufacturer.
   (d) Manufacture is responsible for the holding the goods and any changesin the pricing can only be approved by the dealer

Ans: (c)

3. **Which of the following transactions qualify as revenue for M/s AB Enterprises?**
   (a) Sales of ₹ 20 lakhs made under consignment sales.
   (b) Sale of an old machine amounting ₹ 5 lakhs
   (c) Services provided to the customer in the normal course of business. Sales recorded is ₹ 50,000.
   (d) Sales of ₹ 25 lakhs made under consignment sales

Ans: (c)

4. **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:
   (a) ₹ 5,25,000
   (b) ₹ 5,10,000
   (c) ₹ 5,00,000
   (d) ₹ 5,15,000

Ans: (c)

5. **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**

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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

(a) ₹ 100
(b) ₹ 1,200
(c) Nil
(d) ₹ 1,100

Ans: (b)

Practical Questions Answers

Questions 1

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 arein 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?

Answer 1

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 receivedfrom the goods' damage or destruction will be repaid to GH. Further, thelegal title does not pass until the goods arrive at the customer's premises.

Question 2

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.

Answer 2

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

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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 total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus ₹ 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.

Questions 3

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. Machine2 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 theyear ended 31st March 20X1?

Answer 3

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. Assumingthat there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for theyear ending 31 March 20X1.

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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 cannotbe 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 4

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 20X1-X2 the company wants to recognize the entire interest receivable. Do you agree?

Answer 4

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.

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Illustrations

Question 1 (Illustration)

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.

Answer 1

Journal in the books of Z Ltd.

Year	Particulars		Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account To Bank Account	Dr.	50,00,000	
	(Being Fixed Assets purchased)			50,00,000
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account (Being grant received from the government)			10,00,000
	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account (Being Depreciation charged on SLM)			7,00,000
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account (Being Depreciation transferred to P/L Account)			7,00,000
2nd	Depreciation Account To Fixed Assets Account	Dr.	7,00,000	
	(Being Depreciation charged on SLM)			7,00,000
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account (Being Depreciation transferred to P/L Account)			7,00,000

Question 2 (Illustration)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 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.

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Answer 2

Journal in the books of Z Ltd.

Year	Particulars		Rs. **(Dr.)**	Rs. **(Cr.)**
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account (Being fixed assets purchased)			50,00,000
	Bank Account	Dr.	10,00,000	
	To Deferred Government Grant Account (Being grant received from the government)			10,00,000
	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account (Being depreciation charged on SLM)			9,00,000
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account (Being depreciation transferred to P/L Account)			9,00,000
	Deferred Government Grants Account	Dr.	2,00,000	
	To Profit & Loss Account (Being proportionate government grant taken to P/L Account)			2,00,000
2nd	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account (Being depreciation charged on SLM)			9,00,000
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account (Being depreciation transferred to P/L Account)			9,00,000
	Deferred Government Grant Account	Dr.	2,00,000	
	To Profit & Loss Account (Being proportionate government grant taken to P/L Account)			2,00,000

Question 3 (Illustration)

Santosh Ltd. has received a grant of Rs.8 crores from the Government for setting up a factory in a backward area. Out of this grant, the compa ny distributed Rs.2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.

Answer 3

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.

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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 (Illustration)

X Ltd. runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local Government 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 of the grant and present in the statement of profit & loss when the grant is:

(a) Shown separately as Other Income; and

(b) Deducted against the Salary costs.

Answer 4

ticulars		Dr.)	Cr.)
Bank Account		00,000	
To Deferred Income Account			00,000
ing receipt of grant from government)			
ary Expense Account		00,000	
To Bank Account			00,000
(Being Salary expense paid for the year)			
Deferred Income Account		00,000	
To Other Income Account			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].

Question 5 (Illustration)

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.

Answer 5

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.

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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 (Illustration)

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.

Answer 6

(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 (Illustration)

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

Answer 7

Fixed Assets Account Dr.	,00,000	
To Bank Account		,00,000
Being government grant on asset refunded)		

Question 8 (Illustration)

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.

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Answer 8

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account	Dr.	20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account	Dr.	8	
	To Fixed Asset Account			8
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account	Dr.	2	
	To Depreciation Account			2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
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:

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

1. Depreciation for Year 2

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	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
Less: Depreciation for the first year $\left[\frac{12-4}{4}\right]$	12 2
	10
Add: Government grant refundable	5
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	15

Question 9-Illustration

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?

Answer 9

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. If the grant is credited to Fixed Assets Account:

		(₹ 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-Illustration

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

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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.

Answer 10

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:

		₹	₹
Fixed Assets A/c	Dr.	16 lakhs	
To Bank A/c			16 lakhs
(Being grant refunded)			

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:

		₹	₹
Deferred Grant A/c	Dr.	8 lakhs	
Profit & Loss A/c	Dr.	8 lakhs	
To Bank A/c			16 lakhs
(Being Government grant refunded)			

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

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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
Note: Value of fixed assets given above is after refund of government grant.

Question 10-Illustration

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.

Answer 11

			₹	₹
	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 recognized 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".

Test your knowledge

Multiple Choice Questions

1. **To encourage industrial promotion, IDCI offers subsidy worth Rs. 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?**
   (a) Credit it to capital reserve
   (b) Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations
   (c) Both (a) and (b) are permitted
   (d) Credit it to general reserve

Ans: (a)

2. **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**

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(a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.
(b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.
(c) 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.
(d) Disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item.

Ans: (c)

3. Which of the following is an acceptable method of accounting presentation for a government grant relating to an asset?
(a) Credit the grant immediately to Income Statement
(b) Show the grant as part of Capital Reserve
(c) 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.
(d) Show the grant as part of General Reserve

Ans: (c)

4. X Ltd. has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd has a policy to recognize 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:
(a) ₹ 10 crore
(b) ₹ 6 crore
(c) ₹ 2 crore
(d) ₹ 8 crore

Ans: (b)

5. 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:
(a) ₹ 10 crore
(b) ₹ 6 crore
(c) ₹ 2 crore
(d) ₹ 8 crore

Ans: (c)

Theoretical Questions Answers

Questions 1

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?

Answer 1

A government grant is recognised when there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and

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- 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.

Practical Questions Answers

Question 2

Supriya Ltd. received a grant of Rs. 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 utilization. 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

Answer 2

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

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 3

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 2024. The company debited the said amount to its machinery account in 2024 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 2024 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

Answer 3

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

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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.

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Illustrations

Questions 1 (Illustration)

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.

Answer 1

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 ofthe shares and other securities issued and the payment made in the form of cashor 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'.

Questions 2 (Illustration)

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**

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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. issuingsuch 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 amalgamationhas been carried out on the basis of Amalgamation in the nature of purchase.

Answer 2

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		
(a) Inventory (350 + 250)		600
(b) Trade receivables	7	650
(c) Cash and bank balances (300 + 200)		500
Total		3,520

Notes to Accounts

		(₹in lakhs)	(₹in lakhs)
1.	Share Capital		

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	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**

Working Notes:

		(₹ in lakhs)		
		A Ltd.		B Ltd.
1.	Computation of Purchase consideration			
	a) Preference shareholders:			
	$\left(\frac{3,00,00,000}{100}\ i.e\ 3,00,000\ shares\right) \times$ ₹ 150 each	450		
	$\left(\frac{2,00,00,000}{100}\ i.e\ 2,00,000\ shares\right) \times$ ₹ 150 each			300
	b) Equity shareholders:			
	$\left(\frac{8,00,00,000 \times 5}{100}\ i.e\ 40,00,000\ shares\right) \times$ ₹ 30 each	1,200		
	$\left(\frac{7,50,00,000 \times 4}{100}\ i.e\ 3,00,000\ shares\right) \times$ ₹ 30 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

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	Inventory		350		250
	Trade receivables		300		350
	Cash and bank		300		200
			2000		1500
	Less: Liabilities taken over:				
	Debentures	40		20	
	Trade payables	420		190	
			460		210
	Net assets taken over		1540		1290
	Purchase consideration		1650		1200
	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 capitalA				
	Ltd.- 40,00,000 x 20		800		
	B Ltd.- 30,00,000 x 20				600
	Total		950		700

Note: For problems based on practical application of AS 14 (Revised) students are advised to refer Chapter 14 'Accounting for Amalgamation of Companies' of the study material.

[1] 40,00,000 + 30,00,000

[2] 3,00,000 + 2,00,000

Test your knowledge

Multiple Choice Questions

1. **Which of the following statement is correct:**
   (a) In case of merger – ESH can be issued only equity shares as a part of Purchase consideration.
   (b) In case of purchase – ESH can be issued Preference shares also as a part of Purchase consideration.
   (c) Both (a) and (b) are correct.
   (d) Both (a) and (b) are incorrect.

Ans: (b)

2. **State which statement is correct:**
   (a) In case of merger – assets and liabilities can only be taken over at book values.
   (b) In case of purchase – assets and liabilities can be taken over at book values or agreed values.
   (c) Both (a) and (b) are correct.
   (d) Both (a) and (b) are incorrect.

Ans: (c)

3. **State which statement is correct:**
   (a) In case of merger – All Reserves and surplus of vendor company are taken over by Purchasing company.

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(b) In case of Purchase – None of the Reserves and surplus of vendor company are taken over by Purchasing company.
(c) Both (a) and (b) are correct.
(d) Only (a) is correct.

Ans: (d)

4. State which statement is correct:

(a) In case of merger – We use pooling of interest method for accounting.
(b) 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.
(c) Both (a) and (b) are correct.
(d) Only (a) is correct.

Ans: (d)

5. State which statement is incorrect:

(a) In case of merger – We can issue either preference shares or equity shares to PSH.
(b) In case of Purchase – We can issue either preference shares or equity shares to PSH.
(c) In case of merger – We can issue only preference shares to PSH.
(d) none of the above.

Ans: (c)

Theoretical Questions Answers

Question 1

Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14 (Revised).

Answer 1

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 (Revised) on Accounting for Amalgamation. For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) Names and general nature of business of the amalgamating companies;
(b) Effective date of amalgamation for accounting purposes;
(c) The method of accounting used to reflect the amalgamation; and
(d) Particulars of the scheme sanctioned under a statute.

For amalgamations accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
(b) The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof. For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:
(a) Consideration for the amalgamation and a description of the consideration paid or contingently payable; and
(b) The amount of any difference between the consideration and the value of net identifiable assets

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acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

Question 2

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.

Answer 2

As per AS 14 on "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 3

Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

Answer 3

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

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transferor company.

Practical Questions Answers

Question 4

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.

Answer 4

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 5

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.

Answer 5

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.

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		2,00,000

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To Securities premium A/c		2,50,000
To Bank/Cash A/c (Being payment of cash and issue of shares for discharge of purchase consideration)		50,000

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Illustrations

Question 1 (Illustration)

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 ineach 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

Answer 1

(1) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deductingall 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

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	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 consolidate on 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 (Illustration)

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.

Answer 2

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	
To Profit & Loss A/c			12,000
(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):		₹	₹

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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:			33,000
20% of ₹ 1,65,000 [1,00,000 + 60,000 + 20,000 – 15,000]			

Question 3 (Illustration)

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.

Answer 3

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

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* 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 (Illustration)

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.

Answer 4

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

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		(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)			
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			
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000	(30,000)	12,000	2,44,000
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**

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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 (Illustration)

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 capitalizing 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.

Answer 5

1. Computation of Purchase Consideration

(a) Yield of VR Ltd.: $\left[\frac{40}{100} \times \frac{30+40+65}{3}\right]$ = Rs. 18 Lakhs

(b) Price per share of VR Ltd.:

Capitalized Yield: $\left[\frac{18 \text{ lakhs}}{0.15}\right]$ = Rs. 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) × $\frac{30}{100}$ Rs. 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	

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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		78.25
Purchase Consideration: 54% purchased from Foreign	64.80	
Co.		
Investment: 46% existing stake	15.64	(80.44)
Goodwill on Date of Acquisition		2.19

Question 6 (Illustration)

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.

Answer 6

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., pre- acquisition 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)

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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 (Illustration)

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.

Answer 7

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 (Pre-acquisition) ₹		**Revenue Profit (Post-acquisition) ₹**
Balance on 1.1.20X1	1,25,000	—	
Profit for 20X1 (3,00,000 × 7/12)	1,75,000	(3,00,000×5/12)	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 utilized 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 × 3/5)

Profit for the remaining five months = ₹ 75,000 (i.e.₹ 1,25,000 × 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 utilized 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:

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		₹	₹
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 definiteinformation about the profits utilized. In practice, such treatment is rare.

Question 8 (Illustration)

A Ltd. and B Ltd. provide the following information:

	₹ '000s	
	A Ltd.	**B Ltd.**
Equity Shares	**6,000**	**5,000**
6% Preference Shares	**NIL**	**1,000**
General Reserve	**1,200**	**800**
Profit and Loss Account	**1,020**	**1,790**
Trade Payables	**3,850**	**3,410**
Dividend Payable	**600**	**500**
Goodwill	**100**	**20**
Property, Plant and Equipment	**3,850**	**2,750**
Investment	**1,620**	**1,100**
Inventory	**1,900**	**4,150**
Trade Receivables	**4,600**	**4,080**
Cash & Bank	**600**	**400**

A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following other information is available:

a. Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands bought forward from the previous year.
b. The General Reserve balance is brought forward from the previous year.
c. The directors of both the companies have declared a dividend of 10% on equity share capital for the previous and current year.

From the above information calculate Pre- and Post-acquisition Profits, Minority Interest and Cost of Control.

Answer 8

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
Less: Share of Minority Interest: (¼)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500
	(Cost of Control)	(Post-acquisition Profits)

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Calculation of Minority Interest:

Particulars	**₹**
Paid-up Equity Share Capital (₹ 50,00,000 x ¼)	12,50,000
Paid-up Preference Share Capital	10,00,000
Share in Reserves:	
Profit & Loss Account: ₹ 17,90,000 x ¼	4,47,500
General Reserve: ₹ 8,00,000 x ¼	2,00,000
Minority Interest	**28,97,500**

Calculation of Goodwill/Capital Reserve

	₹	₹
Cost of Investment in Subsidiary:	46,87,500	
₹ 50,00,000 x 75% x 125% (cost + 25% premium)		
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 (Illustration)

On 31st March, 20X1, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	10,50,000
Current Assets	6,45,000
1,50,000 equity shares of ₹ 10 each fully paid	15,00,000
Pre-incorporation profits	30,000
Profit and Loss Account	60,000
Trade payables	1,05,000

P Ltd. and Q Ltd. give the following information on 31st March, 20X3:

	P Ltd. ₹	Q Ltd.₹
Equity shares of ₹ 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	–
Pre-incorporation profits	–	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–

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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.

Answer 9

Shareholding pattern

Particulars	Number of Shares	% of holding
a. P Ltd.		
(i) Purchased on 31.03.20X1	1,05,000	
(ii) Bonus Issue (1,05,000/2)	52,500	
Total	1,57,500	70%
b. Minority Interest	67,500	30%

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 20X3:

(a) Before issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (Share Capital)	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control (i.e., Goodwill)		87,000
(ii)	**Minority Interest**		₹
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account – P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Face value of investments (₹ 10,50,000 + ₹5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000

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	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000
(ii)	**Minority Interest**		₹
	Share Capital (₹4,50,000 + ₹2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd.		
	(W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition) (Before and afterissue of bonus shares) ₹	Revenue Profits (Post-acquisition)	
		BeforeBonus 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 (₹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 Profitand Loss Account.

Question 10 (Illustration)

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March, 20X1 from the following information:

	H Ltd.	S Ltd.
	₹	₹

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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.

Answer 10

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 (₹)
1	**I EQUITY AND LIABILITIES** **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	

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	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 (Illustration)

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.

Answer 11

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

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		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
	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

Notes to Accounts

			Amount (₹)
1.	**Share capital** 15,000 Equity Shares @ ₹10 each		1,50,000
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) Share in Profit and loss account (₹ 40,000 X 20%)	20,000 8,000	28,000
4.	**Trade payables** H Ltd. S Ltd.		1,00,000 60,000
			1,60,000
5.	PPE		
	H Ltd. S Ltd.		1,00,000 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)		(80,000)

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	Share in pre-acquisition profits 80% of [30,000+3/12(40,000-30,000)]		(26,000)
	Goodwill		20,000
7.	**Current Assets**		
	H Ltd. S Ltd.		74,000 70,000
			1,44,000

Question 12 (Illustration)

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
(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

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	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	--

Answer 12

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		

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	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

Working Notes:

1. **Basic Information**

Company Status	Dates	Holding Status
Holding Co. = Virat Ltd. Subsidiary = Anushka Ltd.	Acquisition: Anushka's Incorporation	Holding Company = 80% Minority Interest = 20%
	Consolidation: 31st March, 20X1	

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			(3,20,000)	-

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Goodwill/capital reserve			NIL	
Parent's Balance				1,00,000
Amount for Consolidated Balance Sheet				1,80,000

Question 13 (Illustration)

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	1	6,00,000	1,00,000
(a) Share Capital	2	3,00,000	1,00,000
(b) Reserves and Surplus			
(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		25,000
		1,00,000	
	Total	3,00,000	1,00,000
3.	Property, Plant and Equipment		

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	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**

Answer 13

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**			

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	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
	Intangible assets			
	Goodwill [WN 6]			12,000
	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'.

Working Notes:

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%) × 40,000	32,000
Minority Interest= 1/5 (or 20%) × 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 × 45,000	36,000
Minority Interest 1/5 × 45,000	9,000
3. Post-acquisition reserves of S Ltd.	
Post-acquisition reserves (Total reserves lessreserves pre-acquisition = ₹75,000 – 25,000)	50,000
H Ltd.'s share 4/5 × 50,000	40,000
Minority interest 1/5 × 50,000	10,000
4. Post -acquisition profits of S Ltd.	10,000
Post-acquisition profits (Profit & loss account balance less	

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pre-acquisition profits = ₹25,000 – 15,000)	
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 × 5,750	4,600
Minority Interest 1/5 × 5,750	1,150
5. Minority Interest	
Paid-up value of (1,000 – 800) = 200 shares held by outsiders i.e. 200 × ₹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 × ₹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 (Illustration)

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.

Answer 14

As per para 16 and 17 of AS 21, intragroup balances and intragroup transactionsand 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

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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 transactionof sale and purchase of ₹ 200 lacs each, would be eliminated by reducingboth 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 profitand loss account for the year ended 31 March 20X1, entire transaction ofsale 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 ₹ 37.50lacs (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 (Illustration)

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**

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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 ofH 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..

Answer 15

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
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	

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	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	
	Less: Unrealized profits ₹ 24 lacs × 20/120	(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
7.	Other expenses Administrative expenses		
	H Ltd.	200	
	S Ltd.	100	
	Less: Consultancy fees received by H Ltd. from S Ltd.	(5)	295
	Selling and distribution Expenses:		
	H Ltd.	200	
	S Ltd.	50	
	Less: Commission received by S Ltd. from H Ltd.	(10)	240
			535

Question 16 (Illustration)

Subsidiary B Ltd. provides the following balance sheet:

Particulars		**Note No.**	**20X0 (₹)**	**20X1 (₹)**
(1)	**I. Equity and Liabilities Shareholder's Funds**			
(a)	**Share Capital**	**1**	**5,00,000**	**5,00,000**
(b)	**Reserves and Surplus**	**2**	**2,86,000**	**7,14,000**

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(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
(a)	II. Assets (1) Non-current assets Property, Plant and Equipment	5	2,72,000	2,24,000
(b)	Non-current Investment			4,00,000
(a)	(2) Current assets Inventories		5,97,000	7,42,000
(b)	Trade Receivables		5,94,000	8,91,000
(c)	Cash & Cash Equivalents		51,000	3,000
(d)	Other current assets	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
4.	Short term provisions Provision for taxation	3,10,000	4,30,000
5.	Property, plant and equipment Cost Less: Depreciation	3,20,000 (48,000)	3,20,000 (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

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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.

Answer 16

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 proportionsof 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 inthe 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		

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	(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 pro-visions** Provision for taxation	4,30,000
5.	**Property, plant and equipment** Cost *Less:* Depreciation Total	 3,20,000 (96,000) 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

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	Total	9,00,000
8.	**Other current Assets** Prepaid expenses	 48,000

Test your knowledge

Multiple Choice Questions

1. **Minority interest should be presented in the consolidated balance sheet**
   (a) As a part of liabilities.
   (b) As a part of equity of the parent's shareholders.
   (c) Separately from liabilities and the equity of the parent's shareholders.
   (d) As a part of assets.

Ans: (c)

2. **Minority of the subsidiary is entitled to**
   (a) Capital profits of the subsidiary company.
   (b) Revenue profits of the subsidiary company.
   (c) Both capital and revenue profits of the subsidiary company.
   (d) Neither capital nor revenue profits of the subsidiary.

Ans: (c)

3. **In consolidation of accounts of holding and subsidiary company is eliminated in full.**
   (a) Current liabilities of subsidiary company.
   (b) Reserves and surplus of both holding and subsidiary company.
   (c) Mutual indebtedness.
   (d) Nothing.

Ans: (c)

4. **In consolidated balance sheet, the share of the outsiders in the net assets of the subsidiary must be shown as**
   (a) Minority interest.
   (b) Capital reserve.
   (c) Current liability.
   (d) Current assets.

Ans: (a)

5. **Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of**
   (a) Current liability.
   (b) Revenue profit.
   (c) Capital profit.
   (d) Current assets.

Ans: (a)

Scenario-based Questions

Question 1

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 ₹

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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.

Answer 1

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 2

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.

Answer 2

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

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Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		277
King Ltd.'s share of net assets (70% of 277)		193.9
King Ltd.'s cost of acquisition of shares of Queen Ltd.		
(₹140 lakhs)		(140)
Capital reserve		53.9

Question 3

From the following information, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	%of Share owned	Cost	Date of Acquisition		Consolidation date	
				01-01-20X1		31-12-20X1	
				Share Capital	Profit and Loss A/c	Share Capital	Profit and Loss A/c
				₹	₹	₹	₹
Case-A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case-B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000

Answer 3

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	Minority interest as at the date of acquisition	Minority interest as at the date of consolidation
	[E]	[E] x [A + B] ₹	[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 4

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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
(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	2,40,000	1,35,000
	Total	3,90,000	3,15,000
5.	Non-current Investments		
	Investment in B Ltd (at cost)	3,40,000	--
6.	Cash & Cash equivalents		
	Cash	14,500	8,000

The Profit & Loss Account of B Ltd. showed a credit balance of ₹30,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 20X1 was considered as

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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.

Answer 4

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	

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	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**		*14,500*	
	Cash of A Ltd			
	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.

   fit & Loss Account Dr. 6,000
   To Investment 6,000

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 Less:	 ₹ 82,000 ₹10,000		

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₹ 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 *Less*: Depreciation already charged for 2nd half year on 1,50,000	9,000 (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 pre-revalued 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

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		68,800

Question 5

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
(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 (Dividend payable)		1,200	-
Total		21,387	9,208
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	5	9,468	5,486
(b) Non-current Investments (Shares in S Ltd.)		3,000	
(2) Current assets			
(a) Inventories		3,949	1,956
(b) Trade receivables	6	2,960	1,562
(c) Cash and cash equivalents		1,490	204
(d) Short term loans and advances	7	520	
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

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	Bills Payable	372	160
4.	Short term provisions	1,833	1,014
	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
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.

Answer 5

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		

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	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)		2,892	
	Profit and Loss Account: H Ltd.	2,715		
	Less: Dividend wrongly credited 360			
	Unrealized Profit 20	(380)		
		2,335		
	Add: Share in S Ltd.'s Revenue profits	612	2,947	
	Total			7,159
3.	**Trade payables**			
	Creditors H Ltd. S Ltd.	1,461 854	2,315	
	Bills Payable H Ltd. S Ltd.	₹ 372 ₹ 160 ₹ 532		
	Less: Mutual owing	₹ (45)	487	2,802
4.	**Short term provisions**			
	Provision for Taxation H Ltd. S Ltd		855 394	
	Total			1,249
5.	**Other current liabilities**			

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	Dividend payable H Ltd.			1,200
6.	**Property, plant and equipment**			
	Land and Buildings H Ltd.		2,718	
	Plant and Machinery H Ltd. S Ltd.	₹ 4,905 ₹ 4,900	9,805	
	Furniture and Fittings H Ltd. S Ltd.	₹ 1,845 ₹ 586	2,431	
	Total			14,954
7.	**Inventories**			
	Stock H Ltd. S Ltd.		3,949 1,956 5,905	
	Less: Unrealized profit		(20)	5,885
8.	**Trade receivables**			
	Debtors H Ltd. S Ltd.	₹ 2,600 ₹ 1,363	3,963	
	Bills Receivable H Ltd. S Ltd.	₹ 360 ₹ 199 ₹ 559		
	Less: Mutual Owing	₹ (45)	514	4,477
9.	**Short term loans and advances**			
	Sundry Advances			520
10.	**Cash and cash equivalents**			
	Cash and Bank Balances			1,694

Share holding pattern of S Ltd.

Shares as on 31st March, 20X1 (Includes bonus shares issued on 1st January, 20X1)	480 lakh shares (4,800 lakhs/₹ 10)
H Ltd.'s holding as on 1st April, 20X0	180 lakhs
Add: Bonus received on 1st January, 20X1	108 lakhs (180 / 5 × 3)
Total H Ltd.'s holding as on 31st March, 20X1	288 lakhs i.e. 60 % [288/480×100]
Minority Shareholding	40%

Working Notes:

1. S Ltd.'s General Reserve Account

₹ in lakhs	₹ in lakhs

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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	
To	Dividend paid			year*	1,200
	(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% (General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	(720)
Share of Minority Shareholders (40%)	480

Note: The question can also be solved by taking ₹ 1,020 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 – ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less dividend paid (₹ 1,200 – ₹ 600)	600
	1,800

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs Minority interest = ₹ 1,800 – ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

	₹ in lakhs
Paid up value of shares held (60% of ₹4,800)	2,880
Add: Share in capital profits [WN 4]	1,080
	3,960
Less: Cost of shares less dividend received (₹ 3,000 – ₹ 360)	(2,640)
Capital reserve	1,320

6. Calculation of Minority Interest

	II ₹ in lakhs

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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	4,800
Or we can say these are 1 + $\frac{3}{8}$ or $\frac{8}{5}$	
i.e. Shares before bonus issue should have been $\frac{4,800}{8/5}$ =	3,000
Accordingly, bonus issue would be (4,800-3,000)	1,800

Question 6

Chand Ltd. and its subsidiary Sitara Ltd. provided the following information for the year ended 31st March, 20X4:

Particulars	Chand Ltd (₹)	Sitara Ltd. (₹)
Equity Share Capital	20,00,000	6,00,000
Finished Goods Inventory as on 01.04.2022	4,20,000	3,01,000
Finished Goods Inventory as on 31.03.2023	8,57,500	3,76,250
Dividend Income	1,68,000	43,750
Other non-operating Income	35,000	10,500
Raw material consumed	13,93,000	4,72,500
Selling and Distribution Expenses	3,32,500	1,57,500
Production Expenses	3,15,000	1,40,000
Loss on sale of investments	26,250	Nil
Sales and other operating income	33,25,000	19,07,500
Wages and Salaries	13,30,000	2,45,000
General and Administrative Expenses	2,80,000	1,22,500
Royalty paid	Nil	5,000
Depreciation	31,500	14,000
Interest expense	17,500	5,250

Other information

- **On 1st September 20X1 Chand Ltd., acquired 5,000 equity shares of ₹ 100 each fully paid up in Sitara Ltd.**
- **Sitara Ltd. paid a dividend of 10% for the year ended 31st March 20X3. The dividend was correctly accounted for by Chand Ltd.**
- **Chand Ltd. sold goods of ₹ 1,75,000 to Sitara Ltd. at a profit of 20% on selling price. Inventory of**

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Sitara Ltd. includes goods of ₹ 70,000 received from Chand Ltd.

- **Selling and Distribution expenses of Sitara Ltd. include ₹ 21,250 paid to Chand Ltd. as brokerage fees.**
- **General and Administrative expenses of Chand Ltd. include ₹ 28,000 paid to Sitara Ltd. as consultancy fees.**
- **Sitara Ltd. used some resources of Chand Ltd., and Sitara Ltd. paid ₹ 5,000 to Chand Ltd. as royalty.**

Consultancy fees, Royalty and brokerage received is to be considered as operating revenues. Prepare Consolidated Statement of Profit and Loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended 31st March, 20X4 as per Schedule III to the Companies Act, 2013.

Answer 6

Consolidated statement of profit and loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended on 31st March, 20X4

Particulars	**Note No.**	**₹**
Revenue from operations	1	50,03,250
Other Income	2	1,81,000
Total revenue (I)		51,84,250
Expenses:		
Cost of material purchased/consumed	3	21,45,500
Changes (Increase) in inventories of finished goods	4	(4,98,750)
Employee benefit expense	5	15,75,000
Finance cost	6	22,750
Depreciation and amortization expense	7	45,500
Other expenses	8	8,43,250
Total expenses (II)		41,33,250
Profit before tax (II-III)		10,51,000

Notes to Accounts:

			₹	₹
1.	Revenue from operations			
	Sales and other operating revenues			
	Chand Ltd.		33,25,000	
	Sitara Ltd.		19,07,500	
			52,32,500	
	Less: Inter-company sales		(1,75,000)	
	Consultancy fees received by Sitara Ltd. from Chand Ltd.		(28,000)	
	Royalty received by Chand Ltd. from Sitara Ltd.		(5,000)	
	Brokage received by Chand Ltd. from Sitara Ltd.		(21,250)	50,03,250

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2.	Other Income			
	Dividend income:			
	Chand Ltd.	1,68,000		
	Sitara Ltd.	43,750	2,11,750	
	Loss on sale of investments Sitara Ltd.		(26,250)	
	Other Non-operating Income			
	Chand Ltd.	35,000		
	Sitara Ltd.	10,500		
	Less: Dividend realized from Sitara Ltd. (5,00,000 x 10%)	(50,000)	4,500	1,81,000
3	Cost of material purchased/consumed			
	Chand Ltd.	13,93,000		
	Sitara Ltd.	4,72,500		
		18,65,500		
	Less: Purchases by Sitara Ltd. From Chand Ltd.	(1,75,000)	16,90,500	
	Direct expenses (Production)			
	Chand Ltd.	3,15,000		
	Sitara Ltd.	1,40,000	4,55,000	21,45,500
4.	Changes (Increase) in inventories of finished goods			
	Chand Ltd.		4,37,500	
	Sitara Ltd.		75,250	
			5,12,750	
	Less: Unrealized profits ₹ 7,00,00 × 20/100			
	Employee benefits and expenses Wages and salaries:		(14,000)	4,98,750
	Chand Ltd.		13,30,000	
	Sitara Ltd.		2,45,000	15,75,000
	Finance cost Interest:			
	Chand Ltd.		17,500	
	Sitara Ltd.		5,250	22,750
7.	Depreciation			
	Chand Ltd.		31,500	
	Sitara Ltd.		14,000	45,500
8.	Other expenses			
	General & Administrative expenses:			
	Chand Ltd.	2,80,000		
	Sitara Ltd.	1,22,500		
		4,02,500		
	Less: Consultancy fees received by Sitara Ltd. from Chand Ltd.	(28,000)	3,74,500	

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	Royalty: Sitara Ltd. Less: Received by Chand Ltd. Selling and distribution Expenses:	5,000 (5,000)	Nil	
	Chand Ltd.	3,32,500		
	Sitara Ltd.	1,57,500		
		4,90,000		
	Less: Brokerage received by Chand Ltd. from Sitara Ltd.	(21,250)	4,68,750	8,43,250

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Chapter 10.2

AS 23- Accounting For Investments in Associates In Consolidated Financial Statements

Illustrations

Question 1 (Illustration)

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.

Answer 1

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 (Illustration)

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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.

Answer 2

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

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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 *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	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS

Investment in Associate as per AS 23	₹
Investment in B Ltd.	-

- If, under the equity method, an investor's share of losses of an associate equal or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognizing its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. Ifthe associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the shareof net losses that have not been recognized.
- As far as possible the reporting date of the financial statements should be same for consolidated financial statement. If practically it is not possible to draw up the financial statements of one or more enterprise to such date and, accordingly, those financial statements are drawn up to reporting dates different from the reporting date of the investor, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the consolidated financial statements.

  In any case, the difference between reporting dates of the concern and consolidated financial statement should not be more than six months.
- Accounting policies followed in the preparation of the financial statementsof the investor, investee and consolidated financial statement should be uniform for like transactions and other events in similar circumstances.

  If accounting policies followed by different enterprises in the group are not uniform, then adjustments should be made in the items of the individualfinancial statements to bring it in line with the accounting policy of the consolidated statement.
- The carrying amount of investment in an associate should be reduced to recognize a decline, other than temporary, in the value of the investment,such reduction being determined and made for each investmentindividually.

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Test your knowledge

Multiple Choice Questions

1. **Identity which of the statements are correct.**
   An enterprise can influence the significant economic decision making bymany ways like:
   (i) Representation on the board of directors or governing body of theinvestee.
   (ii) Participation in policy-making processes.
   (iii) Interchange of managerial personnel.
   (iv) Provision of essential technical information.
   (a) Statement (i) and (ii) are correct.
   (b) Statement (i), (ii) and (iii) are correct.
   (c) Statement (i), (ii), (iii) and (iv) are correct.
   (d) Statement (ii) and (iii) are correct.

Ans: (c)

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. Identify which of the statements are incorrect.**
   (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.
   (a) Statement (ii) is incorrect.
   (b) Statement (iii) is incorrect.
   (c) Statement (ii) and (iii) both are incorrect.
   (d) All statements are incorrect.

Ans: (a)

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 significantinfluence?
   (a) Goodwill = ₹ 10,000.
   (b) Goodwill = ₹ 20,000.
   (c) Capital Reserve = ₹ 10,000.
   (d) Capital Reserve = ₹ 20,000.

Ans: (b)

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:**
   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 significantinfluence?
   (a) Goodwill = ₹ 10,000.

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(b) Goodwill = ₹ 20,000.
(c) Capital Reserve = ₹ 10,000.
(d) Capital Reserve = ₹ 20,000.

Ans: (a)

5. Identity which of the statements are correct.

(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 shouldnot be taken into account for determining the voting power of the investor.

(iv) The potential equity shares of the investee held by the investor shouldbe taken into account for determining the voting power of the investor.

(a) Statement (i) and (iii).
(b) Statement (ii) and (iv).
(c) Statement (i) only.
(d) Statement (iii) only.

Ans: (a)

Theoretical Questions Answers

Question 1

Describe the cases when AS 23 does not allow the use of equity method of accounting?

Answer 1

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 theinvestee is treated as investment according to AS 13.

Question 2

When is an investor required to discontinue the use of the equity method of accounting?

Answer 2

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.

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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 theinvestment at that date should be regarded as cost thereafter.

Practical Questions

Question 3

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 3

(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 4

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**

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	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 informationavailable:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at40% 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 AS21 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 theConsolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the ConsolidatedFinancial Statements?

Answer 4

In terms of AS 23, B Ltd. will be considered as an associate company ofA Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill (₹ in lakhs)

ount paid towards acquisition of stake in B Ltd.	3.00
s: Pre-acquisition dividend (₹5,00,000 x 40% x 25%)	0.50
t of Investment in B Ltd.	2.50
Less: Share in the value of Equity of B Ltd. as at the date of investment % of ₹10 lakhs (₹5 lakhs + ₹5 lakhs -₹ 2 lakhs)]	(2.00)
Goodwill	0.50

(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.	2.50	
(including goodwill)		
Share of profit for year 20X1 – 20X2	1.75	4.25

Working Notes:

1. Pre-acquisition dividend received from B Ltd. amounting to ₹0.50 lakhs will be reduced from

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investment value in the booksof 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 creditedwith ₹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.

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Chapter 10.3

AS 27- Financial Reporting of Interests In Joint Ventures

ILLUSTRATIONS

Question 1 (Illustration)

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 go down 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.

Answer 1

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 takenby 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				

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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)		By Land & Building	10,00,000
	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	₹
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 (Illustration)

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.

Answer 2

Consolidated Balance Sheet

		Note	(₹)

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I	**Equity and liabilities**		
	Shareholders' funds:		
	Share Capital	1	71,40,000
			71,40,000
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment:	2	71,40,000
			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

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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 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

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	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 amortization 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 (Illustration)

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**	

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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.

Answer 3

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
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:		

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	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
11.	**Other Current Assets**		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

Question 4 (Illustration)

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**

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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.

Answer 4

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

		₹	₹
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	

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	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

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. **State which of the following statements are incorrect.**
   - **(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**

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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 23 as the case may be.

(a) Point (i) is incorrect.
(b) Point (ii) is incorrect.
(c) Point (iii) is incorrect.
(d) None of the above.

Ans: (b)

2. Identify which of the following is not a feature of a Jointly controlledoperations (JCO):

(a) Each venturer has his own separate business.
(b) There is a separate entity for joint venture business.
(c) Each venturer record only his own transactions without any separately set of books maintained for the joint venture business.
(d) There is a common agreement between all of them.

Ans: (b)

3. Identify which of the following is/are not a feature of a Jointly controlled assets (JCA):

(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.

(a) Point no. (i) only.
(b) Point no. (i) and (iii).
(c) Point no. (iii) and (iv).
(d) Point (i) and (ii).

Ans: (a)

4. Identify which is/ are features of a Jointly controlled entity (JCE):

(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 incurredby the entity itself and sales are also made by this entity.
(iii) The revenues and expenses of the entity is shared by the venturers inthe ratio agreed upon in the contractual agreement.

(a) Point no. (i) only.
(b) Point no. (i) and (ii).
(c) Point no. (iii).
(d) Point no. (iii).

Ans: (b)

5. Identify the correct statements.

From the date of discontinuing the use of the proportionate consolidationmethod:

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(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 whichjoint venture relationship ceases to exist should be regarded as cost thereafter.

(a) Point no. 1 and 2.
(b) Point no. 1, 2 and 3.
(c) Point no. 1, 2, 3 and 4.
(d) None of the above.

Ans: (b)

Theoretical Questions Answers

Question 1

Describe the cases when AS 27 does not allow the use of Proportionate consolidation method of accounting?

Answer 1

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 inthe 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 investeeis treated as investment according to AS 13.

Question 2

When is a venturer required to discontinue the use of the proportionate consolidation method?

Answer 2

A venturer should discontinue the use of the proportionate consolidationmethod 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.

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Practical Questions Answers

Question 3

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 3

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. Thetype 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 inthe 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 businessplans and positive cash flows is based reliable presumptions (such as tenderin favour of QSR Ltd., strong order book etc.), the decline will be regardedas temporary in nature and the investment in equity shares will continue tobe 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.

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Illustrations

Question 1 (Illustration)

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 Rs. 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs. 10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	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%.	

Answer 1

Amount that can be drawn from reserves for 10% dividend		
10% dividend on Rs. 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 ie. ₹ 12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III

The balance of reserves after drawl ₹ 18,42,500 (₹ 25,00,000 - ₹ 6,57,500) should not fall below 15 % of its paid up capital ie. ₹ 14,62,500 (15% of ₹ 97,50,000]

Since all the three conditions are satisfied, the company can withdraw ₹ 6,57,500 from accumulated

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reserves (as per Declaration and Payment of Dividend Rules, 2014.)

Question 2 (Illustration)

The following is the Trial Balance of Omega Limited as on 31.3.20X2:

(Figures in Rs. '000)

	Debit		Credit
Land at cost	220	Equity Capital (Shares of Rs. 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 Rs. 10 each.

(ii) The company on the advice of independent valuer wish to revalue the land at Rs. 3,60,000.

(iii) Declared final dividend @ 10% on 2nd April, 20X2.

(iv) Suspense account of Rs. 4,000 represents cash received for the sale of some of the machinery on 1.4.20X1. The cost of the machinery was Rs. 10,000 and the accumulated depreciation thereon being Rs. 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.

Answer 2

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

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		Total		**1082**
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 Income**		**702**
IV	Expenses:		
	Purchases		320
	Finance costs	6	20
	Depreciation (10% of 760*)		76
	Other expenses	7	120
	Total Expenses		**536**
V.	**Profit (Loss) for the period** (III – IV)		**166**

Notes to accounts

				(₹ in 000)
1.	**Share Capital**			
	Equity share capital			
	Authorized			
	40,000 shares of Rs.10 each			400
	Issued & subscribed & called up			
	30,000 shares of Rs.10 each			300
2.	**Reserves and Surplus**			
	Securities Premium Account			40
	Revaluation reserve (360 – 220)			140
	General reserve			130
	Profit & loss Balance			
	Opening balance	72		
	Profit for the period	166	238	
	Less: Appropriations			
	Interim Dividend		(18)	220
				530

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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 inthe financial statements for the year ended 31 March, 20X2. Such dividends willbe disclosed in notes only.

Question 3 (Illustration)

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 Rs. 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

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Materials consumed	**23,19,000**	**Transfer fees**	**10,000**
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: Rs. 8,23,000.

Answer 3

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

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(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 Rs.10 each			25,00,000
Issued and Subscribed:			
Equity share capital of Rs.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

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Total	31,51,000	1,46,000	30,05,000
5. Cash and bank balances			
Cash and cash equivalents			45,000
Current account balance			8,000
Cash			Nil
Other bank balances			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 4 (Illustration)

You are required to prepare a Statement of Profit and Loss and Balance Sheet fromthe following Trial Balance extracted from the books of the International Hotels Ltd.,on 31st March, 20X2:

	Dr. ₹	Cr. ₹

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Authorised Capital-divided into 5,000 6% Preference Shares of ₹ 100 each and 10,000 equity Shares of Rs. 100 each			15,00,000
Subscribed Capital -			
5,000 6% Preference Shares of Rs. 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	
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 Rs. 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			

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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 Rs. 7,20,000, that is 6,000 shares fully paid and 2,000 shares Rs. 60 paid. The directors made a call of Rs. 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 @ Rs. 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.

Answer 4

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**
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

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	Changes in inventories of finished goods work-in-progress and Inventory-in-Trade	13	(9,700)
	Employee benefits expense	14	29,580
	Finance costs	15	12,000
	Other expenses	16	40,200
	Depreciation and amortisation expense	17	21,315
	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 Rs.100 each		10,00,000
	Issued & subscribed		
	8,000 Equity Shares of Rs.100 each (A)		8,00,000
	Preference share capital		
	Authorised		
	5,000 6% Preference shares of Rs.100 each		5,00,000
	Issued & subscribed		
	5,000 6% Preference shares of Rs.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	
	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

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	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	**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	53,700
	Total		**1,79,700**
10	**Other Income**		
	Transfer fees	700	
	Miscellaneous Receipts	2,800	
	Discount received	3,300	
	Total		**6,800**
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 goodswork-in-progress and Inventory-in-Trade**		
	Wines, Cigarettes etc.		
	Opening Inventory	12,800	
	Less: Closing Inventory	(22,500)	(9,700)
	Total		**(9,700)**

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14	**Employee benefits expense**		
	Wages and Salaries	28,300	
	Add: Wages and Salaries Outstanding	1,280	29,580
	Total		**29,580**
16	**Other expenses**		
	operating expenses		
	Rent, Rates and Taxes	8,900	
	Coal and Firewood	3,290	
	Laundry	750	
	Carriage and Cooliage	810	
	Repairs	4,250	**18,000**
	Selling and administrative expenses		
	Advertising	8,360	
	Sundry Expenses	5,840	**14,200**
			8,000
		Total	**40,200**
17	**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 inthe financial statements for the year ended 31 March, 20X2. Such dividends willbe disclosed in notes only.

Question 5 (Illustration)

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 notesat the foot of the Balance Sheet as may be found necessary -

		Debit ₹	Credit ₹
Equity Capital (Face value of Rs. 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		

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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 Rs. 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 Corporationis 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.

Answer 5

Pioneer Ltd. Balance Sheet as at 31st March, 20X1

	Particulars	Notes	Rs.
	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
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

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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 Rs. 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)		1,42,500
	(Secured by hypothecation of Plant and Machinery)		
	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

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	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 Rs. 1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

Question 6 (Illustration)

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		

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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.

Answer 6

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)

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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	

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	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

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Multiple Choice Questions

1. **Trade payables as per Schedule III will include:**
   (a) Dues payable in respect to statutory obligation
   (b) Interest accrued on trade payables
   (c) Bills payables.
   (d) Bills receivables

Ans: (c)

2. **Securities Premium Account is shown on the liabilities side in the Balance Sheet under the heading:**

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(a) Reserves and Surplus.
(b) Current Liabilities.
(c) Share Capital.
(d) Share application money pending allotment

Ans: (a)

3. "Fixed assets held for sale" will be classified in the company's balance sheet as
(a) Current asset
(b) Non-current asset
(c) Capital work- in- progress
(d) Deferred tax assets

Ans: (a)

4. Current maturities of long term debt will come under
(a) Current Liabilities.
(b) Short term borrowings.
(c) Long term borrowings.
(d) Short term Provisions

Ans: (b)

5. Declaration of dividends for current year is made after providing for
(a) Depreciation of past years only.
(b) Depreciation on assets for the current year and arrears of depreciation of past years (if any).
(c) Depreciation on current year only and by forgoing arrears of depreciation of past years.
(d) Excluding current year depreciation

Ans: (b)

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Theoretical Questions Answers

Question 1

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.

Answer 1

(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 2

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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:

	Rs.
Equity shares capital, fully paid shares of Rs. 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 Rs. 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 Rs. 18,000 with a bank which is not a scheduled Bank and the deposits of Rs. 5 lakhs are for a period of 9 months.

(vi) Unsecured loan includes Rs. 2,00,000 from a Bank and Rs. 1,00,000 from related parties.

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(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.

Answer 2

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	Short term borrowings	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

			Rs.
1	**Share Capital**		
	Equity share capital		
	Issued, subscribed and called up 7,00,000 Equity Shares of Rs. 10 each (Out of the above 4,20,000 shares have been issued for consideration other than cash)	70,00,000	

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	Less: Calls in arrears	(7,000)	69,93,000
	Total		69,93,000
2	**Reserves and Surplus**		
	General Reserve	15,49,100	
	Less: Preliminary expenses	(93,100)	14,56,000
	Surplus (Profit & Loss A/c)		7,00,000
	Total		21,56,000
3	**Long-term borrowings**		
	Secured		
	Term Loans		
	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	8,47,000
	Total		16,97,000
4	**Short term borrowings**		
	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
8	**Trade receivables**		17,50,000
	Debts outstanding for a period exceeding six months		3,80,000
	Other Debts		10,20,000
	Total		14,00,000

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9	**Cash and bank balances**		
	Cash and cash equivalents		
	Cash at bank with Scheduled Banks	12,11,000	
	with others	18,000	12,29,000
	Cash in hand		2,10,000
	Other bank balances		
	Bank deposits for period of 9 months		5,00,000
	Total		19,39,000

Question 3

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 &

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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.

Answer 3

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 assets**		
	a	Long-term borrowings	3	13,17,500
3		**Current liabilities**		
	a	Trade Payables		8,00,000
	b	Short term provision	5	6,40,000
	c	Short term borrowings	4	2,00,000
	d	Other current liabilities: Interest accrued but not due on loans (SFC)		37,500
		Total		**94,73,500**
1		**Assets**		
		Non-current assets		
		PPE	6	56,25,000
2		**Current assets**		
	a	Inventory	7	12,50,000
	b	Trade receivables	8	10,00,000
	c	Cash and Cash equivalents	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 Rs. 100 each (of the above 10,000 shares have been issued for consideration other than cash)	50,00,000	
	Less: Calls in arrears	(5,000)	49,95,000

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	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	**Short term Borrowings**		
	Loans and advances		2,00,000
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) (b.f.)	27,50,000
	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**		
	Outstanding for a period exceeding six months		2,60,000
	Other Amounts		7,40,000
	Total		**10,00,000**
9	**Cash and bank balances**		

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	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 4

Ring Ltd. was registered with a nominal capital of Rs. 10,00,000 divided into shares of Rs. 100 each. The following Trial Balance is extracted from the books on 31st March, 20X2:

Particulars	Rs.	Particulars	Rs.
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
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 Rs. 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 Rs. 16,000 on Building and that of Rs. 24,000 on

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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 Rs. 20,000.

Answer 4

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 income [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	Notes	₹
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 assets**		
	(a)	Long-term borrowings (14% debentures)		4,00,000
	(3)	**Current liabilities**		
	(a)	Trade Payables		1,84,00,000
	(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**		

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	(a)	Inventory	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 (Interest accrued on investments)		4,000
		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 Rs. 100 each		10,00,000
	Issued Capital		
	4,000 Equity Shares of Rs. 100 each		4,00,000
	Subscribed Capital and fully paid		
	4,000 Equity Shares of Rs. 100 each		4,00,000
2.	**Reserve and Surplus**		
	General Reserve [Rs. 80,000 + Rs. 21,280]		1,01,280
	Balance of Statement of Profit & Loss Account		
	Opening Balance	50,000	
	Add: Profit for the period	2,12,800	
		2,62,800	
	Appropriations		
	Transfer to General Reserve @ 10%	(21,280)	2,41,520
			3,42,800
3.	**Other Current Liabilities**		
	Unclaimed Dividend		10,000
	Outstanding Expenses		4,000
	Interest accrued on Debentures		28,000
			42,000
4.	**Short-Term Provision**		
	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
			5,70,000

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6	**Inventories**		
	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 Rs. 2,50,000 less Rs. 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 5

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 (Rs.)	
	Debit	Credit
Equity Share Capital, fully paid shares of Rs. 50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	
Plant & Machinery	24,00,000	
Furniture & Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		26,30,000
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	

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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 Rs. 4,86,000 due for more than 6 months.

(4) Balances with banks include Rs. 56,000, the Naya bank, which is not a scheduled bank.

(5) Loan from Public Finance Corporation repayable after 3 years.

(6) The balance of Rs. 26,30,000 in the loan account with Public Finance Corporation is inclusive of Rs.1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.

(7) Other long term loans (unsecured) includes:

Loan taken from Nixes Bank	Rs. 13,80,000
(Amount repayable within one year	Rs. 4,80,000)
Loan taken from Directors	Rs. 8,50,000

(8) Bills Receivable for Rs. 1,60,000 maturing on 15th June, 20X1 has been discounted.

(9) Short term borrowings includes:

Loan from Naya bank	Rs. 1,16,000 (Secured)
Loan from directors	Rs. 48,000

(10) Transfer of Rs. 35,000 to general reserve has been proposed by the Board of directors out of the profits for the year.

(11) Inventory of finished goods includes loose tools costing Rs. 5 lakhs (which do not meet definition of property, plant & equipment as per AS 10)

You are required to prepare the Balance Sheet of the Company as on March 31st 20X1 as required under Part - I of Schedule III of the Companies Act, 2013.

You are not required to give previous year figures.

Answer 5

SR Ltd.

Balance Sheet as at 31st March, 20X1

Particulars		Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities			
1	Shareholders' funds		
a	Share capital	1	79,85,000
b	Reserves and Surplus	2	30,21,000
2	Non-current liabilities		

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a	Long-term borrowings	3	42,66,000
3	**Current liabilities**		
a	Short-term borrowings	4	9,40,000
b	Trade Payables		8,13,000
c	Other current liabilities	5	2,04,000
d	Short-term provisions	6	3,80,000
	Total		1,76,09,000
Assets			
1	**Non-current assets**		
a	PPE	7	92,00,000
2	**Current assets**		
a	Inventories	8	58,00,000
b	Trade receivables	9	17,50,000
c	Cash and cash equivalents	10	4,84,000
d	Short-term loans and advances		3,75,000
	Total		1,76,09,000

Notes to accounts

				Rs.
1.	**Share Capital**			
	Equity share capital Issued, subscribed and called up 1,60,000 Equity Shares of Rs. 50 each (Out of the above 50,000 shares have been issued for consideration other than cash)		80,00,000	
	Less: Calls in arrears		(15,000)	79,85,000
2.	**Reserves and Surplus**			
	General Reserve		9,41,000	
	Add: Transferred from Profit and loss account		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 3years (Rs. 26,30,000 – Rs. 1,34,000 for interest accrued but not due)] (secured by hypothecation of land)			24,96,000
	Unsecured			
	Bank Loan (Nixes bank)	9,00,000		
	(Rs. 13,80,000 - Rs. 4,80,000 repayable within 1			

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	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 Nixes bank repayable within one year (Current maturity of Long term borrowing)		4,80,000	
	Loan from Directors		48,000	
	Others		2,96,000	9,40,000
5.	**Other current liabilities**			
	Unpaid dividend		70,000	
	Interest accrued but not borrowings Due on		1,34,000	2,04,000
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 bank		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

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Illustrations

Question 1 (Illustration)

Intelligent Ltd., a non-financial company has the following entries in its Bank Account. It has sought .

(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.

Answer 1

(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 fromInvesting activities'.

Question 2 (Illustration)

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

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(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.

Answer 2

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**

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Question 3 (Illustration)

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

Answer 3

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 (Illustration)

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**
		3,246
Payments to suppliers	**2,047**	
Payments for property, plant & equipment	**230**	
Payments for overheads	**115**	
Wages and salaries	**69**	
Taxation	**243**	
Dividends	**80**	
Repayments of bank loan	**250**	**(3,034)**

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Balance at 31.3.20X2		**212**

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31stMarch, 20X2 in accordance with AS-3 (Revised).

The company does not have any cash equivalents.

Answer 4

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 (Illustration)

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 Rs. 45,000).
(11) Investments of ₹ 7,00,000 sold during the year at a profit of Rs. 20,000.
(12) Depreciation on fixed assets amounts to Rs. 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.

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(15) Cash and Cash Equivalents on 31st March, 20X1 ₹ 6,07,500.

Answer 5

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 (Illustration)

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)**
		1,78,000
Operating Expenses		
(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)

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		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 on31st 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.

Answer 6

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	

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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 theperiod		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 (Illustration)

The balance sheets of Sun Ltd. as at 31st March 20X1 and 20X0 were as:

Particulars			Notes	₹ 20X0	₹ 20X1
		Equity and Liabilities			
1		**Shareholders' funds**			
	(a)	**Share capital**	**1**	**60,000**	**50,000**
	(b)	**Reserves and Surplus**	**2**	**5,000**	**4,000**
2		**Current liabilities**			
	(a)	**Trade Payables**		**4,000**	**2,500**
	(b)	**Other current liabilities**	**3**	**-**	**1,000**

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	(c)	Short term provision (provision for tax)		1,500	1,000
		Total		70,500	58,500
Assets					
1		Non-current assets			
	(a)	Property, plant and Equipment	4	39,500	29,000
2		Current assets			
	(a)	Current Investments		2,000	1,000
	(b)	Inventory		17,000	14,000
	(c)	Trade receivables		8,000	6,000
	(d)	Cash and Cash equivalents	5	4,000	8,500
		Total		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
	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

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Prepare a Cash Flow Statement for the year ended 31st March, 20X1.

Answer 7

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 ofperiod (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:

			Rs.
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**		

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	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
		Rs.	Rs.
	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 (Illustration)

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**

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Prepare the Cash Flow Statement for the year ended 31 March 20X1 in accordancewith AS 3. (Make necessary assumptions)

Answer 8

Star Oils Limited Cash flow Statement for the year ended 31st March, 20X1

		(Rs. 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)	(2,895)
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		
Cash flows from investing activities		
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Receipt of grant for capital projects	12	
Interest income on investments	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 (Illustration)

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statementfor 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

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	₹ 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**

Answer 9

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 (Illustration)

Given below are the relevant extracts of the Balance Sheet and the Statement of Profitand Loss of ABC Ltd. along with additional information:

Extract of Balance sheet

		Particulars	Notes	31.3.20X1 (Rs. in lakhs)	31.3.20X0 (Rs. in lakhs)
		Equity and Liabilities			
1		**Current liabilities**			
	(a)	**Trade Payables**		**250**	**230**

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	(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 income (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 fromcontinuing operations		510

Appropriations

Balance of Profit and Loss account brought forward	50
Transfer to general reserve	200
Dividend paid	330

Notes to accounts:

		20X1 (Rs. in lakhs)	20X0 (Rs. 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.

Answer 10

Cash Flows from Operating Activities

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	Rs. in lakhs	Rs. in lakhs
Using Direct Method		
Cash Receipts:		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – ClosingTrade receivables (A)	4,150 + 250 - 400	4,000
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 : Investmentcash 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 (Illustration)

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the followinginformation:

(1) Sales for the year amounted to Rs. 135 crores out of which 60% was cash sales.

(2) Purchases for the year amounted to Rs. 55 crores out of which credit purchase was 80%.

(3) Administrative and selling expenses amounted to Rs. 18 crores and salary paid amounted to Rs. 22 crores.

(4) The Company redeemed debentures of Rs. 20 crores at a premium of 10%. Debenture holders were issued equity shares of Rs. 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was Rs. 1.5 crores.

(5) Dividend paid during the year amounted to Rs. 11.7 crores.

(6) Investment costing Rs. 12 crores were sold at a profit of Rs. 2.4 crores.

(7) Rs. 8 crores was paid towards income tax during the year.

(8) A new plant costing Rs. 21 crores was purchased in part exchange of an old plant. The book value of the old plant was Rs. 12 crores but the vendor took over theold plant at a value of Rs. 10 crores

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only. The balance was paid in cash to the vendor.

(9) The following balances are also provided:

	Rs. in crores 1.4.20X0	Rs. in crores31.3.20X1
Debtors	45	50
Creditors	21	23
Bank	6	18.2

Answer 11

Gamma Ltd. Cash Flow Statement for the year ended 31st March, 20X1(Using direct method)

Particulars	Rs. in crores	Rs. in crores
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors [45+ (135x40%) - 50]	49	
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers [21+ (55x80%) – 23]	(42)	
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 (Illustration)

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

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	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**
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 Rs. 80,000 (accumulated depreciation there on Rs.24,000) was soldfor Rs. 40,000. The provision for depreciation on 1.4.20X0 was Rs. 2,00,000 and 31.3.20X1 was Rs. 3,20,000. The net profit for the year ended on 31.3.20X1 was Rs. 3,60,000.

Answer 12

Cash Flow Statement of Mr. Zen as per AS 3for the year ended 31.3.20X1

			Rs.
(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**

	Rs.		Rs.
To Balance b/d	8,40,000	By Cash – Sales	40,000

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(6,40,000 + 2,00,000)		By Provision forDepreciation 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**

	Rs.		Rs.
To Plant and MachineryA/c	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Profit & Loss A/c (Bal. fig.)	1,44,000
	3,44,000		3,44,000

3. **To find out Mr. Zen's drawings:**

	Rs.
Opening Capital	10,00,000
Add: Net Profit	3,60,000
	13,60,000
Less: Closing Capital	(12,24,000)
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.

Test your knowledge

Multiple Choice Questions

1. While preparing cash flow statement, conversion of debt to equity

(a) Should be shown as a financing activity.
(b) Should be shown as an investing activity.
(c) Should not be shown as it is a non-cash transaction.
(d) Should not be shown as operating activity

Ans: (c)

2. Which of the following would be considered a 'cash-flow item from an "investing" activity'?

(a) Cash outflow to the government for taxes.
(b) Cash outflow to purchase bonds issued by another company.
(c) Cash outflow to shareholders as dividends.
(d) Cash outflow to make payment to trade payables.

Ans: (b)

3. All of the following would be included in a company's operating activities except:

(a) Income tax payments
(b) Collections from customers or Cash payments to suppliers
(c) Dividend payments.
(d) Office and selling expenses.

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Ans: (c)

4. Hari Uttam, a stock broking firm, received Rs. 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?

(a) Operating Activities.
(b) Investing Activities.
(c) Financing Activities.
(d) Non-cash transactions

Ans: (a)

5. 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

(a) Operating activity.
(b) Financing activity.
(c) Investing activity.
(d) Non-cash transactions

Ans: (c)

Theoretical Questions Answers

Question 1

What is the significance of cash flow statement? Explain in brief.

Answer 1

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 2

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

Answer 2

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.

Scenario-based Questions

Question 3

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

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(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

Answer 3

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 4

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**

Answer 4

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)

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

Question 5

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		
	General 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 (issued at end of year)	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.

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(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.

Answer 5

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 (10,00,0008,00,000)	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 decrease in cash and cash equivalents		(2,00,000)
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

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	₹		₹
To Balance b/d	5,00,000	By Depreciation	1,25,000
To Profit and Loss A/c	15000		
(profit on sale of machine)			
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 6

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 ₹
1		Equity and Liabilities			
		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
2	Reserves and Surplus			
	Capital redemption reserve		1,00,000	-
	Capital reserve		70,000	-

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	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.

Answer 6

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)	(35,000)	
Increase in Trade payables	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	

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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

Significant Non-cash Items:

Debentures amounting to ₹ 1,00,000 have been issued as part consideration for acquisition of plant of ₹ 4,50,000.

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

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	₹		₹
To Balance b/d	80,000	By Cash (Sale)	70,000
To Profit and loss account	20,000	By Dividend (Pre-acquisition)	5,000
To Bank (Balancing figure)	25,000	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	By Balance c/d	1,00,000
To Bank (Balancing figure)	35,000		
	1,00,000		1,00,000

Question 7

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**

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	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, plantand 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
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, thecost 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.

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(v) Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the year end.

(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.

Answer 7

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 Premium on redemption of preference share capital	(40,000) 6,000	
	Interest on debentures	36,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	9,80,000	
	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	10,04,000	
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		6,44,000
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)	
	Interest on debentures	(36,000)	
	Net Cash generated from financing activities		(8,000)

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	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 8

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

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Particulars			Notes	₹ 31st March 20X0	₹ 31st March 20X1
		Equity and Liabilities			
1.		Shareholders' funds			
	A	Share capital		50,00,000	50,00,000
	B	Reserves and Surplus		26,50,000	36,90,000
2.		Non-current liabilities			
		Long term borrowings	1	-	9,00,000
3.		Current liabilities			
	A	Short-term borrowings (Bank loan)		1,50,000	3,00,000
	B	Trade payables		8,80,000	8,20,000
	C	Other current liabilities	2	4,80,000	2,70,000
		Total		91,60,000	1,09,80,000
		Assets			
1.		Non-current assets			
	A	Property, plant and Equipment	3	21,20,000	32,80,000
2.		Current assets			
	A	Current Investments		11,80,000	15,00,000
	B	Inventory		20,10,000	19,20,000
	C	Trade receivables	4	22,40,000	26,40,000
	D	Cash and Cash equivalents		15,20,000	15,20,000
	E	Other Current assets (Prepaid expenses)		90,000	1,20,000
		Total		91,60,000	1,09,80,000

Notes to accounts

No.	Particulars		₹20X0	20X1
1	Long term borrowings			
	9% Debentures (issued at the end of year)		-	9,00,000
	Total		-	9,00,000
2.	Other current liabilities			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		4,80,000	2,70,000
3	Property, plant and equipment			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		21,20,000	32,80,000
4	Trade receivables			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000)	(1,90,000)
	Total		22,40,000	26,40,000

Additional Information:

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹

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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.

Answer 8

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		2,70,000	
(₹ 4,20,000 – ₹1,50,000)			
Operating Profit Before Working Capital Changes		14,90,000	
Add: Decrease in Inventories		90,000	
(₹ 20,10,000 – ₹ 19,20,000)			
		15,80,000	
Less: Increase in Current Assets			
Trade Receivables			
(₹ 30,60,000 – ₹23,90,000)	6,70,000		
Prepaid Expenses (₹ 1,20,000 – ₹90,000)	30,000		
Decrease in Current Liabilities:			
Trade Payables (₹ 8,80,000 – ₹ 8,20,000)	60,000		
Expenses Outstanding (₹ 3,30,000 – ₹ 2,70,000)	60,000	(8,20,000)	
Net Cash generated from Operating Activities			7,60,000
Cash Flows from Investing Activities			
Investment in Current Investments		(3,20,000)	
Purchase of Plant & Machinery			
(₹ 40,70,000 – ₹ 27,30,000)		(13,40,000)	
Net Cash Used in Investing Activities			(16,60,000)
Cash Flows from Financing Activities			
Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000)		1,50,000	
Issue of Debentures		9,00,000	
Payment of Dividend		(1,50,000)	
Net Cash Used in Financing Activities			9,00,000
Net Increase in Cash During the Year			-
Add: Cash and Cash Equivalents as on 1.4.20X0			15,20,000
Cash and Cash Equivalents as on 31.3.20X1			15,20,000

Note:

1. Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

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Question 9

Following is the Balance Sheet of Fox Ltd. You are required to prepare cash flow statement using Indirect Method.

Particulars	Note No.	31st March,20X2 (₹)	31st March,20X1(₹)
(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,20X2 (₹)	31st March,20X1 (₹)
1. Share capital		
(a) Equity share capital	4,10,000	2,00,000
(b) Preference share capital	1,50,000	1,00,000
	5,60,000	3,00,000
2. Reserve and surplus		
Surplus in statement of profit and	25,000	
loss at the beginning of the year		
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.**

Answer 9

Fox Ltd.

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Cash Flow Statement for the year ended 31st March, 20X2

	₹	₹
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 31.3.20X2	3,50,000
Add back:	
Depreciation for the year	40,000
	3,90,000
Less: W.D.V. at 31.12.20X1	1,80,000
Acquisitions during 20X1-20X2	2,10,000

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Illustrations

Question 1 (Illustration)

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

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	Total	6,310
3	**Long term borrowings**	
	10% Debentures	400
4	**Property, Plant and Equipment (PPE)**	
	PPE: Cost	3,000
	Less: Provision for depreciation	(250)
	Net carrying value	2,750

The company passed a resolution to buy-back 20% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹30 lakhs for ₹ 25 lakhs.
You are required to pass necessary Journal entries.

Answer 1

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 (Being investment sold for the purpose of buy-back of Equity Shares)			3,000
2.	Equity share capital A/c	Dr.	600	
	Premium payable on buy-back	Dr.	300	
	To Equity shares buy-back A/c (Being the amount due on buy-back of equity shares)			900
3.	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c (Being payment made for buy-back of equity shares)			900
4.	Securities Premium A/c	Dr.	300	
	To Premium payable on buy-back (Being premium payable on buy-back charged from Securities premium)			300
5.	Revenue reserve A/c	Dr.	600	
	To Capital Redemption Reserve A/c (Being creation of capital redemption reserve to the extent of the equity shares bought back)			600

Question 2 (Illustration)

Anu Ltd. (a non-listed company) furnishes you with the following balance sheet as at 31st March, 20X1:

				(in crores ₹)
		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders 'funds**		
	A	Share capital	1	100

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	B	Reserves and Surplus	2	300
2		**Current liabilities**		
	A	Trade Payables		40
		Total		440
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
2		**Current assets**		
	A	Trade receivables		140
	B	Cash and Cash equivalents		200
		Total		440

Notes to accounts

No.	**Particulars**	**₹**
1	**Share Capital**	
	Authorized, issued and subscribed share capital:	
	12% Redeemable preference shares of ₹ 100 each, fully paid up	75
	Equity shares of ₹ 10 each, fully paid up	25
	Total	100
2	**Reserves and Surplus**	
	Capital reserve	15
	Securities premium	25
	Revenue reserves	260
	Total	300
3	**Property, Plant and Equipment**	
	PPE Cost	100
	Less: Provision for depreciation	(100)
	Net carrying value	NIL
4	**Non-Current Investments**	
	Non-current investments at cost (Market value ₹ 400 Cr.)	100

The company redeemed preference shares on 1st April, 20X1. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

(i) Pass journal entries to record the above.

(ii) Prepare balance sheet as at 1.4.20X1.

Answer 2

(i) Journal entries in the books of Anu Ltd.

₹ in crores

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	Particulars		Dr.	Cr.
1st April, 20X1	12% Preference share capital A/c	Dr.	75	
	To Preference shareholders A/c (Being preference share capital accounttransferred to shareholders account)			75
	Preference shareholders A/c	Dr.	75	
	To Bank A/c (Being payment made to shareholders)			75
	Shares buy-back A/c	Dr.	25	
	To Bank A/c (Being 50 lakhs equity shares bought back @ ₹ 50 per share)			25
	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 (Being cancellation of shares bought back)			25
	Revenue Reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5) (Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			80

(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		₹

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1	**Share Capital**		
	Authorized, issued and subscribed share capital		
	200 lakhs Equity shares of ₹10 each fully paid		20
	Total		20
2	**Reserves and Surplus**		
	Capital reserve		15
	Capital redemption reserve		80
	Securities premium	25	
	Less: Utilization for buy-back of shares	(20)	5
	Revenue Reserve	260	
	Less: transfer to Capital redemption reserve	(80)	180
	Total		280
3	**Property, plant and Equipment**		
	PPE: cost		100
	Less: Provision for depreciation		(100)
	Net carrying value		-
4	**Non-Current Investments**		
	Non-current investments at cost		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 (Illustration)

Dee Limited (a non-listed company) furnishes the following Balance Sheet as at 31st March, 20X1:

				(in thousand ₹)
		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,700
	B	Reserves 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

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	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 (Issued two months back for the purpose of buy-back)	200
	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.

Answer 3

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 (Being the investments sold at loss for the purpose of buy-back)			3,000
(ii)	Equity Share buy-back Account	Dr.	2,500	
	To Bank Account (Being the payment made on buy-back)			2,500
(iii)	Equity Share Capital Account	Dr.	500	
	Premium Payable on Buy-Back Account	Dr.	2,000	
	To Equity Shares Buy-Back Account (Being the buy-back amount allocated to equity share capital)			2,500
(iv)	Securities premium Account	Dr.	2,000	
	To Premium payable on buy-back Account (Being the premium payable on buy-back adjustedagainst securities premium account)			2,000

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(v)	Revenue reserve Account	Dr.	300	
	To Capital Redemption Reserve Account (Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)			300

Balance Sheet of Dee Limited as at 1st April, 20X1
(After buy-back of shares)

				(in thousand ₹)
		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	2,200
	B	Reserves and Surplus	2	6,900
2		**Current liabilities**		
	A	Trade Payables		1,400
		Total		10,500
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		9,300
2		**Current assets**		
	A	Inventories		500
	B	Trade receivables		200
	C	Cash and Cash equivalents		500
		Total		10,500

Notes to accounts

No.	**Particulars**		**₹**
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	2,50,000 Equity shares of ₹10 each fully paid up		2,000
	2,000, 10% Preference shares of ₹100 each		200
	(Issued two months back for the purpose of buy-back)		-----
	Total		2,200
2	**Reserves and Surplus**		
	Capital reserve		1,000
	Capital redemption reserve		300
	Securities Premium	2,200	
	Less: Premium payable on buy-back of shares	(2,000)	200
	Revenue reserve	3,000	
	Less: Transfer to Capital redemption reserve	(300)	2,700
	Profit and loss A/c	3,500	

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	Less: Loss on investment	(800)	2,700
	Total		6,900

Question 4 (Illustration)

Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March, 20

				(in lakhs ₹)
		Particulars	**Notes**	**₹**
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	120
	B	Reserves and Surplus	2	118
2		**Non-current liabilities**		
		Long term borrowings	3	4
3		**Current liabilities**		
	A	Trade Payables		70
		Total		312
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50
	B	Non-current Investments		120
2		**Current assets**		
	A	Cash and Cash equivalents		142
		Total		312

Notes to accounts

No.	**Particulars**	**₹**
1	**Share Capital**	
	Authorized, issued and subscribed capital:	
	Equity shares of ₹ 10 each fully paid	100
	9% Redeemable preference shares of ₹ 100 each fully paid	20
	Total	120
2	**Reserves and Surplus**	
	Capital reserves	8
	Revenue reserves	50
	Securities premium	60
	Total	**118**
3	**Long term borrowings**	
	10% Debentures	4

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 20X1.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share. The payment for the above was made out of huge bank balances.

(iii) Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.

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(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.

Answer 4

				(₹ in lakhs)
Date	**Particulars**		**Debit**	**Credit**
20X1 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 (Being preference share capital transferred toshareholders account)			22.00
	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 (Being 3 lakhs equity shares of ₹ 10 eachbought back @ ₹ 30 per share)			90.00
	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy-back A/c (Being cancellation of shares bought back)			90.00
	Revenue reserve A/c	Dr.	50.00	
	To Capital redemption reserve A/c (Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)			50.00
	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debenturesA/c (Being cancellation of own debentures costing ₹2 lakhs, face value being ₹2.20 lakhs and the Balance being profit on cancellation ofdebentures)			0.20
	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Currentliabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00
	To Securities premium A/c (Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)			10.00

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	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preferenceshares A/c (Being premium on redemption of preference shares adjusted through securities premium)			2.00

Balance Sheet of Extra Ltd. as at 01.04.20X1

				(in lakhs ₹)
		Particulars	**Notes**	**₹**
1		**Equity and Liabilities**		
		Shareholders' funds		
	A	Share capital	1	75.00
	B	Reserves and Surplus	2	66.20
2		**Non-current liabilities**		
		Long term borrowings	3	1.80
3		**Current liabilities**		
	A	Other Current Liabilities	4	65.00
		Total		208
		Assets		
1		**Non-current assets**		
	A	Property, plant and Equipment		50.00
	B	Non-current Investments	5	118.00
2		**Current assets**		
	A	Cash and Cash equivalents	6	40.00
		Total		208

Notes to accounts

No.	**Particulars**		**₹**
1	**Share Capital**		
	Equity shares of ₹10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		5
	Total		75
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-
	Securities Premium		
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	

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	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 (Illustration)

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.

Answer 5

Debt Equity Ratio Test

	Particulars	₹
(a)	Loan funds	42,00,000

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(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 bebought back @ ₹30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	₹
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	42,80,000
	72,80,000

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.
Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.
Equation 1 : (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity.
(72,80,000 –x)-21,00,000 = y (1)
Since 51,80,000 – x = y
Equation 2 : $\left(\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \text{ X Nominal Value}\right)$
= Nominal value of the shares bought –back to be transferred to CRR
$= \left(\frac{y}{30} \times 10\right) = x$
3x = y (2)
x = ₹ 12,95,000 crores and y
= ₹ 38,85,000 crores

Question 6 (Illustration)

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**		

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	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.

Answer 6

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 (Being buy-back of 3.75 crores equity shares of ₹10each @ ₹30 per share)			112.5
(b)	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
	To Equity share buy-back account (Being cancellation of shares bought back)			112.5
(c)	General reserve account	Dr.	37.5	
	To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal valueof share capital			37.5

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	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 theratio of 2:1 (₹in crores)	900	600	750
(c)	Present equity shareholders fund (₹in crores)	750	750	750
(d)	Future equity shareholder fund (₹in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] **(SeeNote 2)**	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares thatcan 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 reserveafter 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 outof 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-

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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

Equation 2: $\left[\frac{\text{Maximumbuy-back}}{\text{Offer price for buy-back}} \times \text{Nominal Value}\right]$

= 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

Test your knowledge

Multiple Choice Questions

1. As per section 68(1) of the Companies Act, buy-back of own shares by thecompany, shall not exceed

(a) 25% of the total paid-up capital and free reserves of the company.
(b) 20% of the total paid-up capital and free reserves of the company.
(c) 15% of the total paid-up capital and free reserves of the company.
(d) 10% of the total paid-up capital and free reserves of the company

Ans: (a)

2. The companies are permitted to buy-back their own shares out of

(a) Free reserves and Securities premium
(b) Proceeds of the issue of any shares.
(c) Both (a) and (b)
(d) Neither (a) and (b)

Ans: (c)

3. 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

(a) Revenue redemption reserve.
(b) Capital redemption reserve.
(c) Buy-back reserve
(d) Special reserve

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Ans: (b)

4. **State which of the following statements is true?**
   (a) Buy-back is for more than twenty-five per cent of the total paid-up capital and free reserves of the company.
   (b) Partly paid shares cannot be bought back by a company.
   (c) 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.
   (d) Partly paid shares can be bought back by a company.

Ans: (b)

5. **Premium (excess of buy-back price over the par value) paid on buy-back should be adjusted against**
   (a) Free reserves.
   (b) Securities premium.
   (c) Both (a) and (b).
   (d) Neither (a) nor (b).

Ans: (c)

6. **Advantages of Buy-back of shares include to**
   (a) Encourage others to make hostile bid to take over the company.
   (b) Decrease promoters holding as the shares which are bought back are cancelled.
   (c) Discourage others to make hostile bid to take over the company as the buy-back will increase the promoters holding.
   (d) All of the above.

Ans: (c)

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Theoretical Questions Answers

Question 1

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.

Answer 1

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares.

The Companies Act, 2013 under Section 68 (1) permits companies to buy-back theirown shares and other specified securities out of:

(i) its free reserves; or
(ii) the securities premium account; or
(iii) the proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. For example, if equity shares are to be bought-back, then, preference shares may be used for the purpose.

The other important provisions relating to the buy-back are:

(1) Section 68 (2) further states that no company shall purchase its own shares or other specified

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securities unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back;

However, the above provisions do not apply where the buy-back is ten percent or less of the paid-up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy-back is up to 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

(c) the buy-back must be equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company: (Resource Test)

(d) Further, the buy-back of shares in any financial year must not exceed25% of its total paid-up capital and free reserves: (Share Outstanding Test)

(e) the ratio of the debt owed by the company (both secured and unsecured) after such buy-back is not more than twice the total of its paid-up capital and its free reserves: (Debt-Equity Ratio Test)

Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. Debt here should include both long-term debt as well as short term debt.

(f) all the shares or other specified securities for buy-back are fully paid-up;

(g) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations madeby the Securities and Exchange Board of India in this behalf;

(h) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Provided that no offer of the buy-back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy-back if any. This means that there cannot be more than one buy- back in one year.

(2) The notice of meeting at which special resolution is supposed to be passed must be accompanied by an explanatory statement stating-

(a) a full and complete disclosure of all material facts;

(b) the necessity of the buy-back;

(c) the class of security intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back;

(e) the time limit for completion of the buy-back.

(3) Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors.

(4) The buy-back may be—

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(5) Where a company has passed a special resolution under clause (b) of Sub- section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed

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and verified by an affidavit to the effect that the Board of Directors has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board of Directors. It must be signed by at least two directorsof the company, one of whom shall be the managing director, if any:

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(6) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

(7) Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(8) Where a company buy-back its securities under this section, it shall maintaina register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(9) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares arenot listed on any recognised stock exchange.

(10) If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakh but whichmay extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fineof not less than one lakh rupees but which may extend to three lakh rupeesor with both.

(11) Section 69 (1) states that where a company purchases its own shares out ofthe free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

(12) The shares or other specified securities which are proposed to be bought- back must be fully paid-up.

(13) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(14) Premium (excess of buy-back price over the par value) paid on buy-backshould be adjusted against free reserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buy-back of securities.

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default is subsisting, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank. Provided that the buy–back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.

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(2) In accordance with schedule III, no company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (filling of annual return), 123 (payment of dividend within 30 days of declaration), 127 (failure to distribute dividend) and 129 (preparation of financial statement of the company).
Explanation I.— For the purposes of Section 68 and Section 70 of the companies Act, 2013 "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

Explanation II. — For the purposes of Section 68, "free reserves" includes securities premium account.

Scenario based Questions

Question 2

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	320	320
	(Statutory Reserve)		
(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.

Answer 2

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			

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	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	Dr.	400	
	Reserve / Profit & Loss A/c	Dr.	80	
	To Premium Payable on buy-back account			480
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/c)			
(c)	General Reserve / Profit & Loss A/c	Dr.	240	
	To Capital redemption reserve 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.

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(e)	Maximum permitted buy- back of Equity (₹) [(d) – (b)]	960	Nil
(f)	Maximum number of shares that can be bought back @₹ 30 per share	32 crore shares	Nil
	As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity - Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy-Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy-Back *X* Nominal Value Per Share/Offer Price Per Share

y/30 x 10 = x

or

3x = y (2)

by solving the above two equations we get

x= ₹ 320

y = ₹ 960

Question 3

KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	₹
1		Equity and Liabilities		
		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

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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.

Answer 3

In the books of KG Limited Journal Entries

Date	Particulars		Dr.	Cr.
20X1			(₹ in lakhs)	
April 1	Bank A/c	Dr.	75	
	To Investment A/c			74
	To Profit on sale of investment			1
	(Being investment sold on profit)			
April 5	Equity share capital A/c	Dr.	300	
	Securities premium A/c	Dr.	150	
	To Equity shares buy-back A/c			450
	(Being the amount due to equity shareholders on buy-			

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	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
April 30	(Being amount equal to nominal value of buy- back shares from free reserves transferred to capital redemption reserve account as per the law)		
	Capital redemption reserve A/c Dr.	225	
	To Bonus shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)		225
	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

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No.	Particulars		₹
1	**Share Capital**		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹		
	10 each)		1,125
2	**Reserves and Surplus**		
	General Reserve	265	
	Less: Transfer to CR	(265)	-
	Capital Redemption Reserve	200	
	Add: Transfer due to buy-back of shares		
	from P/L	35	
	Add; Transfer due to buy-back of shares		
	from General Reserve	265	
	Less: Utilisation for issue of bonus shares	(225)	275
	Securities premium	175	
	Less: Adjustment for premium paid on buy- back	(150)	25
	Profit & Loss A/c	170	
	Add: Profit on sale of investment	1	
	Less: Transfer to CRR	(35)	136
	Total		436
3	**Long term borrowings**		
	12% Debentures		750
4	**Property, Plant and Equipment**		
	Land and Building		1,800
	Plant and machinery		226
	Net carrying value		2,026

Working Notes:

1. Amount of bonus shares = 25% of (1,200 – 300) lakhs = ₹ 225 lakhs
2. Cash at bank after issue of bonus shares

Particulars	₹ in lakhs
Cash balance as on 1st April, 20X1	740
Add: Sale of investments	75
	815
Less: Payment for buy-back of shares	(450)
	365

Note: In the given solution, it is possible to adjust transfer to capital redemption reserve account or capitalization of bonus shares from any other free reserves or securities premium (to the extent available) also.

Question 4

Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:

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		Particulars	Notes	₹
1		Equity and Liabilities		
		Shareholders' funds		
	A	Share capital	1	12,50,000
	B	Reserves and Surplus	2	18,75,000
2		Non-current liabilities		
		Long term borrowings	3	28,75,000
3		Current liabilities		
	A	Other Current Liabilities		16,50,000
		Total		76,50,000
		Assets		
1		Non-current assets		
	A	Property, plant and Equipment	4	46,50,000
2		Current assets		
	A	Other Current Assets		30,00,000
		Total		76,50,000

Notes to accounts

No.	Particulars		₹
1	Share Capital		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of ₹ 10 each)		12,50,000
2	Reserves and Surplus		
	Securities premium		2,50,000
	Profit and loss account		1,25.000
	Revenue reserve		15,00,000
	Total		18,75,000
3	Long term borrowings		
	14% Debentures		18,75,000
	Unsecured Loans		10,00,000
	Total		28,75,000
4	Property, plant and equipment		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		9,20,000
	Net carrying value		46,50,000

The company wants to buy-back 25,000 equity shares of ₹ 10 each, on 1st April, 20X1 at ₹ 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

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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.

Answer 4

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) Actual	39,062
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 2F
(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.

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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 capita redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd. as at 31st March, 20X1

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	10,00,000
	B	Reserves and Surplus	2	16,25,000
2		**Non-current liabilities**		
		Long term borrowings	3	28,75,000
3		**Current liabilities**		
	A	Other Current Liabilities		16,50,000
		Total		71,50,000
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	46,50,000
2		**Current assets**		
	A	Other Current Assets (30,00,000 – 5,00,000)		25,00,000
		Total		71,50,000

Notes to accounts

No.	*Particulars*		₹
1	**Share Capital**		

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	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 5

The following information from Balance Sheet of Z Ltd. as on 31st March ,20X1:

	₹ Lakhs
Share Capital:	
Equity shares of ₹ 10 each Fully Paid Up	**16,000**

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10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	5,000
Reserves & Surplus	
Capital Redemption Reserve	2,000
Securities Premium	1,600
General Reserve	12,000
Profit & Loss Account	600
Secured Loans:	
9% Debentures	10,000
Current Liabilities:	
Trade payables	4,600
Sundry Provisions	2,000
Fixed Assets	28,000
Investments	4,700
Cash at Bank	4,600
Other Current Assets	16,500

On 1st April, 20X1 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.

Answer 5

(i) Journal Entries in the books of Z Ltd. (₹ in lakhs)

	Particulars			
1	Bank A/c To Investments A/c To Profit and Loss A/c (Being investment sold on profit for the purpose of buy-back)	Dr.	5,000	 4,700 300
2	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being redemption of preference share capital at premium of 10%)	Dr. Dr.	5,000 500	 5,500
3	Profit and Loss A/c To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	Dr.	500	 500
4	Equity Share Capital A/c Premium on buyback To Equity buy-back A/c (Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)	Dr. Dr.	1,600 1,600	 3,200

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5	Securities Premium A/c (1,600) To Premium on Buyback A/c (Being premium on buyback provided out of securities premium)	Dr.	1,600	1,600
	Preference Shareholders A/c Equity buy-back A/c To Bank A/c (Being payment made to preference shareholders and equity shareholders)		5,500 3,200	8,700
	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)		6,600	6,600

Balance Sheet of C Ltd. (after Redemption and Buyback)

(₹ Lakhs)

	Particulars	**Note No**	**Amount**
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	14,400
	(b) Reserves and Surplus	2	14,400
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	10,000
(3)	Current Liabilities:		
	(a) Trade payables		4,600
	(b) Short Term Provisions		2,000
	Total		45,400
(II)	ASSETS		
	Non-Current Assets		
(1)	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			

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	lakh Equity Shares bought back)			14,400
2.	**Reserves and Surplus**			
	General Reserve	12,000		
	Less: Transfer to CRR	(6,600)	5,400	
	Capital Redemption Reserve	2,000		
	Add: Transfer due to buy-back of shares from Gen. res.	6,600	8,600	
	Securities premium	1,600		
	Less: Adjustment for premium paid on buy back	(1,600)		
	Profit & Loss A/c	600		
	Add: Profit on sale of investment	300		
	Less: Adjustment for premium paid on redemption of preference shares	(500)	400	14,400
3.	**Long-term borrowings**			
	Secured			
	9 % Debentures			10,000

Working Note:

Bank Account

	Amount (₹ Lakhs)		**Amount (₹ Lakhs)**
To balance b/d	4,600	By Preference Shareholders A/c	5,500
To Investment A/c (saleProceeds)	5,000	By Equity buy back A/c	3,200
		By Balance c/d (Balancing figure)	900
	9,600		9,600

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ILLUSTRATIONS:

Question 1 (Illustration)

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 inlieu 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 issuedat 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.

Answer 1

The purchase consideration will be

	₹	Form
ference shareholders : 2,000 × 3/4 × 100	1,50,000	9% Pref. shares
ity shareholders 5,000 × 20	1,00,000	h
00 × 6/5 × 125	7,50,000	ity Shares
	10,00,000	

Note-

1. According to AS 14, 'consideration' excludes the any amount payableto debenture-holders. The liability in respect of debentures of S Ltd. will be takenby 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 (Illustration)

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Following is the balance sheet of A Ltd. as on 31st March, 20X1

		PARTICULARS		Notes	₹ (000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		1	22,50
	B	Reserves and Surplus		2	9,00
2		**Non-current liabilities**			
	A	Long-term borrowings		3	7,00
3		**Current liabilities**			
	A	Trade Payables			5,00
			Total		**43,50**
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		4	32,50
	B	**Non-current investments**		5	6,00
2		**Current assets**			
	A	Inventories			2,00
	B	Trade receivables			2,00
	C	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 andconditions:

(a) Discharge 15% debentures at a premium of 10% by issuing 15% debenturesof 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 paythe balance in

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cash.

Calculate Purchase consideration.

Answer 2

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 (Illustration)

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

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	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
		10,550
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% byissuing 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 issueequity 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 valueof each equity share of Y Ltd. is ₹ 10.

Compute the purchase consideration.

Answer 3

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

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purchase consideration calculation. Such debentures will be taken over by Y Ltd. and then discharged by them later.

Question 4 (Illustration)

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		
1		**Shareholders' funds**			
	A	Share capital		7,75,000	8,55,000
2		**Current liabilities**		6,23,500	5,57,600
		Total		13,98,500	14,12,600
		Assets			
1		**Non-current assets**			
	A	Property, Plant and Equipment		12,35,000	12,54,000
2		**Current assets**		1,63,500	1,58,600
		Total		13,98,500	14,12,600

Notes to accounts:

1	**Property, plant and Equipment**		
	Land and Building	**7,50,000**	**6,40,000**
	Plant and machinery	**4,85,000**	**6,14,000**
		12,35,000	**12,54,000**

Following is the additional information:

(i) The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:

	Neel	Gagan
	₹	₹
Plant and machinery	**5,25,000**	**6,75,000**
Building	**7,75,000**	**6,48,000**

(ii) The purchase consideration is to be discharged as under:

(a) Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion oftheir profitability in the preceding 2 years.

(b) Profits for the preceding 2 years are given below:

	Neel	Gagan
	₹	₹
1st year	**2,62,800**	**2,75,125**
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.,

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(ii) **Purchase consideration.**

Answer 4

(i) Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.

Profits of	**Neel**	**Gagan**
	₹	₹
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

The total profits- ₹4,75,000+ ₹5,25,000= ₹10,00,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profits.

	Neel	**Gagan**
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. andGagan Ltd.

	Neel	**Gagan**
	₹	₹
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued $\left[67,200 \times \frac{100}{12}\right]$ 5,60,000 @ ₹10 each	56,000 shares	
$\left[73,920 \times \frac{100}{12}\right]$ 6,16,000 @ ₹10 each		61,600 shares

(ii) Total Purchase Consideration

	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 shallbe equal to 8% of the return on Net assets.

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Question 5 (Illustration)

Wye Ltd. acquires the business of Zed Ltd. whose balance sheet as at 31st March, 20X1 is as under:

		Particulars	Notes	₹ in'000
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	12,00,000
	B	Reserves and Surplus	2	1,58,000
2		Non-current liabilities		
	A	Long-term borrowings	3	2,00,000
3		Current liabilities		
	A	Trade Payables		1,20,000
	B	Other current liabilities (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	Non-current investments	5	2,90,000
2		Current assets		
	A	Inventories		1,50,000
	B	Trade receivables		1,80,000
	C	Cash and cash equivalents		70,000
		Total		16,90,000

Notes to accounts:

		₹
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(Expected liability ₹ 5,000)	8,000
		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

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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 debenturesin 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% preferenceshare 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.

Answer 5

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 notbe transferred.

Note: Profit and Loss Account (Dr.) and expenses not written off are not assetsand 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 companyis to take over. In case of

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the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is notrequired (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.

e 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

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(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 Debenture holders A/c (amount due to debenture holders for debentures interest)			12,000
Debenture holders	Dr.	12,000	
To Cash A/c (Debentures paid cash ₹12000 for outstanding interest)			12,000

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 (the amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)			4,40,000

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 (cash and preference shares in Wye Ltd. given to preference shareholders)			4,00,000

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 passthe following entries in this regard :

		₹	₹
Equity Share Capital A/c	Dr.	8,00,000	

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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 accountand credit whatever is given to them. Hence:

		₹	₹
Equity Shareholders A/c	Dr.	13,35,000	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c (W.N.2)			2,15,500

Working Notes

1. Realization Account

Particulars	₹	Particulars	₹
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

Particulars	₹	Particulars	₹
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	12,000
		By Preference shareholder	40,000
		By Equity Shareholder (B/F)	2,15,500
	28,00,000		28,00,000

Question 6 (Illustration)

The following Balance Sheets are given as at 31st March, 20X1:

		Particulars	**₹ Best Ltd. (in lakhs)**	**₹ Better Ltd. (in lakhs)**
		Equity and Liabilities		

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1		Shareholders' funds		
	A	Share capital (shares of ₹100 each, fully paid)	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 sharefor 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 fromit, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 outof 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.

Answer 6

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
To Current Assets A/c	5,00,000	By Best Limited (purchase consideration)	15,00,000

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		By 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
To 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
To Share in Best Ltd.	15,00,000	By Reserves & Surplus A/c	3,00,000
	18,00,000		18,00,000

Journal of Best Ltd.

		Dr.	Cr.
20X1		₹	₹
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

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(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 (Discharge of Purchase Consideration by the issue of equity shares of ₹ 10,00,000 at a premium of ₹50 per share as per agreement)			5,00,000
Trade payables A/c	Dr.	1,00,000	
To Trade receivables A/c (Amount due from Better Ltd. and included in its creditors taken over, cancelled against own Trade Receivables)			1,00,000
Capital Reserve A/c	Dr.	10,000	
To Current Asset (Stock) A/c (Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account. 20% on sale value of ₹50,000 shall be eliminated as unrealized profit)			10,000

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**		30,00,000

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	Equity share capital		
	Issued & Subscribed		
	30,000 shares of ₹ 100 (of the above 10,000 shares have been issued for consideration other than cash)		
	Total		30,00,000
2	**Reserves and Surplus**		
	Capital Reserve (3,00,000 – 10,000)		2,90,000
	Securities Premium		5,00,000
	Other reserves and surplus		10,00,000
	Total		17,90,000
3	**Property, Plant and Equipment**		
	PPE	25,00,000	
	Acquired during the year	15,00,000	40,00,000
	Total		40,00,000

Question 7 (Illustration)

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial positionof these two companies as at the date of amalgamation was as under:

		Particulars	Notes	₹ K Ltd.	₹ L Ltd.
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	1	12,00,000	6,00,000
	B	**Reserves and Surplus**	2	3,71,375	1,97,175
2		**Non-current liabilities**			
	A	**Long-term borrowings**	3	2,00,000	2,00,000
3		**Current liabilities**			
	A	**Trade Payables**		1,00,000	2,10,000
		Total		18,71,375	12,07,175
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	4	11,30,000	8,20,000
	B	**Intangible assets**	5	80,000	-
2		**Current assets**			
	A	**Inventories**		2,25,000	1,40,000
	B	**Trade receivables**		2,75,000	1,75,000
	C	**Cash and Cash equivalents**	6	1,61,375	72,175
		Total		18,71,375	12,07,175

Notes to accounts

1	**Share Capital**	**K Ltd.**	**L Ltd.**
	Equity shares of ₹ 100 each	**8,00,000**	**3,00,000**

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	7% Preference Shares of ₹ 100 each	4,00,000	3,00,000
2	Reserves and Surplus	12,00,000	6,00,000
	General reserve	-	1,00,000
	Profit and loss account	3,71,375	97,175
3	Long-term borrowings	3,71,375	1,97,175
	5% Debentures	2,00,000	-
	Secured loan	-	2,00,000
4	Property, plant and Equipment	2,00,000	2,00,000
	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 premiumof ₹ 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 todischarge the 5% debentures in K Ltd. at a discount of 5% after takeover.

(B) (1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively tobe 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.

Answer 7

Books of K Ltd.
Realization Account

		₹			₹
To	Goodwill	80,000	By	5% Debentures	2,00,000

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To	Land & Building	4,50,000	By	Trade payables	1,00,000
To	Plant & Machinery	6,20,000	By	LK Ltd. (Purchase consideration)	15,60,000
To	Furniture & Fitting	60,000	By	Equity shareholders A/c (loss)	51,375
To	Trade receivables	2,75,000	By		
To	Stores & inventory	2,25,000	By		
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

Particulars	₹	Particulars	₹
To Realization A/c (loss)	51,375	By Share Capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit And Loss A/c	3,71,375
To Cash	64,000		
	11,71,375		11,71,375

7% Preference Shareholders Account

Particulars	₹	Particulars	₹
To Preference Shares in LK Ltd.	4,40,000	By Share Capital	4,00,000
		By Realization Account	40,000
	4,40,000		4,40,000

LK Ltd. Account

Particulars	₹	Particulars		₹
To Realization A/c	15,60,000	By Equity Shares in L.K Ltd		
		For Equity	10,56,000	
		For 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 consideration)	7,90,000
To Trade receivables	1,75,000	By Equity shareholders A/c—Loss	37,175

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To Inventory of stores	1,40,000		
To Cash at bank	55,000		
To Cash in hand	17,175		
To Pref. shareholders	30,000		
	12,37,175		12,37,175

Equity Shareholders Account

	₹		₹
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

	₹		₹
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	
		For 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

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Cash at Bank		1,20,000		55,000
Cash in hand		41,375		17,175
		18,60,000		12,00,000
Less : Debentures	2,00,000		–	
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 (Illustration)

Consider the following balance sheets of X Ltd. and Y Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ X Ltd('000)	₹ Y Ltd.('000)
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	1	72,00	47,00
	B	**Reserves and Surplus**	2	15,50	10,50
2		**Non-current liabilities**			
	A	**Long-term borrowings**	3	5,00	3,50
3		**Current liabilities**			
	A	**Trade Payables**		4,50	3,50
	B	**Other current liabilities**		2,00	1,50
		Total		99,00	66,00
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**	4	63,25	36,00
	B	**Non-current investments**	5	7,00	5,00
2		**Current assets**			
	A	**Inventories**		12,50	9,50
	B	**Trade receivables**		9,00	10,30
	C	**Cash and cash equivalents**		7,25	5,20
		Total		99,00	66,00

Notes to accounts

		X Ltd ('000)	Y Ltd ('000)
1	**Share Capital**		
	Equity share capital (₹ 10 each)	50,00	30,00
	14% Preference Shares capital ₹ 100 each	22,00	17,00
		72,00	47,00
2	**Reserves and Surplus**		

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	General reserve	5,00	2,50
	Export profit reserve	3,00	2,00
	Investment allowance reserve	-	1,00
	Profit and loss account	7,50	5,00
		15,50	10,50
3	Long-term borrowings		
	13% Debentures of ₹ 100 each	5,00	3,50
		5,00	3,50
4	Property, Plant and Equipment		
	Land and Building	25,00	15,50
	Plant and machinery	32,50	17,00
	Furniture	5,75	3,50
		63,25	36,00
5	Non-current investments		
	Investments at cost	7,00	5,00
		7,00	5,00

X Ltd. takes over Y Ltd. on 1st April, 20X1.

X Ltd. discharges the purchaseconsideration as below:

(i) Issued 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders ofY Ltd.

(ii) Issued 15% preference shares of ₹ 100 each to discharge the preferenceshareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into equivalent number of debentures of XLtd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the (i) Journal Entries (ii) 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.

Answer 8

(a) the amalgamation is in the nature of merger.

(i) Journal Entries in the books of X Ltd.

Particulars		₹ '000	₹ '000
Business purchase	Dr.	53,70	
To Liquidator of Y Ltd. (Consideration payable for business taken over from Y Ltd)			53,70
Sundry Assets of Y Ltd	Dr.	66,00	
General Reserve (Related to X ltd)		4,20	
To Sundry Liabilities of Y Ltd			8,50
To Export profit Reserve			2,00
To investment allowance Reserve			1,00
To Profit & Loss			5,00
To Business Purchase (Incorporation of various assets and liabilities taken			53,70

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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	
To Equity Share Capital			35,00
To 15% Preference Share Capital (Discharge of consideration of Y Ltd.'s business)			18,70
Sundry Liabilities in Y Ltd (13% Debentures in Y Ltd.)	Dr.	3,50	
To 13% Debentures (Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)			3,50

(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
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**

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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.

Particulars		(₹) Dr.	(₹) Cr.
Business purchase	Dr.	53,70,000	
To Liquidator of Y Ltd. (Consideration payable for business taken over from Y Ltd)			53,70,000
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 (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)			53,70,000
Liquidator of Y Ltd.	Dr.	53,70,000	
To Equity Share Capital			35,00,000
To 15% Preference Share Capital			18,70,000

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(Discharge of consideration of Y Ltd.'s business)			
13% Debentures in Y Ltd	Dr.	3,50,000	
To 13% Debentures (Allotment of 13% Debentures to debenture holders of Y Ltd. at Par)			3,50,000

(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
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

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	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		4,050
	Plant & Machinery		4,950
	Furniture & Fittings		925
	Total		**9,925**

Workings Notes:

Capital Reserve arising on Amalgamation:

(A)	Net Assets taken over:	₹('000)	₹('000)
	Sundry Assets		66,00
	Less: 13% Debentures	3,50	
	Trade payables	3,50	
	Other current liabilities	1,50	(8,50)
			57,50
(B)	Purchase consideration:		
	To Equity Shareholders of Y Ltd.		35,00
	To Preference Shareholders of Y Ltd.		18,70
			53.70
(C)	Capital Reserve (A – B)		3.80

Question 9 (Illustration)

The following are the Balance Sheets of P Ltd. and Q Ltd. as at 31st March, 20X1:

		Particulars	Notes	₹ P Ltd	₹ Q Ltd
1		Equity and Liabilities			
		Shareholders' funds			
	A	Share capital	1	8,00,000	4,00,000
	B	Reserves and Surplus	2	3,00,000	2,00,000
2		Non-current liabilities			
	A	Long-term borrowings		2,00,000	1,50,000
3		Current liabilities			
	A	Trade Payables		2,50,000	1,50,000
		Total		15,50,000	9,00,000
		Assets			
1		Non-current assets			

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	A	Property, Plant and Equipment		7,00,000	2,50,000
	B	Non-current investments		80,000	80,000
2		Current assets			
	A	Inventories		2,40,000	3,20,000
	B	Trade receivables		4,20,000	2,10,000
	C	Cash and Cash equivalents		1,10,000	40,000
		Total		15,50,000	9,00,000

Notes to accounts

		P Ltd.	Q Ltd.
1	Share Capital		
	Equity shares of ₹ 10 each	6,00,000	3,00,000
u	10% Preference Shares of ₹ 100 each	2,00,000	1,00,000
		8,00,000	4,00,000
2	Long term borrowings		
	12% Debentures	2,00,000	1,50,000
		2,00,000	1,50,000

Details of Trade receivables and trade payables are as under:

	P Ltd. (₹)	Q Ltd. (₹)
Trade receivables		
Debtors	3,60,000	1,90,000
Bills Receivable	60,000	20,000
	4,20,000	2,10,000
Trade payables		
Sundry Creditors	2,20,000	1,25,000
Bills Payable	30,000	25,000
	2,50,000	1,50,000

Property, plant and equipment of both the companies are to be revalued at 15% above book value. Both the companies are to pay 10% Equity dividend, but Preference dividend having been already paid. After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by P Ltd. at par against 6 shares ofQ Ltd.

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of10% Preference Shares of ₹ 100 each at par in P Ltd.

(iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 12%Debentures in P Ltd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. SundryCreditors of Q Ltd. include ₹ 10,000 due to P Ltd.

(v) Inventory in Trade and Debtors are taken over at 5% lesser than their bookvalue by P Ltd.

Prepare:

(a) Journal entries in the books of P Ltd.

(b) Statement of consideration payable by P Ltd.

Answer 9

(a) Journal Entries in the Books of P Ltd.

		Dr.	Cr.

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		₹	₹
Property, Plant and Equipment	Dr.	1,05,000	
To Revaluation Reserve (Revaluation of PPE at 15% above book value)			1,05,000
Reserve and Surplus	Dr.	60,000	
To Equity Dividend (Declaration of equity dividend @ 10%)			60,000
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. (Consideration payable for the business taken overfrom Q Ltd.)			4,90,000
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 (₹ 40,000 –₹ 30,000 dividend paid)	Dr.	10,000	
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) (Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference ofnet assets and purchase consideration being credited to capital reserve)			80,000
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital (Discharge of consideration for Q Ltd.'s business)			90,000
12% Debentures in Q Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures (Allotment of 12% Debentures to debenture holdersof Q Ltd. at a discount of 10%)			1,80,000
Sundry Creditors of Q Ltd.	Dr.	10,000	

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To Sundry Debtors of P Ltd. (Cancellation of mutual owing)			10,000
Goodwill	Dr.	30,000	
To Bank (Being liquidation expenses reimbursed to Q Ltd.)			30,000
Capital Reserve	Dr.	30,000	
To Goodwill (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 (Illustration)

The financial position of two companies Hari Ltd. and Vayu Ltd. as at 31st March,20X1 was as under:

		Particulars	otes	Hari Ltd.	Vayu Ltd.
		Equity And Liabilities			
1		Shareholders' funds			
	A	re Capital	1	11,00,000	4,00,000
	B	erves and Surplus	2	70,000	70,000
2		n-current Liabilities			
	A	g term borrowings	3	50,000	20,000
3		rent Liabilities			
	A	de Payables		1,30,000	80,000
		Total		13,50,000	5,70,000
		sets			
1		n-Current Assets			
	A	erty, Plant and Equipment	4	8,00,000	2,50,000
	B	Non-current Investments	5	50,000	25,000
2		rent Assets			
	A	entories		2,50,000	1,75,000
	B	de Receivables		2,00,000	1,00,000
	C	sh 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	---

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	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 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.

Answer 10

In the Books of Vayu Ltd. Realization Account

	₹		₹
To Sundry Assets	5,70,000	By Retirement Gratuity Fund	20,000
To Preference Shareholders (Premium on Redemption)	10,000	By Trade payables	80,000
To Equity Shareholders (Profit on Realization)	50,000	By Hari Ltd. (Purchase Consideration)	5,30,000
	6,30,000		6,30,000

Equity Shareholders Account

	₹		₹
To Equity Shares of Hari Ltd.	4,20,000	By Share Capital	3,00,000
		By General Reserve	70,000
		By Realization Account (Profit on realization)	50,000
	4,20,000		4,20,000

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Preference Shareholders Account

	₹		₹
To 9% Preference Shares of Hari Ltd.	1,10,000	By Preference Share Capital	1,00,000
		By Realization Account (Premium on Redemption of Preference Shares)	10,000
	1,10,000		1,10,000

Hari Ltd. Account

	₹		₹
To Realization Account	5,30,000	By 9% Preference Shares	1,10,000
		By Equity Shares	4,20,000
	5,30,000		5,30,000

In the Books of Hari Ltd.

Journal Entries

		Dr.	Cr.
		₹	₹
Business Purchase A/c	Dr.	5,30,000	
To Liquidators of Vayu Ltd. Account (Being business of Vayu Ltd. taken over)			5,30,000
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 (Being Assets and Liabilities taken over as per agreed valuation).			5,30,000
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 (Being Purchase Consideration satisfied as above)			20,000

Balance Sheet of Hri Ltd. (after absorption) as at 31st March, 20X1

	Particulars	Notes	₹
	Equity and Liabilities		

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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**	70,000
	Retirement Gratuity fund	
	Total	70,000
4	**Property, Plant and Equipment**	4,50,000
	Buildings	
	Machinery	6,60,000
	Total	11,10,000
5	**Intangible assets**	1,00,000

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	Goodwill	
6	**Trade receivables**	3,00,000
	Less: Provision for Doubtful Debts	7,500
		2,92,500

Working Notes:

Purchase Consideration:	₹
Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Inventory	1,57,500
Trade receivables	92,500
Cash at Bank	20,000
	6,30,000
Less: Liabilities:	
Retirement Gratuity Fund	(20,000)
Trade payables	(80,000)
Net Assets/ Purchase Consideration	5,30,000
To be satisfied as under:	
10% Preference Shareholders of Vayu Ltd.	1,00,000
Add: 10% Premium	10,000
1,100 9% Preference Shares of Hari Ltd.	1,10,000
Equity Shareholders of Vayu Ltd. to be satisfied by issue of 40,000 Equity Shares of Hari Ltd. at 5% Premium	4,20,000
Total	5,30,000

Question 11 (Illustration)

The following are the Balance Sheets of A Ltd. and B Ltd. as at 31.3.20X1:

		Particulars	**Notes**	**A Ltd. ('000)**	**B Ltd. ('000)**
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	**Share capital**	**1**	**2000**	**1000**
	B	**Reserves and Surplus**	**2**	**2000**	**(800)**
2		**Non-current liabilities**			
	A	**Long-term borrowings**	**3**	**750**	**450**
3		**Current liabilities**			
	A	**Trade Payables**			
	B	**Short term Borrowings – Bank overdraft**			
		Total		**4,050**	**1000**
		Assets			
1		**Non-current assets**			
	A	**Property, Plant and Equipment**		**2,700**	**850**

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	B	Non-current investments		700	---
2		Current assets			
	A	Trade receivables		400	150
	B	Cash and Cash equivalents (cash at bank)		250	---
		Total		4,050	1,000

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 suchshares into one share of ₹ 100 each (new share).

(iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange ofevery 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.

Answer 11

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 (Being loan from bank waived off to theextent of ₹ 60 thousand)			60
	Equity share capital A/c (₹100)	Dr.	1,000	
	To Equity share capital A/c (₹10)			100
	To Capital reduction A/c (Being equity shares of ₹ 100 eachreduced to ₹10 each)			900

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	Equity share capital A/c (₹10)	Dr.	100	
	To Equity share capital A/c (₹ 100each) (Being 10 equity shares of ₹ 10 eachconsolidated to one share of ₹100 each)			100
	Capital reduction A/c	Dr.	960	
	To Profit and loss A/c			800
	To Capital reserve A/c (Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)			160
	Property, plant and equipment A/c	Dr.	2,700	
	Investment A/c	Dr.	700	
	Trade receivables A/c	Dr.	400	
	Cash at bank A/c	Dr.	250	
	To Trade payables A/c			300
	To Loans from bank A/c			250
	To 10% Debentures A/c			500
	To Liquidator of A Ltd. A/c			2,000
	To Reserves A/c (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 (Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)			2,000
	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
2		**Non-current liabilities**		
	a	Long term borrowings	3	1,140
3		**Current liabilities**		
	a	Trade payables		500

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	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 (Out of the above, 20,000 shares have been issued for consideration other than cash)		2,100
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

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Multiple Choice Questions

1. In case of amalgamation, the entry for elimination of unrealized profit or losson stock is made

(a) By the vendor company
(b) By the purchasing company
(c) By the third party
(d) By the court

Ans: (b)

2. If expenses of liquidation of the vendor company are paid by the purchasing company then, in purchasing company's book, the account debited is

(a) Goodwill account.
(b) Liquidation expense account.
(c) Vendor company account.
(d) General Reserve

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Ans: (a)

3. **Amalgamation adjustment reserve is opened in the books of the amalgamated company to incorporate**
   (a) Assets of the amalgamating company
   (b) Non- Statutory reserves of the amalgamating company
   (c) Statutory reserves of the amalgamating company
   (d) General Reserve of the amalgamating company

Ans: (c)

4. **Amalgamation Adjustment Reserve is presented in the financial statements of the transferee company as**
   (a) Other current asset.
   (b) Separate line item with a negative sign under the head 'Reserves andSurplus'.
   (c) Other non-current assets.
   (d) Investment of the company

Ans: (b)

5. **A company into which the vendor company is merged is called**
   (a) Transferee company.
   (b) Transferor company.
   (c) Selling company.
   (d) Acquiree Company

Ans: (a)

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.**
   (a) Goodwill.
   (b) Capital Reserve.
   (c) Profit
   (d) loss.

Ans: (a)

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Theoretical Questions Answers

Question 1

What are the conditions, which, according to AS 14 on Accounting forAmalgamations, must be satisfied for an amalgamation in the nature of merger?

Answer 1

Amalgamation in the nature of merger is an amalgamation where there is a genuine pooling not only of assets and liabilities of the transferor and transferee companies but also of the shareholders' interests and of the businesses of thecompanies. The accounting treatment of such amalgamations should ensure thatthe resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the respective figures of the transferor and transferee companies.

Amalgamation in the nature of merger is an amalgamation, as per para 3(e) of AS-14, which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and

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liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity sharesof the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company,except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformityof accounting policies. For example, if transferor company is following weighted average method for inventory valuation, the book value of the inventory of the transferor company will be revised by applying the FIFOmethod (if the transferee company follows FIFO method for inventory valuation).

If any one or more of the above conditions are not satisfied in an amalgamation,such amalgamation is called **amalgamation in the nature of purchase**.

Question 2

Distinguish between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation.

Answer 2

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 policiesfollowed by these companies.

As a result the difference between the amount recorded as share capital issued(plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in the reservesof the financial statements of Transferee company (recorded as deduction from the reserves where the capital issued is more than the capital of the transferor company).

In simple terms, where in case of pooling method- the amount to be adjustedagainst the reserves- can be computed in the following 3 steps-

Step I- Equity Share capital + Preference share capital issued+ any other additionalconsideration in form of cash and other assets by the Transferee Company.

Step II- Existing Equity share capital + Existing Preference share capital in the booksof Transferor Company.

Step III- Step I- Step II= amount to be adjusted from the reserves of Transfereecompany.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized as goodwill in the financial statement of the transferee

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company. Any short fall should be shown as capital reserve. Goodwill should be amortized over period of five years unless a somewhat longer period can be justified.

In simple terms, where in case of purchase method- the amount to be transferred to capital reserve or to be recorded as Goodwill- can be computed in the following 3 steps-

Step I- Find out the Net assets amount using the following formula- Total assets- Outside liabilities (Non-current liabilities + Current Liabilities)

Step II- Compute the purchase consideration using any of the methods as given under Purchase consideration computation.

Step III- (a) If Step I- Step II= Positive amount- then it is capital reserve- since the assets received more than the amount paid as purchase consideration to acquire them.

(b) If Step I- Step II= Negative amount- then it is to be recorded as Goodwill (intangible asset) - since the amount paid for acquiring business is more than the Net assets, which is technically due to its goodwill.

Practical Questions Answers

Question 3

The following are the Balance Sheets of Yes Ltd. and No Ltd. as at 31st March, 20X1:

		Particulars	otes	₹ 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 to 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

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2	Long term borrowings			
	Unsecured loan from Yes Ltd.		-	10
				10
3	Property, Plant and Equipment			
	Gross value		70	30
	Depreciation		(50)	(24)
			20	6
4	Non-current investments			
	30 lakhs equity shares of ₹ 10 each		3	
	Long term loan to No Ltd.		10	
			13	

On that day Yes Ltd. absorbed No Ltd. The members of No Ltd. are to get one equity share of Yes Ltd. issued at a premium of ₹ 2 per share for every five equity shares held by them in No Ltd. The necessary approvals are obtained.

You are asked to pass journal entries in the books of the two companies to give effect to the above if the amalgamation is in the nature of merger.

Answer 3

Journal Entries in the books of No Ltd.

PARTICULARS		Dr.	Cr.
		₹	₹
Realization Account	Dr.	64.00	
To Property, plant and equipment Account			30.00
To Current Assets Account (being the assets taken over by Yes Ltd. transferred to Realization Account)			34.00
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 (Being the transfer of liabilities and provision to Realization Account)			49.00
Yes Ltd.	Dr.	1.2	
To Realization Account (Being the amount of consideration due from Yes Ltd. credited to Realization Account)			1.2
Equity Shareholders Account	Dr.	13.80	
To Realization Account (being the loss on Realization transferred to equity shareholders account)			13.80
Equity Share Capital Account	Dr.	5.00	
Reserves and Surplus Account	Dr.	10.00	

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To Equity Shareholders Account (being the amount of share capital reserves and surplus credited to equity shareholders account)			15.00
Equity shares of Yes Ltd.	Dr.	1.20	
To Yes Ltd. (being the receipt pf 10 lakhs equity shares of ₹10 each at ₹12 each per share for allotment to shareholders)			1.20
Equity shareholders Account	Dr.	1.20	
To Equity shares of Yes Ltd. (being the distribution of equity shares received from Yes Ltd to shareholders)			1.20

Journal Entries in the book of Yes Ltd.

PARTICULARS		Dr. ₹	Cr. ₹
Business Purchase Account		1.2	
To Liquidator of No Ltd. Account (being the amount of purchase consideration agreed under approved scheme of amalgamation – W.N.1)			1.2
Property, plant and equipment		6.00	
Current Assets		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* (being the assets and liabilities taken over and the surplus transferred to Profit and Loss Account)			3.80
Liquidator No Ltd.		1.20	
To Equity Share Capital Account			1.00
To Securities Premium Account (Being the allotment to shareholders of No Ltd 10Lakhs equity shares of ₹10 each at a premium of ₹2 per share)			0.20
Unsecured Loan (from Yes Ltd.)		10.00	
To Loan to No. Ltd. (Being the cancellation of unsecured loan given to No Ltd)			10.00

Working Note:

Purchase Consideration Rs. In crores

$\frac{50\text{lakhs}}{5}$ X Rs. 12 i.e., 10 lakhs equity Shares at Rs. 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

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Question 4

The following are the Balance Sheets of X Ltd. and Y Ltd :

		Particulars	otes	₹ X Ltd (in crores)	₹ Y Ltd (in crores)
		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 :		1,35,000	60,000
		ASSETS			
1		Non-Current Assets			
	A	Property, Plant and Equipment	3	1,20,000	60,000
	B	Non-current Investments	4	15,000	-
		TOTAL :		1,35,000	60,000

Notes to accounts

1	Share Capital	X Ltd.	Y Ltd.
	Equity share capital	1,00,000	50,000
		1,00,000	50,000
2	Reserves and Surplus		
	Profit and loss A/c	10,000	--
	Profit and loss A/c (debit balance)	--	(10,000)
		10,000	(10,000)
3	Long term borrowings		
	Loan from X Ltd.	--	15,000
4	Non-current investments		
	Loan to Y Ltd.	15,000	--
		15,000	--

A new company XY Ltd. is formed to acquire the sundry assets and trade payablesof 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.

Answer 4

Books of X Ltd.

Realization Account

PARTICULARS	₹	PARTICULARS	₹
To Sundry Assets	1,20,000	By Trade payables	25,000

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		By XY Ltd. (Purchase consideration)	75,000
		By Shareholders (Loss on realization)	20,000
	1,20,000		1,20,000

Shareholder's Account

PARTICULARS	₹	PARTICULARS	₹
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.

PARTICULARS	₹	PARTICULARS	₹
To Balance b/d	15,000	By shares in XY Ltd.	15,000

Shares in XY Ltd.

PARTICULARS	₹	PARTICULARS	₹
To XY Ltd.	75,000	By shareholders	90,000
To Loan Y Ltd.	15,000		
	90,000		90,000

XY Ltd

PARTICULARS	₹	PARTICULARS	₹
To Realization Account	75,000	By shares in XY Ltd.	75,000

Question 5

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	₹	₹
	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

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	Total		22,60,000	13,00,000

Notes to accounts

		Super Express Ltd. ₹	Fast Express Ltd.₹
1	Share Capital		
	Equity shares of ₹100 each	20,00,000	10,00,000
2	Reserves and Surplus		
	Insurance reserve	1,00,000	--
	Employee profit sharing reserve	--	60,000
	Reserve account	--	1,00,000
	Surplus	--	1,00,000
		1,00,000	2,60,000
3	Long term provisions		
	Provident fund	1,00,000	--
	Total	1,00,000	--
4	Property, Plant and Equipment		
	Land and Building	10,00,000	6,00,000
	Plant and machinery	4,00,000	5,00,000
		14,00,000	11,00,000
5	Intangible assets		
	Goodwill	--	1,00,000
		--	1,00,000
6.	Cash and Cash Equivalents		
	Cash at Bank	2,20,000	10,000
	Cash in hand	1,00,000	10,000
		3,20,000	20,000

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of ₹ 100 each in lieu of purchase consideration amounting to ₹ 30,000 (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.

Answer 5

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

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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 6

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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.

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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
TOTAL	1,200	463
Trade receivables		
Trade debtors	2,120	1,020
Bills Receivable	--	80
TOTAL	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.

Answer 6

Books of P Ltd.
Journal Entries

Particulars		Dr.	Cr.
		₹ (in lacs)	₹ (in lacs)
Business Purchase A/c	Dr.	9,000	
To Liquidator of V Ltd (Being business of V Ltd. taken over for consideration settled as per agreement)			9,000
Plant and Machinery	Dr.	5,000	
Furniture & Fittings	Dr.	1,750	
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 (Being assets & liabilities taken over from V Ltd)			9,000
Liquidator of V Ltd. A/c	Dr.	9,000	

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To Equity Share Capital A/c (Purchase consideration discharged in the form of equity shares)			9,000
Goodwill A/c	Dr.	1	
To Bank A/c (Liquidation expenses paid by P Ltd debited to Goodwill A/c)			1
Profit and loss A/c	Dr.	1	
To Goodwill A/c (being the Goodwill charged to Profit and loss account)			1
Liability for 12% Debentures A/c	Dr.	1,000	
To 13% Debentures A/c (12% debentures discharged by issue of 13% debentures)			1,000
Bills Payable A/c	Dr.	80	
To Bills Receivable A/c (Cancellation of mutual owning on account of bills)			80

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	16,704
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		45,819
	Assets		
1	**Non-current assets**		
A	Property, Plant and Equipment	4	29,054
2	**Current assets**		
A	Inventories		11,903
B	Trade receivables		3,140
C	Cash and cash equivalents		1,722
	Total		45,819

Notes to accounts

		₹
1.	**Share Capital**	

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	Equity share capital	
	Authorized, 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	3,694
	Total	16,704
3.	**Long-term borrowings**	
	Secured	
	13% Debentures	1,000
4.	**Property, Plant and Equipment**	
	Land & Buildings	6,000
	Plant & Machinery	19,000
	Furniture & Fittings	4,054
	Total	29,054

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equityshares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = ₹6,000 lacs × $\frac{3}{2}$ = ₹9,000 lacs.

Question 7

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.

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The purchase consideration is satisfied by issue of the following sharesand debentures.

(i) 60,000 equity shares of Jupiter Ltd. to Sun and Neptune in theproportion 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.

Answer 7

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	275	325
(b) Number	27,500	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	2,20,000	1,96,000

2) Balance Sheet of Jupiter Ltd.

As at 31st March 20X3 (after amalgamation)

Particulars	**Note No**	**₹**
I. Equity and Liabilities		

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(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		
(a) Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
(1) Non-current assets		
(a) 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 (all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash)	3,00,000
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

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	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 8

The following information from Balance Sheet of X Ltd. as at 31st March, 20X1:

	₹
4,000 Equity shares of ₹ 100 each	4,00,000
10% Debentures	2,00,000
Loans	80,000
Trade payables	1,60,000
General Reserve	40,000
Building	1,70,000
Machinery	3,20,000
Inventory	1,10,000
Trade receivables	1,30,000
Bank	68,000
Patent	65,000
Share issue Expenses	17,000

Y Ltd. agreed to absorb X Ltd. on the following terms and conditions:

(1) Y Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) Y Ltd. is to take over trade payables at book value.

(3) The purchase consideration is to be paid in cash to the extent of ₹ 3,00,000 and the balance in fully paid equity shares of ₹ 100 each at ₹ 125 per share.

The average profit is ₹ 62,200. The liquidation expenses mounted to ₹ 8,000. Y Ltd. sold prior to 31st March, 20X1 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, 20X1. Trade payables of X Ltd. include ₹ 20,000 still due to Y Ltd.

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Show the necessary Ledger Accounts to close the books of X Ltd. and prepare the Balance Sheet of Y Ltd. as at 1st April, 20X1 after the takeover.

Answer 8

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	40,000	By	Balance b/d	40,000

shareholders	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

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	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, 20X1 (An extract)

	Particulars	*Notes*	₹
1	**Equity and Liabilities Shareholders' funds**	1	2,44,000
a	Share capital	2	53,500
b	Reserves and Surplus		
2	**Current liabilities**		
a	Trade Payable	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**		

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	Buildings		1,53,000
	Machinery		2,88,000
	Total		4,41,000
5	**Intangible assets**		
	Goodwill		1,08,000
6	**Inventories**		
	Opening balance	99,000	
	Less: Cancellation of profit upon amalgamation	(7,500)	91,500
7	**Trade receivables**		
	Opening balance	1,17,000	
	Less: Intercompany transaction cancelled upon amalgamation	(20,000)	97,000

Working Notes:

1. Valuation of Goodwill	₹
Average profit	62,200
Less: 8% of ₹ 4,40,000	(35,200)
Super profit	27,000
Value of Goodwill = 27,000 x 4	1,08,000
2. Net Assets for purchase consideration	
Goodwill as valued in W.N.1	1,08,000
Building	1,53,000
Machinery	2,88,000
Inventory	99,000
Trade receivables (1,30,000-13,000)	1,17,000
Total Assets	7,65,000
Less: Trade payables	(1,60,000
Net Assets	6,05,000
Out of this ₹ 3,00,000 is to be paid in cash and remaining i.e., (6,05,000 – 3,00,000) ₹ 3,05,000 in shares of ₹ 125. Thus, the number of shares to be allotted 3,05,000/125 = 2,440 shares.	

3. Unrealised Profit on Inventory		₹
The Inventory of X Ltd. includes goods worth ₹ 50,000 which was sold by Y Ltd. on profit. Unrealized profit on this Inventory will be [20,000/80,000 x 50,000]		12,500
As Y Ltd purchased assets of X Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹ 50,000.		(5,000)
Amount of unrealized profit		7,500

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Chapter 14

Internal Reconstruction

ILLUSTRATIONS

Question 1 (Illustration)

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 ason 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Answer 1

Journal Entries

20X2			₹	₹
June	Equity Share Capital (₹ 10) A/c	Dr.	1,60,000	
	To Equity Share Capital (₹ 5) A/c (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)			1,60,000
20X3	Equity Share Capital (₹ 5) A/c	Dr.	1,60,000	
June	To Equity Share Capital (₹ 100) A/c (Being consolidation of 40,000 shares of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 shares with ₹ 80 paid up)			1,60,000

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

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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
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 remainssame. 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 (Illustration)

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 theCompany 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.

Answer 2

Journal Entries

			₹	₹
20X2				
June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c (Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated…)			4,00,000
20X3				
June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c (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...)			4,00,000

Notes to Balance Sheet

	₹

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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 (Illustration)

The Balance Sheet of A & Co. Ltd. as at 31-3-20X2 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

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		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 1-4-20X2, 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 theremaining 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.

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(viii) Remaining freehold property after giving to debenture holders, to be re-valuedat ₹ 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 ofequity 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 becancelled 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 completionof the Scheme.

Answer 3

Journal of A & Co. Ltd.

					Dr.	Cr.
					₹	₹
20X2	Equity Share Capital A/c (₹ 10)				7,50,000	
April 1	To Capital Reduction A/c					6,00,000
	To Equity Share Capital A/c (₹ 2) (Reduction of equity shares of ₹ 10 each to shares of ₹ 2 each as per Reconstruction Scheme dated...)					1,50,000
”	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) (Reduction of preference shares of ₹ 100 each to shares of ₹ 75 each as per reconstruction scheme)					3,00,000
”	Capital Reduction Account			Dr.	24,000	
	To Equity Share Capital Account (Arrears of preference dividends satisfied by theissue of equity shares, 25% of the amount due, ₹ 96,000)					24,000
”	Freehold Property A/c			Dr.	82,500	
	To Capital Reduction A/c (Appreciation in the value of property:					82,500
		Book value	Revalued Figure			
		₹ 1,00,000	₹ 1,20,000			
		₹ 3,25,000	₹ 3,87,500			
	Total	₹ 4,25,000	₹ 5,07,500			
	Profit on revaluation: ₹ 82,500)					
”	6% Debentures A/c			Dr.	1,20,000	
	To Freehold Property A/c (Claims of debenture-holders, in part, inrespect of principal discharged by transfer of freehold property vide Scheme ofReconstruction)					1,20,000

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”	Interest payable A/c	Dr.	22,500	
	To Bank A/c (Debenture interest paid)			22,500
”	Bank A/c	Dr.	1,30,000	
	To 8% Debentures A/c (8% Debentures issued for cash)			1,30,000
”	Bank A/c	Dr.	1,40,000	
	To Investment A/c			55,000
	To Capital Reduction A/c (Sale of Investment for ₹ 1,40,000 cost being ₹55,000; profit credited to Capital ReductionAccount)			85,000
”	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 (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)			5,000
”	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 (Writing off patents, goodwill, profit and loss account and reducing the value of stock, making the required provision for doubtfuldebts and payment for cancellation of capital commitments)			5,35,000

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 April, 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

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		Total		12,49,000
		Assets		5,64,000
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
2	**Long-term borrowings** Secured		
	6% Debentures		2,55,000
	8% DebenturesTotal		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
	Trade Receivables	4,85,000	
	Less: Provision for doubtful debts	68,500	
			4,16,500

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Question 4 (Illustration)

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

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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 summaryof the scheme is as follows:

(a) The equity shareholders have agreed that their ₹ 50 shares should be reducedto ₹ 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 andto 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 sharesof ₹ 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 toreduce 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.

Answer 4

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 (Being equity capital reduced to nominal valueof ₹ 2.50 each)			7,12,500
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)			
3.	7% Preference share capital A/c (₹ 50)	Dr.	6,00,000	

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	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/cTo			1,20,000
	Equity share capital A/c (Being loan to the extent of ₹ 1,50,000converted into share capital)			30,000
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c (Being shares subscribed by the directors)			1,00,000
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 capitalA/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 theextent 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
		Total		15,25,000
		Assets		
1		**Non-current assets**		
	a	Property, plant and equipment	2	6,33,000

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	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 (Illustration)

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%.

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(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 with60000 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 effectto the above.

Answer 5

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 (Being conversion of equity share capital of ₹ 100 each into ₹40 each as per reconstructionscheme)		1,20,00,000
(ii)	6% Cumulative Preference Share capital(₹ 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference ShareCapital (₹ 60) A/c		60,00,000
	To Capital Reduction A/c (Being conversion of 6% cumulative preferenceshares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		40,00,000
(iii)	5% Debentures (₹ 100) A/c Dr.	80,00,000	
	To 6% Debentures (₹ 70) A/c		56,00,000
	To Capital Reduction A/c (Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		24,00,000
(iv)	Sundry Creditors A/c Dr.	40,00,000	
	To Equity Share Capital (₹ 40) A/c		24,00,000
	To Capital Reduction A/c (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)		16,00,000
(v)	Provision for Taxation A/c Dr.	2,00,000	
	Capital Reduction A/c Dr.	1,00,000	
	To Liability for Taxation A/c (Being conversion of the provision for taxationinto liability for taxation for settlement of the amount due)		3,00,000

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(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.) (Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferredto Capital Reserve)		26,00,000
(vii)	Liability for Taxation A/c Dr.	3,00,000	
	To Current Assets (Bank A/c) (Being the payment of tax liability)		3,00,000

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		60,00,000

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	₹ 60 each		
	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 (3,00,000)	87,00,000

Working Note:

Capital Reduction Account

To Liability for taxationA/c	1,00,000	By Equity share capital	1,20,00,000
To P & L A/c Property,	12,00,000	By 6% Cumulativepreferences	
To plantequipment and	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 (Illustration)

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**

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		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	12,20,000
2	C	Non-current investment	6	68,000
		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	3,20,000
		12,20,000
5	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 forallotment of 11% Debentures to them.

(ii) Debenture holders having charge on plant and machinery would accept plantand machinery in full settlement of their dues.

(iii) Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payablesin 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 itsworking capital requirement after settlement of bank overdraft.

Pass necessary Journal Entries in the books of the company. Prepare CapitalReduction account and Balance Sheet of the company after internal reconstruction.

Answer 6

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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 [Being 30% reduction in liability of preference share capital and issue of 11% debentures]			1,80,000
9% Debentures A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c [Settlement of debenture holders by allotment of plant & machinery]			3,00,000
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c [Being settlement of creditors by giving Inventories]			92,000
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c [Being fresh issue of debentures]			3,00,000
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c [Being settlement of bank overdraft]			1,50,000
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 [Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			1,54,000

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

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(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	3,20,000
(c) Non-current investments	5	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.	**Property, Plant and Equipment**		
	Plant & machinery	9,00,000	
	Less: Adjustment on scheme of reconstruction	9,00,000	-
	Furniture & fixtures		3,20,000
5.	**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 (Illustration)

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**

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3		Current liabilities		
	A	Trade Payables		72,000
	B	Other current liabilities	4	24,000
	C	Short term provisions	5	24,000
		Total		7,20,000
		Assets		
1		Non-current assets		
	A	Property, Plant and Equipment	6	1,00,000
2		Current assets		
	A	Inventory		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	
	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.

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(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 theresultant Balance Sheet

Answer 7

		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 (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 asper capital reduction scheme)			5,00,000
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 (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)			72,000
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 (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)			3,64,000

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Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c (Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			4,000

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 Capita Equity Share Capital Issued Capital: 53,600 Equity Shares of ₹ 10 each	**5,36,000**
	Preference Share Capital Preference Shares (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)	1,00,000
		6,36,000
2	**Reserve and Surplus**	
	Capital Reserve	4,000

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	Long-term borrowings	
	Unsecured Loans	
	12% Debentures	50,000
4	**Other current liabilities** Interest	
	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 (Illustration)

Recover Ltd. decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31 st March 20X1 is as follows-

		Particulars	Notes	₹
1		**Equity and Liabilities** **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
		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

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		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 freehold	50,000
	property)	
		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.

Answer 8

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 (Preference shares being reduced to shares of ₹ 2.5 per share and remaining transferred to			1,12,500

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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) (Equity shares reduced to ₹ 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)			1,80,000
Reconstruction A/c	Dr.	48,000	
To Equity share capital A/c (Equity shares of ₹ 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			48,000
10% Debentures A/c	Dr.	50,000	
Interest payable on debentures A/c	Dr	5,000	
Bank A/c	Dr.	20,000	
Reconstruction A/c	Dr.	45,000	
To Freehold property A/c (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)			1,20,000
Reconstruction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c (The assets written off as a part of the internal reconstruction scheme)			10,000
Bank A/c	Dr.	32,000	
Reconstruction A/c	Dr.	8,000	
To Investments A/c (Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)			40,000
Contingent Liability A/c	Dr.	7,000	
To Bank A/c (Contingent liability paid as a part of the internal reconstruction scheme)			7,000
Bank A/c	Dr.	6,300	
Reconstruction A/c	Dr.	700	
To Contingent Liability A/c (The insurance company remitting part of the contingency payment amount)			7,000

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Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c (Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)			70,000
Reconstruction A/c	Dr.	30,800	
To Capital reserve A/c (The balance in reconstruction account transferred to capital reserve as a part of the internal reconstruction scheme)			30,800

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		-
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
2	**Reserves and surplus**	1,05,500
	Capital reserve	30,800
3	**Property, Plant and Equipment**	
	Leasehold property	85,000
	Plant and machinery	1,00,000
		1,85,000
4	**Cash and cash equivalents**	

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	Bank A/c (20,000+32,000-7000+6,300)	51,300

Test your knowledge

Multiple Choice Questions

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**
   (a) Internal reconstruction with liquidation
   (b) Internal reconstruction without liquidation of the company
   (c) External reconstruction
   (d) None of the above.

Ans: (b)

2. **The accumulated losses under scheme of internal reconstruction are written off against**
   (a) Capital Reduction account
   (b) Share Capital account
   (c) Shareholders' account
   (d) Reserve and surplus.

Ans: (a)

3. **A process of reconstruction, which is carried out without liquidating the company and forming a new one is called**
   (a) Internal reconstruction.
   (b) External reconstruction.
   (c) Amalgamation in the nature of merger
   (d) Amalgamation in the nature of purchase

Ans: (a)

4. **Reconstruction is a process by which affairs of a company are reorganized by**
   (a) Revaluation of assets and Reassessment of liabilities.
   (b) Writing off the losses already suffered by reducing the paid up value ofshares and/or varying the rights attached to different classes of shares.
   (c) Both (a) and (b).
   (d) None of the above.

Ans: (c)

5. **For reduction of the share capital, the permission has to be sought from**
   (a) Court.
   (b) Controller.
   (c) State government.
   (d) Shareholders.

Ans: (a)

6. **In case of internal reconstruction**
   (a) Only one company is liquidated.
   (b) Two or more companies are liquidated.
   (c) No company is liquidated.
   (d) Two companies amalgamated.

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Ans: (c)

Theoretical Questions Answers

Question 1

What are the methods of internal reconstruction generally followed by companies?

Answer 1

Methods of Internal reconstruction:

- Sub-division or consolidation of shares into smaller or higher Denominationand Conversion of share into stock or vice-versa
- Variation of shareholders' rights
- Reduction of share capital
- Compromise, arrangements etc.
- Surrender of Shares.

Practical Question Answers

Question 2

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 ₹ 7,00,000showed 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 present9% 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.

Answer 2

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	

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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			72,000
To Reconstruction A/c (Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)			1,28,000
Reconstruction A/c To Profit and loss A/c (Being the loss written off as per reconstruction scheme)	Dr.	70,000	70,000
General reserve A/c To Reconstruction A/c (Being the balance in general reserve utilized to write off the losses as per reconstruction scheme)	Dr.	1,26,000	1,26,000

Question 3

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 sharesof ₹ 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 forthe 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.

Answer 3

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
Bank A/c	Dr.	1,00,000	

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(Being new equity shares, 10% Preference Shares, 8% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
To 10% First Debentures A/c (Being allotment of 10% first Debentures)			1,00,000
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 4

Green Limited had decided to reconstruct the Balance Sheet since it has accumulatedhuge losses. The following is the Balance Sheet of the Company as at 31.3.20X1 beforereconstruction:

		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**

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		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) andto 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) andto 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 theBalance Sheet of the reconstructed company.

Answer 4

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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.₹	Cr.₹
To Equity Share Capital Account (₹ 20)	**Dr.**	75,00,000	
To Capital Reduction Account			30,00,000
			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 To X	Dr.	2,00,000	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	
To14% First Debentures Account			3,00,000
To Capital Reduction Account (The amount due to Y discharged by issue of 14% first debentures)			3,00,000
X	Dr.	14,00,000	
To14% 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

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(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

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Question 5

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.

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(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 effectto the above.

Answer 5

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 (Being conversion of equity share capital of ₹ 100 each into ₹ 40 each as per reconstructionscheme)		60,00,000
(ii)	12% Cumulative Preference Share capital(₹ 100) A/c Dr.	50,00,000	
	To 12% Cumulative Preference ShareCapital (₹ 60) A/c		30,00,000
	To Capital Reduction A/c (Being conversion of 12% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)		20,00,000
(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 (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)		8,00,000
(v)	Provision for Taxation A/c Dr.	1,00,000	

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	Capital Reduction A/c Dr.	50,000	
	To current assets(bank A/c) A/c (Being liability for taxation settled)		1,50,000
(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 (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)		50,000
(vii)	Capital Reduction A/c Dr	50,000	50,000
	To capital Reserve A/c (Being balance in capital reduction accounttransferred 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		

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	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 6

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**

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		Total		36,60,000
		Assets		
1		Non-current assets		
	A	Property, plant and equipment		30,00,000
	B	Intangible assets		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 thepreference shares to be reduced to fully paid shares of ₹ 75 each.

(ii) The debenture holders took over Inventories and Trade receivables in fullsatisfaction of their claims.

(iii) The Land and Building to be appreciated by 30% and Plant and machinery tobe depreciated by 30%.

(iv) The debit balance of profit and loss account and intangible assets are to beeliminated.

(v) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above scheme of reconstruction and preparethe reconstructed Balance Sheet

Answer 6

In the books of X Ltd. Journal Entries

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	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 (Being 24,000 equity shares of ₹ 100 each reduced to ₹ 40 each fully paid up)			14,40,000
(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 (Being 12,000 Preference shares of ₹ 100 each reduced to ₹ 75 each fully paid up)			3,00,000
(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 (Being debenture holders given Inventories and Trade receivables in full settlement of their claims)			60,000
(iv)	Land & Building A/c	Dr.	3,60,000	
	To Capital Reduction A/c (Being Land & Building appreciated by 30%)			3,60,000
(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 (Being various losses written off, assets written down through Capital Reserve A/c)			5,40,000
(vii)	Capital Reduction	Dr.	85,000	
	To Capital Reserve A/c (Bal. Fig.) (Being balance in Capital Reduction A/c transferred to Capital Reserve A/c)			85,000

Balance Sheet (And Reduced) of X Ltd.as at 31st March, 20X1

	Particulars	Notes No.	₹
	Equity and Liabilities		
1	**Shareholders' funds**		

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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 eachfully 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

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Chapter 15

Accounting For Branches Including Foreign Branches

ILLUSTRATION

Question 1(a) (Illustration)

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:

	Rs		Rs
Opening balance (1-1-20X1) Imprest Cash	2,000	Bad Debts	1,000
Sundry Debtors	25,000	Discount to Customers	2,000
Stock: Transferred from H.O.	24,000	Remittances to H.O.	
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	Transfer from H.O.	15,000
Cash expenses		Debtors	?
		Imprest Cash	?
		Petty Cash expenses	4,000

Answer 1(a)

In the Books of Buckingham Bros,
Bombay Nagpur Branch Account

Particulars	Rs	Particulars		Rs
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		

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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
To Bank (Sundry exp.)	30,000	Imprest Cash (W.N. 2)		2,000
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	Rs	Particulars	Rs
To Bal b/d	25,000	By Sales Return	3,000
To Sales	130,000	By Bad Debts	1,000
		By Discount	2,000
		By Cash *	125,000
		By Bal c/d	24,000
	155,000		155,000

2. **Memorandum Petty Cash**

Particulars	Rs	Particulars	Rs
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) = Rs 1,25,000

Question 1(b) (Illustration)

From the information given in the illustration 1(a), prepare Nagpur Branch Trading and Profit and Loss Account in the books of head office.

Answer 1(b)

Buckingham Bros. Bombay

Nagpur Branch-Trading and Profit and Loss Account for the year ending 31st December, 20X1

Particulars	Rs	Particulars	Rs	Rs
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	
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			

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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**

The students may note that Gross Profit and Net Profit earned by the branch are ascertainable in this method and also evaluating the performance of the branch is very much easier in this method than in the 'Debtors method'.

Question 2 (Illustration)

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.

	Rs		Rs
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**
		Debtors	**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.

Answer 2

(a) Debtors Method

Delhi Branch Account

20X1		Rs	Rs	20X1		Rs	Rs
Jan. 1	To Opening Brance 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				By Goods sent to		

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	Branch A/c		26,000		Branch A/c -		
	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	Balance b/d		16,400				

(b) Stock and Debtors Method

Branch Stock Account

20X1		**Rs**	**20X1**			**Rs**
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	
	To Branch P&L A/c	19,900		Credit	28,400	
				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	Balance b/d - Opening Stock	6,500				

Delhi Branch Debtors Account

20X1		**Rs**	**20X1**		**Rs**
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	Balance b/d	9,800			

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Delhi Branch Expenses Account

20X1		Rs	20X1		Rs
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			
	To Allowance to customers	200			
	To Discount	1,400			
	To Bad Debts	600			
		10,500			**10,500**

Delhi Branch Profit & Loss Account

20X1		Rs	20X1		Rs
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

	Rs	Rs			Rs	Rs
To Stock		7,000	By Sales:			
To Goods sent from H.O.	26,000		Cash		17,500	
Less: Returns to H.O.	(1,000)	25,000	Credit	28,400		
To Gross profit c/d		19,900	Less: returns	(500)	27,900	45,400
		51,900	By Closing Stock			6,500
To Salaries & Wages		6,200				**51,900**
To Rent & Rates		1,200	By Gross Profit b/d			19,900
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 3 (a) (Illustration)

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.

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Following further details are given for the year ended 31st December, 20X1:

			Rs
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**
	Rs		**Rs**
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.

Answer 3(a)

Books of Harrison Branch Stock Account

	Rs		Rs
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 (Balancing Figure – Excess of Sale over Invoice Price)	2,000	By Balance c/d Goods in Transit (Rs 2,40,000 – Rs 2,20,000)	20,000
		Closing Stock at Branch	28,000
	2,72,000		**2,72,000**

Branch Debtors Account

	Rs		Rs
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

	Rs		Rs
To Balance b/d	5,000	By Bank Remittance to H.O.	2,22,500
To Branch Stock	59,000	By Branch Expenses [met by Branch (Bal. fig.)]	10,000
To Branch Debtors	1,71,000		
		By Balance c/d	2,500

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	2,35,000		**2,35,000**

Branch Adjustment Account

	Rs		Rs
		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

	Rs		Rs
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

	Rs		Rs
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

	Rs		Rs
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 3(b) (Illustration)

Take figures from Illustration 3 (a) and prepare branch account following debtors' method.

Answer 3(b)

Books of Harrison New Delhi Branch Account

	Rs		Rs
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	2,22,500

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To Net Profit ts/f to H.O. Profit & Loss A/c (Balancing Figure)	16,250	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:

Closing Stock = Stock at branch + Stock in Transit (Goods sent by HO – Goods Received by Branch)

= Rs 28,000 + (Rs 2,40,000 - Rs 2,20,000) = Rs 48,000.

Question 4 (Illustration)

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
	Rs	Rs	Rs
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 Rs 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.

Answer 4

Books of Sell Well Branch Account

	Rs			Rs
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 X 10/110)	4,855	Stock	53,400	

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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

	Rs		Rs
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

	Rs		Rs
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 5 (Illustration)

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:

	Rs
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.

Answer 5

(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
	Rs		Rs
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 unrealized profit = Rs 3,60,000 x (20/120) = Rs 60,000

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Working Note:

	Rs	
Cost Price	100	
Invoice Price	120	
Sale Price	150	
Calculation of closing stock at invoice price	**Rs**	
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 6 (Illustration)

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:

	Rs
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.

Answer 6

Books of Hindustan Industries, Mumbai Cochin Branch Stock Account

	Rs		Rs
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

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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

	Rs		Rs
To Goods sent to Branch A/c (1/5 of Rs 12,000) (on returns)	2,400	By Balance b/d (1/5 of Rs 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 Rs 6,00,000)	1,20,000
To Balance c/d (1/5 of Rs 1,20,000)	24,000	By Branch Stock	24,000
	1,56,000		**1,56,000**

Goods Sent to Branch Account

	Rs		Rs
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

	Rs		Rs
To Balance b/d	72,000	By Bank	3,20,000
To Branch Stock		By Branch P&L A/c Discount	6,000
A/c	3,60,000	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

	Rs		Rs
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

	Rs		Rs
To Branch Expenses A/c	84,000	By Branch Stock Adj. A/c	1,29,600

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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 7 (Illustration)

Arnold of Delhi, trades in Ghee and Oil. It has a branch at Lucknow. He dispatches 25 tins of Oil @ Rs 1,000 per tin and 15 tins of Ghee @ Rs 1,500 per tin on 1st of every month. The branch incurs some expenditure which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

		Delhi	Lucknow
		Rs	Rs
Purchases	Ghee	14,75,000	-
	Oil	29,32,000	-
Direct expenses		3,83,275	-
Expenses paid by H.O.		-	14,250
Sales	Ghee	18,46,350	3,42,750
	Oil	27,41,250	3,15,730
Collection during the year (including Cash Sales)		-	6,47,330
Remittance by Branch to Head Office		-	6,13,250

	(Delhi)	
Balance as on:	1-1-20X1	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	?
Cash on Hand	7,540	12,350
Furniture & Fittings	6,250	5,625
Plant/Machinery	-	

Addition to Plant/Machinery on 1-1-20X1 Rs 6,02,750.

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Rate of Depreciation: Furniture / Fittings @ 10% and Plant / Machinery @ 15% (already adjusted in the above figures).

The Branch Manager is entitled to 10% commission after charging such commission whereas, the General Manager is entitled to 10% commission on overall company profits after charging such commission. General Manager is also entitled to a salary of Rs 2,000 p.m. General expenses incurred by H.O. Rs 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).

Answer 7

In the books of Arnold Lucknow Branch Account

	Rs		Rs
To Balance b/d -Opening Branch Assets		By Bank (Remittance) By Closing Branch Assets	6,13,250
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 (Rs 58,335 × 1/11)	5,303		
To Net Profit transferred to General P & L A/c	53,032		
	7,76,125		**7,76,125**

Arnold Trading and Profit and Loss account for the year ended 31st December, 20X1
(Excluding branch transactions)

		Rs		Rs
To Opening Stock:			By Sales:	
Ghee		1,50,000	Ghee	18,46,350
Oil		3,50,000	Oil	27,41,250
To Purchases:			By Closing Stock:	
Ghee	14,75,000		Ghee	3,12,500
Less: Goods sent to Branch	(2,70,000)	12,05,000	Oil	4,17,250
Oil	29,32,000			
Less: Goods sent to Branch	(3,00,000)	26,32,000		

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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) 1,36,50	1,38,650		
To General Manager's Commission @ 10% (i.e., 4,63,457 × 1/11)	42,132		
To Net profit	4,21,325		
	6,50,107		**6,50,107**

Working Notes:

(1) Memorandum Branch Debtors Account

	Rs		Rs
To Balance b/d	75,750	By Cash Collections (including Cash Sales)	6,47,330
To Sales (including Cash Sales)		By Balance c/d	86,900
Ghee	3,42,750		
Oil	3,15,730		
	7,34,230		**7,34,230**

(2) Memorandum Branch Cash Account

	Rs		Rs
To Balance b/d	7,540	By Remittance	6,13,250
To Collections	6,47,330	By Exp. (Balance fig.)	29,270
		By Balance c/d	12,350
	6,54,870		**6,54,870**

(3) Depreciation on Plant & Machinery

3,07,250 x 15% + 6,02,750 x 15% = Rs1,36,500

Question 8 (Illustration)

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:

	Rs
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	**?**

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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.

Answer 8

Outlet Stock Account

	Rs		Rs
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

	Rs		Rs
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

	Rs		Rs
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:

		Rs
1) Wholesale Price	100+25	= 125
Retail Price	125 + 20%	= 150
Gross Profit at the outlet		
Wholesale Price – Retail Price	(150 – 125)	25
Retail sales value =60,000 × $\frac{150}{25}$ =Rs.3,6,00,000		
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 = Rs 18,000

3) Stock Reserve		
Opening Stock==30,000 × $\frac{25}{125}$ =Rs.6,000		

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Closing Stock==36,000 × $\frac{25}{125}$ =Rs.7,200		

Question 9 (Illustration)

Give Journal Entries in the books of an independent Branch to rectify or adjust the following:

(i) Branch paid Rs 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 Rs 25,000, but the Asset account was retained in H.O Books.

(iii) A remittance of Rs8,000 sent by the branch has not been received by H.O.

(iv) H.O collected Rs 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 Rs 5,000 not entered in branch books.

Answer 9

Journal Entries in Books of Branch

	Particulars		Dr. Amount Rs	Cr. Amount Rs
(i)	Head office account	Dr.	5,000	
	To Salaries account (Being the rectification of salary paid on behalf of H.O.)			5,000
(ii)	Head office account	Dr.	25,000	
	To Bank / Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)			25,000
(iii)	No Entry in Branch Books			
(iv)	Head office account	Dr.	25,000	
	To Debtors account (Being the amount of branch debtors collected by H.O.)			25,000
(v)	Bank A/c	Dr.	5,000	
	To Head Office			5,000
	(Remittance of Funds by H.O. to Branch)			

Question 10 (Illustration)

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. Rs	Cr. Rs	Dr. Rs	Cr. Rs
Share Capital		**1,50,000**		
Fixed Assets	**75,125**		**18,901**	
Current Assets	**1,21,809**		**23,715**	**(Note 3)**

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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 Rs 4,565.**
4. **Goods invoiced by Head Office to Branch at Rs 3,641 were in transit at 31st December, 20X1, as was also a remittance of Rs 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, Rs 2,500, which reached the Branch on December 25th; a sum received on December 30, 20X1 from one of the Branch debtors, Rs 750.

Answer 10

H.O. Books Branch Account

20X1		**Rs**	**20X1**		**Rs**
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		**Rs**	**20X1**		**Rs**
Dec. 31	To Branch A/c	3,500	Dec. 31	By Balance c/d	3,500

Stock Reserve Account

20X1		**Rs**	**20X1**		**Rs**
Dec. 31	To Balance c/d (4,565+3,641) x 10/110	746	Jan. 1	By Balance b/d	693
				By Revenue A/c (b.f.)	53
		746			746

Revenue Account

20X1		Rs	20X1		Rs
Dec. 31	To Stock Reserve	53	Dec. 31	By Balance b/d	43,210
	To Balance c/d	43,157			
		43,210			43,210

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Branch Books

Head Office Account

20X1		Rs	20X1		Rs
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		Rs	20X1		Rs
Dec. 31	To Head Office	3,641	Dec. 31	By Balance c/d	3,641

Motor Vehicle Account

20X1		Rs	20X1		Rs
Dec. 31	To Head Office	2,500	Dec. 31	By Balance c/d	2,500

Sundry Current Assets A/c

20X1		Rs	20X1		Rs
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 11 (Illustration)

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	
	Rs	Rs	Rs	Rs
Raw materials purchased	**35,000**			
Direct wages	**1,08,500**			
Factory overheads	**39,000**			
Stock on 1-1-20X1				

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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 Rs 1,500 to the H.O. and this has not yet been recorded in the H.O. books. Also, on the same date, the H.O. dispatched goods to the branch invoiced at Rs 1,500 and these too have not yet been entered into the branch books. It is the company's policy to adjust items in transit in the books of the recipient.

(2) The stock of raw materials held at the H.O. on 31st Dec., 20X1 was valued atRs 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 Rs 156 under a bilateral agreement.

Answer 11

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
	Rs	Rs	Rs		Rs	Rs	Rs
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	15,000	9,560	24,560

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				including transit (W.N.2)		(Bal Fig)	
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

		Rs	H.O. Rs	Branch Rs	Total Rs		H.O. Rs	Branch Rs	Total Rs
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 Creditor			13,000		13,000	Finished Goods	15,000	9,560	23,313*
Bonus Payable				156	156	(Less Stock Res.)			
H.O. Accoun*				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) = Rs 23,313 or (15,000 + 9,560) – 1,247 (Stock reserve)
** (5,000 + 6,904) – 1500 = Rs 10,404.

Working Notes:

(1) Material consumed
Opening raw material + Raw Material Purchased – Closing raw material
= 1,800 + 35,000 - 2,300 = 34,500

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(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 12 (Illustration)

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	Rs	Assets	Rs
Creditors Balance	40,000	Debtors Balance	2,00,000
Head Office	1,68,000	Building Extension A/c closed by transfer to H.O. A/c	—
		Cash at Bank	8,000
	2,08,000		2,08,000

During the six months ending on 30-9-20X1, the following transactions took place at Delhi.

	Rs		Rs
Sales	2,40,000	Manager's Salary	4,800
Purchases	48,000	Collections from Debtors	1,60,000
Wages paid	20,000	Discounts allowed	8,000
Salaries (inclusive of advance of Rs 2,000)	6,400	Discount earned	1,200
		Cash paid to Creditors	60,000
General Expenses	1,600	Building Account (further payment)	4,000
Fire Insurance (paid for one year)	3,200	Cash in Hand	1,600
Remittance to H.O.	38,400	Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-20X1. Also give journal entries in the Delhi books.

Answer 12

Journal Entries

20X1		Dr.	Cr.
30 Sept.		Rs	Rs
Salary Advance A/c	Dr.	2,000	

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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 (Six months premium transferred to the Prepaid Insurance A/c)			1,600
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		Rs	20X1		Rs
Sep. 30	To Cash-remittance	38,400	April 1	By Balance b/d	1,68,000
	To Sundries (Revenue A/cs)	88,400	Sep. 30	By Sundries (Revenue A/cs)	2,41,200
	To Building A/c	4,000			
	To Balanced c/d	2,78,400			
		4,09,200			4,09,200

Balance Sheet of Delhi Branch as on Sept. 30, 20X1

Liabilities	Rs	Assets	Rs
Creditors Balances	26,800	Debtors Balances	2,72,000
Head Office Account	2,78,400	Salary Advance	2,000
		Prepaid Insurance	1,600

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		Building Extension A/c	
		transferred to H.O.	—
		Cash in Hand	1,600
		Cash at Bank	28,000
	3,05,200		3,05,200

Cash and Bank Account

	Rs		Rs
To Balance b/d	8,000	By Wages	20,000
To Collection from Debtors	1,60,000	By Salaries	6,400
		By Insurance	3,200
		By General Exp.	1,600
		By H.O. A/c	38,400
		By Manager's Salary	4,800
		By Creditors	60,000
		By Building A/c	4,000
		By Balance c/d	
		By Cash in Hand 1,600	
		By Cash at Bank 28,000	29,600
	1,68,000		1,68,000

Debtors Account

	Rs		Rs
To Balance b/d	2,00,000	By Cash Collection	1,60,000
To Sales	2,40,000	By Discount (allowed)	8,000
		By Balance c/d	2,72,000
	4,40,000		4,40,000
To Balance b/d	2,72,000		

Creditors Account

	Rs		Rs
To Cash	60,000	By Balance b/d	40,000
To Discount (earned)	1,200	By Purchases	48,000
To Balance c/d	26,800		
	88,000		88,000
		By Balance b/d	26,800

Question 13 (Illustration)

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

	Rs	Rs

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Share Capital (Authorized: 10,000 Equity Shares of Rs 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

	Rs	**Rs**
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 - Rs 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) - Rs 1,700.

Give the Branch Current Account in Head Office books after incorporating Branch Trial Balance through journal.

Answer 13

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			Rs	Rs
Dec., 31	Cash in Transit A/c	Dr.	3,000	
	To Branch Current A/c (Cash sent by the Branch on 31st Dec., 20X1 but received at H.O. on 1st Jan., 20X2)			3,000
	Loss by theft A/c	Dr.	1,700	

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	To Branch Current A/c (Stock lost in transit from H.O. to Branch)		1,700

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			Rs	Rs
Dec. 31	Branch Current Account	Dr.	31,700	
	To Profit & Loss Account (Branch Profit for the year)			31,700
	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 (Branch assets brought into H.O. Books			1,71,110
	Branch Current A/c	Dr.	10,400	
	To Branch Creditors (Branch creditors brought Into H.O. Books)			10,400

Branch Current Account

	Rs		Rs
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

	Rs		Rs
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 14 (Illustration)

Messrs. Ramchand & Co., Hyderabad has 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.

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Trial Balance of the Delhi Branch as on 31-12-20X1

Debit	Rs	Credit	Rs
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 (H.O. supplies goods at invoice prices)	4,000	Sundry Creditors	3,000
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 Rs 5,000; Sundry Debtors Rs 9,500; Cash Rs 1,000, Creditors Rs 30,000. The closing stock at branch of the head office goods at invoice price is Rs 3,000 and that of purchased goods at cost is Rs 1,000. Depreciation is to be provided at 10 per cent on branch assets.

Answer 14

Delhi Branch Trading and Profit & Loss Account for the year ended 31st Dec., 20X1

		Rs			Rs
To Opening Stock:			By Sales		1,00,000
Head office Goods (4,000 x 80%)	3,200		By Goods from Branch By Closing Stock:		3,000
Others	500	3,700	Head Office goods (3,000 x 80%) Others	2,400	
To Goods to Branch (50,000 x 80%)		40,000		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		Rs	20X1		Rs
Jan. 1	To Balance b/d	5,000	Dec. 31	By Delhi Branch A/c	500

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				(Depreciation)	
				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 15 (Illustration)

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 Rs	Amount in Rs
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 Rs 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 Rs 52 and on 31st December, 20X2 was Rs 51. The average rate for the year was Rs 50. Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of the Branch assuming integral foreign operation.

Answer 15

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 (6,37,500 / 51)	12,500
To Gross profit c/d	23,625		
	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

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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	Dr.	Cr.
	Rs	Rs	Rate	($)	($)
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 16 (Illustration)

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 (Rs thousands)		Sydney (Auster dollars thousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	**2,000**	–	–
Reserves & Surplus	–	**1,000**	–	–
Land	**500**	–	–	–
Buildings (Cost)	**1,000**	–	–	–

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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 Rs 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 $ = Rs 20**
Closing rate	**A $ = Rs 24**
Average rate	**A $ = Rs 22**
For Fixed Assets	**A $ = Rs 18**

Answer 16

Sydney Branch Trial Balance (in Rupees)
As on 31st March, 20X2

(Rs '000)

Conversion	Rate per A$	Dr.	Cr.
Plant & Machinery (cost)	Rs 18	36,00	
Plant & Machinery Dep. Reserve	Rs 18		23,40
Debtors / Creditors	Rs 24	14,40	7,20
Stock (1.4.20X1)	Rs 20	4,00	
Cash & Bank Balances	Rs 24	2,40	
Purchase / Sales	Rs 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	Rs 22	9,90	
Rent	Rs 22	2,64	
Office expenses	Rs 22	3,96	
Commission Receipts	Rs 22		22,00

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H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Question 17 (Illustration)

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 Rs 4,20,000 on 31st March, 20X2.

(c) The rates of exchange may be taken as follows:

- on 1.4.20X1 @ Rs 40 per US $
- on 31.3.20X2 @ Rs 42 per US $
- average exchange rate for the year @ Rs 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.

Answer 17

M/s Carlin

Mumbai Branch Trial Balance in (US $) as on 31st March, 20X2

	Conversion	Dr.	Cr.
	rate per US $	US $	US $
	(Rs)		
Stock on 1.4.X1	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29

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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 $
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

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. **If goods are invoiced to branches at cost, trading results of branch can be ascertained by**
   (a) Debtors method.
   (b) Stock and debtor's method.

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(c) Either (a) or (b).
(d) Both (a) or (b).

Ans: (c)

2. Under branch trading and profit loss account method
(a) H.O prepares profit and loss account.
(b) Each branch is treated separate entity.
(c) Both (a) and (b).
(d) Either (a) or (b).

Ans: (c)

3. Goods may be invoiced to branch at
(a) Cost or Selling price.
(b) Wholesale price.
(c) Both (a) and (b).
(d) Either (a) or (b).

Ans: (c)

4. Under debtor's method, opening balance of debtors is
(a) Debited to branch account.
(b) Credited to branch account.
(c) Debited to H.O account.
(d) Credited to H.O account.

Ans: (a)

5. Cost of goods returned by branch will have the following effect
(a) Goods sent to branch account will be debited.
(b) Branch stock account will be credited.
(c) (a) and (b).
(d) Either (a) or (b).

Ans: (c)

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Theoretical Questions Answers

Question 1

Why goods are marked on invoice price by the head office while sending goods to the branch?

Answer 1

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 2

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Differentiate Branch Accounts with Departmental accounts.

Answer 2

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. For details, refer Para 2 of the Chapter to know the differences.

PRACTICAL QUESTIONS

Question 3

Goods worth Rs 50,000 sent by head office but the branch has received till the closing date goods for worth Rs 40,000 only. Give journal entry in the books of H.O. and branch for goods in transit.

Answer 3

Journal entry in the books of Head Office No entry

Journal entry in the books of Branch

		Rs	Rs
Goods-in-transit account	Dr.	10,000	
To Head Office account (Being goods sent by head office is still in transit)			10,000

Question 4

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 Rs 2,00,000 was received by the branch only to the extent of Rs 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?

Answer 4

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. To Head office A/c [Being Goods sent by Head office is still in transit on the closing date]	50,000	50,000

Question 5

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:

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(1) Received goods from Mumbai – Rs 35,000 and Rs 15,000 from Kolkata.
(2) Sent goods to Chennai – Rs 25,000, Kolkata – Rs 20,000.
(3) Bill Receivable received – Rs 20,000 from Chennai.
(4) Acceptances sent to Mumbai – Rs 25,000, Kolkata – Rs 10,000.

B. Mumbai Branch (apart from the above) :
(5) Received goods from Kolkata – Rs 15,000, Delhi – Rs 20,000.
(6) Cash sent to Delhi – Rs 15,000, Kolkata – Rs 7,000.

C. Chennai Branch (apart from the above) :
(7) Received goods from Kolkata – Rs 30,000.
(8) Acceptances and Cash sent to Kolkata – Rs 20,000 and Rs 10,000 respectively.

D. Kolkata Branch (apart from the above) :
(9) Sent goods to Chennai –35,000.
(10) Paid cash to Chennai to Chennai – Rs 15,000.
(11) Acceptances sent to Chennai – ₹15,000.

Answer 5

Journal entry in the books of Head Office

Date	Particulars	Dr.	Cr.
		Rs	Rs
30th April, 20X1	Mumbai Branch Account Dr.	3,000	
	Chennai Branch Account Dr.	70,000	
	To Delhi Branch Account		15,000
	To Kolkata Branch Account (Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 20X1)		58,000

Working Note:

Inter – Branch transactions

		Delhi	Mumbai	Chennai	Kolkata
		Rs	Rs	Rs	Rs
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.)

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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 6

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses Rs 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 Rs 1,500.

(iii) Branch paid Rs 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 Rs 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 Rs 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of Rs 3,000 on behalf of Branch B.

Answer 6

Books of Branch A Journal Entries

	Particulars		Dr. Amount Rs	Cr. Amount Rs
(i)	Expenses account	Dr.	3,500	
	To Head office account (Being the allocated expenditure by the head office recorded in branch books)			3,500
(ii)	Depreciation account	Dr.	1,500	
	To Head office account (Being the depreciation provided)			1,500
(iii)	Head office account	Dr.	2,000	
	To Salaries account (Being the rectification of salary paid on behalf of H.O.)			2,000
(iv)	Head office account	Dr.	10,000	
	To Debtors account (Being the adjustment of collection from branch debtors)			10,000
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account (Being the expenditure on account of Branch B, recorded in books)			3,000

Note: Entry (vi) Inter branch transactions are routed through Head Office.

Question 7

Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as

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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 Rs 10,000 necessary for meeting immediate requirements of cash. On 31st March, 20X1 the assets at the branch were as follows:

	Rs ('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 Rs 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at Rs 72,000. Other transactions at the branch during the year were as follows:

	(Rs '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 Rs 1 lakh for which payment was made by head office through a cheque. On 31st March, 20X2 branch expenses amounting to Rs 6,000 were outstanding and cash in hand was again Rs 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.

Answer 7

In the Head Office Books

Branch Account for the year ended 31st March, 20X2

	Rs 000		Rs000
To Balance b/d		By Balance b/d	
Cash in hand	10	Stock reserve Rs 1,080 $\times\frac{1}{6}$	180
Trade debtors	384	By Goods sent to branch A/c (Returns to H.O.)	72
Stock	1,080		
Furniture and fittings	500	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 Goods sent to branch A/c	13,200		

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To Bank A/c (Payment for furniture)	100	Bank A/c (Remittance from branch to H.O.) (W.N.5)	11,700
To Balance c/d Stock reserve $\left[1470 \times \frac{1}{6}\right]$	245	By Balance c/d Cash in hand	10
To Net profit transferred to General P/L account	1,096	Trade debtors (W.N.3)	485
		Stock (W.N.1)	1,470
To Balance c/d Outstanding expenses	6	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**

	Rs '000		Rs '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**

	Rs '000		Rs '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**

	Rs '000		Rs '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.

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5. **Memorandum Branch Cash Account**

	Rs '000		Rs '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 8

On 31st March, 20X2 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Debit Balances	Rs 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	
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 Rs 62 lacs. On 29th March, 20X2 the Head Office dispatched goods costing Rs 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 branchRs 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.

Answer 8

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(i) Books of Branch Journal Entries

			(Rs in lacs)
		Dr.	Cr.
Goods in Transit A/c	Dr.	10	
To Head Office A/c (Goods dispatched by head office but not received by branch before 1st April, 20X2)			10
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralized services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 20X2

	Rs in lacs		Rs 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 (centralized services)	1		
To Net Profit Transferred to Head Office A/c	24		
	72		72

Balance Sheet as on 31st March, 20X2

Liabilities	Rs in lacs		Assets	Rs 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

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Outstanding Expenses		3	Cash at bank and in hand		8
		118			118

(iii) Books of Head Office Journal Entries

			Rs	Rs
			Dr.	Dr.
Branch Trading Account		Dr.	365	
To Branch Account				365
(The total of the following items in branch trial balance debited to branch trading account:				
	Rs. in lacs			
Opening Stock	60			
Goods received from Head Office	288			
Goods purchased but not received	10			
Carriage Inwards	7)			
Branch Account		Dr.	437	
To Branch Trading Account				437
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amount being as follows:				
	Rs. in lacs			
Sales	360			
Closing Stock	62			
Goods in transit	10			
Goods returned to Head Office	5)			
Branch Trading Account		Dr.	72	
To Branch Profit and Loss Account				72
(Gross profit earned by branch credited to Branch Profit and Loss Account)				
Branch Profit and Loss Account		Dr.	48	
To Branch Account				48
(Total of the following branch expenses debited to Branch Profit & Loss Account:				
	Rs in lacs			
Salaries	25			
Rent	10			
Advertising	6			
Telephone, Postage & Stationery	3			
Sundry Office Expenses	1			
Head Office Expenses	1			

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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)				
Branch Furniture & Equipment		Dr.	18	
Branch Stock		Dr.	62	
Branch Debtors		Dr.	20	
Branch Cash at Bank and in Hand		Dr.	8	
Goods in Transit		Dr.	10	
To Branch (Incorporation of different assets at the branch in H.O. books)				118
Branch		Dr.	3	
To Branch Outstanding Expenses				3
(Incorporation of Branch Outstanding Expenses in H.O. books)				

Question 9

M/s Marena, Delhi has a branch at Bangalore to which office goods are invoiced at cost plus 25%. The branch sells both for cash and on credit.

Branch Expenses are paid direct from head office and the Branch has to remit all cash received into the Head Office Bank Account.

From the following details, relating to calendar year 20X1, prepare the accounts in the Head Office Ledger and ascertain the Branch Profit under Stock and Debtors Method'.

Branch does not maintain any books of account, but sends weekly returns to the Head Office.

	Rs
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

Answer 9

Bangalore Branch Stock Account

Particulars	Amount	Particulars	Amount

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	(Rs)		(Rs)
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 (Rs)	Particulars	Amount (Rs)
To Stock reserve - 20% of Rs 9,00,000 (closing stock)	1,80,000	By Stock reserve - 20% Of Rs 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 Rs 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 (Rs)	Particulars	Amount (Rs)
To Branch expenses A/c	6,30,000	By Branch adjustment A/c	9,72,000
To Branch debtors A/c (Discount)	45,000	(Gross Profit)	
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 (Rs)	Particulars	Amount (Rs)

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To Bank A/c (Rent, rates & taxes)	1,35,000	By Branch profit and loss A/c (Transfer)	6,30,000
To BankA/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 (Rs)	Particulars	Amount (Rs)
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 (Rs)	Particulars	Amount (Rs)
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 10

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 (Rs)	Branch (Rs)
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**

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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.

Answer 10

Trading and Profit and Loss A/c For the year ended 31st March 20X1

	Head office Rs	Branch Rs		Head office Rs	Branch Rs
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:**	**Rs**
	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:	Rs
	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 Rs 99,000	
	Profit included 80% of cost	
	Hence, unrealized profit would be = Rs 99,000 x 80/180	Rs 44,000

Question 11

Pass necessary Journal entries in the books of an independent Branch of a business entity to rectify or adjust the following:

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(i) Income of Rs 2,800 allocated to the Branch by Head Office but not recorded in the Branch books.
(ii) Branch paid Rs3,000 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 Rs5,000 on behalf of other Branches, this was not recorded in the books of Branch.
(iv) A remittance of Rs 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.
(v) Head Office allocates Rs75,000 to the Branch as Head Office expenses, which has not yet been recorded by the Branch.
(vi) Head Office collected Rs30,000 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 Rs10,000, but not received by the Branch till date of reconciliation. The Goods have been received subsequently.

Answer 11

Books of Branch
Journal Entries

			Amount in Rs	
Sr. No	**Particulars**		**Dr.**	**Cr.**
(i)	Head Office Account To Income Account (Being the income allocated by the Head office not recorded earlier, now recorded)	Dr.	2,800	2,800
(ii)	Head Office Account To Salaries Account (Being rectification of salary paid on behalf of Head Office)	Dr.	3,000	3,000
(iii)	Head Office Account To Cash Account (Being expenditure incurred on account of other branch, now recorded in books)	Dr.	5,000	5,000
(iv)	No entry in Branch Books is required.			
(v)	Expenses Account To Head Office Account (Being allocated expenses of Head Office recorded)	Dr.	75,000	75,000
(vi)	Head Office Account To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)	Dr.	30,000	30,000
(vii)	Goods -in- transit Account To Head Office Account (Being goods sent by Head Office still in-transit)	Dr.	10,000	10,000

Question 12

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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

	Rs		Rs
To Balance b/d	**8,10,000**	**By Cash**	**28,76,000**
To Goods sent to branch	**29,26,000**	**By Balance c/d**	**8,60,000**
	37,36,000		**37,36,000**

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired in past, when $ 1.00 = Rs 40.

Rates of exchange were:

1st January, 20X1	**$ 1.00**	**=**	**Rs 46**
31st December, 20X1	**$ 1.00**	**=**	**Rs48**
Average	**$ 1.00**	**=**	**Rs 47**

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Answer 12

(i) In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars)

for the year ended 31st December, 20X1for 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		

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	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. (Rs)**	**Cr. (Rs)**
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		Rs 3,84,000

(b) Branch Trading and Profit & Loss A/c for the year ended 31st December, 20X1

	Rs		Rs
To Opening stock	5,15,200	By Sales	39,48,000
To Goods from head office	29,26,000	By Closing stock (W.N.2)	3,84,000
To Gross profit c/d	8,90,800		
	43,32,000		**43,32,000**
To Expenses	2,35,000	By Gross profit b/d	8,90,800
To Depreciation @ 10% on Rs 9,60,000	96,000		
To Exchange difference	47,000		
To Manager's commission (W.N.1)	22,560		
To Net Profit c/d	4,90,240		
	8,90,800		8,90,800

(c) Branch Account

	Rs			Rs
To Balance b/d	8,60,000	By Machinery	9,60,000	
To Net profit	4,90,240	Less: Depreciation	(96,000)	

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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 X Rs 48 = Rs 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. $100 \frac{100}{125} \times 84,000 =$	(67,200)
Closing stock	8,000
Closing stock in Rupees = $8,000 x Rs 48 = Rs 3,84,000.	

Note: Manager is entitled to commission on profits earned at the end of the year.

SCENARIOS

Case Scenario 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.

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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.

1. **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.

Ans.(b)

2. **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.

Ans.(d)

3. **Please guide regarding the accounting treatment of both the grants mentioned above in line with the requirements of Accounting Standard 12.**

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(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.

Ans.(d)

Case Scenario 2

Suman Ltd. is in the business of manufacturing electronics equipment and selling these at its various outlets. It provides installation services for the equipment sold and also provide free 1 year warranty on all the sold products.

Beach Resorts are leading resorts in the city. It purchased 5 air conditioners (AC) from Suman Ltd. for its resort. Suman Ltd. sold 5 AC to Beach resort for ₹ 45,000 each which includes installation fees of ₹ 1,000 for each AC. The Company also offers 1 year warranty for any repair etc. The Company also offered ₹ 500 per AC as trade discount. Beach resort placed order on March 15, 2024 and made payment on March 20, 2024. The ACs were delivered on March 27, 2024 and the installation was completed on April 5, 2024.

1. How much revenue should be recognised by the Company as on March 31, 2024:
(a) ₹ 2,25,000
(b) ₹ 2,17,500
(c) ₹ 2,00,000
(d) ₹ 2,30,000

Ans.(b)

2. How much revenue should be recognised by the Company in the financial year 2024-25:
(a) ₹ 5000
(b) ₹ 2,20,000
(c) ₹ 10,000
(d) ₹ 2,40,000

Ans.(a)

3. What will be the accounting for trade discount:
(a) The same will be recognised separately in the profit and loss.
(b) The trade discounts are deducted in determining the revenue.
(c) Trade discount will be recognised after one year, when the warranty will be over.
(d) Trade discount will be recognised after installation is complete.

Ans.(b)

4. Is the Company required to do any accounting for 1 year warranty provided by it:

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(a) No accounting treatment is required till some warranty claim is actually received by the Company.
(b) As there exist a present obligation to provide warranty to customers for 1 year, the Company should estimate the amount that it may have to incur considering various factors including past trends and create a provision as per AS 29.
(c) Accounting for claims will be done on cash basis i.e. expense will be recognised when expense is made.
(d) As the Company is not charging separately for the warranty provided, there is no need to create any provision.

Ans.(b)

Case Scenario 3

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.

1. 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

Ans.(c)

2. How much amount of borrowing cost can be capitalised with the plant:

(a) ₹ 300,000
(b) ₹ 2,00,000
(c) ₹ 7,00,000

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(d) ₹ 6,00,000

Ans.(b)

3. 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

Ans.(c)

4. 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

Ans.(d)

Case Scenario 4

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.

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:

1. 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

Ans.(a)

2. 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

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(c) Cash Flow from Financing Activities
(d) Non-cash Items

Ans.(a)

3. **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

Ans.(b)

4. **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

Ans.(a)

5. **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.

Ans.(b)

Case Scenario 5

Venus Limited received a parcel of land at no cost from the government for the purpose of developing a factory in an outlying area. The land is valued at ₹ 75 lakhs, while the nominal value is ₹ 10 lakhs. Additionally, the company received a government grant of ₹ 30 lakhs, which represents 25% of the total investment needed for the factory development. Furthermore, the company received ₹ 15 lakhs with the stipulation that it be used to purchase machinery. There is no expectation from the government for the repayment of these grants.
Answer the following questions based on the above information:

1. **The land received from Government, free of cost should be presented at:**
   (a) ₹ 75 Lakhs
   (b) ₹ 30 Lakhs

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(c) ₹ 10 Lakhs
(d) ₹ 45 Lakhs

Ans.(c)

2. As per AS 12, how the Government Grant of ₹ 30 Lakhs should be presented:

(a) It should be recognised in the profit and loss statement as per the related cost.
(b) It will be treated as capital reserve.
(c) It will be treated as deferred income.
(d) It will not be recognised in the financial statements

Ans.(b)

3. As per AS 12, how the Government Grant of ₹ 15 Lakhs with a condition to purchase machinery may be presented as:

(a) Capital Reserve
(b) Shareholders Fund
(c) Deferred Income
(d) Income in statement of profit and loss as received.

Ans.(c)

4. Which of the above grants are required to be recognised in the statement of profit and loss on a systematic and rational basis over the useful life of the asset:

(a) Land received as Grant
(b) Government Grant of ₹ 30 Lakhs
(c) Government Grant of ₹ 15 Lakhs with a condition to purchase machinery
(d) Noe of the above

Ans.(c)

Case Scenario 6

Axis limited is a manufacturing company. It purchased a machinery costing ₹ 10 Lakhs in April 2023. It paid ₹ 4 lakhs upfront and paid the remaining ₹ 6,00,000 as deferred payment by paying instalment of ₹ 1,05,000 for the next 6 months. During the year, the Company sold a land which was classified as its 'property, plant and equipment' for ₹ 25,00,000 and paid ₹ 1,00,000 as income tax as long term capital gain on such sale. During the year, the Company also received income tax refund along with interest.

1. As per the requirements of AS 3, 'Cash Flow Statements', how the amount for purchase of machinery should be presented:

(a) ₹ 10 lakhs as 'Cash flows from Investing Activities' and ₹ 30,000 will simply be booked in profit and loss with no presentation if Cash Flow Statement.
(b) ₹ 10.30 lakhs as 'Cash flows from Investing Activities' as entire amount is spend on purchase of machinery.

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(c) ₹ 10 lakhs as 'Cash flows from Investing Activities' and ₹ 30,000 as 'Cash flows from Financing Activities'.
(d) ₹ 10.30 lakhs as 'Cash flows from Financing Activities' as the machinery has been purchased on finance.

Ans.(c)

2. At what amount, the machinery should be recognised in the financial statements:
(a) ₹ 400,000
(b) ₹ 10,30,000
(c) ₹ 600,000
(d) ₹ 10,00,000

Ans.(d)

3. How should the income tax paid on sale of land should be disclosed in the Cash Flows Statement:
(a) Cash flows from Operating Activities
(b) Cash flows from Investing Activities
(c) Cash flows from Financing Activities
(d) No disclosure in Cash Flow Statement

Ans.(b)

4. How should the interest on income tax refunds should be disclosed in the Cash Flows Statement:
(a) Cash flows from Operating Activities
(b) Cash flows from Investing Activities
(c) Cash flows from Financing Activities
(d) No disclosure in Cash Flow Statement

Ans.(b)

Case Scenario 7

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.

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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, 2021.

1. 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.

Ans.(a)

2. 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.

Ans.(d)

3. 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.

Ans.(c)

4. Please comment regarding consolidation requirements for SEAS Ltd. and ADI Ltd. using the below mentioned options as to which one should be correct.

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(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.

Ans.(c)

Case Scenario 8

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.

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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:

1. 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

Ans.(a)

2. 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

Ans.(c)

3. 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

Ans.(d)

4. 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

Ans.(b)

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