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(AIR 1,4,2)

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Whenever I listen to Suraj sir's lecture, feels like I've completed the concept! Made it veryyyy simple sir! Pranams!

Sugam

1Fin is working very hard and providing aeverything we need for CA. Thanks for the support

Parthi purush

Really I'm impressed on his teaching style and it's like a movie and interesti

Kumar G

Much needed classes for CA! Thank you ! IL team

Nilesh

Excellent explanation and you made easy to understand for anyone. Superb.. I was always confused.. now everything is clear. Amazing Sir!

Jagadeesh Chandra

One of best explanation about the concepts among any other avialable...Thanks Sir, thank you 1fin

Purva Kirad

Very nice explanation of all concpets! thank you

KAVITHA

Very clear explanation sir . I was not able to understand before but now u have given a clarity. Thank you so much sir...

Jayashree

Really the classes were very useful for my preparation.... Thanks a lot InidgoLearn

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Crystal clear Thank you sir for such an amazing classes

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Very nice lectures and great explanation sir thank you lots!

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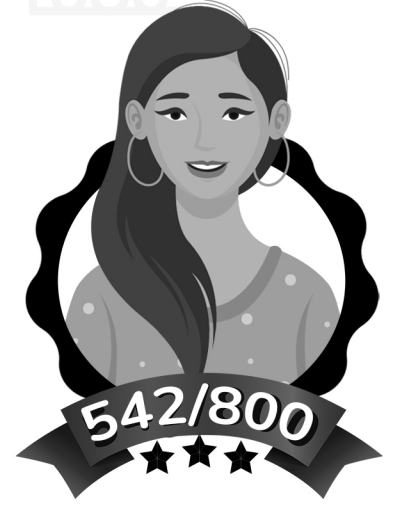
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Note – The chapters have been arranged in a different order from the study material to ensure logical

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Framework for Preparation and Presentation of Financial Statements (FS)

Illustration

Illustration 1

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

Liabilities	Rs.	Assets	Rs.
Capital	60,000	Fixed Assets	65,000
Profit and Loss Account	25,000	Stock	30,000
10% Loan	35,000	Trade receivables	20,000
Trade payables	10,000	Deferred costs	10,000
		Bank	5,000
	1,30,000		1,30,000

Additional information:

(a) The remaining life of fixed assets is 5 years. The pattern of use of the asset is even. The net realisable value of fixed assets on 31.03.X2 was Rs. 60,000.

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

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

(d) Expenses for the year amounted to Rs. 14,900.

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

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

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

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

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

You are required to prepare the Profit and Loss Accounts and Balance Sheets of the trader in two cases

- assuming going concern
- not assuming going concern.

Solution: Illustration 1

Profit And Loss Account					
Particulars	Going Concern	Not Going Concern	Particulars	Going Concern	Not Going Concern
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			
To Depreciation (65,000/5)	13,000	5,000	By Discount (Trade Payable)	-	600
To Deferred cost (10,000/4)	2,500	10,000			
To Provision – bad debt	2,000	6,000			
To Interest	3,500	3,500			
To Penalty – Loan	-	2,500			
To Net Profit	16,100	18,700			
	4,82,000	4,90,600		4,82,000	4,90,600

Assumption – Expenses 14,900 doesn't include depreciation & interest on loan



Balance Sheet as at 31st March, 20X2					
Liabilities	Going Concern	Not Going Concern	Assets	Going Concern	Not Going Concern
Capital	60,000	60,000	Fixed Assets	52,000	60,000
Profit & Loss A/c	41,100	43,700	Stock	32,000	40,000
10% Loan	35,000	37,500	Trade Receivables	25,000	25,000
Interest Payable	3,500	3,500	Less: Provisions	2,000	6,000
Trade Payable	12,000	11,400	Net Trade Receivables	23,000	19,000
			Deferred costs	7,500	-
			Cash & Bank	37,100	37,100
	1,51,600	1,56,100		1,51,600	1,56,100

Working Notes:**1.Fixed Assets**

Value on 31-03-X1	65,000
Less: Depreciation	(13,000)
Net Book Value On 31-03-X2	52,000

2.Inventory

Cost	32,000
Net Realisable Value	40,000
Lower Of Cost & NRV	32,000*

If not a going concern, inventory should be valued at Net realisable Value.

Illustration 2

Suppose at the beginning of an accounting period, aggregate values of assets and liabilities of a trader are Rs. 5 lakhs and Rs. 2 lakhs respectively.

The trader during the year had the following transactions:

- Introduced capital Rs. 20,000.
- Earned income from investment Rs. 8,000.
- A liability of Rs. 31,000 was finally settled on payment of Rs. 30,000.
- Wages paid Rs.2,000
- Rent outstanding Rs.1,000
- Drawings of Rs.4,000

Solution: Illustration 2

Particulars	Assets (A)	Liabilities (L)	Equity (E= A-L)
Opening	5,00,000	2,00,000	3,00,000
Capital Introduced ₹20,000	5,20,000	2,00,000	3,20,000
Income from Investment ₹8,000	5,28,000	2,00,000	3,28,000
Settlement of liability ₹31,000 with ₹30,000	4,98,000	1,69,000	3,29,000
Wages Paid ₹2,000	4,96,000	1,69,000	3,27,000
Rent Outstanding ₹1,000	4,96,000	1,70,000	3,26,000
Drawings of ₹4,000	4,92,000	1,70,000	3,22,000

Illustration 3

- Purchase of machinery @ Rs. 5,00,000
- Book value (historical cost) = Rs. 4,00,000
- Realisable value (today) = Rs.3,00,000
- Future economic benefits (net cash) = Rs. 1,00,000 for each of the next 5 years

Compute Present value of cash flow



Solution: Illustration 3

Years	Cash flow	Present Value Factor	Present Value Of Cash Flow
1	1,00,000	0.909	90,900
2	1,00,000	0.826	82,600
3	1,00,000	0.751	82,600
4	1,00,000	0.683	68,300
5	1,00,000	0.621	62,100
		3.79 (PVAF)	3,79,000

Present Value Factor = $1/(1+r)^n$

PVAF = Present Value Annuity Factor.

Since Equal or uniform cashflows each year, then sum of Present value cash flow is also computed as :

Cash Flow × PVAF

=1,00,000 × 3.79 = 3,79,000

Illustration 4

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

- Current cost of opening stock = (Rs. 12,000 / 100) × 125 = 6,000 × Rs. 2.50 = Rs. 15,000
- Current cost of closing cash = Rs. 12,000 (Rs. 18,000 – Rs. 6,000)
- Opening equity at closing current costs = Rs. 15,000
- Closing equity at closing current costs = Rs. 12,000
- Retained Profit = Rs. 12,000 – Rs. 15,000 = (-) Rs. 3,000

The negative retained profit indicates that the trader has failed to maintain his capital.

The available fund of Rs. 12,000 is not sufficient to buy 6,000 units again at increased price of Rs. 2.50 per unit. The drawings should have been restricted to Rs. 3,000 (Rs. 6,000 – Rs. 3,000). Had the trader withdrawn Rs. 3,000 instead of Rs. 6,000, he would have left with Rs. 15,000, the fund required to buy 6,000 units at Rs. 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.

Solution 4

Financial Capital Maintenance at historical costs

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

Financial Capital Maintenance at current purchasing power

	Rs.	Rs.
Closing capital (At closing price)		12,000
Less: Capital to be maintained		
Opening capital (At closing price)	15,000	
Introduction (At closing price)	Nil	(15,000)
Retained profit/(loss)		(3,000)



Physical Capital Maintenance

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

Illustration 5

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

Solution 5

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)

Illustration 6

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

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

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

Solution 6

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



Illustration 7

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

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

Additional Information:

- Remaining life of Property, Plant and Equipment is 5 years with even use. The net realisable value of Property, Plant and Equipment as on 31 st March, 20X2 was ₹ 64,000.
 - Firm's sales and purchases for the year 20X1-X2 amounted to ₹ 5 lacs and ₹ 4.50 lacs respectively.
 - The cost and net realisable value of the stock were ₹ 34,000 and ₹ 38,000 respectively.
 - General Expenses for the year 20X1-X2 were ₹ 16,500.
 - Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 20X0-X1 i.e. ₹ 5,000 per year.
 - Out of trade receivables worth ₹10,000, collection of ₹4,000 depends on successful re-design of certain product already supplied to the customer.
 - Closing trade payable is ₹10,000, which is likely to be settled at 95%.
 - 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.

Solution 7

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.)	<u>10,000</u>		<u></u>
	5,38,500		5,38,500

Illustration 8

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.

Solution 8

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)			



AS - 1 Disclosure of Accounting Policies

Illustrations

Illustration 1

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

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014 -15. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to Rs. 1,95,000.

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

Solution

Prashant Ltd. should disclose the change in its inventory valuation method along with the financial impact of that change. An appropriate note may be presented as follows:

“The Company measures inventories at the **lower of cost and net realisable value**. In earlier years, cost was determined using the **FIFO** method. From the current financial year (201X-X2), the Company has adopted the **weighted average** cost method, as management believes it provides a more appropriate basis for reflecting the **consumption pattern** of inventories.

Since the **net realisable value** of all inventory items exceeded their respective costs during the year, inventories have been carried at cost. The **change in policy** has resulted in a reduction of the **current year's profit** and **closing inventory value** by **₹16,000.**”

Illustration 2

ABC Ltd. was making provision for non-moving inventories based on issues for the last 12 months up to 31.3.2016. The company wants to provide during the year ending 31.3.2017 based on technical evaluation:

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

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

Solution

Accounting policies are the specific **principles, bases, conventions, rules and practices** applied by an entity in preparing and presenting financial statements. Changing the basis for determining a **provision** for non-moving inventories from usage over the last 12 months to a **technical evaluation** does **not** amount to a **change in accounting policy**.

The **policy** remains the same (i.e., to provide for non-moving/obsolete inventories). Only the **estimation technique** used to quantify the provision has changed, and this does not constitute an accounting policy change.

Entities may revise the **method of estimation** if it results in a **more reliable or prudent estimate**. Hence, the company can adopt the technical evaluation method.

In this case, the reduction in provision from Rs. 3.5 lakhs to Rs. 2.5 lakhs is **not material** considering the overall inventory value of Rs. 100 lakhs. A disclosure may be made as follows:

“The Company has made provision for non-moving inventories based on technical evaluation, unlike the preceding year. Had the earlier method been followed, the profit for the year and the corresponding effect on net assets would have been lower by Rs. 1 lakh.”



Illustration 3

Jagannath Ltd. had made a right issue of shares in 2017. In the offer document to its members, it had projected a surplus of Rs. 40 crores during the accounting year to end on 31st March 2018. The draft results for the year prepared on the hitherto followed accounting policies and presented for perusal of the Board of Directors showed a deficit of Rs. 10 crores.

The Board, in consultation with the Managing Director, decided on the following:

1. Value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation of inventory at Prime Cost (Rs. 30 crores).
2. Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being Rs. 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 2016-17.

Solution

As per **AS-1**, any **change in accounting policies** that has a **material effect** in the current period, or is **reasonably expected to have a material effect** in subsequent periods, must be **disclosed**.

If a change has a material impact in the current period, the **amount of the financial effect** should also be disclosed **to the extent it is ascertainable**. Where it is not fully ascertainable, the fact should be stated clearly.

Accordingly, in this case, the Notes on Accounts should **explicitly disclose the change**, the **reason for such change**, and the **financial impact**.

NOTES ON ACCOUNTS**1. Change in Inventory Valuation Method**

During the year, inventories have been valued at **factory cost** in place of the earlier policy of valuing them at **prime cost**. This change has been made to reflect the **more capital-intensive production process** adopted during the year due to significant expenditure incurred on modernisation.

As a result of this change, the **closing inventory** stands valued at **Rs. 50 crores** (previous basis: Rs. 30 crores), and the **profit for the year has increased by Rs. 20 crores**.

Faculty Note : Refer to AS-2 for Inventory valuation principles.

2. Provision for Permanent Fall in Value of Investments

The company has recognised a **provision of Rs. 10 crores** towards the **permanent diminution in the value of certain long-term investments**, the decline having occurred gradually over the past five years.

This provision has **reduced the profit** shown in the financial statements by **Rs. 10 crores**.

Faculty Note : Refer to AS-13 for investment valuation principles – Long term investments are valued at cost unless the reduction in value is other than temporary

Illustration 4

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.

Solution

AS 1 “**Disclosure of Accounting Policies**” identifies **prudence** as a key consideration in selecting and applying accounting policies. Due to uncertainties surrounding future events, **profits are not anticipated**, whereas **all known liabilities and losses must be provided for**, even if the exact amount is uncertain and only a **best estimate** can be made.

AS 1 also recognises **accrual** as a **fundamental accounting assumption**. Under the accrual concept, once the ICD becomes overdue, the lender is placed in a **disadvantageous position** due to non-payment of interest. Therefore, irrespective of the contract terms, the company has an **obligation** to recognise **overdue interest** unless the lenders have **explicitly waived** it.

Given these principles, XYZ Company should **provide for the overdue interest liability**, using a **reasonable estimate** based on available information. For cases where the overdue interest has already been settled, the company must accrue the **actual settled amount**.

By not providing for the overdue interest from the due date to the date of repayment, the company has **violated the accrual basis of accounting**. Hence, the treatment adopted merely disclosing the claims as “**claims not acknowledged as debt**” i.e a contingent liability is **not correct**.

Faculty Note : Refer to AS 29 for principles related to provisions and contingent liability

Illustration 5

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

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

Solution

(i) False

As per **AS 1 – Disclosure of Accounting Policies**, the fundamental accounting assumptions **underlie** the preparation of financial statements and are **not specifically stated** because their acceptance and use are **assumed**. Disclosure is needed **only when they are not followed**.

(ii) False

If the fundamental accounting assumptions — **Going Concern, Consistency and Accrual** — are followed, no specific disclosure is required. But if **any one of them is not followed**, the fact **must be disclosed** as per AS 1.

(iii) True

All **significant accounting policies** used in the preparation and presentation of financial statements should be **disclosed in one place** as part of the financial statements to ensure proper understanding.

(iv) False

Any **change in accounting policy** that has a **material effect** in the current or future periods must



be disclosed. If the **quantum of impact is not ascertainable**, the fact **should still be indicated**, not omitted.

Illustration 6

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

Solution

Different enterprises may adopt different **accounting policies** even while operating in the same industry. This results in **variations in reported results**, affecting **comparability**.

Examples of Areas Where Accounting Policies Differ

Area	Policy Option 1	Policy Option 2
Inventory Valuation	FIFO	Weighted Average
Depreciation Method	SLM (Straight Line Method)	WDV (Written Down Value)
Property, Plant & Equipment	Cost Model	Revaluation Model
Treatment of Forex Differences	Capitalize exchange differences (AS 11 option)	Charge to P&L
Valuation of Investments	Fair Value through P&L	Amortised Cost / Cost model

These differences may significantly impact the **profit, net assets**, and key performance indicators.

Impact of Different Policies

While each entity may choose policies that best reflect a **true and fair view**, differing policies **reduce comparability** of financial statements for users such as analysts, investors, lenders and regulators.

How AS 1 Addresses This Issue

AS 1 – Disclosure of Accounting Policies requires that all **significant accounting policies** used in preparing financial statements be **disclosed in one place**.

This helps users:

- understand the **basis of preparation**
- adjust for differences, if needed
- make **meaningful comparisons** between entities in the same industry



AS - 2 Inventories

Illustrations

1. Illustration

Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:

- (a) Cost of purchases (based on vendors' invoices) Rs. 5,00,000
- (b) Trade discounts on purchases Rs. 10,000
- (c) Import duties Rs. 200
- (d) Freight and insurance on purchases Rs. 250
- (e) Other handling costs relating to imports Rs. 100
- (f) Salaries of accounting department Rs. 15,000
- (g) Brokerage commission payable to indenting agents for arranging imports Rs. 300
- (h) Sales commission payable to sales agents Rs. 150
- (i) After-sales warranty costs Rs. 600

Advise as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per AS 2.

Solution

Expense	Included in Inventory?	Reason	Amount (₹)
(a) Cost of purchases (based on vendors' invoices)	✓ Yes	Purchase cost	5,00,000
(b) Less: Trade discounts	✗ Deducted	Discount reduces purchase cost	(10,000)
(c) Import duties	✓ Yes	Directly attributable to purchase	200
(d) Freight and insurance on purchases	✓ Yes	Direct cost of bringing inventory	250
(e) Other handling costs relating to imports	✓ Yes	Directly related to bringing inventory	100
(f) Salaries of accounting department	✗ No	Administrative expense	–
(g) Brokerage commission for arranging imports	✓ Yes	Cost directly related to purchase	300
(h) Sales commission	✗ No	Selling expense	–
(i) After-sales warranty costs	✗ No	Not a cost to bring inventory to location/condition	–
		Total	4,90,850

2. Illustration

ABC limited has a plant with a capacity to produce 1,00,000 units of a product per annum and the expected fixed overheads is Rs. 18,00,000. Determine the amount of overheads to be allocated to the inventory in the following cases.

- (i) Actual Production is 1,00,000 units
- (ii) Actual Production is 90,000 units
- (iii) Actual Production is 1,20,000 units

Solution

Case	Actual Production (Units)	Treatment of Recovery Rate	Calculation of	Overheads Allocated (₹)	Adjustment / Remark



			Overheads Allocated		
Predetermined Rate	1,00,000 (Estimated)	$\text{₹}18,00,000 \div 1,00,000 = \text{₹}18$ per unit		—	—
Case I	1,00,000	Use predetermined rate	$1,00,000 \times \text{₹}18$	₹18,00,000	No adjustment required
Case II	90,000	Recovery rate not revised	$90,000 \times \text{₹}18$	₹16,20,000	₹1,80,000 (under-absorbed) to be charged to P&L
Case III	1,20,000	Recovery rate revised Revised rate = $\text{₹}18,00,000 \div 1,20,000 = \text{₹}15$ per unit	Overheads = $1,20,000 \times \text{₹}15$	₹18,00,000	No under/over absorption

3. Illustration

X Co. Ltd purchased goods at a cost of Rs. 40 lakhs in October 2016. Till March 2017, 75% of the stock was sold. Company wants to disclose closing stock at Rs. 10 lakhs. Expected sales value is Rs. 11 lakhs and a commission of 10% is payable to the agent. Compute the value of Inventory.

Solution

According to AS-2, Inventory will be valued at lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Particulars	Amount in ₹
Selling price	11,00,000
Less: selling expenses	1,10,000
Net Realisable Value	9,90,000

The cost of inventory is Rs. 10 lakhs. Hence, the inventory will be valued at Rs. 9.9 lakhs.

Illustration 3

You are required to value inventory per Kg of finished goods.

Material: Rs. 200 per kg

Direct Labour: Rs. 40 per kg

Direct Variable Overhead: Rs. 20 per kg

Fixed production charges for the year on normal working capacity of 2,00,000 Kgs is Rs. 20,00,000.

Solution

Material Cost: Rs. 200

Labour Cost: Rs. 40

Variable Overhead: Rs. 20

Total Variable Cost: Rs. 260

Fixed Overhead: Rs. 10

Cost Per Kg : Rs. 270

Working:

Fixed Overhead Recovery Rate: $\text{Rs. } 20,00,000 / 2,00,000 = \text{Rs. } 10$ per Kg



4. Illustration

In a production process normal waste is 5% input. 5,000 MT of input was put in process resulting in wastage of 300 MT. The cost per MT of input is Rs. 1,000. Entire quantity of waste is in stock at year end. With reference to Accounting Standard, How will you value inventories in this case?

Solution:

Particulars	Amount in ₹
Normal wastage	$5000 \times 5\% = 250$ units
Actual wastage	300 units
Abnormal wastage	50 units
Total cost	Rs. $1,000 \times 5000 =$ Rs. 50,00,000
Allocable units	$5000 - 250 = 4750$ units.
Cost per MT	Rs. $50,00,000 / 4,750 =$ Rs. 1052.63 per unit
Inventory at hand	$5000 - 300 = 4700$ units
Value of inventory	$4700 \times$ Rs. 1052.63 = Rs. 49,47,368/-
Abnormal loss	$50 \times$ Rs. 1052.63 = Rs. 52,632

5. Illustration

Anil Pharma Limited ordered 16,000 Kgs of certain material at Rs. 160 per unit. The purchase price includes GST in respect of which GST full input tax credit is admissible at Rs.10 per kg.

- Freight incurred amounted to Rs. 140,160.
- Normal Transit Loss is 2%.

The company actually received 15,500 units. The company consumed 13,600 units of material. Compute cost of inventory under AS-2 and amount of abnormal loss.

Solution

Working Notes

1. Since the price already includes GST which is adjustable, the ITC in respect of GST would be deducted to arrive at cost of inventory.
2. Freight Inward will form part of cost of inventory
3. Normal Transit Loss – 2% of 16,000 units – 320 units
4. Expected receipt – $16,000 - 320 = 15,680$ units
5. Abnormal loss = $15,680 - 15,500 = 180$ units.

Particulars	Amount (Rs)
Purchase cost ($16,000 \times 160$)	25,60,000
Less : Input Tax Credit ($16,000 \times 10$)	1,60,000
Add : Freight	1,40,160
Total Cost	25,40,160
Expected Units ($16,000 - 2\% \text{ of } 16,000$)	15,680 units
Cost per unit	$25,40,160 / 15,680 =$ Rs. 162 per unit
Units in Inventory	$15,500 - 13,600 = 1,900$
Value of Inventory	$= 1,900 \times$ Rs. 162 = Rs. 3,07,800
Abnormal Loss (180 units X Rs. 162)	Rs. 29,160

6. Illustration

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 Rs. 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.

Solution:



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 @ Rs.150 = Rs.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	Rs. 23,437.50
[150 units @ Rs. 156.25 (Rs. 18,00,000/11,520)]	

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

7. Illustration

Cost of a partly finished unit at the end of 2016-17 is Rs. 150. The unit can be finished next year by a further expenditure of Rs. 100. Finished units can be sold at Rs. 250 per unit subject to payment of 4% brokerage on selling price. Value of inventory is to be determined.

Solution

Workings

1. Brokerage: 4% of Rs. 250 = Rs. 10
 2. Net Proceeds from Sale = Rs. 250 - Rs. 10 = Rs. 240
- Cost of Partly finished unit = Rs. 150

Selling Price	= Rs. 250
(-) Estimated Cost of Completion	= Rs. 100
(-) Selling Cost (Brokerage)	= Rs. 10
Net Realisable Value	= Rs. 140

Inventories are valued at Rs.140

According to AS-2, Inventory will be valued at lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

8. Illustration

The cost and net realisable value of two items that a company has in its inventory are given below.

Item	Cost (Rs.)	Net Realisable Value (Rs.)
I	50,000	45,000
II	20,000	24,000
Total	70,000	69,000

Compute the value of inventory.

Solution

Inventory is valued at lower of cost or net realisable value (NRV). Inventory should not be valued on a global basis but on item by item basis.

Item I: Lower of Cost or NRV is Rs. 45,000.

Item II: Lower of Cost or NRV is Rs. 20,000

Total Value of Inventory: Rs. 45,000 + Rs. 20,000 = Rs. 65,000

9. Illustration

USA limited purchased raw material at Rs. 400 per Kg. The company does not sell material but uses it in production of finished goods. Finished goods in which the raw material is expected to be used are expected to be sold at below cost.



At the end of the accounting year, the company is having 10,000 Kgs of raw material in stock. As the company doesn't sell raw material, it doesn't know the selling price of raw material and hence cannot calculate realisable value of material for valuation of inventory. However, the replacement cost of raw material is Rs. 300 per kg. How will you value inventory of raw material?

Solution

According to AS-2, Raw Material is generally valued at Cost. However, if the Finished goods in which raw materials are incorporated are expected to be sold below cost, the raw materials are valued at net realisable value. Replacement cost is a measure of realisable value. Hence in this case, Raw Material is valued at realisable value.

Raw Material Inventory

= Rs. 300 X 10,000

= Rs. 30,00,000

Illustration 10

On 31st March 20X1, a business firm finds that cost of a partly finished unit on that date is Rs. 530. The unit can be finished in 20X1-X2 by an additional expenditure of Rs. 310. The finished unit can be sold for Rs. 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.

Solution:

Valuation of unfinished unit

	Rs.
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

10. Illustration

In a manufacturing process of Vijay Ltd, one by-product BP emerges besides two main products – MP1 and MP2 apart from scrap. Details of cost of production process are hereunder:

Particulars	Amount (Rs.)
Raw Material : 15,000 units	1,60,000
Wages	82,000
Fixed Overheads	58,000
Variable Overheads	40,000

Product	Production units	Closing Stock (31.03.2012)
MP1	6,250	800
MP2	5,000	200
BP	1,600	

Average Market Price of MP1 and MP2 is Rs 80 per unit and Rs. 50 per unit respectively. By-Product is sold at Rs. 25 per unit. There is a profit of Rs. 5,000 on sale of by-product after incurring separate processing charge of Rs. 4,000 and packing charges of Rs. 6,000. Rs. 6,000 is realised from sale of scrap.

Calculate the value of closing stock MP1 and MP2 as on 31st March 2012.



Solution*Hint for Exam –*

Joint Cost	Raw Material + Wages + Overheads
Less:	NRV of By-product and Scrap
	Net Joint Cost

Allocate the net joint cost between MP1 and MP2

Particulars	Amount (Rs.)
Raw Material Cost	1,60,000
Wages	82,000
Fixed Overhead	58,000
Variable Overhead	40,000
Total Joint Cost	3,40,000
(Less): NRV of by-product [1600X Rs. 25 – Rs. 4000 – Rs. 6000] [40,000-4,000-6,000]	30,000
(Less): NRV of Scrap	6,000
Net Joint Cost	3,04,000

The joint cost of Rs. 3,04,000 must be split between MP1 and MP2 on a reasonable basis. In this case the joint cost can be allocated on relative sale price.
Computation of Sale Value

Product	Qty	Sale Price (Rs.)	Sale Value (Rs.)
MP1	6,250	80	5,00,000
MP2	5,000	50	2,50,000

Allocation of Joint Cost

Joint Cost	Unit Cost
MP1 : Rs. 3,04,000 X 2/3 = Rs. 2,02,667	Rs. 2,02,667/6,250 = Rs. 32.42
MP2 : Rs. 3,04,000 X 1/3 = Rs. 1,01,333	Rs. 1,01,333/5,000 = Rs. 20.26

Closing Stock:

MP1 = Rs. 32.42 X 800 = Rs. 25,944/-

MP2 = Rs. 20.26 X 200 = Rs. 4,054/-

11. Illustration

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

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

Additional Information:

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

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

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

(a) Net realisable value of Chemical Y is Rs. 800 per unit

(b) Net realisable value of Chemical Y is Rs. 600 per unit

Solution

As per AS 2 "Valuation of Inventories" closing stock of finished goods are valued at lower of cost or net realisable value.

Closing stock of raw material are generally valued at cost, unless the finished goods into which such raw material gets incorporated is sold or likely to be sold below the cost

Cost per unit of chemical Y (finished good)

Particulars	Rs.
Material consumed	440
Direct labour	120
Variable overhead	80
Fixed overhead [Rs.4,00,000/ 20,000 units]	20
Cost per unit of chemical Y	660

Cost per unit of raw material X

Particulars	Rs.
Cost price	380
Freight inward	40
Unloading charges	20
Cost per unit of raw material	440

Replacement cost of raw material X = Rs. 300

Calculation of closing stock at Raw Material X and Chemical Y

(a) Net realisable value (NRV) of Chemical Y is Rs. 800 per unit

NRV > Cost of finished good

Rs. 800 > Rs. 660

Closing stock of raw material X is valued at cost of Rs. 440 per unit and chemical Y is valued at cost of Rs. 660 per unit.

Particulars	Units	Cost per unit (Rs.)	Amount (Rs.)
Raw material X	1000	440	4,40,000
Chemical Y	2400	660	15,84,000
Closing balance			20,24,000

(b) Net realisable value of Chemical Y is Rs. 600 per unit

NRV < Cost of finished goods .

Rs. 600 < Rs. 660

Closing stock of raw material X is valued at replacement cost of Rs. 300 and chemical Y is valued at NRV of Rs. 600.

Particulars	Units	Cost per unit (Rs.)	Amount (Rs.)
Raw material X	1000	300	3,00,000
Chemical Y	2400	600	14,40,000
Closing balance			17,40,000

12. Illustration

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

Solution

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

In this case,

Cost of inventories is Rs. 5 lakhs

Net Realisable value = Expected sale value - selling commission

= Rs. 5.5 lakhs - Rs. 0.55 lakhs (10% of 5.5 lakhs)

= Rs. 4.95 lakhs

So the closing stock should be valued at Rs. 4.95 lakhs .



13. Illustration

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 @ Rs. 120). Replacement cost of raw material A as on 31-3-20X1 is Rs. 90 per unit.
- (ii) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs. 260 per unit. These units can be finished next year by incurring additional cost of Rs. 60 per unit.
- (iii) 1500 units of finished Product X and total cost incurred Rs. 320 per unit. Expected selling price of Product X is Rs. 300 per unit.

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

Solution:

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

Hence the valuation will be done as under:

- (i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at Rs. 90 per unit.
- (ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost (Rs. 260) or Net realisable value Rs. 240 (Estimated selling price Rs. 300 per unit less additional cost of Rs. 60).
- (iii) 1,500 units of finished product X will be valued at NRV of Rs. 300 per unit since it is lower than cost Rs. 320 of product X.

Valuation of Total Inventory as on 31.03.20X1:

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

14. Illustration – Nov 2023 | 5 Marks

In the following cases, find the value of closing stock as per AS 2:

- (i) Sonu is a retailer dealing in toys. During the year, he purchased items worth Rs. 1,47,000 and made a total sale Rs. 1,54,000. The average percentage of gross margin is 10% on cost. Opening stock of toys at cost was Rs. 20,000.
- (ii) On 21st March, 2023, Mohan purchased 250 chairs at Rs. 300 each. The selling price of the chair is Rs. 400 each. Owing to a manufacturing defect, net realisable value of the whole lot of chair was determined at 70% of their normal selling price. No chairs were sold during the year.



Case (i): Sonu – Retailer in Toys

Particulars	Calculation	Amount (₹)
Sale value of opening stock and purchases	$(₹20,000 + ₹1,47,000) \times 1.10$	1,83,700
Less: Sales made during the year		(1,54,000)
Sale value of unsold stock		29,700
Less: Gross margin on cost	$(₹29,700 \div 1.10) \times 0.10$	(2,700)
Cost of closing inventory		27,000

Value of closing stock (as per AS 2) = ₹27,000

Case (ii): Mohan – Manufacturer of Chairs

Particulars	Calculation	Amount (₹)
Closing stock at cost	$250 \times ₹300$	75,000
Net realisable value (NRV)	$₹400 \times 70\% = ₹280$ per chair $₹280 \times 250$ chairs	70,000
Value of closing stock	Lower of (Cost ₹75,000 and NRV ₹70,000)	70,000

Value of closing stock (as per AS 2) = ₹70,000

15. Illustration

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'?

Solution:

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

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

Alpha Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale.

Therefore, empty bottles are assets for the company.

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

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

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

16. Illustration

Can PT limited, a wire netting company, while valuing its finished goods at the year end, include interest on bank overdraft as an element of cost for the reason that overdraft has been taken specifically for the purpose of financing current asset like inventory and working capital expenses?

Solution



As per AS-2 Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. Hence PT limited cannot include interest on bank overdraft as an element of cost.

However, if interest in relation to inventory which is a qualifying asset as per AS-16, interest cost can form part of cost of inventory

17. Illustration

Knight Limited sells beers to customers. Some of the customers consume the beer in the bar run by Knight Limited. While leaving the bars, consumers leave empty bottles in the bar and the company takes possession of these empty bottles.

The company has laid down a detailed internal control procedure for accounting for these empty bottles which are sold by the company by calling for tenders.

Keeping this in view, decide whether stock of empty bottles is an asset of the company.

If so, whether stock of empty bottles existing as on date of balance sheet is considered to be inventory and is valued as per AS-2 or to be treated as scrap and shown at realisable value with corresponding credit to other income?

Solution

Empty Bottles, generally, would be scrap and valued at Realisable value.

In the given case, Empty Bottles

- have internal control procedure
- Are sold through tenders
- Revenue is important component of revenue

Hence, Empty bottles in this case can be considered as Inventory because of the significance of revenue from these bottles. Thus, the inventory should be valued at Net Realisable Value.

18. Illustration

Sun limited has fabricated special equipment (Solar power panel) during 2014-15 as per drawings and design supplied by the customer. However due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items

As a result of the above, the details of the customer balance and the goods held by the company as work in progress and finished goods as on 31-03-2016 are as follows:

Solar Power Panel (WIP)	Rs.85 lakhs
Solar Power Panel (Finished goods)	Rs.55 lakhs
Sundry Debtors (solar power panel)	Rs.65 lakhs

The petition for winding up against customer has been filed during 2015-16 by Sun Ltd.

Comment with explanation on provision to be made on 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 2015-16.

Solution

Inventories

Assumption 1	Assumption 2
Net Realisable Value > Cost	Net Realisable Value = 0
Inventories are valued at cost	Inventories are valued at net realisable value
Value of inventories (Solar panel)	Value of inventory = Rs. 0
Work in progress = Rs. 85 lakhs	Rs. 140 lakhs will be transferred to profit and loss account.
Finished goods = Rs. 55 lakhs	
----- Rs.140 lakhs	

Debtors

Since a winding up petition has been filed, the entire amount of sundry debtors is doubtful for recovery. The entire amount of Rs. 65 lakhs should be provided as bad debts.



AS 10
PROPERTY, PLANT AND EQUIPMENT

Inclusions and Exclusions from Cost

Summary of Various costs

Item No.	Particulars	Classification	Explanation
(1)	Import duties and non-refundable purchase taxes	Purchase Price of PPE	Part of the directly paid price for acquiring the asset.
(2)	Initial delivery and handling costs	Directly attributable cost of PPE	Necessary to bring the asset to its working condition.
(3)	Initial operating losses (e.g., low demand at start)	Cost not included	Not necessary to bring the asset to usable condition; expensed.
(4)	Costs while asset is capable of operating but not fully utilized	Cost not included	Post-ready-for-use costs are excluded.
(5)	Trade discounts and rebates	Purchase Price of PPE (deduction)	These reduce the purchase price of PPE.
(6)	Costs of relocating or reorganizing operations	Cost not included	Do not relate to bringing asset to condition/location.
(7)	Installation and assembly costs	Directly attributable cost of PPE	Required to put the asset in working condition.
(8)	Administration and general overhead costs	Cost not included	Not directly attributable unless specifically incurred for installation.

1. Illustration (Past Exam – 5 Marks)

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period –Salaries of the staff engaged in preparation of restaurant before its opening Rs.7,50,000 Construction and remodelling cost of restaurant Rs.30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

Solution

The cost of an item of **PPE** should be recognised as an **asset** if, and only if:

- (a) It is **probable** that **future economic benefits** associated with the item will **flow** to the enterprise, and
- (b) The **cost** of the item can be **measured reliably**.

As per provisions of AS 10, **any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating** in the manner indicated by the management are called **directly attributable costs and would be included in the costs of an item of PPE**.



Management of Neon Enterprise should **capitalize the costs of construction and remodelling the restaurant**, because **they are necessary to bring the restaurant to the condition necessary for it to be capable of operating** in the manner intended by management.

Thus the **expenditure of Rs.30,00,000** should be **considered part of the asset**.

However, the **cost of salaries of staff engaged** in preparation of restaurant Rs.7,50,000 before its opening are in the **nature of operating expenditure** that would be incurred if the **restaurant was open** and **these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management**. Hence, **Rs.7,50,000** should be **expensed**.

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 Rs.5,00,000 to install machinery in the new location.
2. Rent of Rs.15,00,000
3. Removal costs of Rs.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?

Solution

Any **costs directly attributable** to bringing the **asset** to the **location and condition** necessary for it to be capable of **operating** in the manner **intended by management** can be capitalized. The costs to be incurred by the company are in the nature of **relocating** or **reorganising operations** of the company and are **not necessary** for bringing the **asset** to the **location and condition** as intended by management.

The costs to be incurred by the company are in the nature of **relocating** or **reorganising operations** and do **not meet** the requirement of **AS 10 (Revised)** and therefore, **cannot be capitalised**.

3. 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 claims 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.

Solution

Any **costs directly attributable** to bringing the **asset** to the **location and condition** necessary for it to be capable of **operating** in the manner **intended by management** should be **capitalised**.

Costs incurred after the asset is ready to use are not capitalised.

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 should be expensed** as incurred.



4. Illustration

An entity bought a plot of land for development of office buildings. Development of the land was scheduled into six phases. The land scheduled for development in phases five and six was leased to another entity on a short-term basis as a parking lot for heavy vehicles. What is the treatment of rental income from car parking lot?

Solution

Some operations occur in connection with the construction or development of an item of PPE, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case the land scheduled for development was leased on a short term basis as a parking lot for heavy vehicles. The car park activity is incidental to the entity's principal activity of property development. The income and related expenses of incidental operations are recognized in the Statement of Profit and Loss for the period.

Computation of Cost of PPE

5. Illustration

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

s.n	Particulars	Amount(Rs.)
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	Present Value 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).

Solution

According to AS-10 (Revised), the cost of an item of property, plant & equipment comprises its purchase price, all taxes (other than those refundable or eligible as input tax credit) and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The initial estimates of dismantling costs must be capitalised at their present values. Initial operating losses do not form part of the cost of property, plant and equipment.

s.no	Particulars	capitalization	Amount in ₹
1	Cost of the plant (cost per supplier's invoice plus taxes)	Yes	25,00,000
2	Initial delivery and handling costs	Yes	2,00,000
3	Cost of site preparation	Yes	6,00,000
4	Consultants used for advice on the acquisition of the plant	Yes	7,00,000
5	Present Value Estimated dismantling costs to be incurred after 7 years	Yes	3,00,000
	Total Cost to be capitalised		43,00,000

Interest charges paid to suppliers will not be capitalised unless the asset is a qualifying asset as defined by AS-16.



6. Illustration

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 Rs. 1.10 crores on demolishing the old Factory Building thereon. A sum of Rs. 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 Rs. 8,00,000 for land acquisition and incurred Rs. 1,25,000 on title guarantee insurance. Compute the value of the land acquired.

Solution:

Particulars	Rs.
Purchase Price: 5,000 acres x Rs. 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) [Rs. 110 lakhs (-)Rs. 60 lakhs (Rs. 63 lakhs x 100/105)]	50.00
Cost of Land	3,269.25

7. Illustration

Star Limited purchased machinery for Rs. 6,80,000 (inclusive of GST of Rs. 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 (200 out of the total of 500 men hours worked, were spent on installation of the machinery)	56,000
Spare parts and tools consumed in installation	5,000
Total salary of supervisor (Time spent for installation was 25% of the total time worked)	26,000
Total technical expense (1/10 relates to the plant installation)	34,000
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 Rs. 8,900 were incurred. Calculate the value at which the plant should be capitalized in the books of Star Limited.

Solution:

Calculation of Cost of Plant

Particulars	Calculation / Given	Rs.
Purchase Price	Given	6,80,000
Add: Site Preparation Cost	Given	21,200
Labour Charges	(56,000 × 200 / 500)	22,400
Spare Parts	Given	5,000
Supervisor's Salary	25% of Rs. 26,000	6,500
Technical Costs	1/10 of Rs. 34,000	3,400
Test Run & Experimental Production Charges	Given	18,000
Architect Fees for Setup	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 Capitalised	7,39,500	



Note: Further Expenses of Rs. 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.

8. Illustration (5 Marks)

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs. 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs.45,000 per month. The technician's services were given by Department B to Department A, which billed the services at Rs. 49,500 per month after adding 10% profit margin.

The machine was purchased at (Rs.1,58,34,000 inclusive of IGST @12% for which input credit is available to Shrishti Ltd. Rs. 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of Rs.30,000 to supervise machinery installation at the factory site.

Also, payment under the invoice was due in 5 months. However, the Company made the payment in the 3rd month. The company operates on Bank Overdraft @ 14% p.a. Ascertain the amount at which the Machinery should be capitalised under AS 10.

Solution

As per AS-10 , All Costs incidental to bring the asset to its present form, location and condition should be capitalised including the cost to dismantle the asset at a future date .

S.n	Particulars	Calculations	Cost (₹)
1.	Site preparation	Given	1,41,870
2.	Supervisor's salary	Rs. 45,000 * 3 months	1,35,000
3.	Purchase price (excluding adjustable taxes)	1,58,34,000 * 100/112	1,41,37,500
4.	Transportation	Given	55,770
5.	Architect's fees	Given	30,000
			1,45,00,140

Machinery is to be capitalised at Rs. 1,45,00,140 as per AS 10

9. Illustration (May 2025-7 Marks)

Hardy Ltd. intends to extend the factory set up on the adjacent plot with disintegrated old premises. It acquired the land having an area of 250 hectares at a cost of Rs. 25,000 per hectare.

Hardy Ltd. incurred Stamp duty and registration charges of 5% of land value. Legal fees were paid Rs. 4,75,000 for land acquisition.

Hardy Ltd. incurred Rs. 37,85,000 for demolishing old premises thereon. A sum of Rs. 12,60,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site.

Till the new site with extended factory premises is ready, the company needs to move the present production facilities to another (temporary) site. The following incremental costs will be incurred.

- Set up costs of Rs. 7,50,000 to install machinery in the new location.
- Rent of Rs. 12,00,000.
- Removal costs of Rs. 2,50,000 to transport the machinery from the old location to the temporary location.
 - Management is of the opinion that the cost of moving the production facilities to another temporary location can be capitalised. You are required to advise.
 - You are also required to compute the cost of land acquired.

Answer:

(i)



1. **Constructing or acquiring a new asset** may result in **incremental costs** that would have been **avoided** if the asset had not been **constructed or acquired**.
2. These **costs** are **not 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**.
3. The **costs** to be incurred by the company are in the nature of **relocating** or **reorganising operations** of the company and do **not meet** the requirements of **AS 10 (Revised)**.
4. Therefore, these **costs cannot be capitalised**.

Computation of cost of land.

Particulars	Calculation	Rs.
Purchase Price	250 hectares × Rs. 25,000 per hectare	62,50,000
Add: Stamp Duty and Registration Charges	5% of Rs. 62,50,000	3,12,500
Add: Legal and Consultancy Fees		4,75,000
Add: Cost of demolition		25,85,000
Less: Net Salvage Income from Demolition	Rs. 12,60,000 × (100 / 105)	(12,00,000)
Cost of Land	-	96,22,500

Exchange of Assets

10. Illustration

Entity A exchanges surplus land with a book value of Rs.10,00,000 for cash of Rs.20,00,000 and plant and machinery valued at Rs.25,00,000. What will be the measurement cost of the assets received?

Solution

When Property, Plant & Equipment is acquired in exchange for another asset and the transaction has a commercial substance, the PPE acquired is measured at fair value. The plant and machinery acquired in this case will be measured at Rs. 25,00,000.

**The value of land realised in this case is Rs. 45,00,000 [Plant and Machinery Rs. 25,00,000 and Cash Rs. 20,00,000]*

Dr. PPE	25,00,000
Dr. Cash	20,00,000
Cr. Land	10,00,000
Cr. Profit on disposal of land	35,00,000

11. Illustration

Entity A exchanges car X with a book value of Rs.13,00,000 and a fair value of Rs.13,25,000 for cash of Rs.15,000 and car Y which has a fair value of Rs.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?

Solution

When **Property, Plant & Equipment (PPE)** is acquired in **exchange** for another **asset** and the transaction has a **commercial substance**, the PPE acquired is measured at **fair value**. If the transaction **lacks commercial substance**, the acquired items are measured at **book value** of the **assets given up**.



Particulars	Amount (Rs.)
Book Value of Car X (given up)	13,00,000
Less: Cash received	15,000
Value of Car Y (measured at book value since no commercial substance)	12,85,000

Dr. Car Y	12,85,000	
Dr. Cash	15,000	
Cr. Car X		13,00,000

If we assume that the transaction has commercial substance,

Particulars	Amount (Rs.)
Fair value of Car X (Given up)	13,25,000
Less: Cash received	15,000
Value of Car Y (FV of Asset given up – Cash received)	13,10,000

Replacement of Major Parts / Inspections

12. Illustration

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of Rs. 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 Rs. 450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.

Solution:

As per **AS 10 – Property, Plant & Equipment**, when a major part of an asset is replaced, the **old part must be removed from the books** (derecognised), whether or not its original cost was separately identified.

If the original cost of the old part is **not available**, the company can use the **replacement cost (or cost of a similar part in future)** as an estimate of what the old part would have cost when the asset was purchased.

In this case, the **new turbine** gives future economic benefits and its cost is known, so it will be **capitalised as a separate asset**. Since the original cost of the turbine is not available, the **current replacement cost (₹450 lakhs) is discounted back by 6 years at 8%** to estimate the original cost for derecognition.

$$\text{Cost of Turbine} = 450 / (1.08)^6 = 283.58$$

	Turbine	Other Parts	Total
Cost	283.58	716.42	1,000.00
Years	10	10	
Depreciation per year	28.36	71.64	100.00
Depreciation for 6 years	170.15	429.85	600.00
Carrying Amount	113.43	286.57	400.00
Derecognition	(113.43)	-	(113.43)
Recognition of new turbine	450	-	450
Revised Carrying Amount	450.00	286.57	736.57



13. Illustration

A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul. A ship which cost ₹20 million with a 20-year life must have major overhaul every five years. The estimated cost of the overhaul at the five-year point is ₹5 million. However, the actual cost after 5 years turned out to be ₹6 million.

Solution:

Ind AS 16 requires **component accounting** where different components of an asset have different useful lives or consumption patterns. When **major inspections or overhauls** are required at regular intervals (e.g., dry-docking of ships), the **cost of such inspection/overhaul is capitalised as a separate component**, and the carrying amount of the replaced component is derecognised.

The depreciation charge for the first five years of the assets life will be as follows:

	Overhaul component (million)	Ship (other than overhaul component) (million)	Total
Cost	5	15	20
Years	5	20	
Depreciation per year	1	0.75	1.75
Depreciation for 5 years	5	3.75	8.75
Carrying Amount	Nil	11.25	11.25

Total accumulated depreciation for the first five years will be ₹ 8.75, and the carrying amount of the ship at the end of year 5 will be ₹ 11.25 million.

Assume, the actual overhaul costs incurred at the end of year 5 are ₹ 6 million. This amount will now be capitalised into the costs of the ship, to give a carrying amount of ₹ 17.25 million.

The depreciation charge for years 6 to 10 will be as follows:

	Overhaul component	Ship (other than overhaul component)
Cost	6	11.25
Years	5	15
Depreciation per year	1.2	0.75

Annual depreciation for years 6 to 10 will now be ₹ 1.95 million. This process will be continued for years 11 to 15 and years 16 to 20. By the end of year 20, the capital cost of ₹ 20 million will have been depreciated plus the actual overhaul costs incurred at years 5, 10 and 15.

Depreciation

14. 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?

Solution

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.



15. Illustration

Entity A purchased an asset on 1st January 2013 for Rs.1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2017, the directors reviewed the estimated life and decided that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if the company charges depreciation on a Straight Line basis.

Solution

Particulars	Amount in ₹
Depreciation for years 1-4	$10,000 \times 4 = 40,000$
WDV at beginning of year 5	$1,00,000 - 40,000 = 60,000$
Balance useful life	4 years
Depreciation for balance useful life	$60,000/4 = 15,000$ per year

16. Illustration

Entity B constructs a machine for its own use. Construction is completed on 1st November 2016 but the company does not begin using the machine until 1st March 2017. Comment when the entity should start charging depreciation.

Solution

The entity should begin charging depreciation from the date the machine is ready for use - that is, 1st November 2016. 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.

17. Illustration

A property costing Rs.10,00,000 was bought in 2016. 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 2016 prices, is:

Case (a) Rs.10,00,000 Case (b) Rs.9,00,000. Calculate the amount of depreciation.

Solution

Case a	Amount
Cost of Property	Rs. 10,00,000
Less : Estimated Salvage Value	Rs. 10,00,000
Depreciable Amount	Nil
Depreciation	Nil

Case b	Amount
Cost of Property	Rs. 10,00,000
Less : Estimated Salvage Value	Rs. 9,00,000
Depreciable Amount	Rs. 1,00,000
Useful Life	20 Years
Depreciation	$Rs. 1,00,000/20 = Rs. 5000$

18. Illustration

B Ltd. owns an asset with an original cost of Rs. 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be Rs 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to Rs.10,000. How would the above changes in estimates be made by B Ltd?

Solution

Particulars	Amount in ₹
Depreciable amount	$2,00,000 - 20,000 = 1,80,000$
Annual depreciation	$1,80,000/10 = 18,000$
Total depreciation	1,44,000



Carrying amount of an asset at the end of 8 years	$2,00,000 - 1,44,000 = 56,000$
Asset can be used for 4 more years - revised depreciation	$(56,000 - 10,000) / 4 = 11,500$

19. Illustration

In the year 2016-17, an entity acquired a new freehold building with a useful life of 50 years for Rs. 90,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows

Component	Useful life (Years)	Cost (₹)
Land	Infinite	20,00,000
Roof	25	10,00,000
Lifts	20	5,00,000
Fixtures	10	5,00,000
Remainder of building	50	50,00,000
		90,00,000

Calculate depreciation for the year 2016-17 as per componentization method.

Solution

Component	Useful life (Years)	Cost (₹)	Depreciation (₹) = cost / useful life
Land (non-depreciable)	Infinite	20,00,000	-
Roof	25	10,00,000	40,000
Lifts	20	5,00,000	25,000
Fixtures	10	5,00,000	50,000
Remainder of building	50	50,00,000	1,00,000
			2,15,000

Amount of depreciation for the year 2016-17 is Rs.2,15,000

20. Illustration

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 wants 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?

Solution

- A company can choose to apply a **Cost Model** or **Revaluation Model** to measure **PPE**, and must apply a **single policy** to a **class of PPE**. A **class of PPE** is a grouping of assets of a **similar nature and use** in the operations of an enterprise.
- 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**.

Hence, **Entity A's management** can apply the **Revaluation Model** only to the **office buildings**. However, **all properties within the class of office buildings** must be carried at the **revalued amount**



21. Illustration

A Ltd. has an item of plant with an initial cost of Rs.1,00,000. At the date of revaluation, accumulated depreciation amounted to Rs.55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be Rs. 65,000. Pass Journal Entries with regard to Revaluation.

Solution

Particulars		Debit(₹)	Credit (₹)
Accumulated depreciation A/c To Asset A/c (Being elimination of accumulated depreciation against the cost of the asset)	Dr.	55,000	55,000
Asset A/c To Revaluation Surplus A/c (Being increase of net asset value to Fair value)	Dr.	20,000	20,000

22. Illustration

Arka Ltd. purchased machinery for Rs. 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 Rs. 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.

Solution:

Particulars	Rs. in Lakhs
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years $(3,000 \times 10\% \times 4)$	(1,200.00)
Book Value at the end of Year 4	1,800.00
Add: Revaluation Surplus (Balancing figure)	900.00
Revalued Amount (Revised depreciable value)	2,700.00
Less: Depreciation for Year 5 $(2,700 \div 6 \text{ years})$	(450.00)
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 $(2,700 \div 6 \text{ years})$	(450.00)
Carrying Amount at the end of Year 6	1,800.00

Comprehensive Illustrations**23. Illustration**

Skanda Ltd. acquired a machinery for Rs. 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 Rs. 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 Rs. 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 Rs. 42,50,000 now?

Solution:

Particulars	Rs.
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years $(2,50,00,000 \times 10\% \times 2)$	(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 (Revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3–5 $(3,00,00,000 \div 8 \times 3)$	(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	Case 1: Disposal Proceeds = Rs. 1,12,50,000	Case 2: Disposal Proceeds = Rs. 42,50,000
Carrying Amount (at end of Year 5)	Rs. 1,87,50,000	Rs. 1,87,50,000
Less: Disposal Proceeds	Rs. 1,12,50,000	Rs. 42,50,000
Loss recognised in Profit or Loss	Rs. 75,00,000 (Loss)	Rs. 1,45,00,000 (Loss)
Revaluation Surplus transferred directly to Retained Earnings	Rs. 1,00,00,000	Rs. 1,00,00,000

24. Illustration

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): Rs. 30,00,000
- Initial delivery and handling costs: Rs. 1,00,000
- Cost of site preparation: Rs. 2,00,000
- Consultant fee for advice on acquisition of Plant: Rs. 50,000
- Interest charges paid to supplier against deferred credit: Rs. 1,00,000
- Estimate of Dismantling and Site Restoration costs: Rs. 50,000 after 10 years (Present Value is Rs. 30,000)
- Operating losses before commercial production: Rs. 40,000

The company identified motors installed in the Plant as a separate component and a cost of Rs. 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 Rs. 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 Rs. 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 Rs. 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.

Solution:

Cost at Initial Recognition:

Particulars	Rs.
Cost of the Plant (as per Invoice)	30,00,000
Add: Initial Delivery and Handling Costs	1,00,000
Add: Cost of Site Preparation	2,00,000
Add: Consultants' Fees	50,000
Add: Estimated Dismantling and Site Restoration Costs	30,000
Total Cost of Plant including Motors	33,80,000
Less: Cost of Motors (identified separately – 1/6*)	(5,63,333)
Cost of Plant (excluding Motors – balance 5/6)	28,16,667

* Purchase price of Motors = Rs. 5,00,000 out of Rs. 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 Rs. 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.

Recognition of Motors Replacement

Particulars	Rs.
Cost of Motors (determined earlier)	5,63,333
Less: Depreciation for 4 years (SLM basis) $(5,63,333 \div 6 \text{ years} \times 4 \text{ years})$	(3,75,555)
Carrying Amount of Motors at the end of Year 4	1,87,778



Accounting: The company should derecognize the existing Carrying Amount of Motors replaced of Rs. 1,87,778. Further, the acquisition cost of new motors of Rs. 6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at Rs. $6,00,000 \div 5 \text{ years} = \text{Rs. } 1,20,000 \text{ p.a.}$

Revaluation

Particulars	Rs.
Cost of the Plant at initial recognition (from working 1)	28,16,667
Less: Depreciation for 4 years (SLM basis) $(28,16,667 \div 10 \text{ years} \times 4 \text{ years})$	(11,26,667)
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors) [Rs. 25,00,000 – Rs. 6,00,000]	19,00,000
Gain on Revaluation transferred to Revaluation Reserve	2,10,000
Revised Depreciation Charge (p.a.) $(19,00,000 \div 6 \text{ years})$	3,16,667

Derecognition

Particulars	Motors (Rs.)	Plant (Excl. Motors) (Rs.)
Cost / Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5–8	$(1,20,000 \times 4) =$ 4,80,000	$(3,16,667 \times 4) =$ 12,66,668
Carrying Amount before Disposal / Derecognition	1,20,000	6,33,332
Less: Disposal Proceeds allocated in ratio of carrying amounts	95,575	5,04,425
Loss transferred to Profit & Loss A/c	24,425	1,28,907

Notes:

(a) The Revaluation Surplus of Rs. 2,10,000 would be transferred directly to Retained Earnings.

(b) The allocation of disposal proceeds of Rs. 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.

Miscellaneous Questions

25. Illustration

An entity acquires the right to use an underground cave for gas storage purposes for a period of 50 years. The cave is filled with gas, but a substantial part of that gas will only be used to keep the cave under pressure in order to be able to get gas out of the cave. It is not possible to distinguish the gas that will be used to keep the cave under pressure and the rest of the gas. Evaluate whether AS 10 would apply or AS 2.

Solution

As per AS 10, certain items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets and such assets are depreciated over the period.

The total volume of gas must be virtually split into

- (i) Gas held for sale, (related assets)
- (ii) Gas held to keep the cave under pressure.

The former must be accounted for under AS 2 as Inventories.

The latter must be accounted as PPE under AS 10 and depreciated over the period the cave is expected to be used.



26. Illustration

An entity operates an oil refining plant. For the refining process to take place, the plant must contain a certain minimum quantity of oil. This can only be taken out once the plant is abandoned and would then be polluted to such an extent that the plant's value is significantly reduced. Evaluate whether AS 10 would apply or AS 2?

Solution

As per AS 10, certain items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets and such assets are depreciated over the period.

The portion of oil which remains in the plant should be treated as per AS 10. It should be accounted as PPE under AS - 10 and depreciated over a period.

27. Illustration

What happens if the cost of the previous part / inspection was / was not identified in the transaction in which the item was acquired / constructed?

Solution

When each **major inspection** is performed, its **cost** is **recognised** in the **carrying amount** of the item of **PPE** as a **replacement**, if the **recognition criteria** are satisfied.

Any **remaining carrying amount** of the **previous inspection** (as distinct from **physical parts**) is **derecognized**. **Derecognition** 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**.

28. Illustration

Entity A carried plant and machinery in its books at Rs.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 Rs.20,00,000. The machines were acquired by the insurance company and the company did not receive the Rs.20,00,000 as cash compensation. State, how Entity A should account for the same.

Solution

Entity A should account for a loss in the Statement of Profit and Loss on derecognition of the carrying value of plant and machinery in accordance with AS 10 (Revised).

Entity A should separately recognize 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.

Particulars	Debit (₹)	Credit (₹)
Profit & Loss Account Dr. To Plant & Machinery Account (Being loss on account of fire)	2,00,000	2,00,000
Insurance Company Account Dr. To Profit & Loss Account (Being claim settlement by insurance company)	20,00,000	20,00,000
Plant & Machinery Account Dr To Insurance Company Account (Being plant received from insurance company)	20,00,000	20,00,000



AS - 12
Accounting for Government Grants

Illustrations

Illustration 1

Supriya Ltd. received a grant of Rs. 2,500 lakhs during the accounting year 2010-11 from Government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 2011-12, 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 correct accounting treatment, with reference to the provisions of AS-12.

Solution :

- The Government grant was received for carrying out welfare activities for its employees. The Grant received was of revenue in nature and hence would have been credited to profit and loss account at the time of receipt (or in proportion of expenses over the years in which expenses for employee welfare was incurred). The amount refundable in respect of a government grant related to revenue is applied first, against any unamortised deferred credit remaining in respect of the grant.
- To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to the profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year 2011-12

A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

Illustration 2

A Ltd. purchased machinery for Rs. 40 lakhs. (Useful life 4 years and residual value Rs. 8 lakhs). Government grant received is Rs. 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the 2nd year and the value of the fixed assets, if:

- The grant is credited to Fixed Assets A/c.
- The grant is credited to Deferred Grant A/c.

Solution :

i. If the grant is credited to Fixed Asset Account,

Fixed Asset A/c Dr. ...

Rs. 16 lacs

To Cash/Bank

Rs. 16 lacs

Particulars	Amount in ₹
Original Cost	40 lacs
Less: Grant Received	16 lacs
Carrying Amount	24 lacs
Less: Residual Value	8 lacs
Depreciable Value	16 lacs
Useful Life	4 years
Depreciation Per Year	16 lacs/4 = Rs. 4 lacs
WDV at the end of Second Year	24 lacs – Rs. 4 lacs X 2 = Rs. 16 lacs
Add: Amount of Refund	16 lacs
Value of Asset after Refund	32 lacs



ii. If the grant was credited to the Deferred Grant Account.

Depreciation per year = Rs. (40 lacs – Rs. 8 lacs) / 4 = Rs. 8 lacs per annum.

The grant will be credited to the Profit and Loss Account equally (because depreciation is charged on SLM basis and hence ratio of depreciation is 1:1:1:1).

Amount credited to Profit & Loss Account for 2 years = Rs. 16 lacs/4 X 2 = Rs. 8 lacs.

Balance left in Deferred Grant Account after 2 years = Rs. 16 lacs – Rs. 8 lacs = Rs. 8 lacs.

The refund of grant in this case should be debited to Deferred Grant Account to the extent of balance available.

Since the amount of refund is more than the balance in the Deferred Grant Account, the shortfall will be debited to a profit and loss account.

The journal entry will be:

Deferred Government Grant Dr	Rs. 8 lacs	
Profit & Loss Account	Dr.....	Rs. 8 lacs
To Cash/Bank		Rs. 16 lacs

The refund of the grant will not impact the fixed asset account.

Balance in fixed asset account at the time of refund = Rs. 40 lacs – Rs. 8 lacs X 2 = Rs. 24 lacs.

Illustration 3

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

Solution :

Grant received for setting up a factory is in the nature of the promoter's contribution and should be credited to the Capital Reserve.

Such an amount is not available for distribution as a dividend. Hence, the company is not permitted to distribute dividends out of such grant.

The accounting treatment given by the company is not in accordance with AS-12. According to AS-12, if assets are received free of cost from the Government as a grant, such assets should be recorded at nominal value. Hence, in the given case, the company must record the land received free of cost at a nominal value (say Rs. 1 or Rs. 10). The accounting treatment given by the company is not correct.

Illustration 4 (Q&A Part 1)

Viva Limited received a specific grant of Rs. 30 lacs for acquiring a plant of Rs. 150 lacs during 2007-08 having a useful life of 10 years. The grant received was credited to deferred income in the balance sheet.

During 2010-11, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the government. Balance in the deferred income account on that date was Rs. 21 lacs and the written down value of the plant was Rs. 105 lacs.

- What should be the treatment of refund of grant and the effect on cost of the fixed asset and amount of depreciation charged during the year 2010-11 in profit and loss account?
- What should be the treatment of refund, if grant was deducted from the cost of plant during 2007-08 assuming plant account showed a balance of Rs. 84 lacs as on 1.4.2010?



Solution :

i. If the amount was initially recorded to deferred income initially, the amount of refund must be debited to the deferred account to the extent of balance available.

Any shortfall in a deferred income account should be debited to a profit and loss account.

The total amount of refund is Rs. 30 lacs and the balance available in deferred income account is only Rs. 21 lacs. The shortfall of Rs. 9 lacs must be debited to the profit and loss account.

Deferred Income A/c	Dr.	Rs. 21 lacs	
Profit & Loss A/c	Dr.	Rs. 9 lacs	
	To Cash/Bank a/c		Rs. 30 lacs

ii. If the grant was deducted from the cost of the fixed asset account, the amount of refund must be debited to the fixed asset account.

The value of the fixed asset account in this case would be increased by Rs. 21 lacs and the revised value of fixed asset would be depreciated over the balance useful life.

Fixed Asset A/c Dr. ...	Rs. 30 lacs
To Cash/Bank	Rs. 30 lacs

Balance in Fixed Asset account = Rs. 84 lacs + Rs. 30 lacs = Rs. 114 lacs.

Revised depreciation = $\text{Rs. } 114/7 = \text{Rs. } 16.286$ lacs per year.

Illustration 5

Samrat Limited has set up its business in a designated backward area which entitles the company for a subsidy of 25% of the total investment from the Government of India.

The company has invested Rs. 80 crores in the eligible investments. The company is eligible for the subsidy and has received Rs. 20 crores from the government in February 2019.

The company wants to recognize the said subsidy as its income to improve the bottom line of the company. Do you approve the action of the company in accordance with the Accounting Standard?

SolutionTechnical context :

As per AS 12 "Accounting for Government Grants", if government grants are given with reference to the total investment in an undertaking or by way of contribution towards its capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as Capital Reserves/Capital Subsidy which can be neither distributed as dividend nor considered as deferred income.

which can be neither distributed as dividend nor considered as deferred income.

Conclusion - Company cannot recognize the said subsidy as its income for increasing bottom line.

- It has to be credited to the Capital Reserve.
- It can neither be distributed as dividend nor considered as deferred income.

Illustration 6

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 amount is deducted from the value of fixed asset.



Solution:**Journal in the books of Z Ltd.**

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

Method II:

- Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
- Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.
- If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

Illustration 7

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.

Solution:**Journal in the books of Z Ltd.**

Year	Particulars	Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account Dr.	50,00,000	
	To Bank Account		50,00,000
	(Being fixed assets purchased)		
	Bank Account Dr.	10,00,000	



	To Deferred Government Grant Account		10,00,000
	(Being grant received from the government)		
	Depreciation Account Dr.	9,00,000	
	To Fixed Assets Account		9,00,000
	(Being depreciation charged on SLM)		
	Profit & Loss Account Dr.	9,00,000	
	To Depreciation Account		9,00,000
	(Being depreciation transferred to P/L Account)		
	Deferred Government Grants Account Dr.	2,00,000	
	To Profit & Loss Account		2,00,000
	(Being proportionate government grant taken to P/L)		
2nd	Depreciation Account Dr.	9,00,000	
	To Fixed Assets Account		9,00,000
	(Being depreciation charged on SLM)		
	Profit & Loss Account Dr.	9,00,000	
	To Depreciation Account		9,00,000
	(Being depreciation transferred to P/L Account)		
	Deferred Government Grant Account Dr.	2,00,000	
	To Profit & Loss Account		2,00,000
	(Being proportionate government grant taken to P/L)		

Illustration 8

X Ltd. runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of Rs. 30 lakhs per annum. As a support, the local Government grants a lumpsum payment of Rs.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:

- Shown separately as Other Income; and
- Deducted against the Salary costs.

Solution**Journal Entries**

Particulars	Rs. (Dr.)	Rs. (Cr.)
Bank Account Dr.	90,00,000	
To Deferred Income Account		90,00,000
(Being receipt of grant from government)		
Salary Expense Account Dr.	30,00,000	
To Bank Account		30,00,000
(Being Salary expense paid for the year)		
Deferred Income Account Dr.	18,00,000	



To Profit & loss Account		
(Being Year 1 Grant income recognised in Profit & Loss)		18,00,000

Note: The grant has been spread on a straight-line basis over a period of 5 years [Rs.90,00,000/5 years = Rs. 18,00,000].

Statement of Profit & Loss Account (Extract)

(a) Shown separately as Other Income:

Particulars	Notes	(Rs.)
Other Income		<u>18,00,000</u>

(b) Deducted against the Salary costs:

Particulars		(Rs.)
Salary cost	30,00,000	
Less: Deferred Government Grant	<u>(18,00,000)</u>	<u>12,00,000</u>

Illustration 9

A fixed asset is purchased for Rs. 20 lakhs. Government grant received towards it is Rs. 8 lakhs. Residual Value is Rs. 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 Rs. 5 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years.

Solution:

Year	Particulars		Rs. in lakhs (Dr.)	Rs. 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:**1. Depreciation for Year 1**

	Rs. in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	<u>12</u>
Depreciation $[(12-4)/4]$	2

2. Depreciation for Year 2

	Rs. in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
Less: Depreciation for the first year $[(12-4)/4]$	12
	<u>2</u>
	10
Add: Government grant refundable	<u>5</u>
	<u>15</u>
Depreciation for the second year $[(15-4)/3]$	3.67

Illustration 10

On 1.4.20X1, ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of machinery costing Rs. 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?

Solution

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.

		(Rs. in lakhs)
1st April, 20X1	Acquisition cost of machinery (Rs. 1,500 – Rs. 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 Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

Illustration 11

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of Rs. 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of Rs.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.

Solution

			Rs.	Rs.
	Deferred Grant A/c	Dr.	36 lakhs	90 lakhs
	Profit & Loss A/c	Dr.	54 lakhs	
	To Bank A/c			
	(Being Government grant refunded)			

Total grant received: Rs. 90 Lakhs Grant recognised as income for first 3 years: Rs. 18 lakhs × 3 = Rs. 54 lakhs
 Remaining Deferred Income = Rs. 90 Lakhs – 54 lakhs = Rs. 36 lakhs



AS 16 Borrowing Costs

1. Illustration

GHI Limited obtained a loan for Rs.70 lacs on 15.4.20X0 from JKL Bank to be utilised as under: On March 31st construction of the factory shed was completed and machinery which was ready for its intended use was installed. Delivery of Truck was received in the next financial year.

Particulars	Amount (₹)
Factory shed	25 lakhs
Purchase of machinery	20 lakhs
Working capital	15 lakhs
Advance for purchase of truck	10 lakhs
	70 lakhs

Total interest of Rs.9.1 lacs was charged by the bank for FY11. Show the treatment of interest under AS 16 and explain the nature of the asset.

Solution:

Treatment of Interest (Borrowing cost) as per AS 16 'Borrowing Costs'

Construction of Factory Shed:

If the period April 20X0 to March 20X1 is substantial period as per the Company's policy, then interest incurred on borrowings taken for such construction can be capitalised, if not such interest cost should be charged off to the P&L Interest attributable to Factory shed:

Rs. 9.1lacs x Rs.25 lacs /Rs. 70 lacs = Rs.3.25 lakhs

Purchase of Machinery:

It is not a qualifying asset as it is ready for intended use on its purchase itself. The interest cost on same should be charged off to P&L: Rs. 9.1 lacs X 20/70 = Rs. 2.6 lakhs

Working Capital:

Interest cost on inventory can be capitalised if it takes a substantial period of time. Working capital is generally a non-qualifying asset and interest cost on such working capital should be charged off: Rs. 9.1 lacs X 15/70 = Rs. 1.95 lakhs

Advance for purchase of truck:

Even after delivery is made, if an asset takes a substantial period of time to be ready for intended use only then will it be considered as a qualifying asset.

Hence, a truck is a non-qualifying asset and the interest pertaining to the loan will be debited to a profit and loss account: Rs. 9.1 X 10/70 = Rs. 1.3 lacs.

2. Illustration

On 18th April, 20X1, Amazing Construction Ltd. obtained a loan of Rs. 32 crores to be utilised as under:

Sl.n	Particulars	Amount(Rs.)
1	Construction of sea link across two cities (work has held up totally for a month during the year due to high water levels)	25 crores
2	Purchase of equipments and machines	3 crores
3	Working capital	2 crores
4	Purchase of vehicles	50 lakhs



5	Advances for tools/Cranes etc	50 lakhs
6	Purchase of technical know-how	1 crores
7	Total interest charged by the bank for the year ending 31st March 20X2	80 lakhs

Show the treatment of interest by Amazing Construction Ltd.

Solution:

According 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.

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.

- In the given case, construction of a sea-link is a qualifying asset. The capitalisation is continued for periods in which active development is stopped due to high water levels (which is common in construction of bridges).
- Purchase of equipment and vehicles are not qualifying assets as they are generally ready for use at the time of purchase.
- Similarly, technical know-how are not qualifying assets.
- Working capital for day to day operations of business is not a qualifying asset.

The treatment of interest by Amazing Construction Ltd. can be shown as:

Particulars	Qualifying asset	Calculation of an interest	Interest to be capitalised (₹)	Interest charged to P&L a/c (₹)
Construction of sea link	yes	$[80,00,000 \times (25/32)]$	62,50,000	Nil
Purchase of equipment and machinery	No	$[80,00,000 \times (3/32)]$	Nil	7,50,000
Working capital	No	$[80,00,000 \times (2/32)]$	Nil	5,00,000
Purchase of vehicles	No	$[80,00,000 \times (0.5/32)]$	Nil	1,25,000
Advance for tools, cranes etc.	No	$[80,00,000 \times (0.5/32)]$	Nil	1,25,000
Purchase of technical know how	No	$[80,00,000 \times (1/32)]$	Nil	2,50,000
Total			62,50,000	17,50,000

3. Illustration

Suhana limited issued 12% secured debentures of Rs.100 lakhs on 1.5.20X3 to be utilised as under:

- Construction of factory building – Rs.40 lacs
- Purchase of Machinery – Rs.35 lacs
- Working Capital Rs.25 lacs



In March 20X4 construction of the factory building was completed and Machinery was installed and is ready for its intended use.

Total interest on debentures for FY1X4 was 11 lacs. During the year X3-X4, the company had invested idle funds out of the money raised from debentures in Bank FDs and earned interest of Rs.2 lacs. Show the treatment of interest under AS 16 and explain the nature of the asset.

Solution :

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also para 10 of AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = Rs. 11,00,000 - Rs. 2,00,000 = Rs. 9,00,000

Particulars	Qualifying asset	Calculation of interest	Interest to be capitalised (₹)	Interest charged to P&L a/c (₹)
Construction of factory building	Yes	$9,00,000 \times 40/100$	3,60,000	Nil
Purchase of machinery	No	$9,00,000 \times 35/100$	Nil	3,15,000
Working capital	No	$9,00,000 \times 25/100$	Nil	2,25,000
Total			3,60,000	5,40,000

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

4. Illustration

Shan Builders Limited has borrowed a sum of US \$ 10,00,000 at the beginning of Financial Year 20X4-X5 for its residential project at LIBOR + 3 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, exchange rate was Rs. 56 per US \$ and the rate as on 31st March, 20X5 was Rs. 62 per US \$. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 20X5 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Solution :

- (i) Applicable interest rate : $1\% + 3\% = 4\%$
Interest for the period 20X4-X5 = US \$10,00,000 $\times$ 4% $\times$ Rs. 62 per US \$ = Rs. 24.80 lakhs
- (ii) Increase in the liability towards the principal amount = US \$ 10,00,000 $\times$ Rs. (62 - 56) = Rs. 60,00,000
- (iii) Interest that would have resulted if the loan was taken in Indian currency = US \$ 10,00,000 $\times$ Rs. 56 $\times$ 10.5% = Rs. 58,80,000
- (iv) Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 58,80,000 - Rs. 24,80,000 = Rs. 34,00,000.



Borrowing Costs include exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Therefore, out of exchange fluctuation loss of Rs.60 lakhs towards principal amount, only Rs. 34 lakhs will be considered as the borrowing cost.

Total Borrowing Cost = Rs. 24,80,000 + Rs. 34,00,000 = Rs. 58,80,000

Hence, Rs. 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining Rs.26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

5. Illustration

M/s First Limited began a construction of a new building on 1.4.20X7. It obtained Rs. 2 lakh as a special loan to finance the construction of a factory building on 1.1.20X7 at an interest rate of 8% per annum.

Further, expenditure on construction of the factory building was financed through other non-specific loans.

Details of the company's other outstanding non-specific loans were:

Loan	Rate of Interest
Rs.4,00,000	9%
Rs.5,00,000	12%
Rs.3,00,000	14%

The expenditure that was made on the buildings project were as follows:

Date	Expenditure on buildings
1 st April 20X7	Rs.3,00,000
31 st May 20X7	Rs. 2,40,000
1 st Aug 20X7	Rs. 4,00,000
31 st Dec 20X7	Rs.3,60,000

Construction of Building was completed by 31.03.20X8. As per the provisions of AS-X6, you are required to:

1. Calculate the amount of interest to be capitalised and
2. Pass Journal entry for capitalising the cost and borrowing cost in respect of the factory building

Solution

If it is assumed that the specific loan is used for the first expense of the project

A. Interest capitalised out of average accumulated expenses

Loan Date	Computation	Avg. Expenses (₹)	Interest@ 11.5% (₹)
1 st Apr	1,00,000 x 12/12	1,00,000	11,500
31 st May	2,40,000 x 10/12	2,00,000	23,000
1 st Aug	4,00,000 x 8/12	2,66,667	30,667
31 st Dec	3,60,000 x 3/12	90,000	10,350
		6,56,667	75,517



B. Interest on specific loan of Rs.2,00,000 @ 8% on total period = 16,000

Interest to be capitalised(A+B) = Rs.91,517

6. Illustration

In May, 20X6, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 20X7 and the building was put to its use immediately thereafter.

Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 20X7 amounted to Rs. 25 lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalised on the plea that the loan was specifically taken for the construction of factory building?

Explain the treatment in line with the provisions of AS 16.

Solution

Given

- Qualifying Asset – Factory Building
- Loan Taken – May 20X6
- Asset ready for intended use & put to use – January 20X7
- Interest till January 20X7 – Rs.18,00,000
- Interest till 31st March 20X7 – Rs.25,00,000

Technical context

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

Conclusion

Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 20X7)

- Rs. 18 lakhs alone can be capitalised.
- Rs. 25 lakhs will be charged to P&L a/c as interest expense

7. Illustration

A company incorporated in June 20X7, has set up a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalised although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

Solution:

As per para 3.2 to AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

It is a rebuttable presumption that 12 months period constitutes a substantial period of time. Ordinarily, a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case considering the time which an asset takes, technologically and commercially, to get it ready for its intended use or sale, which the management might decide as an accounting policy.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use. An enterprise that completes



the asset in 8 months should not be penalised for its efficiency by denying it interest capitalization and vice versa.

8. Illustration (Weighted Average Interest)

X Ltd. Began construction of a new building on 1st January, 20X1. It obtained Rs.1 lakh special loan to finance the construction of the building on 1st January, 20X1 at an interest of 10%

The Company's other outstanding two non-specific loans were:

Amount	Rate of Interest
Rs.5,00,000	11%
Rs. 9,00,000	13%

The expenditures that were made on the building project were as follows:

Month	Amount withdrawn
January 20X1	Rs.2,00,000
April 20X1	Rs.2,50,000
July 20X1	Rs.4,50,000
December 20X1	Rs.1,20,000

Building was completed by 31st December 20X1. Following the principles prescribed in AS 16 'Borrowing Costs', 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.

Solution Assumption : Assume that 1.1.20X1 to 31.12.20X1 is considered as a substantial period to make this asset a qualifying asset and thereby capitalise the borrowing cost.

The total expenditure on the project over the year is Rs.10,20,000. It is not incurred on one single day, so we should calculate interest only for such a period on such amounts. Assumed that borrowings are drawn on the 1st of that respective month.

Working notes :

1. Computation of weighted average interest rate

Amount (₹)	Rate of Interest	Interest per annum (₹)
5,00,000	11%	55,000
9,00,000	13%	1,17,000
14,00,000		1,72,000

Weighted average rate of interest = $1,72,000 / 14,00,000 * 100 = 12.285 \%$

2. Interest on expenses

Month	Amount withdrawn (₹)	Interest calculation	Interest (₹)
January 20X1	Rs.2,00,000	$1,00,000 * 12/12 * 10\% + 1,00,000 * 12/12 * 12.285\%$	10,000 12,285
April 20X1	Rs.2,50,000	$2,50,000 * 9/12 * 12.285\%$	23,034.375



July 20X1	Rs.4,50,000	$4,50,000 \times 6/12 \times 12.285\%$	27,641.25
December 20X1	Rs.1,20,000	$1,20,000 \times 1/12 \times 12.285\%$	1,228.5
			74,189.125

Borrowing cost is ₹ 74,189.

3. Amount for capitalization

Cost of asset	Amount (₹)
Cost of building	10,20,000
Borrowing cost	74,189
	10,94,189

Journal entries

Date	Particulars	Debit (₹)	Credit(₹)
31/3/20X1	Building a/c Dr.	10,94,189	
	To bank a/c		10,94,189
	(Being cost of building and borrowing cost thereon capitalised)		

9. Illustration

In May, 20X8, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 20X9 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 20X9 amounted to Rs. 25 lakhs. Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalised on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

Solution

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to date of completion (January, 20X9) i.e., Rs.18 lakhs alone can be capitalised. It cannot be extended to Rs.25 lakhs.

10. Illustration

The company has obtained Institutional Term Loan of Rs. 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to Rs. 406 lakhs, Rs. 58 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 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 Rs. 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of Rs. 580 lakhs.

Solution:



As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. 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 Rs. 52.20 lakhs can be given as:

Purpose	Nature	Interest to be capitalised	Interest to be charged to profit and loss account
		Rs. in lakhs	Rs. in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	$52.20 \times (406/580) = 36.54$	
		$52.20 \times (58/580) = 5.22$	
Advance to supplies for additional assets	Qualifying asset		$52.20 \times (116/180) = 10.44$
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, Rs. 52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 20X2.

11. Illustration

Rainbow Limited borrowed an amount of Rs. 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 Rs. 19.50 crores for the accounting period ending on 31.3.20X2. Due to surplus fund out of Rs. 150 crores, income of Rs. 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.

Solution:

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	Rs. in crores
Actual interest for 20X1-20X2 (11% of Rs. 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

12. Illustration

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:

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

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Solution:

Computation of amount to be capitalized

No.	Particulars	Rs.
1.	Interest expense on loan Rs. 2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (Rs. 34,00,000 + 64,00,000)	98,00,000
3.	Total cost of Phases III and IV (Rs. 55,00,000 + Rs. 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000



6.	Interest on loan used for Phases I & II, based on proportionate $\text{Loan amount} = \frac{30,00,000}{2,21,00,000} \times 98,00,000$	13,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate $\text{Loan amount} = \frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	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 Rs. 6,65,158.50 (i.e. Rs. 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 Rs. 6,65,158.50 (i.e. Rs. 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 Rs. 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.

13. Illustration

Expert Limited issued 12% secured debentures of Rs. 100 lakhs on 01.06.20X1. Money raised from debentures to be utilized as under:

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

Additional Information:

- Interest on debentures for the Financial Year 20X1-20X2 was paid by the Company.
- During the year, the company invested idle fund of Rs. 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of Rs. 50,000.
- In March, 20X2 construction of factory building was not completed (it is expected that it will take another 6 months).
- In March 20X2, Machinery was installed and ready for its intended use.
- Furniture was put to use at the end of March 20X2.
- 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.

Solution:

According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the Standard, borrowing



costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. 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 = Rs. 10,00,000 (100 lakhs x 12% x 10/12) – Rs. 50,000 = Rs. 9,50,000

Particulars	Nature of assets	Interest to be capitalized (Rs.)	Interest to be charged to Profit & Loss Account (Rs.)
Construction of factory building	Qualifying Asset	$9,50,000 \times 40/100$ = Rs. 3,80,000	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	$9,50,000 \times 15/100$ = 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	$9,50,000 \times 2/100$ = 19,000
Purchase of truck	Not a Qualifying Asset	NIL	$9,50,000 \times 13/100$ = 1,23,500
Working Capital	Not a Qualifying Asset	NIL	$9,50,000 \times 30/100$ = Rs. 2,85,000
Total		<u>Rs. 3,80,000</u>	<u>Rs. 5,70,000</u>



AS 26 Intangible Assets

Illustrations

1. Illustration – 5 marks

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

- (1) ₹23,00,000 paid by a manufacturing company to the legal advisor defending the patent of a product is treated as a capital expenditure.
- (2) During the year 2018-19 a company spent ₹7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.
- (3) A company spent ₹25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹25,00,000 by disclosing it as a prior period item.
- (4) A company with a turnover of ₹200 crores and an annual advertising budget of ₹1,50,00,000 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.

Solution

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.

1. 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.
2. 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, 2019 because no benefit will arise in the future.
3. 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
4. Expenditure of Rs. 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.

2. Illustration

AB Limited launched a project for producing product X in October 2009. The Company incurred ₹20 lakhs towards R&D expenses up to 31st March 2010. Due to prevailing market conditions, the Management concluded 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.

Solution

- As per **AS 26**, expenditure on **Research** should be **fully expensed in the Profit & Loss Account** when incurred.
- **Development expenditure** may be recognized as an intangible asset only if all the following conditions are demonstrated:



- Technical feasibility of completing the asset.
- Intention to complete and use or sell the asset.
- Ability to use or sell the asset.
- Evidence of probable future economic benefits.
- Availability of resources to complete the project.
- Reliable measurement of expenditure attributable to the asset.

Application to the Case

- Here, the Company itself has concluded that the product **cannot be manufactured and sold for the next 10 years**.
- This clearly indicates that **future economic benefits are not probable**, and therefore the recognition criteria for capitalization of development expenditure are **not satisfied**.

Conclusion

The entire amount of **₹20 lakhs should be charged off to the Profit & Loss Account immediately**. Deferring or capitalizing this expenditure is not permissible under **AS 26**.

3. Illustration

A company with a turnover of Rs.500 crores and an annual advertising budget of Rs.4 crore had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs.50 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of Rs.4 crore incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by the company correct?

Answer:

Provision:

According to AS 26 'Intangible Assets', expenditure on an intangible item should be recognized as an expense only when it is incurred unless it forms part of the cost of an intangible asset.

Analysis:

In the given case, advertisement expenditure of Rs.4crores 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 Rs.500crores.

Conclusion

Here, no intangible asset or another asset is acquired or created that can be recognized. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs.4crores to the Profit and Loss account of the year is correct.

4. Illustration

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before, the company comes to know through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya". X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks?

Answer

As per AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the **subsequent expenditure** enables the asset to generate future economic benefits in **excess** of its originally assessed **standard of performance** or can be measured and attributed to the asset reliably, then such subsequent expenditure should be **added to the cost** of the intangible asset.



The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs incurred for both trademarks **must be recognized as an expense**

Calculation of Cost

5. Illustration – 5 marks

A company acquired for its internal use a software on 28.01.2012 from the USA for US \$ 1,00,000. The exchange rate on that date was Rs. 52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:

- (i) Import Duty 20%
- (ii) Purchase Tax 10%
- (iii) Entry Tax 5% (Recoverable later from tax department)
- (iv) Installation expenses : Rs. 25,000
- (v) Profession fees for Clearance from Customs : Rs.20,000

Compute the cost of Software to be capitalized.

Answer:

Purchase cost	A	USD 100,000
Less: Discount	B	5% - 5,000
Net Purchase cost	C = A-B	USD 95,000
Exchange Rate	D	Rs. 52
Net purchase cost in Rs.	E = C x D	Rs. 49,40,000
Import duty @20% (assumed as non refundable)	F = E x 20%	Rs. 9,88,00
Total	G = E + F	Rs. 59,28,000
Purchase tax @10%	H = G x 10%	Rs. 5,92,800
Installation expenses	I	Rs. 25,000
Professional fees for customs clearance	J	Rs. 20,000
Total capitalized value of Asset	K = G + H + I + J	Rs. 65,65,800

*Since entry tax is refundable, the same will not form part of cost of intangible assets.

Amortisation

6. Illustration (Past exam – 4 marks)

A Company had capitalised development cost of Rs.150 lakhs. Sales expected in the subsequent years are as under:

Year 1	Rs.400 lakhs
Year 2	Rs.300 lakhs
Year 3	Rs.200 lakhs
Year 4	Rs.100 lakhs

You are asked to suggest how should Development cost be charged to Profit and Loss account.

If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

Answer:

Part 1

Technical Context

As per AS 26 an intangible asset should be amortised on straight line basis, but if there is a more appropriate way (i.e the ratio of benefits is known), the same should be used for amortisation.

Analysis and Conclusion

In the current case as the ratio of benefits is known and hence the development expenditure should be amortized in that ratio. i.e., as follows:

Ratio of Benefits – 4:3:2:1



Year	Sales (Rs. Lacs)	Amortisation Ratio	Amortisation Amount (Rs Lacs)
1	400	400/1000	$0.4 \times 150 = 60$
2	300	300/1000	$0.3 \times 150 = 45$
3	200	200/1000	$0.2 \times 150 = 30$
4	100	100/1000	$0.1 \times 150 = 15$
Total	1000		150

Part 2

Entire sum unamortized at end of year 3 is Rs.45 lacs (150-60-45). This entire sum should be written off in year 3. Hence the amount to be written off in Year 3 = Rs. 45 lacs.

7. Illustration

An enterprise acquired patent right for Rs. 400 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year 1 Rs. 200 lacs

Year 2 Rs. 200 lacs

Year 3 Rs. 200 lacs

Year 4 Rs. 100 lacs

Year 5 Rs. 100 lacs

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be Rs. 50 lakhs. Determine the amortization under Accounting Standard 26.

Answer:

Technical Context

As per AS 26 an intangible asset should be amortised on straight line basis, but if there is a more appropriate way (i.e the ratio of benefits is known), the same should be used. Hence the patent would be amortised in the ratio of cash flows i.e.2:2:2:1:1

Particulars	Calculation	Amortisation (₹ lakhs)	Carrying Amount (₹ lakhs)
Cost of Patent	—	—	400
Year 1	$(2/8 \times 400)$	100	300
Year 2	$(2/8 \times 400)$	100	200
Year 3	$(2/8 \times 400)$	100	100
(Revised estimate after Year 3)	Remaining = 100, to be amortised over 3 years in ratio 2:2:1	—	—
Year 4	$(2/5 \times 100)$	40	60
Year 5	$(2/5 \times 100)$	40	20
Year 6	$(1/5 \times 100)$	20	0

8. Illustration – 5 marks

Swift Ltd. acquired a patent at a cost of Rs. 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 Rs. 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 Rs. 36,00,000, Rs. 46,00,000, Rs. 44,00,000, Rs. 40,00,000 and Rs. 34,00,000. Find out the amortization cost of the patent for each of the years.

Solution:

Swift Limited amortised Rs. 10,00,000 per annum for the first two years i.e. Rs. 20,00,000.

Carrying amount after Year 2 = ₹80,00,000 – ₹20,00,000 = ₹60,00,000. Allocate this ₹60,00,000 over Years 3–7 in proportion to expected net cash flows



Year	Net cash flows (₹)	Ratio	Amortisation (₹)	Carrying amount at end (₹)
1	—	—	10,00,000	70,00,000
2	—	—	10,00,000	60,00,000
3	36,00,000	$36/200 = 0.180$	$0.180 \times 60,00,000 = 10,80,000$	49,20,000
4	46,00,000	$46/200 = 0.230$	13,80,000	35,40,000
5	44,00,000	$44/200 = 0.220$	13,20,000	22,20,000
6	40,00,000	$40/200 = 0.200$	12,00,000	10,20,000
7	34,00,000	$34/200 = 0.170$	10,20,000	0
Total	2,00,00,000	1.000	60,00,000 (post-Year2)	—

9. Illustration

Base Limited acquired an intangible asset 3 years back for Rs. 112 lakhs and the same was available for use from that date.

The company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis without any supporting evidence. Comment on the accounting treatment of the above with reference to the relevant accounting standard

Answer:

- As per **AS 26 – Intangible Assets**, the **presumptive maximum useful life is 10 years**, unless a longer period can be **clearly demonstrated** with supporting evidence of economic benefits.
- If no such demonstration is possible, amortisation over 12 years is **not appropriate**.

(Amt in lacs)

Particulars	Accounted by Company	Correct treatment
Cost	112	112
Useful life	12	10
Amortisation for 3 years	$112 \times 3/12 = 28$	$112 \times 3/10 = 33.6$
Shortfall in amortisation		5.6

This sum of Rs.5.6. lacs should be written off in the Current year as a prior period item. Amortisation in the current years should be charged at Rs. 11.2 lacs per annum.

10. Illustration

ABC Ltd. developed know-how by incurring expenditure of Rs. 20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

Solution:

Journal Entry

		Rs.	Rs.
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	14,00,000
Amortization A/c	Dr.	2,00,000	
To Know-how A/c			
[Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)]			



11. Illustration

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred Rs. 10 lakh on research during first 5 months of the financial year 2012-13. The development of the process began on 1st September, 2012 and upto 31st March, 2013, a sum of Rs. 8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2013, the Company has implemented the new process design and it is likely that this will result in after tax saving of Rs.2 lakh per annum for next five years. The cost of capital is 10%. The present value of annuity factor of Rs. 1 for 5 years @ 10% is 3.7908.

Decide the treatment of Research and Development Cost of the project as per AS 26.

Answer:

Technical context

As per AS 26, Research expenditure should be charged off to P&L, fully and immediately. Development expenditure that meets the criteria specified by the standard should be amortized over the period, during which benefits are expected to be realized.

Particulars	Amount (Rs. in Lakhs)	Treatment as per AS 26
Research Expenditure (Apr–Aug 2012)	10.00	Charged off to P&L in FY 2012-13
Development Expenditure (Sep 2012 – Mar 2013)	8.00	Subject to capitalisation
Present Value of Future Economic Benefits	$2 \times 3.7908 = 7.58$	Maximum amount that can be capitalised
Capitalised Amount	7.58	Shown as Intangible Asset
Excess Development Expenditure Written Off	$8.00 - 7.58 = 0.42$	Charged to P&L in FY 2012-13
Amortisation of Intangible Asset	$7.58 \div 5 = 1.516$ p.a.	Charged to P&L from FY 2013-14 onwards

12. Illustration [Past exam – 5 marks]

M/s. Mahesh Ltd is developing a new production process. During FY13 total expenditure incurred on the process was Rs.60 lacs. The Production process met the criteria for asset recognition as an intangible asset on 1.12.12.

Expenditure incurred till this date was Rs.32 lacs. Further expenditure incurred on the process for FY14 was Rs.90 lacs. As on 31.3.14 the recoverable amount of knowhow embodied in the process is estimated to be Rs.82 lacs. This includes estimates of future cash flows and inflows.

You are required to compute the expenditure to be charged to P&L for the year ended 31.3.13 and the carrying amount of the intangible asset on that day, expenditure to be charged to the P&L at the end of 31.3.14 and carrying value of intangible asset on that day.

Answer:

Particulars	Rs. Lacs
Amount incurred towards R&D in FY13	60
Amount incurred till 1.12.12	32
Amount incurred in Research Phase to be charged off to P&L in FY13	32
Carrying value of asset at end of FY13	28
Additional expenditure on development incurred in FY14	90
Total Development Expense	118
Amount recoverable from new process	82
Impairment loss (Rs.118 lacs – Rs.82 lacs) – To be accounted in FY14	36
Carrying value at end of FY14	82



AS 19
Leases

Illustrations

1. Illustration – Classification

A limited wishes to obtain a machinery on lease from B limited. The price at which machinery can be bought immediately is Rs. 30 lacs. The life of machinery is 14 years. The lease rentals of Rs. 8 lacs is payable at the end of each year for the next 5 years. What is the nature of lease? The implicit rate of return is 10%.

Year	Lease Payment	Formula (10%)	Present value factor	PV
1	8,00,000	$1/(1+1)$ or $1/1.1$	0.9091	727,280
2	8,00,000	$0.9091/1.1$	0.8264	661,120
3	8,00,000	$0.8264/1.1$	0.7513	601,040
4	8,00,000	$0.7513/1.1$	0.6830	546,400
5	8,00,000	$0.6830/1.1$	0.6209	496,720
		Total	3.7908	30,32,650

PV of lease payment = 8 lacs X 3.7909
= 30.32 lacs

A lease is classified as a **finance lease** if it **transfers substantially all risks and rewards** incidental to ownership of an asset. The legal title may or may not eventually be transferred. If any one of the following condition is satisfied, the lease is considered as finance lease.

1. **Ownership Transfer** – The lease transfers ownership of the asset to the lessee by the end of the lease term.
2. **Bargain Purchase Option**– The lessee has an option to purchase the asset at a price significantly lower than fair value, and at the inception it is reasonably certain that the option will be exercised.
3. **Lease Term vs. Useful Life**– The lease term covers a **major part** of the economic life of the asset, even if title is not transferred.
4. **Present Value of MLP vs. Fair Value**– At inception, the present value of minimum lease payments (MLP) amounts to **substantially all** of the fair value of the asset.
5. **Specialised Nature** – The asset is of a specialised nature, such that only the lessee can use it without major modifications.

In the given case, the present value of lease payment which is Rs. 30.32 lacs substantially amounts to the fair value of the machinery i.e, the cost at inception of Rs. 30 lacs. The lease must be classified as a finance lease.

2. Example – Compute IRR & Accounting for finance lease in books of lessee

- **Annual lease rent:** ₹50,000 (payable at end of each year)
- **Lease period:** 5 years
- **Guaranteed residual value (GRV):** ₹25,000
- **Unguaranteed residual value (UGR):** ₹15,000
- **Fair value of asset at inception:** ₹2,00,000

Determination of Interest Rate Implicit in Lease

The interest rate implicit in the lease is the discount rate at which the present value (PV) of Minimum Lease Payments (MLP) plus Unguaranteed Residual Value (UGR) equals ₹2,00,000.



Year	Cash Flow (MLP + UGR)	PVF (10%)	PV (₹)	PVF (14%)	PV (₹)
1	50,000	0.909	45,450	0.877	43,850
2	50,000	0.826	41,300	0.769	38,450
3	50,000	0.751	37,550	0.675	33,750
4	50,000	0.683	34,150	0.592	29,600
5	50,000	0.621	31,050	0.519	25,950
5	25,000 (GRV)	0.621	15,525	0.519	12,975
5	15,000 (UGR)	0.621	9,315	0.519	7,785
Total PV			2,14,340		192,360
NPV	PV of Inflow – PV of Outflow		14,340		-7,640
	Difference in NPV or Diff in PV of Inflow			21,980	
IRR	10% + (4% × 14,340)/21,980	10%+2.61%	12.61%		

Alternatively, PV of 50,000 annual payment can be computed as below

Rate	Payment × PVA/PVF	PV
10%		
Lease Payments	50,000 × 3.790	1,89,500
RV	40,000 × 0.621	24,840
	Total	2,14,340
14%		
Lease Payments	50,000 × 3.432	1,71,600
RV	40,000 × 0.519	20,760
	Total	1,92,360

$$IRR = (\text{Lower Rate}) + \frac{(\text{Diff in rates})}{\text{Diff in PV}} \times \text{NPV @ Lower Rate}$$

Accounting by Lessee

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.

Year	MLP / Residual Value (₹)	Discount Factor (12.6%)	PV (₹)
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000 (GRV)	0.552	13,800
Total PV (MLP)			1,91,500

Since the PV of MLP is lower, the lessee would recognise asset & liability at Rs. 1,91,500.

Asset A/c Dr.	1,91,500
To Lease Liability	1,91,500

The lessee allocated lease payment towards interest expense and reduction in lease liability as below

Year	Opening Liability (₹)	Finance Charge @12.6% (₹)	Lease Payment (₹)	Closing Liability (₹)
1	1,91,500	24,139	50,000	1,65,639
2	1,65,639	20,869	50,000	1,36,498
3	1,36,498	17,199	50,000	1,03,697
4	1,03,697	13,066	50,000	66,763
5	66,763	8237 (b.f)	75,000	-



Journal Entries in the books of lessee for Year 1.

Particulars	Debit	Credit
Finance Charges / Interest expenses Dr.	24,139	
To Lease liability / Lessor		24,139
Lease Liability Dr.	50,000	
To Bank		50,000
Profit & Loss A/c	24,139	
To Finance Charges		24,139

Accounting by Lessee if rate implicit in lease is not known and incremental borrowing rate is 10%

Year	MLP / Residual Value (₹)	Discount Factor (10%)	PV (₹)
1	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150
5	50,000	0.621	31,050
5	25,000 (GRV)	0.621	15,525
Total PV (MLP)			2,05,025

Since the PV of MLP is greater than FV of asset, the Asset and Liability is recognized at Rs .2,00,000.

Also, since the present value of liability is Rs. 2,00,000, we need to compute IRR at which PV of MLP would be equal to Rs. 2,00,000. The IRR works out to 10.95%

[Note to students – Compute the IRR using the method explained above considering 10% and 12% rate]

Year	Opening Liability (₹)	Finance Charge @12.6% (₹)	Lease Payment (₹)	Closing Liability (₹)
1	200,000	21,900	50,000	171,900
2	171,900	18,823	50,000	140,723
3	140,723	15,409	50,000	106,132
4	106,132	11,621	50,000	67,753
5	67,753	7,247	75,000	-

Accounting entries can be passed as explained above.

3. Illustration – Classification - Theory

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

- Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.
- Lessee has option to purchase the asset at lower than fair value at the end of lease term.
- Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.
- Present Value (PV) of Minimum Lease Payment (MLP) = "X" Fair value of the asset is "Y" And X = Y.
- Economics life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.



Answer

- (i) The lease will be classified as a **finance lease**, since a **substantial portion** of the life of the asset is covered by the lease term.
- (ii) If it becomes **certain** at the inception of lease itself that the **option will be exercised** by the lessee, it is a **Finance Lease**.
- (iii) It is an **operating lease** under which lease payments are recognized as expense in the profit and loss account of lessee to have better **matching between cost and revenue**.
- (iv) The lease is a **finance lease** if $X = Y$, or where X substantially equals Y .
- (v) Since the asset is of special nature and has been procured **only for the use of lessee**, it is a finance lease.

4. Illustration – Computation finance lease (Lessee)

S limited has taken machinery on lease from R limited. The following information is available

Particulars	Details
Lease Term	4 years
Fair Value of Asset at inception	₹ 20,00,000
Annual Lease Rent (Years 1–4)	₹ 6,25,000 p.a.
Guaranteed Residual Value (by Lessee)	₹ 1,25,000
Expected Residual Value (at end of 4 years)	₹ 3,75,000

Present Value factors are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

Compute the amount of liability to be recorded in lessee's book assuming it to be a finance lease.

Solution:

The residual value guaranteed by lessee is relevant for computing the value at which the leased asset would be capitalized in the books of lessee

According to AS 19,

The lessee should recognise the lease as an asset and a liability at an amount which is lower of

- a. Fair value of leased asset at the inception of lease
- b. Present value of minimum lease payment from the standpoint of lessee.

The rate used to compute the PV of lease payments is the implicit rate of return.

Computation of PV of MLP from standpoint of lessee

Year	Lease payment	PV (15%)	PV of payment
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,938
4	7,50,000	0.5718	4,28,850
	26,25,000	Total	18,55,850

Since the present value of minimum lease payments is lower than the fair value at inception, The lessee will recognise the lease as an asset at Rs. 18,55,850 being the lower of Fair Value and PV of MLP. A corresponding liability of Rs. 18,55,850 will be recognised.

5. Illustration

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being Rs. 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 Rs. 3,00,000.

The Lessee has guaranteed a residual value of Rs. 22,000 on expiry of the lease to the Lessor. However, Lessor Ltd., estimates that the residual value of the machinery will be only Rs. 15,000.

The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.



Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year

Solution:

The lessee should recognize the lease as an asset and a liability at the inception of a finance at lower of

- the fair value of the leased asset or
- the present value of minimum lease payments from the standpoint of the lessee
-

Computation of Value of machinery:

Present value of minimum lease payment = Rs. 6,99,054

Fair value of leased asset = Rs. 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

	Payment	PVF/PVAF	PV
Annual lease payments	3,00,000	2.282	6,84,600
Residual Value Guarantee	22,000	0.657	14,454
PV of MLP			6,99,054

Computation of finance charges:

Year	Opening Bal	Finance charge	Payment	Reduction in outstanding liability	Closing Bal
End of 1 st year	6,99,054	1,04,858	3,00,000	1,95,142	5,03,912
End of 2 nd year	5,03,912	75,587	3,00,000	2,24,413	2,79,499
End of 3 rd year	2,79,499	41,449*	3,00,000	2,58,075	22,000

6. Illustration – Computation of Lease payments & Lease Accounting (Lessor)

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 Rs. 10,00,000 and has an expected useful life of 5 years.
- (ii) The Fair market value is also Rs. 10,00,000.
- (iii) The property reverts back to the lessor on termination of the lease.
- (iv) The unguaranteed value is estimated at Rs. 1,00,000 at the end of the year 2011.
- (v) 3 equal annual payments are made at the end of each year.

Consider IRR = 10%

The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is Re. 0.7513.

The present value of annuity of Re. 1 due at the end of 3rd year at 10% IRR is Rs. 2.4868.

State whether the lease constitute finance lease and also calculate unearned Finance income.

[May 24, Jan 25 – 5 marks]

Answer:

A lease is classified as a **finance lease** if it **transfers substantially all risks and rewards** incidental to ownership of an asset. The legal title may or may not eventually be transferred. If any one of the following condition is satisfied, the lease is considered as finance lease.

1. **Ownership Transfer** – The lease transfers ownership of the asset to the lessee by the end of the lease term.
2. **Bargain Purchase Option**– The lessee has an option to purchase the asset at a price significantly lower than fair value, and at the inception it is reasonably certain that the option will be exercised.
3. **Lease Term vs. Useful Life**– The lease term covers a **major part** of the economic life of the asset, even if title is not transferred.



4. **Present Value of MLP vs. Fair Value**– At inception, the present value of minimum lease payments (MLP) amounts to **substantially all** of the fair value of the asset.
5. **Specialised Nature** – The asset is of a specialised nature, such that only the lessee can use it without major modifications.

Particulars	Working / Formula	Amount (₹)
Fair Value		10,00,000
PV of unguaranteed residual value	₹1,00,000 × 0.7513	75,130
PV of rentals (i.e. PV of MLP) required to recover fair value	10,00,000 – 75,130	9,24,870
Annual lease rent (R)	= PV of rentals / PV annuity = 9,24,870 / 2.4868	3,71,911.69
Total rentals (3 years) [MLP of lessee]	3 × 3,71,911.69	11,15,735.07
Gross Investment (GI) to lessor	MLP of Lessee + Unguaranteed RV = 11,15,735.07 + 1,00,000	12,15,735.07
Net Investment (NI) at inception (PV at implicit rate)	Fair value (given) or PV of MLP + PV of UGRV	10,00,000.00
Unearned Finance Income (UFI)	GI – NI = 12,15,735.08 – 10,00,000.00	2,15,735.08

The present value of lease payment i.e., Rs. 9,24,870 equals 92.48% of the fair market value i.e., Rs. 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset it constitutes a finance lease.

7. Illustration – Lessor Unearned Finance Income

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

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

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

Ascertain Unearned Finance Income.

Solution:

As per AS 19 on Leases, unearned finance income is the difference between

- (a) the gross investment in the lease and
- (b) the present value of minimum lease payments under a finance **lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor**, at the interest rate implicit in the lease.

Where:

Gross investment = Minimum lease payments + Unguaranteed residual value
 = [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)
 = [(Rs. 8,00,000 × 5 years) + Rs. 1,60,000] + Rs. 1,40,000
 = Rs. 43,00,000

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



Year	MLP inclusive of URV (Rs.)	PVF @ 15%	Present Value (Rs.)
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	<u>79,552</u>
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	<u>69,608</u> (ii)
	43,00,000	(i)+ (ii)	<u>28,30,920</u> (b)
	Alternatively,		
	Payments	PVAF/PVF @ 15%	<u>PV</u>
	800,000	3.3522	2,681,760
	160,000	0.4972	79,552
	140,000	0.4972	69,608
		Total	2,830,920

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

Note : Since the PV of MLP from point of view of lessee and UGRV discounted at implicit rate should be equal to the fair value – the computation is not required. However in exams if such questions are asked for 5 marks or more, do the computation]

8. Illustration – Operating Lease

Sun Limited wishes to obtain a machine costing Rs. 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for Rs. 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advice.

You are required to explain the necessary accounting treatment in line with AS 19 (use annuity factor at @ 15% for 3 years as 3.36)

Answer:

A lease is classified as a **finance lease** if it **transfers substantially all risks and rewards** incidental to ownership of an asset. The legal title may or may not eventually be transferred. If any one of the following condition is satisfied, the lease is considered as finance lease.

1. **Ownership Transfer** – The lease transfers ownership of the asset to the lessee by the end of the lease term.
2. **Bargain Purchase Option**– The lessee has an option to purchase the asset at a price significantly lower than fair value, and at the inception it is reasonably certain that the option will be exercised.
3. **Lease Term vs. Useful Life**– The lease term covers a **major part** of the economic life of the asset, even if title is not transferred.
4. **Present Value of MLP vs. Fair Value**– At inception, the present value of minimum lease payments (MLP) amounts to **substantially all** of the fair value of the asset.
5. **Specialised Nature** – The asset is of a specialised nature, such that only the lessee can use it without major modifications

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment• amounts to at least substantially all of the fair value of leased asset.



In the given case, the implicit rate of interest is given at 15% and annuity factor @ 15% for 3 years is 3.36)

The present value of minimum lease payments at 15% = (Rs.3 lakhs each year x 3.36) = Rs.10.08 lakhs (approx.)

Thus, present value of minimum lease payments is Rs.10.08 lakhs and the fair value of the machine is Rs.30lakhs hence the PV does not cover substantially all of the fair value of the asset. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.

However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

9. Illustration – Operating Lease payments computation [Dec 21 – 5 marks]

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

- Annual Lease Rent
- Lease Rent income to be recognized in each operating year and
- Depreciation for 3 years of lease.

Solution:

(i) Annual lease rent

Particulars	Calculation	Amount (₹)
Total required revenue (cost + 30% on cost)	130% of ₹1,50,000	1,95,000
Total output over 5 years	40,000+50,000+60,000+80,000+70,000	300,000 units
Output during lease period (years 1-3)	40,000+50,000+60,000	150,000 units
Total lease receipts (for 3 years)	$1,95,000 \times (150,000 / 300,000) = 1,95,000 \times 0.5$	97,500
Annual equal lease rental	$97,500 \div 3$	32,500

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

Year	Output (units)	Lease income recognised
Year 1	40,000	$97,500 \times 40/150 = 26,000$
Year 2	50,000	$97,500 \times 50/150 = 32,500$
Year 3	60,000	$97,500 \times 60/150 = 39,000$
Total (yrs 1-3)	150,000	97,500

	Particulars	Debit	Credit
Year 1	Bank A/c Dr	32,500	
	To Lease income		26,000
	To Lease equalization reserve		6,500
Year 2	Bank A/c Dr	32,500	
	To Lease income		32,500
Year 3	Bank A/c Dr	32,500	
	Lease equalization reserve	6,500	
	To Lease income		39,000



(iii) Depreciation for three years of lease

Year	Output (units)	Depreciation
Year 1	40,000	$1,50,000 \times 40/300 = 20,000$
Year 2	50,000	$1,50,000 \times 50/300 = 25,000$
Year 3	60,000	$1,50,000 \times 60/300 = 30,000$
Year 4	80,000	$1,50,000 \times 80/300 = 40,000$
Year 5	70,000	$1,50,000 \times 70/300 = 35,000$
Total	300,000	1,50,000

10. Illustration – Sale & Leaseback [Jan 21 – 5 Marks]

X Ltd. sold JCB Machine having WDV of Rs.20 Lakhs to Y Ltd. for Rs.24 Lakhs and the same JCB was leased back of Y Ltd to X Ltd. The lease is operating lease.

Comment according to relevant Accounting Standard if

- (i) Sale price of Rs.24 Lakhs is equal to fair value
- (ii) Fair Value is Rs. 20 Lakhs and sale price is Rs. 24 Lakhs.
- (iii) Fair value is Rs. 22 Lakhs and sale price is Rs. 25 Lakhs.
- (iv) Fair value is Rs. 25 Lakhs and sale price is Rs. 18 Lakhs
- (iv) Fair value is Rs. 18 Lakhs and sale price is Rs. 19 Lakhs

Answer:

Case	Fair value (F)	Sale price (S)	Profit / (Loss) on sale = (S – WDV)	Immediate recognition (AS 19)	Deferred / amortised (treatment)	Explanation
(i)	₹24,00,000	₹24,00,000	₹4,00,000 (24 – 20)	₹4,00,000 recognised immediately	Nil	S = F → normal sale; full profit immediately recognised.
(ii)	₹20,00,000	₹24,00,000	₹4,00,000 (24 – 20)	Immediate = F – WDV = 20 – 20 = ₹0	₹4,00,000 deferred & amortised over lease term	S > F → excess (S – F = ₹4,00,000) deferred and amortised.
(iii)	₹22,00,000	₹25,00,000	₹5,00,000 (25 – 20)	Immediate = F – WDV = 22 – 20 = ₹2,00,000	Deferred = S – F = ₹3,00,000; amortise over lease term	Part immediate (up to F – WDV) + balance deferred.
(iv)	₹25,00,000	₹18,00,000	(₹2,00,000) loss (18 – 20)	Loss ₹2,00,000 recognised immediately (unless loss is compensated by below-market future rentals)		S < F and S < WDV → immediate loss. Note: check for compensation by future lease payments.
(v)	₹18,00,000	₹19,00,000	(₹1,00,000) loss (19 – 20)	Immediate = F – WDV = 18 – 20 = (₹2,00,000) recognised as loss	Deferred = S – F = ₹1,00,000 (amortise over lease term)	Net effect: immediate loss ₹2.00 lac; excess over fair value (S–F) deferred.

11. Illustration – Sale & Leaseback [RTP Sep 25]

On 1st April, 2024, Mansi Ltd. sold a plant for Rs. 8,52,800. The carrying amount of the plant on that date was Rs. 1,80,000. The sale was a part of the package under which Akash Ltd. leased the asset to Mansi Ltd. for eight years term.



The economic life of the asset is estimated as 8 years. The minimum lease rents payable by the lessee has fixed at Rs. 1,60,000 payable annually beginning from 31st March, 2025.

The incremental borrowing interest rate of Mansi Ltd. is estimated at 10% p.a.

Calculate the net effect on the Statement of profit and loss in the books of Mansi Ltd.

Answer:

For calculation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.

The lease term is for 8 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is Rs. 8,53,600 [Rs. 1,60,000 x 5.335 (Annuity factor of Rs. 1 @10% for 8 years)] and amounts to at least substantially all of the fair value (sale price i.e. Rs. 8,52,800) of the leased equipment. Thus, lease is a finance lease.

As per AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of Rs. 6,72,800 (Sale value Rs. 8,52,800 less carrying amount Rs. 1,80,000) will not be recognized as income in the year of sale in the books of lessee i.e. Mansi Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Particulars	Amount (₹)
Sale value of plant	8,52,800
Carrying amount	(1,80,000)
Profit on sale (deferred)	6,72,800
Lease classification	Finance Lease
Depreciation (8,52,800 ÷ 8)	1,06,600 p.a.
Amortisation of deferred profit (6,72,800 ÷ 8)	(84,100) p.a.
Net debit to P&L each year	22,500

Therefore, assuming that depreciation is charged on straight line basis, Mansi Ltd. will recognize depreciation of Rs. 1,06,600 per annum for 8 years (Rs. 8,52,800/8) and amortise profit of Rs. 6,72,800 over the lease term of 8 years, i.e. Rs. 84,100 p.a.

The net effect is a debit of (Rs. 1,06,600-84,100) Rs. 22,500 p.a. to the Statement of Profit and Loss, for 8 years as covered under the lease term.



AS – 29
Provisions, Contingent Liabilities and Contingent Assets
Illustrations

1. Illustration

X Ltd. has its financial year ended 31.3.2011. Fifteen law suits outstanding on this date; none of which has been settled by the time the accounts are approved by the directors. The directors have estimated probable outcomes as below:

For First 10 cases:

Result	Probability	Loss (Rs)
Win	0.6	0
Loss- Low damages	0.3	90,000
Loss – High damages	0.1	2,00,000

For Next 5 cases:

Result	Probability	Loss (Rs)
Win	0.5	0
Loss – Low Damages	0.3	60,000
Loss – High Damages	0.2	1,00,000

The outcome of each case is independent of other cases. Discuss the treatment according to provisions of AS-29?.

Answer:

A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent liability is disclosed in notes to accounts if the following conditions are satisfied.

- There is a present obligation but does not meet the criteria of a provision or
- The obligation is not probable or
- The outflow of economic resources is not probable or
- A reliable estimate of amount of obligation cannot be made.

The loss does not appear probable but there is a reasonable possibility/probability of losses and hence, a contingent liability must be disclosed.

Expected loss in first ten cases = Rs. $(90,000 \times 0.3 + 2,00,000 \times 0.1) \times 10$ = Rs. 470,000

Expected loss in next five cases = Rs. $(60,000 \times 0.3 + 1,00,000 \times 0.2) \times 5$ = Rs. 1,09,000

Hence the total contingent liability to be disclosed is Rs. 6,60,000.

2. Illustration

Shyam Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2010-11, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2006 based on the recommendations of the commission.

The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2010-11 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company makes the following disclosures in its notes to accounts "Salaries and benefits include the provision of Rs. 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made."

The accountant feels that the company should also book/recognise the income by Rs. 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit.



Comment on the opinion of the accountant with reference to relevant accounting standard.

Answer:

Technical Context: As per para AS-29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

Analysis and Conclusion: The reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received. In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract.

Therefore, the liability of Rs. 680 lakhs is matched by the counter claim from the client. The receivable towards reimbursement should be recognised only if the ultimate collectability is certain.

3. Illustration

A company is in a dispute involving allegation of infringement of patent by a competitor company who is seeking damages of Rs. 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal with same in annual accounts of the company?

Answer:

Technical Context: The following conditions must be satisfied to recognize a provision:

- There must be a present obligation arising out of a past event
- It is probable that outflow of economic resources would be required to settle the obligation.
- A reliable estimate can be made of the obligation.

If any of the above conditions are not met, no provision would be recognised.

A contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the enterprise

Analysis and Conclusion: The company should disclose a contingent liability when the outflow of resources is not probable but is possible. The outflow of resources is dependent upon the verdict of the court.

In the given case since the directors are of the opinion that the claim can be successfully resisted which means that the outflow of resources is not probable. The outcome of the case is not within the control of the company. Hence, the company would disclose the case as a contingent liability by way of note.

4. Illustration

An airline is required by law to overhaul its aircraft once in every five years. The Pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to AS-29.

Answer:

Technical Context: The following conditions must be satisfied to recognize a provision:

- There must be a present obligation arising out of a past event
- It is probable that outflow of economic resources would be required to settle the obligation.
- A reliable estimate can be made of the obligation.

Analysis and Conclusion: In the given case, Pacific Airlines does not have a present obligation to service the aircraft. The cost of overhauling aircraft is a future obligation and the expenditure would be incurred only if the company decides to



continue the usage of aircrafts. AS-29 also does not permit provision of future operating expenses.

The airline would not recognise any provision under AS-29 as there is no present obligation due to a past event.

5. Illustration

An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following policy for making provision for warranties on the invoices amount, on the remaining warranty period.

Less than 1 year : 2% provision More than 1 year : 3% Provision

The company has raised invoices as under:

Invoice Date	Amount (Rs)
19.01.2011	40,000
29.01.2012	25,000
15.10.2012	90,000

Calculate the provision to be made for warranty under AS-29 for 31.03.2012 & 31.03.2013. Also compute amount to be debited to profit and loss account for the year ended 31.03.2013.

Answer:

Provision as on 31.03.2012

Sale made on 19.01.2011 : 40,000 X 2% =	Rs.800
Sale made on 29.01.2012 : 25,000 X 3% =	Rs.750
Total Provision as on 31.03.2012	= Rs.1,550

Provision as on 31.03.2013

Sale made on 29.01.2012 - 25,000 X 2% =	Rs. 500
Sale made on 15.10.2012 - 90,000 X 3% =	Rs. 2,700
Total Provision as on 31.03.2013	= Rs. 3,200

Provision for Warranties A/c for 2012-13

Date	Particulars	Amount	Date	Particulars	Amount
			01.04.2012	By Bal c/d	1,550
31.03.2013	To bal c/d	3,200	31.03.2013	By Profit & Loss Account (bal fig)	1,650
	Total	3,200			3,200

The amount to be debited to Profit and Loss Account for year ended 31st March 2013 is Rs. 1,650.

*No provision is required for sale made on 19.01.2011 in the year ending 31st March 2013 as the period of two years from date of sale is lapsed.

6. Illustration

Mini Ltd. took a factory premises on lease on 1.4.07 for Rs.2,00,000 per month. The lease is operating lease. During March 2008, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice.

Answer:

Technical Context

In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets, if an enterprise has the present obligation under the contract, it should be recognized and measured as a provision.



Analysis

In the given case, the operating lease contract has become economic benefit of lease contract for next 33 months up to 31.12.2010 that will be nil. However, the lessee, Mini Ltd., has to pay lease rent of Rs.66,00,000 (i.e., Rs.2,00,000 p.m. for next 33 months).

Conclusion

Therefore, provision on account of Rs.66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right.

7. Illustration

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

Answer:**Technical Context**

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only if it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

Analysis

The provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability.

Conclusion

The accounting treatment adopted by the company with respect to warranty is not correct.

8. Illustration

M/s XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of Rs.200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? Explain in brief giving reasons for your answer.

Answer:**Technical Context**

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

Analysis

However, the directors are of the opinion that the claim can be successfully resisted by the company, and there is no probable outflow of resources.

Conclusion

If these conditions are not met, no provision should be recognized. In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources.



Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note: "Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of Rs.200 lakhs.

9. 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 (Rs.)
In respect of five cases (Win)	100%	₹
Next ten cases (Win)	50%	₹
Lose (Low damages)	40%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	₹
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

Solution:

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

- There is a present obligation arising out of past events but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- 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 Rs. 1,20,000 + 10% of Rs. 2,00,000

$$= \text{Rs. } 48,000 + \text{Rs. } 20,000 = \text{Rs. } 68,000$$

Expected loss in remaining five cases = 30% of Rs. 1,00,000 + 20% of Rs. 2,10,000

$$= \text{Rs. } 30,000 + \text{Rs. } 42,000 = \text{Rs. } 72,000$$

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



10. Illustration

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.

Less than 1 year: 2% provision More than 1 year: 3% provision The company has raised invoices as under :	
Invoice Date	Amount (Rs.)
11 th Feb, 20X0	60,000
25 th Dec, 20X0	40,000
04 th 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.

Solution:

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

$$\begin{aligned}\text{As at 31st March, 20X1} &= \text{Rs. } 60,000 \times .02 + \text{Rs. } 40,000 \times .03 \\ &= \text{Rs. } 1,200 + \text{Rs. } 1,200 = \text{Rs. } 2,400\end{aligned}$$

$$\begin{aligned}\text{As at 31st March, 20X2} &= \text{Rs. } 40,000 \times .02 + \text{Rs. } 1,35,000 \times .03 \\ &= \text{Rs. } 800 + \text{Rs. } 4,050 = \text{Rs. } 4,850\end{aligned}$$

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

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

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



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

10.1

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. Rs. 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,25,000	0.735 (4 Years)	4,59,375
2	6,25,000	0.794 (3 Years)	4,96,250
3	6,25,000	0.857 (2 Years)	5,38,625
4	6,25,000	0.926 (1 Year)	5,78,750
5	6,25,000	1 (0 Year)	6,25,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,59,375	4,59,375
2	4,59,375	36,750	4,96,250	9,92,375
3	9,92,375	79,390	5,35,625	16,07,390
4	16,07,390	1,28,591	5,78,750	23,14,731
5	23,14,731	1,85,269 *	6,25,000	31,25,000

*Due to approximations used in calculation, this figure is adjusted accordingly

Illustration 4

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:

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

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

Answer

The company argues that since the **Settlement Allowance**:

- Does not depend** upon the **length of service**; and
- Is either restricted to **travel entitlement** or **one month's last drawn salary**;

It should be **accounted for on claim basis**.

The company's contention is **not correct** because:

- AS 15 (Revised)** requires that **all retirement benefits** (whether linked to service length or not) are treated as **Defined Benefits**, if they create an obligation on the employer at retirement.
- Even if the **obligation is uncertain** and requires **estimation** of future conditions/events (outside the company's control), the company must still recognise it systematically.



Correct Treatment:

1. **Settlement Allowance** is a **Defined Benefit** covered by **AS 15 (Revised)**.
2. The company should create a **Provision every year** for the **accruing liability** on account of settlement allowance.
3. The provision must be based on **Actuarial Valuation** to ensure appropriate matching of cost with service period.
4. However, where the liability is **not material**, the company may adopt an **alternative simplified method** of accounting.

The company's contention that settlement allowance should be recognised **only on claim basis** is **incorrect**. As per **AS 15 (Revised)**, a **provision (actuarially valued)** must be made annually for this **Defined Benefit Obligation**.

Illustration 5

As on 1st April, 20X8 the fair value of plan assets was Rs. 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of Rs. 19,000 and received inward contributions of Rs. 49,000. On 31st March, 20X2 the fair value of plan assets was Rs. 1,50,000 and present value of the defined benefit obligation was Rs. 1,47,920. Actuarial losses on the obligations for the year 20X1-20X2 were Rs. 600. On 1st April, 20X1, the company made the following estimates, based on its market studies, understanding and prevailing prices.

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

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

Answer**Computation of Expected and Actual Returns on Plan Assets**

		Rs.
Return on Rs. 1,00,000 held for 12 months at 10.25%		10,250
Return on Rs. 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	<u>49,000</u>	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		<u>20,000</u>

Alternatively, the above question may be solved without giving compound effect to rate of return.

Illustration 6

Kumar Limited is an engineering company. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the 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

According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or



expense. Therefore, surplus amount of Rs. 6 lakhs is required to be credited to the profit and loss statement of the current year.

Illustration 7

Z Ltd changed its employee remuneration policy from 1 April 2012 to provide for 12% contribution to Provident fund on leave encashment also. As per the leave encashment policy the employees can either utilise or encash it. As at 31 March 2013 the company opted an actuarial valuation for leave encashment liability.

However it did not provide for 12% provident fund contribution on it.

The auditor of the company wants it to be provided but the management replied that as and when employees availed leave encashment provident fund contribution was made. The company further contends that this is correct treatment as it is not sure whether the employees will avail leave encashment or utilise it. Comment

Answer:

The employee benefit include leave encashment.

- Accrual concept has to be followed
- Expenses and liability recognition should happen today
- Use probability theory to establish whether the employees will utilise leave or encash it.
- Best estimate to be made using actuarial assumption.

Illustration 8

P Ltd has 3 business segments which are **FMCG, Batteries and Sports Equipment**.

The **Batteries segment** has been consistently under performing and P Ltd, after several discussions with labour unions, has finally decided on **closure of this segment**.

Under the agreement with the labour union:

- The employees of the battery segment will **earn no further benefit**, as the arrangement is a **curtailment without settlement**.
- The employees of the discontinued segment will continue to receive **benefits of services rendered** when the segment was functioning.

As a result of curtailment, the company's **obligations** that were arrived on the basis of **actuarial valuation** before the curtailment have come down.

Particulars	Amount (₹ in lacs)
Gross obligation (before curtailment, actuarial basis)	4,000
Unamortised past service costs	100
Reduction in gross obligations due to curtailment	500
Anticipated effect on unamortised past service costs	Proportional decline
Fair value of plan assets (on date of curtailment)	3,250

You are required to calculate the gain from curtailment and also show the liability to be recognized in the P&L a/c and Balance Sheet of P Ltd after curtailment

Answer:

Particulars	Before Curtailment (₹ lacs)	After Curtailment (₹ lacs)	Impact of Curtailment (₹ lacs)
Gross Obligation	4,000	3,500	500 (reduction)
Fair Value of Plan Assets	3,250	3,250	–
Unamortised Past Service Cost	100	87.5	12.5 (reduction)
Net Reduction (Curtailment Gain)			487.5
Net Liability	650	162.5	



Illustration 9

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 Rs. 18 (10% of Rs. 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:

- Immediately before the curtailment, gross obligation is estimated at Rs. 6,000 based on current actuarial assumption.
- The fair value of plan assets on the date is estimated at Rs. 5,100.
- The unamortized past service cost is Rs. 180.
- Curtailment reduces the obligation by Rs. 600, which is 10% of the gross obligation.

Answer

Gain from curtailment is estimated as under:

	Rs.
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	Rs.
Reduced gross obligation (90% of Rs. 6,000)	5,400
Less: Fair value of plan assets	(5,100)
Less: Unamortised past service cost (90% of Rs. 180)	300
Liability to be recognised in the balance sheet	(162)
	138

Illustration 10

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

Answer

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

- short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
 - post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;
 - 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 liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.



Illustration 11

The fair value of plan assets of Anupam Ltd. was Rs. 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of Rs. 25,000 and received inward contributions of Rs. 55,000. On 31st March, 20X2 the fair value of plan assets was Rs. 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

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, as per AS 15

	Rs.
Return on opening value of plan assets of Rs. 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of Rs. 30,000 (i.e. Rs. 55,000 –Rs. 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	<u>22,000</u>

**Computation of Actual Returns on Plan Assets as on 31st March, 20X2,
as per AS 15**

	Rs.	Rs.
Fair value of Plan Assets as on 31st March, 20X2		3,00,000
Less: Fair value of Plan Assets as on 1st April, 20X1	(2,00,000)	
Add: Contribution received as on 30th September, 20X1	<u>55,000</u>	<u>(2,55,000)</u>
		45,000
Add: Benefits paid as on 30th September, 20X1		<u>25,000</u>
Actual returns on Plan Assets as on 31st March, 20X2		<u>70,000</u>



1. Illustration

Arjun Ltd Sold its Farm equipment through its dealers. One of the conditions at the time of the sale is that payment of consideration in 14 days and in the event of delay, interest is payable @15% p.a.

The Company has not realized interest from dealers in the past. However, for the year ended 31.3.2015 it wants to recognize interest due on the balances due from the dealers. The amount is ascertained at Rs.9 lacs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9.

Answer:

AS 9 prescribes recognition of revenue only when the amount is measurable and collectible.

In the current case though the amount of interest is measurable, past experience indicates very low probability of collection. Hence, the Company should recognize revenue of Rs.9 lacs only when the amount is collected.

2. Illustration

The Board of Directors of X Limited decided on 31.3.2015 to increase sale price of certain items of goods sold, retrospectively from 1st Jan 2015.

As a result of this decision, the Company has to receive Rs.5 lacs from its customers in respect of sales made from 1.1.2015 to 31.3.2015. But the Company's accountant was reluctant to make up his mind. You are asked to offer your suggestion.

Answer:

Once a sale is made, a customer may not easily accept revision of that sale price. Unless, customer agrees to make such a payment, collectability of such an amount is not reasonably certain.

Hence, Revenue recognition should be postponed till the money is collected.

3. Illustration

A Ltd, entered into a contract with B Ltd to dispatch goods, valuing Rs.25,000 every month for 4 months upon receipt of entire payment.

B Limited accordingly made a payment of Rs.1 lac and A Ltd started dispatching the goods. In the 3rd month, due to a natural calamity, B Ltd asked A Ltd to not dispatch goods until further notice, though A Ltd is holding entire goods worth Rs.50,000 ready for dispatch.

A Ltd accounted Rs.50,000 as sales and transferred the balance to Advance received against Sales. Comment upon the treatment of balance amount with reference to the provisions of the Accounting Standards.

Answer:

Risk and Reward of the goods has already been transferred and Delivery is postponed at the request of the buyer. A Ltd can recognize sales to the extent of entire Rs.1 lac.

4. Illustration

M/S. Moon Ltd sold goods worth Rs.6.5 lacs to Mr. Star. Mr. Star asked for a trade discount amounting to Rs.53,000 and the same was agreed upon by M/S. Moon Ltd. The sale was affected, and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth Rs.67,000 are defective. Mr. Star returned defective goods and made payment of Rs.5.3 Lacs to M/S. Moon Ltd. The Accountant of M/S. Moon Ltd booked the sale for Rs.5.3 Lacs. Discuss the contention of the accountant with reference to AS 9.



Answer:

If trade discount is in the normal course of business, then the sale should be recorded by M/S. Moon limited at Rs.6.5 lacs – Rs.53,000 = Rs.5.97 lacs – (This is generally assumed) If not, the sale should be recorded at Rs.6.5 lacs.

Defective goods returned should be treated as sales returns and not netted off against sales

Sales should be shown at Rs.5.97 lacs even though the payment is made only for Rs.5.3 Lacs if the discount was in ordinary course of business. If the discount was not in ordinary course of business, sales should have been shown at Rs.6.5 Lacs.

5. Illustration

Saritha Publications Ltd publishes a monthly magazine on 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of release of publication.

The sale of space for the March 2014 issue was made in Feb 2014. The magazine was published on its schedule date. It received Rs.2.4 lacs on 10.3.2014 and Rs.60,000 on 10.4.2014 for the March 2014 issue.

Discuss in context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31st March 2014.

What will be the treatment if the publication is delayed till 2.4.2014?

Answer:

In the first scenario, as per AS 9 the entire sale value needs to be recorded.

In the second scenario, revenue should be booked in the month of April 2014 and the sum of Rs.2.4 lacs will be shown as advance received.

6. Illustration

SM company has taken a Transit Insurance Policy. Suddenly in the year 2016-17 the percentage of accident has gone up to 7% and the company wants to recognize insurance claim as revenue in 2016-17 in accordance with relevant Accounting Standards. Do you agree? Explain in brief as per the relevant Accounting Standards.

Answer:

Scope of AS 9 does not cover treatment of insurance claims received.

A disproportionate increase in insurance claims cannot mean they can be recognized as revenue. Such inflows have to be adjusted with the loss. Insurance Claim money can be recognized in books of accounts only when such a claim is accepted by the Insurance Company

7. Illustration

Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with registrar subsequent to Balance Sheet date. But before finalization, is it possible to recognise the sale and the gain at the Balance Sheet date? Give your view with reasons.

Answer:

Registration could be just a formality and sale is substantially complete on entering into a sale agreement / deed. In such a case, gain could be recognized in the period in which such a deed was entered. Else the sale and gain are recognized only in the period when the property is registered.



8. Illustration

Golden Eagle Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of apparels business and sales increased 5 times. One of the conditions for sales was that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy with reference to AS-9.

Answer:

As per AS 9 revenue should be recognized when there is certainty about measurability and collectability.

In the Jewellery business there are NO concerns regarding measurability as well as collectability. Hence Revenue should be recognized in this business, immediately on sale, in-line with principles outlined in AS 9

In the apparels business, Sales should be recognized only to the extent of 75% of items shipped at the time of shipping and balance 25% should be recognized when there is greater certainty.

9. Illustration

Given below are the following information of B.S. Ltd.

- (i) Goods of Rs. 50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.
- (ii) On 13-01-2018 goods of Rs. 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.
- (iii) Rs. 1,00,000 worth of goods were sold on approval basis on 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9.

Answer:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

1. The seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership.
2. No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

CASE 1: The sale is complete but delivery has been postponed at request of the buyer. So, the entire sale revenue of Rs.50,000 should be recognized for the year ended 31st March, 2018 on 18/3/2018.

Case 2: In case of consignment sale revenue should not be recognized until the goods are sold to a third party. 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for Rs.1,00,000(80% of Rs.1,25,000).

Case 3: 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 to RS.1,00,000 as on the expiry of time period for rejecting the goods.

Thus, total revenue amounting Rs.2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.



10. Illustration

A Manufacturing Company has the following stages of production and sale in manufacturing Fine Paper Rolls:

Date	Activity	Costs to Date (Rs.)	Net Realizable Value (Rs.)
15.01.2016	Raw Material	1,00,000	80,000
20.01.2016	Pulp (WIP 1)	1,20,000	1,20,000
27.01.2016	Rough & Thick Paper (WIP 2)	1,50,000	1,80,000
15.02.2016	Fine Paper Rolls	1,80,000	3,50,000
20.02.2016	Ready for Sale	1,80,000	3,50,000
15.03.2016	Sale agreed and Invoice raised	2,00,000	3,50,000
02.04.2016	Delivered and paid for	2,00,000	3,50,000

Explain the state on which you think Revenue will be generated and state how much would be the Net Profit for year ending 31.03.2016 on this product, according to AS-9.

Answer:

As per AS-9, Revenue from Sale of Goods is recognized only when the following conditions are satisfied –

- Transfer of Property / Significant Risks and Rewards of Ownership, from the Seller to the Buyer,
- No effective control of Seller over the Ownership of Goods,
- No significant uncertainty exists as to the amount of consideration derived from sale of goods,
- It is reasonable to expect ultimate collection at the time of performance.

Raw Material, WIP 1 and WIP 2 are not “saleable”. Only when the goods are produced and ownership is transferred to the Buyer for consideration, the revenue is recognized. Since the sale is agreed and the Invoice is raised on 15.03.2016, the ownership is assumed to be transferred on 15.03.2016. Hence, Revenue will be recognized on 15.03.2016. Hence, Sale Value of Rs.3,50,000 and related Costs is Rs.2,00,000.

So, the Net Profit for the year ended 31.03.2016 will be Rs.1,50,000 (3,50,000 – 2,00,000).

11. 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	Rs. 200 lakhs
Delivery charges	Rs. 60 lakhs
GST	Rs. 40 lakhs
Total	Rs. 300 lakhs

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

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

Solution:

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



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

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

12. Illustration

AB sells goods to CD on 1st January 20X1 for Rs. 2 lakhs. After the sale was made, CD is having significant cash flows issues. It is trying to raise funding through bank loan to be able to run its operations in future. However, it is unable to do so and has gone under liquidation on 15th of March 20 X1.

At the time of sale, there was no reason for AB to believe that it will not be able to collect the amount from CD in future.

Explain how the recognition of revenue be done by AB for the year ended 31 st March 20X1?

Solution:

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 Rs. 2 lakhs on 1st of January 20X1 and recognise a receivable for the same amount.

Later, since CD went into liquidation, AB should write off the receivables and book a loss in his books.

Accounting in the books of AB

1st January 20X1

CD A/c (Receivables)	Dr	Rs. 2 lakhs	
To Revenue A/c (<u>Being goods sold to CD Ltd</u>)	.		Rs. 2 lakhs

15th March 20X1

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

13. Illustration

During the year ended 31st March 20X1, ZX Enterprises has recognized Rs. 100 lakhs on accrual basis income from dividend on units of mutual funds held by it. The dividends on mutual funds were declared on 15th June, 20X1. The dividend was proposed on 10th April, 20X1.

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

Solution:

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 Rs. 100 lakhs on accrual basis in the financial year 20X0-20X1 is not correct as per AS 9 'Revenue Recognition'.

14. Illustration

A claim lodged with the Railways in March, 20X1 for loss of goods of Rs. 2,00,000 had been passed for payment in March, 20X3 for Rs. 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 20X3.

Solution:

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 Rs. 1,50,000 were collected against a claim of Rs. 2,00,000. So this transaction can not be taken as a Prior Period Item.

Hence receipt of Rs. 1,50,000 shall be recognized as revenue in year ended 31st March, 20X3

In the light of AS 5, it will not be treated as extraordinary item. However, AS 5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

15. Illustration

GH manufactures and sells televisions. The televisions are shipped to the customer by sea. In order to transfer risk related to the shipment of the televisions, GH also gets an insurance coverage for the goods while they are in transit from the factory to customer's location.

The insurance policy will reimburse GH for the value of the goods in the event of loss or damage arising anytime up to these goods reaching customer's location. The legal title passes when the goods arrive at the customer's premises one month later.

When should Entity GH recognize revenue in its books?

Solution:

GH should recognize revenue for the sale when the goods arrive at the customer's premises. GH has not transferred the televisions' significant risks and rewards of ownership to the customer when the goods depart from the factory. This is evidenced by the fact that any insurance proceeds received from the goods' damage or destruction will be repaid to GH. Further, the legal title does not pass until the goods arrive at the customer's premises.

16. Illustration

For the year ended 31st March 20X1, KY Enterprises has entered into the following transactions.

On 31 March 20X1, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 20X1. Machine 1 was a machine that was routinely supplied by KY to many customers and the installation process was very simple.

Machine 1 was installed on 2 April 20X1 by ST's employees.

Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 20X1. Details of costs and sales prices are as follows:



	Machine 1	Machine 2
Sale Price	3,20,000	3,00,000
Cost of production	1,60,000	1,50,000
Installation fee	Nil	10,000

How should above transactions be recognized by KY Enterprises for the year ended 31st March 20X1?

Solution:

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

Revenue (Machine 1)	Rs. 3,20,000
Cost of Goods Sold	Rs. 1,60,000
Profit during the period	Rs. 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 20X1. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to ST.

Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 20X1.

Revenue (Machine 2)	Rs. 3,00,000
Cost of Goods Sold	Rs. 1,50,000
Profit during the period	Rs. 1,50,000

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges Rs.10,000 needs to be recognized on 5 April 20X1 once the installation process gets completed.

17. Illustration

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?

Solution:

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.



AS – 7
Construction Contracts
Illustrations

1. Illustration

Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs. 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss.

Answer:

Mr. X wants to recognise incentive related income before the project is completed because based on past experience, such projects have been completed on time. According to AS 7, Revenue on account of incentive should not be recognized -

- **If the contract has not made sufficient amount of progress** (is not at a advanced stage of completion) **and**
- **unless there is certainty that incentive would be received,**

The contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue on account of incentive.

2. Illustration

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March 2017.

Using this data and applying the relevant Accounting Standard you are required to:

- (i) Compute the amount of profit/loss for the year ended 31st March 2017.
- (ii) Arrive at the contract work in progress as at the end of financial year 2016- 17.
- (iii) Determine the amount of revenue to be recognized out of the total contract value.
- (iv) Work out the amount due from/to customers as at year end.
- (v) List down relevant disclosures with figures as per relevant Account Standard

	Amount in Crores
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress payments in pipeline	300

Answer:**(i) & (ii) Contract Profit/Loss & Contract Work in Progress**

Work Certified	1,250
Work pending certification	250
Contract Work in Progress	1,500
Estimated further cost to completion	1,750
Total Cost of Contract [A]	3,250
Contract Revenue [B]	2,400
Expected Loss [A-B]	850

Entire anticipated loss has to be provided for fully and immediately. Rs. 850 crores must be charged off to profit and loss account as loss.

(iii) Revenue to be recognised

Percentage of Completion (Amount in Crores) Total Cost Incurred : Rs. 1,250 +Rs. 250
= Rs. 1,500



Total Estimated Cost : Rs 1,250 + Rs. 250 + Rs. 1,750 = Rs. 3,250

Percentage of Completion = $\frac{\text{Rs. 1,500}}{\text{Rs. 3,250}} \times 100\%$
 = 46.15%

Revenue to be recognised
 = 46.15% of Rs. 2,400 crores
 = Rs. 1,107.6 crores

(iv) Amount Payable/Due

= Cost Incurred + Profits - Progress Payments received/receivable - Losses
 = Rs. (1,500 + 0 - 1,400 - 850) Crores
 = Rs 750 Crores payable

(v) Disclosures

1. Contract Revenue : Rs. 1,107.6
2. Contract Expenses : Rs. 1,500
3. Loss : Rs. 850
4. Progress Billing : Rs. 1,400
5. Progress Billing (Not yet received) : Rs. 300
6. Gross amount due to customers : Rs. 750

3. Illustration

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

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

Answer:

Provision:

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 in these cases:

1. When separate proposals have been submitted for each asset
2. When each asset has been subject to separate negotiation between contractor and customer that are able to accept or reject that part of the contract relating to each asset
3. When the costs and revenues of each asset can be identified.

Analysis:

In the given case, the completion time for each unit is submitted separately. The value of 3 units is also mentioned separately.

Conclusion:

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

4. Illustration

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next financial year. The contract is for a fixed price of Rs. 12 crores with an escalation clause. The costs to complete the whole contract are estimated at Rs. 9.50 crores of rupees. You are given the following information for the year ended 31.03.2016:



- Cost incurred upto 31.03.2016 Rs. 4 crores
- Cost estimated to complete the contract Rs. 6 crores
- Escalation in cost by 5% and accordingly the contract price is increased by 5%.

You are required to identify the state of completion and calculate the revenue and profit to be recognized for the year as per AS 7.

Answer:

Calculation of total contract price

Particulars	Amount (in Cr)
Cost of construction of bridge incurred till 31.3.19	4
Add: Estimated future cost	6
Total estimated cost of construction	10
Contract Price (Rs.12 crore x 1.05)	12.6

Stage of completion

Percentage of completion till date to total estimated cost of construction = $(4/10) \times 100 = 40\%$

Revenue and Profit to be recognized for the year ended 31st March, 2019 as per AS 7

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = Rs. 12.60 crore x 40% = Rs. 5.04 crore

Profit for the year ended 31st March, 2019 = Rs. 5.04 crore less Rs. 4 crore = Rs. 1.04 crore.

5. Illustration

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

Fixed price (agreed) ₹5 crore

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

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

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

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

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

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

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

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

Also measure the total contract revenue in this case.

Solution:

	Rs.
Total Revenue after considering the escalation costs, claims and incentives:	5.00 crore
Incentive for early completion	0.50 crore



Material costs recovery (to the extent of 20%)	0.40 crore
Labour costs recovery (Actual increase is less than 30%) [1.20 crore x 25%]	0.30 crore
Total Contract Revenue	6.20 crore
Add: Variation to the contract	1.00 crore
Add: Claims recoverable from XY	0.20 crore
Total Contract Revenue	7.40 crore

6. Illustration

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.

Solution:

Profit & Loss Account

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

Customer's Account

Year		Rs. 000	Year		Rs. 000
20X1-X2	To Contract Price	90	20X1-X2	By Bank	79
				By Balance c/d	11
		90			90
20X2-X3	To Balance b/d	11	20X2-X3	By Bank	121
	To Contract Price	110			
		121			121

AS 7 provides that the percentage completion method should not be applied if the outcome of a construction contract cannot be estimated reliably. In such cases:

- revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and
- contract costs should be recognised as an expense in the period in which they are incurred.



An expected loss on the construction contract should be recognised as an expense immediately

7. 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.

Solution:

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.

8. Illustration

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data for Year 1.

Information for Year 1	Rs. 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).

Solution:

		Amount INR Rs. 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)

	Rs.		Rs.
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)

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

9. 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.

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

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

Solution:

(a)		(Rs. in lakhs)
	Amount of foreseeable loss:	
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognized as expense	<u>100</u>

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

(b)		(Rs. in lakhs)
	Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs	
	Work certified	500
	Work not certified	<u>105</u>
		<u>605</u>
	This is 55% $(605/1,100 \times 100)$ of total costs of construction.	

(c) Proportion of total contract value recognized as revenue: 55% of Rs. 1,000 lakhs = Rs. 550 lakhs



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

$$= (605 + \text{Nil} - 100) - (400 + 140)$$

Rs. in lakhs

$$= [505 - 540] \text{ Rs. in lakhs Amount due to customers} = \text{Rs. 35 lakhs}$$

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

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

	Rs. in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognised losses	(100)
Progress billings Rs. (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35
Method of revenue recognition (use of percentage completion method)	
Method of determining state of completion (based on proportionate cost	

10. Illustration

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

Solution:

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

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

Contract work in progress = Rs. 64, 99, 000 / 97, 00, 000 X 100 = 67%

Proportion of total contract value recognised as turnover:

$$= 67\% \text{ of Rs. } 85,00,000 = \text{Rs. } 56,95,000.$$

The amount of expected loss will be split as under:

Particulars	Workings	Amount
Expected Loss	97,00,000 – <u>85,00,000</u>	12,00,000
Contract revenue	67% of <u>85,00,000</u>	56,95,000
Contract cost	Given	64,99,000
Actual loss	56,95,000 – 64,99,000	8,04,000
Amount of provision required [As per Para 35]	12,00,000 – 8,04,000	3,96,000



11. Illustration

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

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

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

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

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

Solution:

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

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

Working Note:

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

12. Illustration

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

- Materials used Rs. 71,00,000



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

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

Solution:

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

	Cost of Construction	Rs.	Rs.
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.20X2		38,00,000
		<u>2,00,000</u>	
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		<u>15,00,000</u>
	Cost incurred upto 31.03.20X2		1,34,00,000
Add:	Estimated future cost		<u>33,50,000</u>
	Total Estimated cost of construction		<u>1,67,50,000</u>
	Degree of completion $(1,34,00,000 / 1,67,50,000 \times 100)$		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 $(1,34,00,000 - 1,20,00,000)$		<u>14,00,000</u>
	Loss to be provided for		3,50,000

13. Illustration

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is Rs. 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be Rs. 200 crore. At the end of year 1, this estimate stands revised to Rs. 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 Rs. 5 crore and the costs will increase by Rs. 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: Rs. 52.52 crore

Year 2: Rs. 154.20 crore (including unused material of 2.5 crore) Year 3: Rs. 205 crore.

You are required to calculate:

- Stage of completion for each year.
- Profit to be recognised for each year.

Solution:

- Stage of completion = $\text{Costs incurred to date} / \text{Total estimated costs}$

Year 1: $52.52 \text{ crore} / 202 \text{ crore} = 26\%$

Year 2: $(154.20 \text{ crore} - 2.50 \text{ crore}) / 205 \text{ crore} = 74\%$

Year 3: $205 \text{ crore} / 205 \text{ crore} = 100\%$



(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

14. Illustration

On 1st December, 20X1, GR Construction Co. Ltd. undertook a contract to construct a building for Rs. 45 lakhs. On 31st March, 20X2, the company found that it had already spent Rs. 32.50 lakhs on the construction. Additional cost of completion is estimated at Rs. 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?

Solution:

	<i>Rs. in lakhs</i>
Cost of construction incurred till date	32.50
Add: Estimated future cost	<u>15.10</u>
Total estimated cost of construction	<u>47.60</u>

Percentage of completion till date to total estimated cost of construction

$$= (32.50/47.60) \times 100 = 68.28\%$$

Proportion of total contract value recognised as revenue for the year ended 31st March, 20X2 per AS 7 (Revised)

$$= \text{Contract price} \times \text{percentage of completion}$$

$$= \text{Rs. 45 lakh} \times 68.28\% = \text{Rs. 30.73 lakhs.}$$

	<i>(Rs. in lakhs)</i>
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	<u>2.60</u>

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.



AS 13
Accounting For Investments

Illustrations

1. Illustration

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of Rs. 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year. On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at Rs. 101 cum-interest prices, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at Rs. 106 cum-interest prices, again paying brokerage @ 1% of cum-interest amount.

Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

Solution: Illustration 1

In the books of M/s Bull & Bear, Investment Account
For the period from 1st December 20X2 to 1st March, 20X3

Date	Particulars	Face Value	Principal	Interest	Date	Particulars	Face Value	Principal	Interest
1.12.X2	To Bank (WN1)	10,00,000	10,00,100	20,000	1.03.X3	By Bank A/c (WN2)	10,00,000	9,99,400	50,000
1.03.X3	To P&L - Interest Earned (b/f)	-	-	30,000	1.03.X3	By P&L - Loss on Sale (b/f)	-	700	-
		10,00,000	10,00,100	50,000			10,00,000	10,00,100	50,000

Working Notes:

1. 1.12.X2 – Cost of Purchase

10,000 Debentures @ ₹101 cum interest

⇒ Out Of which Interest Portion = $10,000 \times \text{Face value } ₹100 = ₹20,000$

⇒ Principal Portion = $(10,000 \times ₹101 - 20,000) = ₹9,90,000$

Add: Brokerage $(1\% \times 10,000 \times ₹101) = ₹10,100$
= 10,00,100

2. 1.03.X3 Sale proceeds of 12% debentures sold

Sale Proceeds = $10,000 \times ₹106$ Cum interest

⇒ Out Of which Interest Portion = $(10,000 \times 100 \times 12\% \times 5/12) = ₹50,000$

⇒ Principal Portion = $(10,000 \times ₹106 - 50,000) = ₹10,10,000$

Less: $(1\% \text{ of } ₹10,000 \times 106) = (10,600)$
= Total = ₹9,99,400

3. Profit / Loss on Sale

Principal value of sale = ₹9,99,400

Principal value of Purchase = ₹10,10,100

Loss on sale (Transferred to P&L) = ₹700

4. Interest Income

Interest Received = 50,000

Interest Paid = 20,000

Interest Income (Transferred to P&L) = 30,000



2. Illustration

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of Rs. 100 each in TELCO Ltd. @ Rs. 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per Rs. 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 Rs.175 per share and Rs. 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.

Solution: Illustration 2

In the books of Mr. Krishna Murty

Investment Account

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
1.4.20X1	To Bank A/c (WN1)	1,00,000	1,23,000	31.3.20X2	By Bank A/c (WN3)	50,000	44,100
31.1.20X2	To Bonus shares(WN2)	50,000	-	31.3.20X2	By Balance c/d (WN4)	1,00,000	82,000
31.3.20X2	To Profit & loss A/c (WN3)	-	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

Working Notes:

1. Purchase

Purchase Price = 1,000 Equity Shares × ₹120 = 1,20,000

Add: Brokerage 2% of ₹1,20,000 = 2,400

Add: Stamp Duty = 0.5% of 1,20,000 = 600

Purchase Value = 1,23,000

Note: Unlike in the case of Debentures we don't split Purchase Price into Principal & Dividend, As

The amount of dividend and the very declaration are uncertain. Everything is accounted in cost (Cost).

2. Bonus Shares

⇒ When the **bonus shares** are issued by the company, for the recipient there is no extra cost.

⇒ Based on the bonus ratio. Nominal Value of shares held will increase, as new shares will be received at no extra cost.

⇒ As a result, average cost per share will be reduced.

Bonus Ratio – 1:2

1 Bonus Share For 2 held.

Therefore, Number of Bonus shares to be issued – (1,000 shares / 2) × 1 = 500 shares

⇒ Bonus equity shares of 500 are received by Mr. Krishna Murty at no extra cost.

⇒ Total number of shares held (1000 + 500) 1500 shares

⇒ On account of bonus shares, average cost per share held will come down, as denominator increases without corresponding change in the numerator.



3. Sale

(i) Number of Shares sold = 500

(ii) Sale Price = ₹90

(iii) Sale Proceeds (i) × (ii) = ₹45,000

Add: Brokerage Paid = ₹45,000 × 2% = 900

Net Sale Proceeds (₹45,000 - ₹900) = ₹44,100

Cost Price = ₹82 per share (WN2) × 500 = 41,000

Profit on sale = Net Proceeds - Cost

= ₹44,100 - 41,000 = 3,100

4. Valuation (on Balance Sheet Date)

Current investments are valued at lower of Cost or Net Realisable Value, Valuation of equity shares on 31st March, 20X2

Cost = 1,000 × 82 = ₹82,000 or Market Value = 1,000 × ₹90 = ₹90,000, Closing balance has been valued at ₹82,000 being lower than the market value.

3. Illustration

Mr. X purchased 500 equity shares of Rs.100 each in Omega Co. Ltd. for Rs.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 Rs.175 per share. After the capitalisation, the shares were quoted at Rs.92.50 per share. Mr. X. sold the bonus shares and received at Rs.90 per share.

Prepare the Investment Account in X's books on average cost basis.

Solution: Illustration 3

In the books of A, Investment Account

Particulars	Nominal Value (₹)	Cost (₹)	Particulars	Nominal Value (₹)	Cost (₹)
To Cash	50,000	62,500	By Bank - Sale (500 × 90)	50,000	45,000
To Bonus shares	50,000	-	By Balance c/d (WN2)	50,000	31,250
To P & L A/c (WN2)	-	13,750			
	1,00,000	76,250		1,00,000	76,250

Working Notes:

1. Bonus Shares do not have any cost.

2. Profit on sale of bonus share

= Sale value = ₹90 per share

= Profit per share = ₹90 - ₹62.5 = ₹27.5

Profit on 500 Shares = ₹27.5 × 500 shares = 13,750

Sale value of 500 shares = 500 shares × ₹90 = ₹45,000

Profit = 13,750

Balance = 31,250 (500 × ₹62.5)

4. Illustration

On 01-04-20X1, Mr. T. Shekharan purchased 5,000 equity shares of Rs.100 each in V Ltd. @ Rs.120 each from a broker, who charged 2% brokerage. He incurred 50 paise per Rs.100 as cost of shares transfer stamps. On 31-01-20X2 bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at Rs.175 per share and



Rs.90 per share respectively. On 31-03-20X2, Mr. T. Shekharan sold bonus shares to a broker, who charged 2% brokerage.

Show the Investment Account in the books of T. Shekharan, who held the shares as Current Assets and closing value of investments shall be made at cost or market value whichever is lower.

Solution: Illustration 4

In the books of T. Shekharan

Investment Account

for the year ended 31st March, 20X2

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
1.4.20X1	To Bank A/c (WN1)	5,00,000	6,15,000	31.3.20X2	By Bank A/c	2,50,000	2,20,500
31.1.20X2	To Bonus shares	2,50,000	-	31.3.20X2	Balance c/d	5,00,000	4,10,000
31.3.20X2	To P&L	-	15,500				
		7,50,000	6,30,500			7,50,000	6,30,500

Working Notes:

1. Cost of equity shares purchased on 1st April, 20X1

= Cost + Brokerage + Cost of transfer stamps
 = (5,000 × ₹120) + (2% of ₹6,00,000) + (½% of ₹6,00,000)
 = ₹6,15,000

2. Bonus Issue

Ratio of Bonus Shares = 1:2

Therefore, Number of Bonus shares to be issued- (5,000 shares / 2) × 1 = 2,500 shares

Shares after the bonus issue = 5,000 + 2,500 = 7,500 Shares

Average cost after Bonus issue =

$\frac{₹6,15,000}{7,500 \text{ Shares}} = ₹82 \text{ per Share}$

3. Sale proceeds of equity shares sold on 31st March, 20X2

= Sale price – Brokerage
 = (2,500 × ₹90) – (2% of ₹2,25,000)
 = ₹2,25,000 – ₹4,500 = ₹2,20,500

Cost = 2,500 × 82 = ₹2,05,000

Profit on sale of bonus shares = ₹2,20,500 – ₹2,05,000 = ₹15,500

4. Valuation of equity shares on 31st March, 20X2

Cost of the closing stock = 5,000 × ₹82 = ₹4,10,000

Market Value of the Closing stock = 5,000 × ₹90 = ₹4,50,000

Cost being lower than market value, Value of closing stock = ₹4,10,000

5. Illustration

On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of Rs.15 per share (nominal value Rs.10 each). He provides you the further information:

- (1) On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at Rs.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 Rs.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 Rs.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.

Solution: Illustration 5

In the books of Rajat, Investment Account

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
1.4.20X1	To Balance b/d	5,00,000 (50,000×₹10)	7,50,000 50,000×₹15	31.3.20X2	Balance c/d	9,00,000	12,10,000
20.6.20X1	To Bank A/c	1,00,000 (10,000×₹10)	1,60,000 (10,000×₹16)				
1.8.20X1	To Bonus Shares	1,00,000 (10,000×₹10)	-				
5.11.X1	To Bank A/c (Rights)	2,00,000 (20,000×₹10)	3,00,000 (20,000×₹15)				
		9,00,000	12,10,000			9,00,000	12,10,000

Working Notes:

1. Bonus Issue:

Number of shares already held by Rajat

= 50,000 + 10,000

= 60,000

Bonus Ratio = 1:6 (1 for 6 held)

Therefore, Number of Bonus shares to be issued- (60,000 shares / 6) X 1 = 10,000 shares

2. Rights Shares

- No journal entries required for declaration of Rights by P Ltd.
- Entry will be required only when Rajat encashes or subscribes to the right shares on 5th November, 20X1.

Rights Ratio: - 3:7 (3 for 7 held)

- If 7 shares are held currently 3 right shares offered
- For 70,000 shares (i.e. 50,000 opening + 10,000 purchased + 10,000 Bonus) 30,000 rights will be offered.
- 30,000 rights

Rights Encashed:

- Encashed 1/3 rd rights @₹2 = 10,000 (30,000/3) × ₹2 = ₹20,000
- Credited to P&L as Rights Encashed. (It will not affect Investment A/c)

Rights Subscribed:

- Remining (2/3)rd rights – (2/3 × 30,000) = 20,000 rights
- Subscription price for Rights shares = ₹15
- Total amount paid = 20,000 × ₹15 = ₹3,00,000



6. Illustration

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. At a book value of Rs.15 per share (Nominal value Rs.10). On 20.6.20X1, he purchased another 5,000 shares of the company at Rs.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 Rs.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 Rs.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 Rs.5 per share.

You are required to prepare in the books of Sundar.

1. Investment Account

2. Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1 and shares are valued at average cost.

Solution:

Books of Sundar- Investment Account

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
1.4.20X1	To Bal b/d	25,000	3,75,000	31.10.20X1	By Bank (W.N.3)	-	10,000
20.6.20X1	To Bank	5,000	80,000	15.11.20X1	By Bank	25,000	3,75,000
16.8.20X1	To Bonus (WN1)	5,000	-				
30.9.20X1	To Bank (Rights)	10,000	1,50,000	31.12.20X1	By Bal. c/d (Bal. Fig.)	20,000	2,64,444
15.11.20X1	To P&L	-	44,444				
		45,000	6,49,444			45,000	6,49,444

Profit & Loss Account (Extract)

To Balance c/d	1,04,444	By Sale of rights (WN2)	10,000
		By Dividend (W.N.3)	50,000
		By Profit transferred	44,444
	1,04,444		1,04,444

Working Notes:

1. Bonus Issue:

Number of Shares held $(25,000 + 5,000) = 30,000$

Bonus Ratio = 1:6 (1 for 6 held)

Therefore, Number of Bonus shares to be issued- $(30,000 \text{ shares} / 6) \times 1 = 5,000 \text{ shares}$

2. Rights Shares

Number of shares = $25,000 + 5,000 + 5,000 = 35,000$

Rights Ratio = 3:7

Therefore, Number of Rights shares to be issued- $(35,000 \text{ shares} / 7) \times 3 = 15,000 \text{ shares}$

- Encashed $1/3$ rd rights @ ₹2 = $5,000 (15,000/3) \times ₹2 = ₹10,000$



- Remaining (2/3)rd rights Subscribed @ Issue Price = ₹15 – (2/3 × 15,000) = 10,000 rights
- Therefore, Amount paid on rights = 10,000 × 15 = ₹1,50,000

*Pre – Acquisition dividend should be treated as Returning or reduction of investment. And should be credited to investment account.

3.Dividend

Dividend Income

Shares (A)	Nominal Value (B) ₹	Dividend Rate ©	Dividend Rate (A×B×C) ₹	Accounting Treatment
25,000 shares	10	20%	50,000	Credited to P&L

Pre – acquisition Dividend

Shares (A)	Nominal Value (B) ₹	Dividend Rate ©	Dividend Rate (A×B×C) ₹	Accounting Treatment
5,000 shares	10	20%	10,000	Credited to Investment A/c

4. Profit on sale of 25,000 shares

Sales proceeds = 25,000 × ₹15 = ₹3,75,000

Cost = (25,000 + 5,000 + 10,000 Shares) → (₹3,75,000 + ₹80,000 + 0 + ₹1,50,000 – ₹10,000)
= ₹5,95,000 for 45,000 shares

= Therefore for 25000 shares = 25,000 ×

₹5,95,000/45,000Shares = ₹13,222.22

= ₹3,30,556

Profit = ₹3,75,000 – ₹3,30,556 = ₹44,444.

7. Illustration

On 1st January 20X1, Singh had 20,000 equity shares in X Ltd. Nominal value of the shares was Rs.10 each but their book value was Rs.16 per share. On 1st June 20X1, Singh purchased 5,000 more equity shares in the company at a premium of Rs.4 per share.

On 30th June, 20X1, the directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 20X1.

The terms of the rights issue were:

- Rights shares to be issued to the existing holders on 10th August, 20X1.
- Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at Rs.15 per share-the whole sum being payable by 30th September, 20X1.
- Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.
- Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of Rs.1.50 per share.
- Dividends for the year ended 31st March, 20X1, at the rate of 15% were declared by the Company and received by Singh on 20th October, 20X1.
- On 1st November, 20X1, Singh sold 20,000 equity shares at a premium of Rs.3 per share.

The market price of share on 31-12-20X1 was Rs.14. Show the Investment Account as it would appear in Singh's books on 31-12-20X1 and the value of shares held on that date.



Solution:

Investment Account-Equity Shares in X Ltd.

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
20X1 Jan. 1	To Bal b/d	2,00,000	3,20,000	20X1. Oct 20	By Bank	-	7,500
June 1	To Bank	50,000	70,000	Nov. 1	By Bank	2,00,000	2,60,000
Aug. 2	To Bonus	50,000	-	Nov .1	By P&L A/c (WN3)	-	1,429
Sep. 30	To Bank (Rights)	50,000	75,000	31.12.20X1	By Bal. c/d (Bal. Fig.)	1,50,000	1,96,071
		3,50,000	4,65,000			3,50,000	4,65,000

Working Notes:

1. Right shares

No. of right shares issued = $(20,000 + 5,000 + 5,000) / 3 = 10,000$ shares
 No. of right shares subscribed = $10,000 \times 50\% = 5,000$ shares

Amount of right shares issued = $5,000 \times ₹15 = ₹75,000$

No. of right shares sold = $10,000 - 5,000 = 5,000$ shares

Sale of right shares = $5,000 \times ₹1.5 = ₹7,500$ to be credited to statement of profit and loss

2. Dividend

Dividend received on 20,000 shares (opening) = $20,000 \times 15\% = 30,000$ credited to P & L

Dividend on shares purchased on June 1 (since the dividend pertains to the year ended 31st March, 20X1, i.e., the pre-acquisition period) = $5,000 \times 10 \times 15\% = ₹7,500$

3. Cost of shares sold – Amount paid for 35,000 shares

	₹
(₹3,20,000 + ₹70,000 + 0 + ₹75,000)	4,65,000
Less: Pre - Acquisition Dividend	(7,500)
Cost of 35,000 shares	4,57,500
Cost of 20,000 shares (Average cost basis) 20,000 × ₹4,57,500/35,000 Shares	2,61,429
Sale proceeds	2,60,000
Loss on sale	1,429

4. Value of investment at the end of the year

Assuming investment as current investment, closing balance will be valued based on lower of cost or net realisable value.

Here, Net realisable value is $15,000 \text{ shares} \times ₹14 = ₹2,10,000$ and cost = ₹1,96,071. Therefore, value of investment at the end of the year will be ₹1,96,071.

8. Illustration

A Limited purchased 5,000 equity shares (nominal value Rs.100 each) of Allianz Limited for Rs.105 each on 1st April, 20X1. The shares were quoted cum dividend. On 15th May, 20X1, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 20X1. On 30th June, 20X1 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 20X1 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share. A Limited subscribed to half of the rights issue and the balance was sold at Rs.5 per right entitlement.



The company declared interim dividend of 1% on 30th November, 20X1. Right shares were not entitled to dividend. The company sold 3,000 shares on 31st December, 20X1 at Rs.95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares. You are required to prepare Investment Account in books of A Ltd for the year ended 31st March, 20X2.

Solution:

In the books of A Ltd

Investment in equity shares of Allianz Ltd, for the year ended 31st March, 20X2

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
1.4.20X1	To Bank (WN1)	5,00,000	5,35,500	15.5.20X1	By Bank (WN2)	-	10,000
30.6. 20X1	To Bonus Issue (WN3)	1,00,000	-				
1.10. 20X1	To Bank (WN4)	25,000	11,250	31.12.20X1	By Bank A/c (WN6)	3,00,000	2,79,300
15.11.20X1	To P&L (WN6)	-	21,660		By Balance b/d	3,25,000	279,110
		6,25,000	5,46,750			6,25,000	5,46,750

Working Notes:

1. Purchase of Shares on 1.4.20X1

5,000 shares @ ₹105 = 5,25,000

Add: Brokerage of 2% of 5,25,000 = 10,500

= Purchase Value = 5,35,000

2. Dividend

2% × 5000 × 100 = ₹10,000

3. Bonus Shares

Number of Shares held = 5,000

Bonus Ratio = 1:5 (1 for 5 held)

Therefore, Number of Bonus shares to be issued- (5,000 shares / 5) × 1 = 1,000 shares

4. Rights Issue

No. of shares hold till date = (5,000 + 1,000) = 6,000

Rights Ratio = 1:12

Therefore, Number of Rights shares to be issued- (6,000 shares / 12) × 1 = 500 Rights

- Encashed 250 rights @ ₹5 = ₹1,250 (Credited to P&L)
- Remining 250 rights Subscribed @ ₹45 = 11,250
-

5. Interim Dividend

(5,000 + 1,000) × ₹100 × 1% = ₹6,000 (Credited to P&L)

1. Sale of Shares

2.

	₹
(₹5,35,500 + 0 + ₹11,250)	5,46,750
Less: Pre - Acquisition Dividend	(10,000)
Cost of 6,250 shares	5,36,750
Cost of 3,000 shares (Average cost basis)	2,57,640
3,000 ×	
₹5,36,750 / 6,250 Shares = ₹86.20	
₹86.20 × 3,000 Shares = ₹2,57,640	



Net Sale proceeds ($\{3000 \times ₹95\} - 2\% \text{ Brokerage}$)	2,79,300
$2,85,000 \times 98\%$	
Profit on Sale ($₹2,79,300 - ₹2,57,640$)	21,660

Closing Balance: $3,250 \times (₹5,36,750 / 6,250 \text{ Shares}) = ₹2,79,110$

9. Illustration

The following transactions of Nidhi took place during the year ended 31st March 20X2:

Date	Transactions
1st April	Purchased Rs.12,00,000, 8% bonds at Rs.80.50 cum-interest. Interest is payable on 1st November and 1st May.
12th April	Purchased 1,00,000 equity shares of Rs.10 each in X Ltd. for Rs.40,00,000
1st May	Received half-year's interest on 8% bonds.
15th May	X Ltd. made a bonus issue of three equity shares for every two held. Nidhi sold 1,25,000 bonus shares for Rs.20 each.
1st October	Sold Rs.3,00,000, 8% bonds at Rs.81 ex-interest.
1st November	Received half-year's bond interest.
1st December	Received 18% dividend on equity shares in X Ltd.

Prepare the relevant investment account in the books of Nidhi for the year ended 31st March, 20X2.

Solution:

In the books of Nidhi 8% Bonds Account - Investment Account

Date	Particulars	Face Value	Amount	Interest	Date	Particulars	Face Value	Amount	Interest
1.4.20X1	To Bank (WN1)	12,00,000	9,26,000	40,000	1.5.20X1	By Bank A/c (WN2)	-	-	48,000
1.10.20X1	To P&L (WN3)	-	11,500	-	1.10.20X1	By Bank (WN3)	3,00,000	2,43,000	10,000
31.3.20X2	To P&L	-	-	84,000	1.11	By Bank (WN4)	-	-	36,000
					31.3	By Balance c/d	9,00,000	6,94,500	30,000
		12,00,000	9,37,500	1,24,000			12,00,000	9,37,500	1,24,000

Investment in Equity Shares of X Ltd. Account

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
12.4.20X1	To Bank (WN5)	10,00,000	40,00,000	15.5.20X1	By Bank (WN2)	12,50,000	25,00,00
15.5.20X1	To Bonus Issue (WN6)	15,00,000	-				
15.05.20X1	To P&L - profit on sale (WN7)	-	5,00,000	31.3.20X2	By Balance c/d (Bal. fig)	12,50,000	20,00,000
		25,00,000	45,00,000			25,00,000	45,00,000



Profit & Loss Account

		By Bank (Dividend)	2,25,000
To Balance	7,75,000	By Profit on Sale	5,00,000
	7,75,000		7,75,000

Working Notes:**1. Cost of Investment (Bonds) Purchased on 1st April, 20X1**

12,00,000 Face Value, 8% Per Annum Bonds

₹100/ Bond → Face Value

12,000 Bonds Purchased

=

$\frac{₹80.5}{₹100} \times ₹12,00,000 = ₹9,66,000$

= ₹9,66,000

Interest on Bonds

Accrued interest for 5 months, i.e. 1st November, 20XX to 31st March, 20X1. Accrued interest will be $₹12,00,000 \times \frac{8}{100} \times \frac{5}{12} = ₹40,000$

Therefore, cost of investment purchased = ₹9,66,000 – 40,000 = ₹9,26,000 (Principal). Note: It has been assumed that the nominal value of a bond is ₹100.

2. Interest for 1/5

= $₹12,00,000 \times 8\% \times \frac{6}{12}$

= ₹48,000 (Income)

3. Sale of Bonds on 1st October, 20X1

3,000 bonds Face Value of ₹3,00,000

3,000 bonds were sold @ ₹81 ex-interest, i.e., Total amount received = 2,43,000

Add: Accrued Interest (Received) of 5 months = $(3,00,000 \times 8\% \times \frac{5}{12}) = ₹10,000$

Therefore, Cum Interest Value is ₹2,43,000 + ₹10,000 = ₹2,53,000

Cost = $\frac{₹3,00,000 \times ₹9,36,000}{₹12,00,000} = ₹2,31,500$

Profit on sale (₹2,43,000 – ₹2,31,500) = ₹11,500

4. Interest received on 1st November, 20X1

Interest will be received for 9,000 bonds @ 8% for 6 months, i.e., $₹9,00,000 \times 8\% \times \frac{1}{2} = ₹36,000$.

Note:

- On 31st of March, 20X2, Interest on Bonds for 5 months, i.e. 31st of March 20X2 – 1st of November 20X1 is accrued.
- It's not yet due, will fall due for payment on 1st of May, 20X2.
- 5 months interest should be accrued as Income by crediting to interest Account even though it not yet received.

Interest accrued on bonds on 31.3.20X1 = $9,00,000 \times 8\% \times \frac{5}{12} = ₹30,000$

5. Purchase of Shares

= 1,00,000 shares × ₹10 = ₹10,00,000

= Amount Paid = (1,00,000 shares × ₹40) = ₹40,00,000

6. Bonus Shares

Number of Shares held (25,000 + 5,000) = 30,000

Bonus Ratio = 3:2 (3 for 2 held)

Therefore, Number of Bonus shares to be issued - $(1,00,000 \text{ shares} / 2) \times 3 = 1,50,000 \text{ shares}$

Average cost after Bonus issue = $₹4,00,000 / (₹1,00,000 + ₹1,50,000) = ₹16 \text{ per share}$



7. Sale of Shares

Sale Price = ₹20

Sale Proceeds = ₹20 × 1,25,000 = ₹25,00,000

Cost per Share = ₹16 (WN6)

Profit = (20 - 16) × 1,25,000 = ₹5,00,000

8. Interim Dividend

It will be treated as income for the current period = 1,25,000 shares × ₹10 per share × 18% = ₹2,25,000 (Credited to P&L)

9. Value of equity at end of year

Cost per share after bonus = ₹16 Number of shares = 1,25,000

Value of equity at end of year = 1,25,000 × ₹16 = ₹20,00,000

10. Illustration

Smart Investments made the following investments in the year 20X1-X2:

12% State Government Bonds having nominal value Rs.100

01.04.20X1	Opening Balance (1200 bonds) book value of Rs.126,000
02.05.20X1	Purchased 2,000 bonds @ Rs.100 cum interest
30.09.20X1	Sold 1,500 bonds at Rs.105 ex interest

Interest on the bonds is received on 30th June and 31st December each year.

Equity Shares of X Ltd.	
15.04.20X1	Purchased 5,000 equity shares @ Rs.200 on cum right basis Brokerage of 1% was paid in addition (Nominal Value of shares Rs.10)
03.06.20X1	The company announced a bonus issue of 2 shares for every 5 shares held.
16.08.20X1	The company made a rights issue of 1 share for every 7 shares held at Rs.250 per share. The entire money was payable by 31.08.20X1.
22.8.20X1	Rights to the extent of 20% was sold @ Rs.60. The remaining rights were subscribed.
02.09.20X1	Dividend @ 15% for the year ended 31.03.20X1 was received on 16.09.20X1.
15.12.20X1	Sold 3,000 shares @ Rs.300. Brokerage of 1% was incurred extra.
15.01.20X2	Received interim dividend @ 10% for the year 20X1 -X2
31.03.20X2	The shares were quoted in the stock exchange @ Rs.220

Prepare Investment Accounts in the books of Smart Investments. Assume that the average cost method is followed.

Solution:

In the books of Smart Investments, 12% Govt. Bonds for the year ended 31st March, 20X2

Date	Particulars	Face Value	Amount	Interest	Date	Particulars	Face Value	Amount	Interest
1.4.20X1	To Balance b/d	1,20,000	1,26,000	3,600	30.6.X1	By Bank A/c (WN3)	-	-	19,200
2.5.X1	To Bank	2,00,000	1,92,000	8,000	30.9.X1	By Bank (WN4)	1,50,000	1,57,500	4,500
30.9.X1	To P&L (Profit on sale)	-	8,437	-	31.12.X1	By Bank (WN5)	-	-	10,200
31.3.X2	To P&L (b.f) (interest)	-	-	27,400	31.3.X2	By Balance c/d	1,70,000	1,68,937	5,100



		3,20,000	3,26,437	39,000			3,20,000	3,26,437	39,000

Investments in Equity shares of X Ltd. for year ended 31.3.20X2

Date	Particulars	Face Value	Amount	Dividend	Date	Particulars	Face Value	Amount	Dividend
15.4.20X1	To Bank (WN7)	50,000	10,10,000	-	16.9.X1	By Bank (Dividend)	-	7,500	-
3.6.X1	To Bonus Issue (WN9)	20,000	-	-	15.12.X1	By Bank (sale)	30,000	8,91,000	-
31.8.X1	To Bank (WN9)	8,000	2,00,000	-	15.1X1	By Bank (Interim Dividend)	-	-	4,800
15.12.X1	P & L A/c (WN11)	-	4,28,500	-	31.3.X2	By Balance c/d (Bal. fig)	48,000	7,40,000	-
31.3.X2	P & L A/c	-	-	4,800					
		78,000	16,38,500	4,800			78,000	16,38,500	4,800

Working Notes:

1. Interest = $1,200 \times 100 \times 12\% \times 3/12 = 3,600$

2. Interest on Bonds Purchased on 31.12.X1

= $2,000 \times 100 \times 12\% \times 4/12 = ₹8,000$

Therefore, On the purchase price 1,92,000 towards principal (2,00,000 - 8,000)

3. Interest Received = $(2,000 + 1,200) \times ₹100 \times 12\% \times 6/12 = ₹19,200$

4. Profit on sale of bonds on 30.9.X1

Sale Price = 1,57,500 (i.e., 1,500 x 105)

Interest Portion = $1,500 \times 100 \times 12\% \times 3/12 = 4,500$

Amount collected = 1,62,000

Average cost = $₹[(1,26,000 + 1,92,000) 1,500/3,200] = 1,49,063$

Profit = $₹1,57,500 - ₹1,49,063 = ₹8,437$.

5. Interest Received on 31.12.X1

$1,700 \times 100 \times 12\% \times 6/12 = ₹10,200$

6. Interest accrued on closing balance of bonds

$1,700 \times 100 \times 12\% \times 3/12 = ₹5,100$

7. Cost of equity shares purchased on 15/4/20X1

= Cost + Brokerage

= $(5,000 \times ₹200) + 1\% \text{ of } (5,000 \times ₹200) = ₹10,10,000$

8. Bonus Shares

Number of Shares held $(25,000 + 5,000) = 30,000$

Bonus Ratio = 2:5 (2 for 5 held)

Therefore, Number of Bonus shares to be issued - $(5,000 \text{ shares} / 3) \times 2 = 2,000 \text{ shares}$

9. Right shares

No. of right shares issued = $(5,000 + 2,000) / 7 \times 1 = 1,000 \text{ Rights shares}$

• No. of right shares subscribed = $1,000 \times 80\% = 800 \times ₹250 = 2,00,000$

• No. of Rights Sold = $1,000 \times 20\% = 200 \times ₹60 = 1,200 \text{ (credited to P&L)}$

10. Sale proceeds of equity shares on 15/12/20X1

= Sale price - Brokerage

= $(3,000 \times ₹300) - 1\% \text{ of } (3,000 \times ₹300) = ₹8,91,000$

11. Profit on sale of shares on 15/12/20X1

= Sales proceeds - Average cost

= Sales proceeds = ₹8,91,000



= Average cost = ₹ $[(10,10,000 + 2,00,000 - 7,500) \times 3,000 / 7,800]$

= ₹ $12,02,500 \times 3,000 / 7,800$ = ₹4,62,500

= Profit = ₹8,91,000 – ₹4,62,500 = ₹4,28,500

12. Amount of interim dividend = $(5,000 + 2,000 + 800 - 3,000) \times 10 \times 10\%$ = ₹4,800 (not affect on investment account)

13. Valuation of equity shares on 31st March, 20X2

Cost = $(12,02,500 \times 4,800 / 7,800)$ = ₹7,40,000

Market Value = 4,800 shares × ₹220 = ₹10,56,000

Closing stock of equity shares has been valued at ₹7,40,000 i.e. cost being lower than the market value.

Note:

1. It is presumed that no dividend is received on bonus shares as bonus shares are declared on 3.6.20X1 and dividend pertains to the year ended 31.03.20X1.
2. The amount of dividend for the period, for which shares were not held by the investor, has been treated as capital receipt.

11. Illustration – RTP Nov 2019

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of Rs. 100 each of P Ltd. on 1st [May 2018 @ Rs.105](#) on cum interest basis.

The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st, 2018 the company again purchased 2,500 of such debentures @ Rs. 102.50 each on cum interest basis.

On 1st October 2018 the company sold 2,000 Debentures @ Rs. 103 each. On 31st December 2018 the company received 10,000 equity shares of Rs. 10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018.

The market value of the debentures and equity shares as at the close of the year were Rs. 106 and Rs. 9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis.

Solution:

Investment in 13.5% Convertible Debentures in P Ltd.

Date	Particulars	Face Value	Interest	Amount	Date	Particulars	Face Value	Interest	Amount
2018 May 1	To Bank (WN1)	5,00,000	5,625	5,19,375	2018 Sep. 30	By Bank (6 months Int)	-	50,625	-
Aug.1	To Bank (WN2)	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000	-	2,06,000
Oct.1	To P&L A/c	-	-	2,167	Dec. 31	By Investment in Equity (WN5)	1,10,000	-	1,12,108
Dec. 31	To P&L A/c		52,313 (b.f)		Dec. 31	By Bank	-	3,713	-
					Dec. 31	By Balance c/d	4,40,000 (Bal. fig)	14,850	4,48,434 (Bal. fig)
		7,50,000	69,188	7,66,542			7,50,000	69,188	7,66,542



Investment in Equity shares in P Ltd. Account

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
2018 Dec 31	To 13.5% Deb.	1,00,000	1,12,108	2018 Dec 31	By P&L A/c	-	22,108
					By Bal. c/d	1,00,000	90,000
		1,00,000	1,12,108			1,00,000	1,12,108

Note: Cost being higher than Market Value the shares are carried forward at Market Value.

Working Notes:**1. 2018 May 1 Purchase of Debentures**

= 5,000 Debentures × ₹105 (Cum Interest)

- Interest Portion = $100 \times 13.5\% \times 1/12 = 1.125 \times 5,000 = ₹5,625$
- Principal portion = 5,19,375

2. Interest paid on ₹2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018 as part of purchase price:

$2,50,000 \times 13.5\% \times 4/12 = ₹11,250$

Therefore, Principal portion = $(2,500 \times ₹105) - ₹11,250 = ₹2,45,000$

3. Interest received on 30th Sept. 2018

On $(5000+2,500) \times 100 \times 13.5\% \times \frac{1}{2} = 7,50,000 \times 13.5\% \times \frac{1}{2} = ₹50,625$

4. Debenture Sold

Sale Price $(2,000 \times ₹103) = 2,06,000$

Less: Cost = $(₹519,375 + ₹2,45,000) \times ₹2,00,000 / ₹7,50,000 = ₹2,03,833$

Profit on sale = ₹2,167

5. Conversion of Debentures to Equity shares

$7500 - 2,000$ sold = 5,500 Debentures, Out of Which:

- 20% Converted into Equity = i.e., 1,100 Debentures into 10,000 equity shares of ₹10 each
- 80% Debentures = 4,400 Debentures

Cost of debentures converted into equity = $(₹519,375 + ₹2,45,000) \times ₹1,10,000 / ₹7,50,000 = ₹1,12,108$

1. Interest on 1,100 Debentures (being those converted) for 3 months i.e. Oct-Dec. 2018
 $1,10,000 \times 13.5\% \times 3/12 = ₹3,713$

7. Interest on Closing Debentures for period Oct - Dec. 2018 carried forward {accrued (not received) interest} $₹4,40,000 \times 13.5\% \times 3/12 = ₹14,850$

12. Illustration (RTP Nov 2019)

Z Bank has classified its total investment on 31-3-2018 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines.

'Held to maturity' investments are carried at acquisition cost less amortized amount.

'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored.

You are required to comment whether the policy of the bank is in accordance with AS 13?



Solution:

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

13. Illustration

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2014 at a cost of Rs.2,50,000. It also earlier purchased Gold of Rs.4,00,000 and Silver of Rs.2,00,000 on 1st March, 2012. Market value as on 31st March, 2015 of above investments are as follows :

- Shares Rs.2,25,000
- Gold Rs.6,00,000
- Silver Rs.3,50,000

How will the above investments be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2015 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Solution:

Investments	Value (long term investments)	Value (current investments)
Shares	Valued at <u>cost of Rs. 2,50,000</u> unless the drop in market value is permanent ; In case of permanent fall ,it is valued at Rs. 2,25,000	Valued <u>at lower of Cost or Market value</u> So, valued at <u>market value of Rs. 2,25,000.</u>
Gold	Valued at Cost - 4,00,000	Valued at cost - 4,00,000
Silver	Valued at Cost - 2,00,000	Valued at Cost - 2,00,000

14. Illustration

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of rs. 15 per share (nominal value rs. 10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for rs. 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 rs. 8 per share.
- (iii) Sold half of its shareholdings on 1st January 20X2 at rs. 16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31st March 20X2 assuming the shares are being valued at average cost.

Solution:

In the books of XY Ltd.

Investment in equity shares of ABC Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Divide nd Rs.	Amount Rs.	Date	Particulars	No.	Divide nd Rs.	Amount Rs.
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	-	-	Marc h 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 = (15,000 shares+5,000 shares)/5 x 1= 4,000 shares

2.Calculation of right shares subscribed

Right Shares = (15,000 shares+5,000 shares+4,000 shares)/6 = 4,000 shares

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

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

3. Calculation of sale of right entitlement

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

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

4.Calculation of profit on sale of shares

Total holding = 15,000 shares original

5,000 shares purchased

4,000 shares bonus



2,000 shares right shares
26,000 shares

50% of the holdings were sold

i.e. 13,000 shares (26,000 x 1/2) were sold.

Cost of total holdings of 26,000 shares (on average basis)

= rs. 2,25,000 + rs. 1,00,000 + rs. 24,000 – rs. 10,000 = rs. 3,39,000

Average cost of 13,000 shares would be

= $3,39,000 / 26,000 \times 13,000$

= rs. 1,69,500

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

5. Dividend received on investment held as on 1st April, 20X1

= 15,000 shares x rs. 10 x 20%

= rs. 30,000 will be transferred to Profit and Loss A/c Dividend received on shares purchased on 1st June, 20X1

= 5,000 shares x rs. 10 x 20% = rs.10,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus 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

$13,000 \times 3,39,000 / 26,000 = \text{Rs.} 1,69,500$

15. Illustration

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (nominal value) rs. 1,20,000, Cost rs. 1,18,000 (Nominal value of each unit is rs. 100).

1.3.20X1	Purchased 200 units, ex-interest at rs. 98.
1.7.20X1	Sold 500 units, ex-interest out of original holding at rs. 100.
1.10.20X1	Purchased 150 units at rs. 98, cum interest.
1.11.20X1	Sold 300 units, ex-interest at rs. 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.

Solution:

In the Books of Mr. Z
 9% Central Government Bonds (Investment) Account

Particulars		Nominal Value	Interest	Principal	Particulars		Nominal Value	Interest	Principal
20X1		Rs.	Rs.	Rs.	20X1		Rs.	Rs.	Rs.
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	-



Mar c h 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	-
Oc t. 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
No v. 1	To P&L A/c (W.N.8)	-	-	200	Dec. 31	By Balanc e c/d (W.N. 9 & W.N.10)	75,000	1,688	73,633
Dec . 31	To P&L A/c (b.f.) (Transfer)		9,938						
		1,55,000	13,388	1,53,333					
							1,55,000	13,388	1,53,333

Working Note:

- Interest element in opening balance of bonds = $1,20,000 \times 9\% \times 3/12 = \text{rs. } 2,700$
- Purchase of bonds on 1. 3.20X1
Interest element in purchase of bonds = $200 \times 100 \times 9\% \times 5/12 = \text{rs. } 750$
Investment element in purchase of bonds = $200 \times 98 = \text{rs. } 19,600$
- Interest for half-year ended 31 March = $1,400 \times 100 \times 9\% \times 6/12 = \text{rs. } 6,300$
- Sale of bonds on 1.7.20X1
Interest element = $500 \times 100 \times 9\% \times 3/12 = \text{rs. } 1,125$
Investment element = $500 \times 100 = \text{rs. } 50,000$
- Profit on sale of bonds on 1.7.20X1
Cost of bonds = $(1,18,000 / 1,200) \times 500 = \text{rs. } 49,167$ Sale proceeds = rs. 50,000
Profit element = rs. 833
- Interest for half-year ended 30 September
= $900 \times 100 \times 9\% \times 6/12 = \text{Rs. } 4,050$
- Sale of bonds on 1.11.20X1
Interest element = $300 \times 100 \times 9\% \times 1/12 = \text{rs. } 225$
Investment element = $300 \times 99 = \text{rs. } 29,700$
- Profit on sale of bonds on 1.11.20X1
Cost of bonds = $(1,18,000 / 1,200) \times 300 = \text{Rs. } 29,500$ Sale proceeds = Rs. 29,700
Profit element = Rs. 200
- Closing value of investment

Calculation of closing balance:	Nominal value		Rs.
Bonds in hand remained in hand at 31 st 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 1 st October	15,000		14,700



	75,000		73,633

10. Interest element in closing balance of bonds = $750 \times 100 \times 9\% \times 3/12 = \text{Rs. } 1,688$

16. Illustration

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

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

Solution:

Investment A/c of Mr. Purohit for the year ending on 31-3-20X2 (Scrip: 8% Debentures of P Limited)

(Interest Payable on 30th September and 31st March)

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

- Purchase of debentures on 1.7.20X1
Interest element = $100 \times 100 \times 8\% \times 3/12 = \text{rs. } 200$
Investment element = $(100 \times 98) + [1\% (100 \times 98)] = \text{rs. } 9,898$
- Purchase of debentures on 1.1.20X2
Interest element = $50 \times 100 \times 8\% \times 3/12 = \text{rs. } 100$
Investment element = $\{(50 \times 98) + [1\% (50 \times 98)]\} = \text{rs. } 4,949$
- Valuation of closing balance as on 31.3.20X2: Market value of 950 Debentures at Rs. 99 = Rs. 94,050
Cost of

800 Debentures cost	= 78,667	(1,18,000/1,20,000 X 80,000)
100 Debentures cost	= 9,898	
50 Debentures cost	= 4,949	
	<u>93,514</u>	

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

4. Profit on sale of debentures as on 1.10.20X1

	Rs.
Sales price of debentures (200 x rs. 100)	20,000
Less: Brokerage @ 1%	<u>(200)</u>
	19,800
Less: Cost of Debentures $\frac{1,18,000}{1,20,000} \times 20,000$	(19,667)
Profit on sale	133

5. Loss on sale of debentures as on 1.2.20X2

	Rs.
Sales price of debentures (200 x rs. 99)	19,800
Less: Brokerage @ 1%	(198)
	19,602
Less: Cost of Debentures $\frac{1,18,000}{1,20,000} \times 20,000$	(19,666)
Loss on sale	64
Interest element in sale of investment = $200 \times 100 \times 8\% \times 4/12$	rs. 533

17. Illustration

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of Rs. 4,50,000 (Face Value rs. 10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for rs. 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 rs. 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 rs. 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 rs. 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:

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

		No.	Amount			No.	Amount
			Rs.				Rs.
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	20,000	3,00,000
					(Sale of shares)		
				31.3.20X2	By Bal. c/d	30,000	4,02,000
		<u>50,000</u>	<u>7,12,000</u>			<u>50,000</u>	<u>7,12,000</u>

Working Notes:

(1) Bonus Shares = $(30,000 + 5,000) / 7 = 5,000$ shares

(2) Right Shares = $(30,000 + 5,000 + 5,000) / 8 \times 3 = 15,000$ shares

(3) Rights shares sold = $15,000 \times 1/3 = 5,000$ shares

(4) Dividend received = $30,000 \times 10 \times 20\% = \text{Rs. } 60,000$ will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.20X1

= $5,000 \times 10 \times 20\%$

= Rs. 10,000 is adjusted to Investment A/c

(6) **Profit on sale of 20,000 shares**

= Sales proceeds – Average cost

Sales proceeds = Rs. 3,00,000

Average cost = $(4,50,000 + 80,000 + 1,50,000 - 10,000) / 50,000 \times 20,000 = 2,68,000$

Profit = Rs. 3,00,000 – Rs. 2,68,000 = Rs. 32,000.

(7) Cost of shares on 31.3.20X2

$(4,50,000 + 80,000 + 1,50,000 - 10,000) / 50,000 \times 30,000 = \text{Rs. } 4,02,000$

(8) Sale of rights amounting Rs. 10,000 (Rs. 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.



AS 11 The Effects of Changes in Foreign Exchange Rates

Illustrations

1. Illustration (Q&A Part1)

Explain Monetary Items as per AS 11. How are Foreign Currency Monetary items to be recognized at each balance sheet date?

Classify the following as monetary or non-monetary items.

Share Capital, Trade Receivables, Investments, Fixed Assets

Solution:

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Example : debtors, creditors, loans etc.

Foreign Currency monetary items are recognized at closing rate at each balance sheet date.

• Share Capital	-	Non Monetary Item
• Trade Receivables	-	Monetary Item
• Investments	-	Non Monetary Item
• Fixed Assets	-	Non Monetary Item

2. Illustration (Q&A Part1)

BK Limited purchased a fixed asset costing Rs. 5,000 lacs on 1.4.2012 payable in foreign currency (USD) on 5.4.2013. Exchange rate of 1 USD is Rs.50 and Rs.54.98 as on 1.4.2012 and 31.3.2013 respectively. The Company also obtained a soft loan of USD 100,000 on 1.4.12 payable in 3 equal annual instalments. First instalment was due on 1.5.13. You are required to state how these transactions are to be accounted for in the books of accounts for the year ended 31.3.13

Solution:

Part 1

Date of acquisition of Fixed Asset 1.4.2012

Cost of acquisition: Rs.5000 lacs = USD 100 lacs X Rs. 50/USD

Creditor Reinstatement Date: 31.03.2013; Exchange rate 1 USD = Rs.54.98

Rupee Depreciation over the year 2012-13: Rs.4.98 per USD

Increase in creditor payables consequent to reinstatement following rupee depreciation:

Rs.4.98 /USD x USD 100 lacs = Rs.498 Lacs

Option 1: Rs.498 lacs of forex fluctuation can be debited to P&L in FY13

Option 2: The Company may also choose to capitalise this loss to the cost of the fixed asset so acquired.

Part 2:

Assume USD 100,000 of loan was used to acquire a Fixed asset / a non-monetary item

Loss on the reinstatement of the loan for FY2013 is

USD 100,000 x Rs.4.98 / USD = Rs. 4.98 lacs

Option 1: If the asset is depreciable, the loss of Rs.4.98 lacs has to be transferred to the fixed asset account or charged off in P&L

Option 2:

If the asset so acquired is not a depreciable fixed asset or is for Long term working capital, the loss can be transferred to Foreign Currency Monetary Item Translation Difference Account (FCMITDA) and written off in 3 years starting FY13. That will be transferred before 31.03.2020, the date before which all FCMITDA balances are to be written off as mandated by AS11.

3. Illustration (Q&A Part2)

Sterling Ltd. purchased a plant for US \$ 20,000 on 31st December, 2011 payable after 4 months. The company entered into a forward contract for 4 months @ Rs. 48.85 per dollar. On 31st December, 2011, the exchange rate was Rs. 47.50 per dollar. How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2012?



Solution:

Forward premium Paid by the Company per USD = Rs.48.85 - 47.50 = Rs1.35

The forward premium of Rs.1.35 is for a period of 4 months

Total forward premium = Rs. 1.35 X 20,000 = Rs. 27,000

Amount to be amortised per month = Rs 27,000/4 = Rs. 6750

Amount to be amortised for year ending 31.03.2012 = Rs. 6,750 X 3 months = Rs. 20,250

Rs.20,250 will be recognized in the books of sterling limited as forward premium expense for the year ended 31st March 2012.

4. Illustration (Q&A Part2)

Goods purchased on 1.1.11 of USD 10,000 when USD 1 = Rs.45. Exchange rate on 31.3.11 is Rs.44 and the exchange rate on the date of actual payment (07.07.11) was Rs.43 . Ascertain the gain or loss for FY10-11 and FY11-12. Also give treatment as per AS 11.

Solution :Technical context:

As per AS 11, Monetary items have to be restated at the end of an accounting period at the closing rate prevailing on such date

Analysis & Conclusion

Liability towards Creditors for Cost of goods purchased on 1.1.11 = Rs.45 X 10,000 = Rs.4,50,000

On 31.3.11 such creditor balance (monetary item) needs to be reinstated at closing rate.

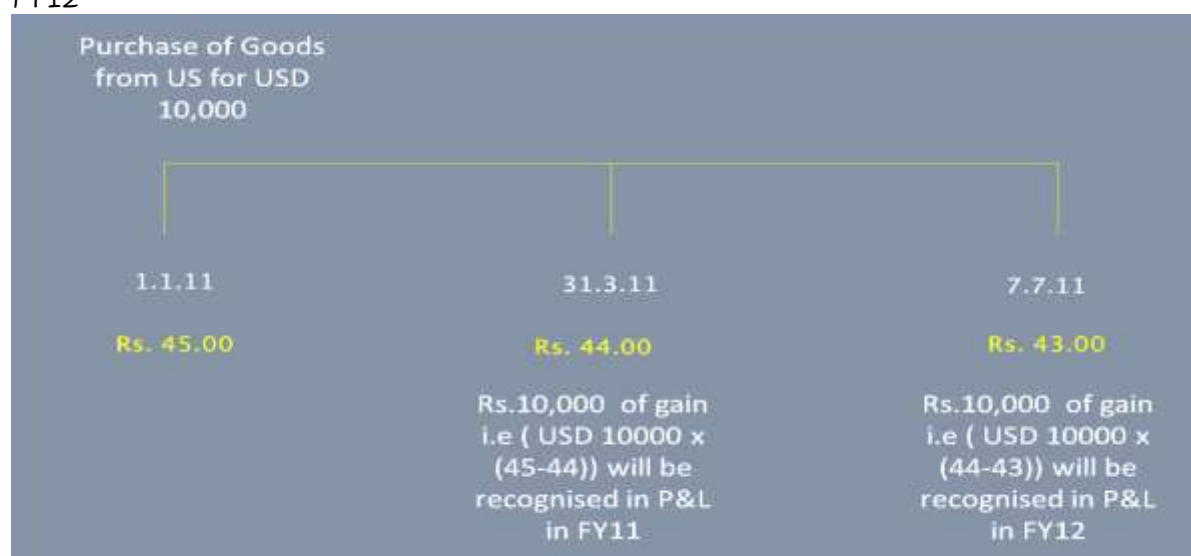
Closing rate on 31.3.11 is Rs.44 / USD

Rupee appreciated from Rs.45/ USD to Rs.44 USD – there is gain of Re 1.

For FY11 gain of Rs.10,000 (USD 10,000 x Re.1/ USD of gain) will be recognized in P&L

Rupee appreciated by additional Re.1 between 31.3.11 and 7.7.11 and the payment was made at Rs.43/ USD on 7.7.11

Additional gain of Rs.10,000 (USD 10,000 x Re.1/ USD of gain) will be recognized in P&L in FY12

**5. Illustration (Q&A Part2)**

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was Rs. 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was Rs. 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was Rs. 49 per US Dollar.

The Chief Accountant of the company passed an entry on 31st March, 2011 adjusting the cost of raw material consumed for the difference between Rs. 48 and Rs. 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11.

Solution:Technical context:

As per AS 11, Monetary items have to be restated at the end of an accounting period at the closing rate prevailing on such date



Analysis:

In the current case, creditor in respect of raw materials is a monetary item and has to be restated at the closing rate on 31.3.11 in the books of Sunshine Limited.

The creditor has to be reinstated on 31.3.11 at the exchange rate prevailing on 31.3.11 i.e. at Rs. 49 per USD

Exchange loss of Rs.45,000 i.e. $\text{USD } 9000 \times (\text{Rs.49} - \text{Rs.44} = \text{Rs.5})$ is recognized in FY11.

There is an exchange gain from the balance sheet date (31.03.2011) to the date of actual payment.

Exchange gain of Rs.9000 i.e. $\text{USD } 9000 \times (\text{Rs.49/ USD} - \text{Rs.48/ USD} = \text{Rs.1/USD})$ is recognized in FY12.

Conclusion

The amount payable to the creditor (which is a monetary item) must be reinstated. Any loss or gain arising due to such reinstatement must be transferred to a profit and loss account as "Foreign Exchange Fluctuation Gain/(Loss)". Treatment of recognizing exchange gain of Rs.36000 by reducing the cost of raw material in FY11 as proposed by the chief accountant is not justified

6. Illustration (Q&A Part3)

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.15:

- 1) Sundry debtors include amount receivable from Umesh Rs.5 lacs recorded at the prevailing Exchange rate on the date of sale. Transaction recorded at USD 1 = Rs. 58.50
- 2) Long term loan taken from a US company amounting to Rs.60 lacs recorded at USD 1 = 55.6; exchange rate taken at rate prevailing on date of transaction.

On 31st March 2015 USD 1 = Rs.61.20

Solution :

Sundry Debtors: Amount receivable from Umesh in USD = $\text{Rs. } 5,00,000 / (\text{Rs.58.5 per USD}) = \text{USD } 8547$

Accounting as on 31.3.15:

Rupee depreciation from date of transaction to 31.3.15 :

$\text{Rs. } 61.20 / \text{USD} - \text{Rs. } 58.5 / \text{USD} = \text{Rs. } 2.70 / \text{USD}$ of gain

Total gain on monetary items i.e. receivable from Umesh = $\text{USD } 8547 \times \text{Rs.2.70} / \text{USD} = \text{Rs.23,077}$ This gain will be recognized in P&L with corresponding increase in the receivable account.

Treatment of long term loan:

Loan in USD = $\text{Rs.60 lacs} / \text{Rs.55.60 per USD} = \text{USD } 107913.67$

For a monetary payable, rupee depreciation will result in a loss.

Loss is $\text{Rs.61.20/ USD} - \text{Rs.55.60 / USD} = \text{Rs.5.60/ USD}$

Total loss = $\text{Rs.5.60 / USD} \times \text{USD } 107913.67 = \text{Rs.604317}$

This loss on long term loan can be

- 1) transferred to P&L or
- 2) If it is for a depreciable asset capitalised it along with the cost of the fixed asset, If not it can be accumulated in FCMITDA and written off

7. Illustration

AXE Limited purchased fixed assets costing \$ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ Rs. 62.50 per dollar.

The exchange rate per dollar was as follows :

On 1st January, 2018 Rs. 60.75 per dollar

On 31st March, 2018 Rs. 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11

Solution

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortised as expenses or income over the life of the contract.



Forward Rate	₹ 62.50
Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 1.75

Contract Amount US\$ 5,00,000

Total Loss (5,00,000 × 1.75) ₹ 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18

$(8,75,000/5) \times 3 \text{ months} = ₹ 5,25,000$

Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

8. Illustration (RTP Nov 2019)

(i) Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh Rs. 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US \$ 1= Rs. 58.50. US \$ 1 = Rs. 61.20 on 31.3.2019.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019.

(ii) Power Track Ltd. purchased a plant for US\$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @Rs. 64.25 per Dollar. On 31st October, 2018, the exchange rate was Rs.61.50 per Dollar.

You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019.

Solution

(i) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Particulars	Calculations	Amount (₹)
Trade receivables as on 31/3/2019	₹5,00,000 × ₹ 61.20 / ₹ 58.50	5,23,076
Less : Trade receivables as on 31/3/2018	Given	5,00,000
Difference on trade receivables		23,076

Accordingly, exchange difference on trade receivables amounting ₹23,076 should be charged to Profit and loss account.

(ii) Calculation of profit or loss to be recognized in the books of Power Track Limited

Particulars	
Forward contract rate	₹ 64.25
Less : Spot rate	₹ (61.50)
Loss on forward contract	₹ 2.75
Forward Contract Amount	\$ 50,000
Total loss on entering into forward contract = (\$ 50,000 × ₹ 2.75)	₹ 1,37,500
Contract period	6 months
Loss for the period 1st Nov, 2018 to 31st March, 2019 (5 months falling in the year 2018-19)	5 months
Hence the loss for 5 months will be ₹ 1,37,500 × 5 / 6	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.



9. 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:
 01/01/20X1 1 US\$ = Rs. 48.00
 31/03/20X1 1 US\$ = Rs. 49.00
 31/07/20X1 1 US\$ = Rs. 49.50

Solution:**Journal Entries in the Books of Kalim Ltd.**

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

10. Illustration

Mr. A bought a forward contract for three months of US\$ 1,00,000 on 1st December at 1 US\$ = Rs. 47.10 when exchange rate was US\$ 1 = Rs. 47.02. On 31st December when he closed his books exchange rate was US\$ 1 = Rs. 47.15. On 31st January, he decided to sell the contract at Rs. 47.18 per dollar. Show how the profits from contract will be recognised in the books.

Solution:

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	Rs. 47.18
Less: Contract Rate	(Rs. 47.10)
Premium on Contract	Rs. 0.08
Contract Amount	US\$ 1,00,000
Total Loss (1,00,000 x 0.08)	Rs. 8,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)
 Loss to be recognised $(30,000/3) \times 2 = \text{Rs. } 20,000$ in the year ended 31st March, 20X1. Rest Rs. 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

11. 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.



Solution:

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 rate 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.

12. 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	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account (Recorded in HO books as Rs. 4,02,000)	6,100	
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as Rs. 1,91,000)	2,900	
Head Office Account (Recorded in HO books as Rs. 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– Rs. 61; 01.04.20X3– Rs. 63 & 31.03.20X4 – Rs. 67



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

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	Rs. (Dr.)	Rs. (Cr.)
Machinery	5,000		Transaction date rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400	20,000	Opening Rate	25,200	13,00,000
Goods Received from HO	6,100		Actuals	4,02,000	
Sales			Average Rate		
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	

13. Illustration

A Ltd. purchased fixed assets costing Rs. 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 = Rs. 40.00 and Rs. 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

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

Solution:

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 ₹ Rs. 3,000 lakhs/Rs.40 = 75 lakhs US Dollars

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

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



14. 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\$ = Rs. 48.00

31/03/20X2 1 US\$ = Rs. 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.

Solution:

Journal Entries in the Books of A Ltd.

- (i) Option under Para 46A is not availed

Date	Particulars	Rs. (Dr.)	Rs. (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 Rs. 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 Rs. 30,000 is recognised as an expense in the Statement of Profit and Loss for the year ending 31 March 20X2.

- (ii) Option under Para 46A is availed

Date	Particulars	Rs. (Dr.)	Rs. (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 Rs. 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 Rs. 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	Rs. (Dr.)	Rs. (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 Rs. 51)	25,500	
			25,500
	To Bank Account		
Mar 31	Foreign Exchange Difference Account Dr.	30,000	
			30,000
	To Foreign Loan Account [10,000 x (51-48)]		
Mar 31	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA) Dr.	30,000	
			30,000
	To Foreign Exchange Difference Account		

In this case, since the option under Para 46A is availed, the Exchange Loss of Rs. 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.



AS – 22
Accounting for Taxes on Income
Illustrations

1. Illustration – 5 marks

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 Rs. 11,00,000, Rs. 16,00,000 and Rs. 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of Rs. 7,00,000, Rs. 18,00,000 and Rs. 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

Solution:

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-X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1-X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2-X3	<u>21,00,000</u>	<u>23,00,000</u>	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

2. Illustration – (RTP)

Particulars	
FY ending every year	31 st March
1.04.2001: Purchase of machinery	Rs 150,000
Useful life	3 years
Expected scrap value	Zero
IT depreciation	100% - year 1
Accounting depreciation	SLM
Profit before depreciation and taxes (each year)	Rs 200,000
Corporate tax rate	40%

Answer:

The purchase of machine at a cost of Rs. 1,50,000 in 20x1 gives rise to a tax saving of Rs. 60,000. If the cost of the machine is spread over three years of its life for accounting purposes, the amount of the tax saving should also be spread over the same period as shown below:

	(Rs in '000)		
	2001	2002	2003
Profit before depreciation and tax	200	200	200
Less: Depreciation for accounting purposes	50	50	50
Profit before tax	150	150	150
Tax expense			
Current tax (WN 1)	20	80	80
Deferred tax (WN 2)	40	(20)	(20)
Tax expense	60	60	60
Profit after tax	150-60 = 90	150-60 = 90	150-60 = 90
Dr. Profit & Loss A/c	60	60	60



Dr. Deferred Tax liability		20	20
Cr. Income Tax Payable	20	80	80
Cr. Deferred Tax Liability	40		

(Rs in '000)

WN 1: Current Tax	2001	2002	2003
Profit before depreciation and tax	200	200	200
Depreciation as per Taxation	150	0	0
Profit before tax (as per P&L)	50	200	200
Tax @ 40% [A]	20	80	80
WN 2: Deferred tax			
Depreciation as per Taxation	150	0	0
Depreciation as per accounts	50	50	50
Difference - current period	100	(50)	(50)
Cumulative difference	100	100 - 50 = 50	50 - 50 = 0
As the difference originated in 2001 reversed in 2002 and 2003, it is timing difference, Hence, deferred tax can be applied.			
Enacted or substantively enacted tax rate	40%	40%	40%
Deferred tax liability (closing bal.)	100 x 40% = 40	50 x 40% = 20	0 x 40% = 0
Cumulative difference x Tax rate			
Closing position	DTL	DTL	DTL
P&L impact	40 is expense debited to P&L	40 - 20 = 20. This is reversal of DTL of 2001, reduced (credited) from Tax expense of 2002	20 - 0 = 20. This is reversal of DTL of 2001, reduced (credited) from Tax expense of 2013

3. Illustration

If in Illustration 1, the substantively enacted tax rates for 2001, 2002 and 2003 are 40%, 35% and 38% respectively, how will be the amount of deferred tax liability computed.

If the rate of tax changes, it would be necessary for the enterprise to adjust the amount of deferred tax liability carried forward by applying the tax rate that has been enacted or substantively enacted by the balance sheet date on accumulated timing differences at the end of the accounting year.

(in Rs '000)

WN 1: Current Tax	2001	2002	2003
Profit before depreciation and tax	200	200	200
Depreciation as per Taxation	150	0	0
Profit before tax (as per P&L)	50	200	200
Tax @ 40% [A]	20	80	80
WN 2: Deferred tax			
Depreciation as per Taxation	150	0	0
Depreciation as per accounts	50	50	50
Difference - current period	100	(50)	(50)
Cumulative difference	100	100 - 50 = 50	50 - 50 = 0



As the difference originated in 2001 reversed in 2002 and 2003, it is timing difference, Hence, deferred tax can be applied.			
Enacted or substantively enacted tax rate	40%	35%	38%
Deferred tax liability (closing bal.) Cumulative difference x Tax rate	$100 \times 40\% = 40$	$50 \times 35\% = 17.5$	$0 \times 40\% = 0$
Closing position	DTL	DTL	DTL
P&L impact	40 is expense debited to P&L	$40 - 17.5 = 22.50$. This is reversal of DTL of 2011, reduced (credited) from Tax expense	$17.5 - 0 = 17.5$. This is reversal of DTL of 2001, reduced (credited) from Tax expense

4. Illustration (5 marks)

The following particulars are stated in the **Balance Sheet** of **Deep Limited** as on **31st March, 2020**:

Particulars	(₹ in Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following **transactions** were reported during the year **2020-21**:

- Depreciation** as per **books** was ₹70 Lakhs whereas **Depreciation for Tax purposes** was ₹42 Lakhs. There were no additions to **Fixed Assets** during the year.
- Expenses disallowed** in 2019-20 and **allowed for tax purposes** in 2020-21 were ₹14 Lakhs.
- Share issue expenses** allowed under **the Income Tax Act** for the year 2020-21 (**1/10th of ₹70.00 lakhs** incurred in 2019-20).
- Repairs to Plant and Machinery** were made during the year for ₹140.00 Lakhs and were **spread over 2020-21 and 2021-22** equally in the books. However, the **entire expenditure** was allowed for **income-tax purposes** in 2020-21.

Tax Rate: 40%

You are required to show the impact of above items on **Deferred Tax Assets** and **Deferred Tax Liability** as on **31st March, 2021**.

Solution

Transactions	Analysis	Nature of Difference	Effect	Amount
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Reversing timing difference	Reversal of DTL	28 lakhs $\times 40\% =$ ₹11.20 lakhs



Disallowances (earlier years)	Tax payable for the earlier year was higher on this account.	Reversing timing difference	Reversal of DTA	14 lakhs × 40% = ₹5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act , tax payable in the earlier years was higher.	Reversing timing difference	Reversal of DTA	7 lakhs × 40% = ₹2.8 lakhs
Repairs to Plant and Machinery	Due to allowance of full expenditure under IT Act , tax payable of the current year will be less	Originating timing difference	Increase in DTL	70 lakhs × 40% = ₹28 lakhs

5. Illustration – (5 marks)

The following information is provided for **Mohit Limited** for the year ending **31st March, 2022**:

1. **Depreciation** as per **accounting records**: ₹56,000
2. **Depreciation** as per **Income Tax records**: ₹38,000
3. A new machinery purchased on **1st April 2021** costing ₹24,000, on which **100% depreciation** is allowed in the **first year** for income tax purposes. For **accounting purposes**, **straight-line depreciation** is used over **4 years**.
4. **Profit before depreciation and taxes**: ₹1,28,000
5. **Donation to private trust** during the year: ₹15,000 (**not allowed under Income Tax laws**)
6. **Corporate Tax rate**: 40%

Required:

1. Prepare the **Statement of Profit & Loss (extract)** for the year ended **31st March, 2022**, highlighting the **impact of various items** in terms of **Deferred Tax Liability / Deferred Tax Asset**.

Answer

Statement of profit and Loss for the year ended 31st March, 2022 (An Extract)

Particulars	Amount (₹)
Profit before depreciation and taxes	1,28,000
Less: Depreciation (Old: 56,000 + New: 6,000)	62,000
Profit before tax	66,000
Less: Current Tax (W.N) @40%	32,400
Deferred Tax	Nil
Profit after tax	33,600

Working Note:

Computation of taxable income

Particulars	Amount (₹)
Profit before depreciation and taxes	1,28,000
Less: Depreciation (Old: 38,000 + New: 24,000)	62,000
Profit before tax as per Income Tax	66,000
Add: Donation to private trust (disallowed)	15,000
Taxable Income	81,000
Current Tax @40%	32,400

Note: The profit of ₹ 1,28,000 given in the question is before depreciation and taxes. It has been considered that this amount is after making adjustment of donation amounting ₹ 15,000.

Impact of various items in terms of deferred tax liability/deferred tax asset



Transactions	Nature of Difference	Effect	Amount (₹)
Difference in depreciation (old machinery)	Timing difference	Reversal of DTL	(+) 7,200 (56,000 – 38,000) × 40%
Depreciation on new machinery	Timing difference	Creation of DTL	(-) 7,200 (24,000 – 6,000) × 40%
Donation to private trusts	Permanent difference	Not applicable	–

6. Illustration

Rama Ltd. has provided the following information:

	Rs.
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:

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

7. Illustration

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of Rs. 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of Rs. 1,00,000 and Rs. 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, 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.

Solution:

Statement of Profit and Loss

Particulars	31.3.20X1 (Rs.)	31.3.20X2 (Rs.)	31.3.20X3 (Rs.)
Profit / (Loss) before tax	(2,00,000)	1,00,000	1,20,000
Less: Current Tax	–	–	(8,000)
Deferred Tax:			
- Tax effect of timing differences originating during the year (Carry forward loss × 40%)	80,000	–	–
- Tax effect of timing differences reversed / adjusted during the year (Loss set off × 40%)	–	(40,000)	(40,000)
Profit / (Loss) after Tax Effect	(1,20,000)	60,000	72,000

8. Illustration

Saras Ltd. closes its books as on 31st March 20X2. They have accrued Rs. 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 the Income Tax Act, Any expenditure in the nature of taxes, duty, cess, fees, etc. accrued in the statement of profit and loss on mercantile basis will be



allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 20X2.

Solution:

Calculation of difference between taxable income and accounting income

Particulars	Amount (Rs.)
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act	Nil
Timing difference	5,00,000

Tax expense is less than the current tax due to timing difference. Therefore, deferred tax Asset = $30\% \times 5,00,000 = 1,50,000$

9. Illustration

ABC Company limited had an investment in Venture Capital amounting Rs. 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 (Rs. 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 Rs. 8 Crores on sale of shares of star Limited and entire proceeds of Rs. 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 Rs. 4 Crores.
- (3) Due to COVID-19, the remaining start-ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

Solution:

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	Amount (Rs. 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 (Rs. in Crores)	Rationale
Taxable Income	4	As per income tax laws
Accounting Income	Nil	As the same is deducted from the cost of investment
Timing Difference	4	

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of Rs. 0.8 Crores and company should recognise only current tax liability of Rs. 0.8 Crores.

10. Illustration

Goodwill Limited is a full tax-free enterprise for the first 10 years of its existence and is in second year of operations. Depreciation timing difference resulting in a deferred tax liability in 1st & 2nd year is Rs.200 lakhs and Rs.400 lakhs respectively. From the 3th year onwards, it is expected that the timing difference would reverse each year by Rs.10 lakhs. Assuming tax rate @40%, find out the deferred tax liability at the end of 2nd year and any charge to the Profit and Loss Account.

Answer:

As per **AS 22 – Accounting for Taxes on Income**, **deferred tax** in respect of **timing differences** which **originate during the tax holiday period** and **reverse during the tax holiday period** should **not be recognised** to the extent that **deduction from the total income** of an enterprise is **allowed under 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 principle of **prudence**.

For this purpose, **timing differences which originate first** should be considered to **reverse first (first-in, first-out basis)**.

Therefore, the treatment of Deferred Tax is as follows:

Deferred Tax Liability Account

Particulars	Amount (₹in lacs)	Particulars	Amount (₹in lacs)
Year 1		By Balance b/d	-
To Balance c/d	48	By Deferred Tax	48
	48		48
Year 2		By Balance b/d	48
To Balance c/d	208	By Deferred Tax	160
	208		208

Workings:

Year 1

Total Difference	200
Reversal in tax holiday period	10 lakhs x 8 = 80 lakhs
Balance which will not reverse in tax holiday period	120 lakhs
Tax rate	40%



Deferred Tax liability	$120 \times 40\% = 48$ lakhs
Year 2	
Total difference	600
Reversal in tax holiday period	80 lakhs
Balance	520 lakhs
DTL	$520 \text{ lakhs} \times 40\%$ 208 lakhs
Opening balance	48 lakhs
Amount to be provided in Year 2	160 lakhs
Alternatively DTL in Y2 (Since entire amount will reverse after tax holiday period)	$400 \times 40\% = 160$ Lakhs

11. Illustration

Is it permissible not to recognise deferred tax liability on the ground that an enterprise intends to carry out a major capital expansion programme in near future? You are required to give advice to the Company.

Answer:

The Company Should provide for deferred tax liability on the timing differences irrespective for the fact that there will be losses both for accounting and tax purposes in near future. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

If the same in the case of a Deferred Tax Asset (DTA) can be recognised only when the company reliably estimates sufficient future taxable income based either on reasonable or virtual certainty.



AS – 4
Contingencies and Events Occurring after
the Balance Sheet Date
Illustrations

1. Illustration

You are an accountant preparing accounts of A Ltd. as on 31.3.2011. After year end the following events have taken place in April, 2011:

- (i) A fire broke out in the premises damaging, uninsured stock worth Rs. 10 lakhs (Salvage value Rs. 2 lakhs).
- (ii) A suit against the company's advertisement was filed by a party claiming damage of Rs. 20 lakhs

Answer:

First Event

Technical Context:

Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date'. The materiality of event must be assessed.

Analysis:

The event of fire damaging stock is an event occurring after the balance sheet. In case of loss due to the fire, there is no reason to believe that circumstances existed on balance sheet date. If the loss is a matter affecting going concern, it will be treated as an adjusting event. In case the loss is material it should be disclosed and if it not a material event, it need not be disclosed in director's report.

Conclusion:

In the instant case the item appears to be a matter not affecting going concern but still material and hence it needs to be disclosed.

Assumption : The fire occurred before the board of directors approved the annual accounts.

Second Event

Technical Context:

A contingent Liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

Analysis & Conclusion:

If the Company is sure of losing the case then the Company should provide for the same as per AS 29.

If the Company is fairly confident of winning the case, the Company should treat this as a contingent liability and disclose the same.

If the Company is sure of winning the case the Company can ignore the case.

*It is assumed that the case pertains to advertisement done by the company in previous year.

2. Illustration

MEC Limited could not recover an amount of Rs.8 lakhs from a debtor. The Company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31st March 2011 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2011, the debtor became bankrupt and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of Rs.8 lakhs in books of account for the year ended 31st March 2011?



Answer:

Technical Context:

As per para 8 of AS 4, 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date if such event provides additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

Analysis and Conclusion:

In the given case, the debtor was already in a great financial difficulty at the time of closing of accounts in March 2011. Bankruptcy of the debtor in May 2011 is only an additional information to the condition existing on the balance sheet date. Also, the effect of a debtor becoming bankrupt is material as total amount of Rs.8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of Rs.8 lakhs in the books of account for the year ended 31st March, 2011.

3. Illustration

A major fire has damaged the assets in a factory of a Limited Company on 5th April – five days after the year end and closure of accounts. The loss is estimated at Rs.10 Crores out of which Rs.7 Crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts of the previous year.

Answer:

Technical Context:

The loss due to break out of fire is an example of event occurring after the balance sheet date. The event does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements. Disclosure is generally made for events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence of the enterprise after the balance sheet date.

Analysis and Conclusion:

In the given case, the amount of loss of assets in a factory is material and may be considered as an event affecting the substratum of the enterprise. Hence, disclosure of the event should be made in the director's report.

4. Illustration

A Company entered into an agreement to sell its immovable property to another company for Rs.35 lakhs. The property was shown in the Balance Sheet at Rs.7 lakhs. The agreement to sell was concluded on 15th February, 2011 and sale deed was registered on 30th April, 2011.

You are required to state, with reasons, how this event would be dealt with in the financial statements for the year ended 31st March, 2011.

Answer:

Technical Context:

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

Analysis:

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2011 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2011, simply provides additional information relating to the conditions existing at the balance sheet date.

Conclusion:

Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2011.



5. Illustration

In Raj Co. Ltd., theft of cash of Rs. 2 lakhs by the cashier in January, 2011 was detected in May, 2011. The accounts of the company were not yet approved by the Board of Directors of the company. Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2011. Decide.

Answer:

Technical Context:

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

Analysis:

Though the theft, by the cashier Rs. 2,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date.

Conclusion:

Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2011 for recognition of the loss amounting Rs. 2,00,000.

Case 2: What if the Company gets to know about the cash loss after Board Approval?

Solution Case 2: If the Company gets to know after Board Approval, the matter will not be within the scope of AS 4. The loss will be treated as a prior period item in line with AS-5.

6. Illustration

A Company follows April to March as its financial year. The Company recognizes Cheques dated 31st March or before, received from customers after balance sheet date, but before approval of financial statement by debiting 'Cheques in hand account' and crediting 'Debtors account'.

The 'Cheques in hand' is shown in the Balance Sheet as an item of cash and cash equivalents. All Cheques in hand are presented to bank in the month of April and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether the collection of Cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company?

Answer:

Even if the Cheques bear the date 31st March or before, the Cheques received after 31st March do not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of Cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date".

Moreover, the collection of Cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

7. Illustration

In preparing the financial statements of Lotus Limited for the year ended 31st March, 2010 you come across the following information. State with reason, how you would deal with this in the financial statements?



The company invested Rs.50 lakhs in April, 2010 in the acquisition of another company doing similar business, the negotiations for which had just started.

Answer:

Technical Context:

As per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

Analysis:

The investment of Rs. 50 lakhs in April 2010 for acquisition of another company is under negotiation stage, and has not been finalized yet. On the other hand it is also not affecting the figures stated in the financial statements of 2009-10.

Conclusion:

Hence the details regarding such negotiation and investment planning of Rs. 50 lakhs in April, 2010 in the acquisition of another company may be disclosed in the Director's Report to enable users of financial statements to make proper evaluations and decision.

8. Illustration

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operating again.

State the reasons whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of provisions of AS 4.

Answer:

Technical Context:

As per AS 4 "Contingencies and events occurring after the balance sheet date" an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes only if the event provides further evidence of the situations which subsisted the balance sheet date.

For events that are indicative of situation which occurred following balance sheet date, determine if affecting going concern

- If affecting going concern is adjustable
- If not affecting going concern not material is to be ignored.
- If not affecting going concern but material is to be disclosed.

Analysis:

In the given case the loss due to fire is a subsequent event as it occurred after the balance sheet date on 15th April. This is an unusual event that effects the existence or substratum of the enterprise. This event doesn't provide any further evidence of the enterprise to continue as going concern.

Conclusion:

Therefore, the event is an adjusting event. So, the financial statements for the year ended 31st March 2018 have to be prepared on liquidation basis and not on going concern basis. Besides, a statement in notes to accounts has to be given in this regard.

9. Illustration

The Board of Directors of M/s. New Graphics Ltd. in its Board Meeting held on 18th April 2017, considered and approved the Audited Financial results along with Auditor's Report for the Financial Year ended 31st March, 2017 and recommended a dividend of Rs.2 per



equity share (on 2 crores fully paid up equity shares of Rs.10 each) for the year ended 31st March, 2017 and if approved by the members at the forth coming AGM of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements.

Answer:

Technical Context:

As per AS 4 - "Contingencies and Events Occurring After the Balance Sheet Date" the events which take place after the balance sheet date, are reflected in the financial statements because of statutory requirements. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time.

Analysis:

In the given case, M/s New Graphics Ltd. Declares a dividend on 18th April, 2018 of Rs. 2 per equity share for year ended 31st March, 2017. Such a subsequent event is non adjusting event as the condition for liability doesn't exist as the date of closure of balance sheet date.

Conclusion:

Thus, the dividend of Rs.4cr recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid only after approval in the Annual General Meeting of the company. Such dividends are to be disclosed in the notes to financial statements.

10. Illustration

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2019.

- The accounting year of the company ended on 31.3.2019.
- The accounts were approved on 30.6.2019.

The loss from earthquake is estimated at Rs. 25 lakhs.

State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.

Answer:

Technical Context:

As per AS 4- "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. Any 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.

Analysis:

The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e., 31.3.2019. Therefore, loss occurred due to earthquake is not to be recognized in the financial statements.

Conclusion:

However, the earthquake has caused major destruction. Therefore, the fundamental accounting assumption of going concern is not valid. Hence, the fact of earthquake incurred estimated loss of Rs. 25 lakhs. This event should be disclosed in the Board Report for the financial year 2018-2019 as a significant event.



11. Illustration

A company has filed a legal suit against the debtor from whom Rs. 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 Rs. 15 lakhs as provision for doubtful debts? Discuss.

Solution:

As per AS 4 (Revised) "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 20X1.

12. 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

Rs. 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

Solution:

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

13. 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 Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 20X1 the trade receivable became a bankrupt. Can the company provide for the full loss arising out of insolvency of the trade receivable in the final accounts for the year ended 31st March, 20X1?

Solution:

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

So full provision for bad debt amounting to Rs. 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31 st 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.

14. 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?



Solution:

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.

15. Illustration

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

Solution:

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

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by Rs. 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 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.



AS 5

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

Illustrations

1. Illustration (Q&A Part1)

A listed company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2010-2011. Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2011.

The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard should this revision be considered as an extraordinary item or prior period item?

Answer:

Technical Context:

As per AS5, Net profit or loss for the period, prior period items and changes in accounting policies,

- Items that are not arising from ordinary activities of an entity are extraordinary items.
- Prior period items are items of income or expenses which arise in the current period because of an error or omission in one or more previous period.
- Changes in accounting estimates as a result of availability of new or additional information are not treated as extraordinary / prior period items.

Analysis:

Provision for bad and doubtful debts is an accounting estimate. The accounting estimates might require change in light of new information. Such a change cannot be considered as a prior period item or an extraordinary item. Hence, in the current case, the change in receivables provision is a change in accounting estimate. Further, as the accounts have not yet been approved by the Board, changes in estimates / adjustments to financials can be made for a specific financial period applying the provisions of AS-4.

Conclusion:

Provision for bad and doubtful debts is an ordinary item; change in an Accounting Estimate is not a correction hence it is not a prior period item.

Changes in Accounting Estimates with material effect in the current period, should be disclosed and quantified. Changes in the accounting estimates which are expected to have a material effect in later periods should also be disclosed and quantified.

2. Illustration (Q&A Part1)

X Co. Ltd. signed an agreement with its employees' union for revision of wages in June, 2012. The wage revision is with retrospective effect from 1.4.2008. The arrear upto 31.3.2012 amounts to Rs.80 lakhs. Arrear wages for the period from 1.4.2012 to 30.06.2012 (being the date of agreement) amounts to Rs. 7 lakhs. Decide whether a separate disclosure of arrear wages is required.

Answer:

Technical Context

As per AS5, Net profit or loss, prior period items and changes in accounting policies,

- Items that are not arising from ordinary activities of an entity are extraordinary items. However, if ordinary items can be categorized as exceptional considering their nature, size and frequency of recurrence, such items must be disclosed separately.
- Items that are accounted in the current year resultant of an error or omission in any preceding year are prior period items.



- Changes in accounting estimates as a result of availability of new or additional information are not treated as extraordinary / prior period items.

Analysis:

In the current case, the wage arrears were finalized only in June 2012. There was no indication of wage arrears till March 31, 2012. It is not an error of omission or commission. Further wages are ordinary items, however a revision in wages with retrospective effect might be considered as an exceptional item requiring separate disclosure.

Conclusion:

Considering that arrears of wages are neither an extraordinary item nor prior period item, they are ordinary items of exceptional nature in the P&L for FY12-13. Rs.7 lakhs go into current period wages as an ordinary item.

3. Illustration

S.T.B. Ltd. makes provision for expenses worth Rs.7,00,000 for the year ending March 31, 2009, but the actual expenses during the year ending March 31, 2010 comes to Rs. 9,00,000 against provision made during the last year.

State with reasons whether difference of Rs. 2,00,000 is to be treated as prior period item as per AS-5.

Answer:

Technical Context:

As per AS5, Net profit or loss for the period, prior period items and changes in accounting policies, Items of income or expenses that are accounted in the current year due to an error or omission in any preceding year are prior period items

Analysis:

In the instant case, change in an estimate cannot be categorized as a prior period item as there has been no error in one or more previous accounting period.

Conclusion:

This is a change in Accounting Estimate. Changes in Accounting Estimates with material effect in the current period, should be disclosed and quantified. Changes in the accounting estimates which are expected to have a material effect in later periods should also be disclosed and quantified.

4. Illustration

A company created a provision of Rs. 75,000 for staff welfare while preparing the financial statements for the year 2010-11. On 31st March, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to Rs. 1,00,000.

The accounts were approved by Board of Directors on 15th April, 2011.

Explain the treatment of such revision in financial statements for the year ended 31st March 2011.

Answer:

Technical Context

As per AS5, Net profit or loss, prior period items and changes in accounting policies,

- Items that are not arising from ordinary activities of an entity are extraordinary items. However, if ordinary items can be categorized as exceptional considering their nature, size and frequency of recurrence, such items must be disclosed separately.
- Items that are accounted in the current year resultant of an error or omission in any preceding year are prior period items.
- Changes in accounting estimates as a result of availability of new or additional information are not treated as extraordinary / prior period items.

Analysis:

In the instant case, the original estimate and revised estimate both are made in the month of March 2011. The revision is neither due to an error nor is it an item of extraordinary nature.



Conclusion:

It is an Ordinary Item and it should be disclosed as such – The provision should be increased to Rs.1 Lakh instead of Rs.75,000/-

5. Illustration

Closing stock for the year ending on 31.3.2013 is Rs.1,50,000 which includes stock damaged in a fire in 2011-12. On 31.3.2012, the estimated net realizable value of the damaged stock was Rs. 12,000. The revised estimate of net realizable value of damaged goods included in closing stock at 2012-13 is Rs.4, 000. Find the value of closing stock to be shown in Profit and Loss account for the year 2012-13, using provision of Accounting Standard 5.

Answer:

There is a Change in Accounting Estimate of value of closing stock from Rs. 12,000 to Rs. 4,000 and such reduction in value of inventory needs to be written off and separately disclosed as may be required.

	Rs.
Closing Stock (including damaged goods) as on 31.03.13	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

6. Illustration

PQR Ltd. is in the process of finalising its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

- (i) Goods worth Rs.5,00,000 were destroyed due to flood in September 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March 2018 the claim was passed and the company received the payment of Rs.3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31st March 2018.
- (ii) Floods in September 2015
- (iii) No entry passed in 2015-16
- (iv) Goods destroyed – Rs.5,00,000
- (v) Insurance claim received Rs.3,50,000 in March 2018

Answer:**Technical Context:**

As per the provisions of AS 5 “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies”, prior period items are income or expenses, which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Any loss identified should be recognized immediately as per prudence concept.

Analysis:

Here, it is a case of error/omission in preparation of financial statements for the year 2015-16. It is not a prior period item but a regular event. AS per accrual concept, the claim should be recognized as soon as it approved but not at the time of receipt.

Conclusion:

Therefore, the event should be considered as ordinary activity. However, considering its size and nature, it should be disclosed separately as it is a ordinary event of exceptional nature.

7. Illustration

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of Rs.10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at Rs. 8 Lakhs



was destroyed. The loss from fire was set off against the profit from sale of land and profit of Rs. 2 lakhs was disclosed as net profit from sale of assets.

You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5.

Answer:

Technical Context:

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

Analysis:

In the given case the selling of land to tide over liquidation problems is within the control of the company that implies it is an ordinary activity of exceptional nature. Whereas fire in the Factory is extraordinary activity as it is outside the control of company. Both the events are material and expected not to recur regularly.

Conclusion:

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land and loss due to fire should be disclosed separately in the statement of profit and loss. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

8. Illustration

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. You are required to advise him in the following situations in accordance with the provisions of AS 5

- (i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.
- (ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.
- (iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.
- (iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.
- (v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

Answer:

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that is different from previous years will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction substantially differs from the previous policy but will not be treated as change in an accounting policy. It is a introduction of new policy.

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



(iv) The adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

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

9. Illustration

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

Solution:

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 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 as 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.

10. Illustration

- (i) During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by Rs. 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 Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?

Solution:

- (i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

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

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

- (ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of Rs. 7,50,000 (for 1½ years @ Rs. 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. 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.

11. Illustration

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

Solution:

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

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

12. 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 organisation. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organisation.

Solution:

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

- (i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.
- (ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy.

13. 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?

Solution:

No.

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



A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense.

A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

14. Illustration

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?

Solution:

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

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

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



AS 17

Segment Reporting

Illustrations

1. Illustration

Tirumala Limited has the following business or geographical segments. Examine which of these are reportable segments under AS 17.

(Rs. In lakhs)

Segments	Revenue	Profit (+)/Loss(-)	Assets
A	9,600	1,750	4,100
B	300	180	450
C	100	70	450

Answer:

Test 1 : Revenue Test

Segments	Revenue (Rs.)
A	9,600
B	300
C	100
Total	10,000
10% of Revenue	1,000

Since only Segment A has revenue $\geq 1,000$, Segment A is reportable.

Test 2 : Segment Result Test

Segments	Profit (+)/Loss (-)
A	1,750
B	180
C	70
Total	2,000
10% of Segment Results	200

Since only Segment A has results ≥ 200 , Segment A is reportable.

Test 3 : Segment Assets Test

Segments	Assets (Rs.)
A	4,100
B	450
C	450
Total	5,000
10% of Segment Results	500

Since only Segment A has results ≥ 500 , Segment A is reportable.

External revenue is not given in question and hence, 75% test is not recognised. As per the three tests, only Segment A is reportable.

2. Illustration

Chief Accountant of Sports Limited gives the following data on its six segments:

Segments	Assets	Results	Revenue
M	40	50	300
N	80	-190	620
O	30	10	80



P	20	10	60
Q	20	-10	80
R	10	30	60
Total	200	-100	1200

Chief Accountant is of the opinion that M & N alone should be reported. Is he justified in his view? Discuss.

Answer:

Segments	Assets	Absolute Profits	Absolute Loss	Revenue
M	40	50		300
N	80		190	620
O	30	10		80
P	20	10		60
Q	20		10	80
R	10	30		60
Total	200	100	200	1200
10%	20	20 (higher)		120

As per Revenue Test, Segment A&B are reportable

As per Asset Test, Segments M, N, O, P & Q are reportable

As per Segment Result test, M, N & R are reportable

Hence, all segments are reportable and the contention of the Chief Accountant is not correct.

3. Illustration

M/s XYZ Ltd has three segments namely X, Y and Z.

The total of the assets of the company are Rs.10 crores. The details of segment wise assets are given below.

X : Rs. 2 Crores Y : Rs. 3 Crores Z : Rs. 5 Crores.

Deferred tax assets included in the assets of each segment are

Segment X – 0.5 cr Segment Y – 0.4 cr Segment Z – 0.3 cr

The accountant contends that all three segments are reportable segments. Comment

Answer:

As per AS-17, Deferred Tax Assets do not form a part of Segment Assets.

Segment	Total Assets	Deferred Assets	Segment Assets
X	2	0.5	1.5
Y	3	0.4	2.6
Z	5	0.3	4.7
Total			8.8
10% of Assets			0.88

Since all segments have assets more than 10% of total segment assets, all segments are reportable. The contention of Accountant is correct.

4. Illustration

A Company has an inter-segment transfer pricing policy of charging at cost less 5%. The market prices are generally 20% above cost.

You are required to examine whether the policy adopted by the company is correct or not?



Answer:**Provision**

As per AS17 "Segment Reporting", inter segment transfers should be measured on the basis that the enterprise actually use to price these transfers. The basis is pricing inter segment transfers, and any change should be disclosed in the financial statements.

Analysis

Hence, the enterprise can have its own policy for pricing inter segment transfers. These transfers may be based on cost, below cost or market place. The policy chosen by the enterprise should be disclosed and applied consistently.

Conclusion

Therefore, in the given case the policy of charging price for inter segment transfer at cost below 5% when market price is above 20% of cost is correct only if it is followed consistently.

5. Illustration

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:**Provision**

As per AS 17 "Segment Reporting", when the primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical segment whose revenue from sales to external customers is 10% or more of the enterprise revenue.

Analysis

Accordingly, for the purpose of disclosing secondary information, PK Ltd. is not required to disclose segment revenue from exports sales to UK. This is because that segment does not meet the 10% or more of enterprise revenue.

Conclusion

PK. Ltd is required to disclose the USA exports sales. But it is not required to disclose segment revenue from export sales to UK but it can do so if the management opts to. However, other secondary segment information should be disclosed if it meets the threshold criteria.

6. Illustration

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	<i>Rs. (‘000)</i>
<i>Forging Shop Division</i>	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	<u>6,135</u>
	<u>10,800</u>
<i>Bright Bar Division</i>	
Sales to Fitting Division	45
Export Sales to Rwanda	<u>300</u>
	<u>345</u>
<i>Fitting Division</i>	
Export Sales to Maldives	<u>270</u>



Particulars	Head Office Rs. ('000)	Forging Shop Division Rs. ('000)	Bright Bar Division Rs. ('000)	Fitting Division Rs. ('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

Solution:

Diversifiers Ltd. Segmental Report

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging shop	Bright Bar	Fitting		
Segment Revenue					
Sales:					
Domestic	90	-	-	-	90
Export	<u>6,135</u>	<u>300</u>	<u>270</u>	=	<u>6,705</u>
External Sales	6,225	300	270	-	6,795
Inter-Segment Sales	<u>4,575</u>	<u>45</u>	<u>?</u>	<u>4,620</u>	=
Total Revenue	<u>10,800</u>	<u>345</u>	<u>270</u>	<u>4,620</u>	<u>6,795</u>
Segment Result (Given)	240	30	(12)		258
Head Office Expenses					<u>(144)</u>
Operating Profit					114
Interest Expense					<u>(16)</u>
Profit Before Tax					<u>98</u>
Information in Relation to Assets and Liabilities:					
Fixed Assets	300	60	180	?	540
Net Current Assets	<u>180</u>	<u>60</u>	<u>135</u>	<u>?</u>	<u>375</u>
Segment assets	<u>480</u>	<u>120</u>	<u>315</u>	<u>?</u>	915
Unallocated Corporate Assets (75 + 72)	-	-	-	-	<u>147</u>
Total assets					<u>1,062</u>
Segment liabilities	30	15	180	?	225
Unallocated corporate liabilities					<u>57</u>
Total liabilities					<u>282</u>

Sales Revenue by Geographical Market

	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



7. Illustration

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)
	(Rs. in crore)
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	1,480

Identify the Reportable segments.

Solution:

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 Rs. 8,280 crores.
- (ii) All segments in loss, i.e., C and D - Total loss ₹ 6,800 crores.

Greater of the above - Rs. 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		

8. Illustration

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:

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
O	0	5,250	(750)	10,500
P	500	5,500	900	10,500
Q	1,200	1,050	600	5,250
	10,400	35,350	3,750	1,02,750

Heavy Goods Ltd. needs to determine how many reportable segments it has.

You are required to advise Heavy Goods Ltd. as per the criteria defined in AS 17.



Solution:

Quantitative Threshold Test:

Revenue Test:

Combined total sales of all the segment = Rs. 10,400 + Rs. 35,350 = Rs. 45,750. 10% thresholds = $45,750 \times 10\% = 4,575$.

Profitability Test:

In the given situation, combined reported profit = Rs. 6,000 and combined reported loss (Rs. 2,250). Hence, for 10% thresholds Rs. 6,000 will be considered.

10% thresholds = $\text{Rs. } 6,000 \times 10\% = \text{Rs. } 600$

Asset Test:

Combined total assets of all the segment = Rs. 1,02,750 10% thresholds = $\text{Rs. } 1,02,750 \times 10\% = 10,275$

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.

9. Illustration

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 (allocated in 5 :4 : 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000



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

Solution:

Computation of segment result:

Segments	A Rs.	B Rs.	C Rs.	Total Rs.
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 :4 :2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue (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

10. Illustration

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

(Rs. in lakhs)

Particulars	P	Q	R	S	T	Total
	(Rs.)	(Rs.)	(Rs.)	(Rs.)	(Rs.)	(Rs.)
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'.

Solution:

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



- (i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or
- (ii) Its segment result whether profit or loss is 10% or more of:
 - (1) The combined result of all segments in profit; or
 - (2) The combined result of all segments in loss, whichever is greater in absolute amount; or
- (iii) Its segment assets are 10% or more of the total assets of all segments.

Accordingly,

- (a) On the basis of revenue from sales criteria, segment P is a reportable segment
- (b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of Rs. 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.



AS 18

Related Party Disclosures

Illustrations

1. Illustration

As a statutory auditor, how would you deal with the following?

A husband and wife are controlling 34% of voting power in XY Co. Ltd. They are having a separate partnership firm which supplies mainly the raw material to the company. The management says that the above transaction need not be disclosed.

Answer:

The husband and wife hold more than 20% of voting power and hence exercise significant influence over XY Co. Ltd. Hence, they are related parties as per AS-18. If the persons having significant influence over the reporting entity control or have significant influence over another entity, the other entity is also considered as a related party.

Hence, the partnership firm which is controlled by them is also a related party under AS-18.

If there is any transaction with related party,

- Name and nature of relationship needs to be disclosed.
- Transactions which occur during the existence of relationship party relationship needs to be disclosed.

Conclusion: The contention of management is not correct.

The treatment given by the company is not in accordance with AS-18 on Related Parties. The auditor (I) would issue a suitable modified report.

2. Illustration

Narmada Ltd. sold goods for Rs. 90 lakhs to Ganga Ltd. during financial year ended 31st March 2006. The managing director of Narmada Ltd owns 100% Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed 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 Accounting Standard. Is the Chief Accountant correct?

Answer:

As per AS-18, Key Management Personnel [KMP], Managing Director in this case, are considered to be related party. The enterprises controlled by KMP are also considered to be related parties. Since Ganga Ltd. is controlled by Managing Director, Narmada Ltd and Ganga Ltd are considered to be related parties. Disclosure of related parties transaction is required irrespective of the fact that the transactions are at market/normal prices.

Transactions of 90 lakhs happened between Narmada Ltd. and Ganga Ltd. The transaction is a related party transaction which requires disclosure.

Conclusion: The view of the chief accountant is not in line with AS-18. The transactions must be disclosed even if the transactions are at normal market prices.

3. Illustration

P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. [22325] Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd. How would you assess the situation from the viewpoint of AS 18 on Related Party Disclosures?

Answer:

A company has significant influence over another company if it enjoys at least 20% of voting rights. Since P Ltd enjoys voting right of 34% [14% directly and 20% thorough Q Ltd] in R Ltd, it exercises significant influence over R Ltd. As per AS-18 two parties are considered to be related if one exercises significant influence over the other.



Hence a related party relationship exists between P & R.

According to the disclosure requirements of AS-18, R Ltd. should disclose the relationship with P Ltd in its financial statements. The transactions with P Ltd. should also be disclosed.

4. Illustration

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

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

Answer:

Provision

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

Conclusion

Hence, Mr. Sumit, a relative of key management personnel should be identified as related party as at the closing date i.e., on 31.3.2018 as he received remuneration for his services in the company from 1st April, 2017 to 30th June, 2017 and this period comes under the reporting period.

5. Illustration

Identify the related parties as per AS-18:

Maya Ltd. holds 61 % shares of Sheetal Ltd. Sheetal Ltd. holds 51 % shares of Fair Ltd. Care Ltd. holds 49% shares of Fair Ltd.

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

Answer:

	Reporting entity- Maya Ltd.	Reporting entity- Sheetal Ltd.	Reporting entity- Fair Ltd.	Reporting entity- Care Ltd.
Related Parties	Sheetal Ltd. (subsidiary) Fair Ltd. (subsidiary)	Maya Ltd. (holding company) Fair Ltd. (subsidiary)	Maya Ltd. (holding company) Sheetal Ltd. (holding company) Care Ltd. (investor/ investing party)	Fair Ltd. (associate)

6. Illustration

Identify the related parties as per AS-18:

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

Answer:

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



AS 20

Earnings per Share

Illustrations

1. Illustration

Net profit for the year 2012: Rs.24,00,000

Weighted average number of equity shares outstanding during the year 2012: 10,00,000

Average Fair value of one equity share during the year 2012 : Rs.25.00

Weighted average number of shares under option during the year 2012: 2,00,000 Exercise price for shares under option during the year 2012 : Rs.20.00

Compute Basic and diluted earnings per share.

Answer:

Computation of Earning Per Share

	Earnings (Rs.)	Shares	Earnings per share
Net profit for the year 2012	24,00,000		
Weighted average number of shares outstanding during the year 2012		10,00,000	
Basic earnings per share			Rs. 2.40
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value: (2,00,000 × 20.00)/25.00		(1,60,000)	
Shares to be issued without consideration (considered diluting)		40,000	
Diluted earnings per share	24,00,000	10,40,000	Rs.2.31

*The earnings have not been increased and the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of computation to have been issued for no consideration.

2. Illustration

In April, 2010, A Limited issued 18,00,000 Equity shares of Rs. 10 each, Rs. 5 per share was called up on that date which was paid by all the shareholders. The remaining Rs. 5 was called up on 1-9-2010. All the Shareholders (except one having 3,60,000 shares) paid the sum in September 2010. The net profit for the year ended 31-3-2011 is Rs. 33 lakhs after dividend on preference shares and dividend distribution tax of Rs. 6.60 lakhs.

Compute the basic EPS for the year ended 31st March, 2011 as per AS 20

Answer:

Basic Earnings per share (EPS) = Net profit attributable to equity shareholders / Weighted Average number of Equity Shares

= Rs. 33,00,000 / 13,20,000 (working note) = Rs. 2.5 per share

Calculation of weighted average number of equity shares

As per para 19 of AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period.



Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share Rs.	WANES
1.4.2010	18,00,000	5	$18,00,000 \times 5/10 \times 5/12 = 3,75,000$
1.9.2010	14,40,000	10	$14,40,000 \times 7/12 = 8,40,000$
1.9.2010	3,60,000	5	$3,60,000 \times 5/10 \times 7/12 = 1,05,000$
	Total		13,20,000

*The information relating to preference dividend is not relevant as the same is already deducted to arrive at Net Profit.

3. Illustration

While calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during that period." Explain. Also calculate the diluted earnings per share from the following information:

- Net profit for the current year Rs. 85,50,000
- No. of equity shares outstanding 20,00,000
- No. of 8% convertible debentures of Rs. 100 each 1,00,000
- Each debenture is convertible into 10 equity shares
- Interest expenses for the current year Rs. 6,00,000
- Tax relating to interest expenses 30%

Answer:

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per para 26 of AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

The following items are adjusted in numerator -

- any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders (E.g preference dividend)
- interest recognised in the period for the dilutive potential equity shares; and (E.g interest on debentures)
- any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

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

Computation of diluted earnings per share = Adjusted net profit for the current year/ Weighted Average Number of Equity Shares

Adjusted net profit for the current year

Net profit for the current year (assumed to be after tax) 85,50,000

Add: Interest expense for the current year 6,00,000

Less: Tax relating to interest expense (30% of Rs. 6,00,000) 1,80,000

Adjusted net profit for the current year 89,70,000

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



Period for which debentures were outstanding = Rs. 6 lacs / 8 Lacs x 12 = 9 months

Time adjusted number of debentures to be considered in denominator = 10 lacs x 9/12 = 7.5 lacs
 Denominator for Diluted EPS = 20 lacs + 7.5 lacs = 27.5 lacs

Diluted Earnings Per Share = Rs. 89.7 lacs / 27.5 lacs = Rs. 3.26 / share

Interest on debentures for full year amounts to Rs. 8,00,000 (i.e. 8% of Rs. 1,00,00,000). However, interest expense amounting Rs. 6,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 9 months.

4. Illustration

Compute Basic Earnings per share from the following information:

Date	Particulars	No. of shares
1 st April, 2008	Balance at the beginning of the year	1,500
1 st August, 2008	Issue of shares for cash	600
31 st March, 2009	Buy Back of Shares	500

Net profit for the year ended 31st March, 2009 was Rs. 2,75,000.

Answer:

Computation of weighted average number of shares outstanding during the period

Date	No. of equity shares	Period Outstanding	Weight (months)	Weighted average number of shares
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1 st April, 2008	1,500 (Opening)	12 months	12/12	1,500
1 st August, 2008	600 (Additional)	8 months	8/12	400
31 st March, 2009	500 (buy back)	0 months	0/12	-
Total				1,900

Basic Earnings per share (EPS) = Net profit attributable to equity shareholders / Weighted average number of Equity Shares = Rs.2,75,000 / 1900 = Rs.144.74

5. Illustration

From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

	Rs. Cr
Profit before V.R.S. payments but after depreciation	75.00
Depreciation	10.00
VRS payments	32.10
Provision for taxation	10.00
Fringe benefit tax	5.00
Paid up share capital (shares of Rs. 10 each fully paid)	93.00



Answer:

Particulars	Amount in Cr.
Profit before VRS payments & Depreciation	75.00
(-) VRS payments	(32.10)
(-) Provision for tax	(10.00)
(-) Fringe benefit tax	(5.00)
Earnings available to Equity Shareholders	27.90

No of Equity shares = 9.3 Cr

EPS = Rs27.9 Cr / 9.3 Cr = Rs.3.00 per share

*Fringe Benefit tax is no longer applicable. It used to be a tax expense in the past.

6. Illustration

The following information is available for Raja Ltd for the year 09-10 and 10-11

- Net profit 09-10 – Rs.25 lacs; Net profit 10-11 – Rs.40 lacs
- Shares outstanding prior to rights issue: 12 lac shares.
- Right issue:
 - One new share for each three outstanding i.e. 4,00,000 shares Right issue price Rs. 22
 - Last date to exercise rights 30-6-2010
 - Fair value of one equity share immediately prior to exercise of rights on 30-6-2010 = Rs. 28.

You are required to compute the basic earnings per share for the years 2009-10 and 2010-11.

Answer:

Amounts in Rs. Lacs	09-10	10-11
(1) Earnings available to equity shareholders	25	40
(2) Weighted average number of shares	12 x 1.06 = 12.72 (W Note)	12/12 x 12.72 + 9/12 x 3.28 = 15.08
EPS (1/2)	1.97	2.64

1. Theoretical ex rights price (TERP) = $(3 \times \text{Rs. } 28 + 1 \times \text{Rs. } 22) / 4 = \text{Rs. } 26.5$
2. Right Adjustment ratio = Fair value before rights issue / TERP = $28 / 26.5 = 1.06$

7. Illustration

Net profit for the year 20X1 Rs. 18,00,000

Net profit for the year 20X2 Rs. 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.

Solution:

No. of Bonus Issue $20,00,000 \times 2 = 40,00,000$ shares

Earnings per share for the year 20X2 = $\text{Rs. } 60,00,000 / (20,00,000 + 40,00,000) = \text{Rs. } 1.00$



Adjusted earnings per share for the year 20X1 Rs. $18,00,000 / (20,00,000 + 40,00,000) = \text{Rs. } 0.30$

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 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:

Fair value per share immediately prior to the exercise of rights/Theoretical ex-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.

8. Illustration

Net profit for the year 20X1 Rs. 11,00,000

Net profit for the year 20X2 Rs. 15,00,000

.No. of shares outstanding prior to rights issue 5,00,000 shares

Rights issue price Rs. 15.00

Last date to exercise rights 1st March 20X2

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was Rs. 21.00. Compute Basic Earnings Per Share.

Solution:

(Fair value of shares immediately prior to exercise of rights + Total amount received from exercise)/(Number of shares outstanding prior to exercise + Number of shares issued in the exercise)

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

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

Computation of adjustment factor:

Fair value per share prior to exercise of rights/ Theoretical ex-rights value per share = $\text{Rs. } 21.00 / \text{Rs. } 20.00 = 1.05$

Computation of earnings per share:

EPS for the year 20X1 as originally reported: $\text{Rs. } 11,00,000 / 5,00,000 \text{ shares} = 2.20$

EPS for the year 20X1 restated for rights issue: $\text{Rs. } 11,00,000 / (5,00,000 \text{ shares} \times 1.05)$

= Rs. 2.10

EPS for the year 20X2 including effects of rights issue:

$(5,00,000 \times 1.05 \times 2/12) + (6,00,000 \times 10/12) = 5,87,500 \text{ shares}$

$\text{EPS} = 15,00,000 / 5,87,500 = \text{Rs. } 2.55$



9. Illustration

Net profit for the year 20X1	Rs. 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	Rs. 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	Rs. 15.00

Compute Basic and Diluted Earnings Per Share.

Solution:

Computation of earnings per share

	<i>Earnings</i>	<i>Shares</i>	<i>Earnings/Share</i>
	<i>Rs.</i>		<i>Rs.</i>
Net profit for the year 20X1	12,00,000		
Weighted average no. of shares during year 20X1		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at			
fair value (100,000 × 15.00)/20.00		<u>(75,000)</u>	
Diluted earnings per share	<u>12,00,000</u>	<u>5,25,000</u>	<u>2.29</u>

10. Illustration

NAT, a listed entity, as on 1st April, 20X1 had the following capital structure:

<i>Particulars</i>	<i>Rs.</i>
10,00,000 Equity Shares having face value of Rs. 1 each	10,00,000
10,00,000 8% Preference Shares having face value of Rs. 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.

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:

- 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.
- Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?



Solution

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

= Rs. 62.30 x 10,00,000 equity shares

= Rs. 6,23,00,000

Adjusted/Restated Earnings per share for the year ended 31st March 20X1:

(after taking into consideration bonus issue) Adjusted/Restated Basic EPS:

= Earnings for the year 20X0-20X1 / (Total outstanding shares + Bonus issue)

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

= Rs. 6,23,00,000 / 15,00,000

= Rs. 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)

= (Rs. 90,00,000 – Rs. (1,00,00,000 x 8%)) / (10,00,000 + 5,00,000 +

(2,00,000 x 3/12))

= Rs. 82,00,000 / 15,50,000 shares

= Rs. 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.

11. Illustration

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: Rs. 20,00,000
	:	Year 20X2: Rs. 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 – Rs. 20
		Last date of exercise rights– 31.3.20X2.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2	:	Rs. 25

Solution:

Computation of Basic Earnings Per Share

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

	Year 20X1	Year 20X2
	Rs.	Rs.
<i>EPS for the year 20X1 as originally reported</i>		
<i>Net profit of the year attributable to equity shareholders</i>		
<i>Weighted average number of equity shares outstanding during the year</i>		
= (Rs. 20,00,000 / 10,00,000 shares)	2.00	
<i>EPS for the year 20X1 restated for rights issue</i>		
= [Rs. 20,00,000 / (10,00,000 shares × 1.04 ¹)]	1.91	
<i>EPS for the year 20X2 including effects of rights issue</i>	(approx.)	
<i>Rs. 30,00,000</i>		
<i>(10,00,000 shares × 1.04 × 3/12) + (12,50,000 shares × 9/12)</i>		
<i>Rs. 30,00,000</i>		
<i>11,97,500 shares</i>		2.51 (approx.)

Working Notes:

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

(Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise) / (Number of shares outstanding prior to exercise + Number of shares issued in the exercise)

(Rs. 25 × 10,00,000 shares) + (Rs. 20 × 2,50,000 shares) / (10,00,000 shares + 2,50,000 shares)

Rs. 3,00,00,000 / 12,50,000 shares = Rs. 24

2. Computation of adjustment factor

= Fair value per share prior to exercise of rights / Theoretical ex-rights value per share

= Rs. 25 / Rs. 24 (Refer Working Note 1) = 1.04 (approx.)

12. Illustration

On 1st April, 20X1 a company had 6,00,000 equity shares of Rs. 10 each (Rs. 5 paid up by all shareholders). On 1st September, 20X1 the remaining Rs. 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 20X2 was Rs. 21,96,000 after considering dividend on preference shares of Rs. 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".

Solution:

Basic Earnings per share (EPS) =



Net profit attributable to equity shareholders / Weighted average number of equity shares outstanding during the year

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

Working Note:

Calculation of weighted average number of equity shares

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

<i>Date</i>	<i>No. of equity shares</i>	<i>Amount paid per share</i>	<i>Weighted average no. of equity shares</i>
	Rs.	Rs.	Rs.
1.4.20X1	6,00,000	5	$6,00,000 \times 5/10 \times 5/12 = 1,25,000$
1.9.20X1	5,40,000	10	$5,40,000 \times 7/12 = 3,15,000$
1.9.20X1	60,000	5	$60,000 \times 5/10 \times 7/12 = 17,500$
Total weighted average equity shares			<u>4,57,500</u>

13. Illustration

Following information is supplied by K Ltd.:

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - Rs. 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 Rs. 102.

Net Profit to equity shareholders:

20X1-20X2 - Rs. 50,00,000

20X2-20X3 -Rs. 75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earnings per Share.

Solution:

(Fair value of shares immediately prior to exercise of rights + Total amount received from exercise) / (Number of shares outstanding prior to exercise + Number of shares issued in the exercise)

$$(102 \times 2,50,000 \text{ Shares}) + (\text{Rs. } 98 \times 1,00,000 \text{ shares}) / 3,50,000 \text{ shares}$$

Theoretical ex-rights fair value per share = Rs. 100.86

Computation of adjustment factor:

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

Computation of earnings per share:

$$\text{EPS for the year 20X1-X2 as originally reported: Rs. } 50,00,000/2,50,000 \text{ shares} = \text{Rs. } 20$$



EPS for the year 20X1-X2 restated for rights issue: =Rs. 50,00,000/ (2,50,000 shares x 1.01) = Rs. 19.80

EPS for the year 20X2-X3 including effects of rights issue: EPS = 75,00,000/3,25,625* = Rs. 23.03

* $[(2,50,000 \times 1.01 \times 3/12) + (3,50,000 \times 9/12)] = 63,125 + 2,62,500 = 3,25,625$ shares

Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.



AS 24 Discontinuing Operations

Illustrations

1. Illustration

A cosmetic article producing company provides the following information [Units per month]

Month	Cold Cream	Vanishing Creams
Jan – Sep 2006	2,00,000	2,00,000
Oct – Dec 2006	1,00,000	3,00,000
Jan – Mar 2007	0	4,00,000

The company has forced gradual change in product line on the basis of an overall plan. The board of directors of the company has passed a resolution in March 2006 to this effect. The company follows calendar year as its accounting year. Should this be treated as discontinuing operations? Give reasons in support of your answer.

Answer: As per AS 24, gradual or evolutionary phasing out of a product line or class of service is not considered to be discontinuance.

In the given case, the company has downsized the production of cold cream and increased the production of vanishing cream. Reduction of production of cold cream alone does not amount to discontinuing operation.

Conclusion : Hence, the given case of changeover cannot be considered as discontinuance.

2. Illustration

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

You are required to comment:

- (i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.
- (ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?
- (iii) Would your answer to (ii) above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

Solution:

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

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

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

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



- (iii) terminating through abandonment; and
- (b) that represents a separate major line of business or geographical area of operations; and
- (c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation

as defined under AS 24, 'Discontinuing Operations'.

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

- (i) Gradual or evolutionary phasing out of a product line or class of service;
 - (ii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
 - (iii) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.
- (ii) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

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

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

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



AS 25
Interim Financial Reporting
Illustrations

1. Illustration

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

Quarter	Period Ending	Sales %
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:

Particulars	Amount (₹ Crores)
Sales	80
Salary and Other Expenses	60
Advertisement Expenses (Routine)	4
Administrative and Selling Expenses	8

While preparing interim financial report for first quarter Sincere Corporation wants to defer

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

Solution

Results of First Quarter ended 30 th June 20X1	
Turnover	80
Other Income	Nil
Total (a)	80
Less: Changes in inventory	Nil
Salaries and other cost	60
Admin & Selling expenses	12
Total (b)	72
Profit (a-b)	8

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

2. 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:

Quarter	Period Ending	Income (Rs. Crores)
1st quarter	31st December, 20X0	200
2nd quarter	31st March, 20X1	200
3rd quarter	30th June, 20X1	200
4th quarter	30th September, 20X1	200
Total		800



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.

Solution:

Quarter	Period Ending	Income (₹ Crores)	Applicable Tax Rate	Tax Expense (₹ Crores)
Q1	31-Dec-20X0	200	20% (FY 20X0-20X1)	40
Q2	31-Mar-20X1	200	20% (FY 20X0-20X1)	40
Q3	30-Jun-20X1	200	30% (FY 20X1-20X2)	60
Q4	30-Sep-20X1	200	30% (FY 20X1-20X2)	60
Total		800		200

3. Illustration

Accountants of Poornima Ltd. showed a net profit of Rs. 7,20,000 for the third quarter of 20X1 after incorporating the following:

- (i) Bad debts of Rs. 40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
- (ii) Extraordinary loss of Rs. 35,000 incurred during the quarter has been fully recognized in this quarter.
- (iii) Additional depreciation of Rs. 45,000 resulting from the change in the method of charge of depreciation assuming that Rs. 45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

Solution

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 Rs. 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) Rs. 20,000 to the next quarter. Therefore, Rs. 20,000 should be deducted from Rs. 7,20,000. The treatment of extra-ordinary loss of Rs. 35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of Rs. 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 Rs. 7,00,000 (Rs. 7,20,000 – Rs. 20,000).

4. Illustration

Intelligent Corporation (ICorp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

Quarter I	II	III	IV
Ending 30th June 15%	30th September 15%	31st December 50%	31st March 25%

For the First quarter ending 30th June, 20X1, ICorp. gives you the following information:

	Rs. 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 Rs. 21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, third quarter should be debited by higher expenditure, considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

Solution

Result of the first quarter ended 30th June, 20X1

	(Rs. 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)	<u>10</u>
Profit	<u>10</u>

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

- it is appropriate to anticipate that type of cost at the end of the financial year, and
- costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of Rs. 21 crores is not tenable as expenditures are uniform throughout all quarters.

5. Illustration

On 30th June, 20X1, Asmitha Ltd. incurred Rs. 2,00,000, net loss from disposal of a business segment. Also, on 31st July, 20X1, the company paid Rs. 60,000 for property taxes assessed for the calendar year 20X1. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 20X1.

Solution:

According to 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 Rs. 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 Rs. 60,000 Property tax payment relates to entire calendar year 20X1, Rs. 30,000 would be reported as an expense for six months ended on 30th September, 20X1 while out of the remaining Rs. 30,000, Rs. 15,000 for January, 20X1 to March, 20X1 should be shown as payment of the outstanding amount of previous year and another Rs. 15,000 related to quarter October, 20X1 to December, 20X1 would be reported as prepaid expenses.

6. Illustration

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

Calculate the tax expense to be recognized in each quarter.

Solution

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

	Rs.
Estimated Annual Income (A)	<u>10,00,000</u>
Tax expense:	
30% on Rs. 5,00,000	1,50,000
40% on remaining Rs. 5,00,000	<u>2,00,000</u>
(B)	<u>3,50,000</u>

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

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

7. Illustration

11. Antarbarti Limited reported a Profit Before Tax (PBT) of Rs. 4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:

- Dividend income of Rs. 4 lakhs received during the quarter has been recognized to the extent of Rs. 1 lakh only.
- 80% of sales promotion expenses Rs. 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.
- In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of Rs. 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only Rs. 3 lakhs.
- Rs. 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.
- Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of Rs. 3 lakhs. Out of this loss Rs. 1 lakh relates to previous quarters.



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

Prepare the adjusted profit before tax for the third quarter.

Solution

As per AS 25 "Interim Financial Reporting", **seasonal or occasional revenue and cost** within a **financial year** should **not be deferred** as of **interim date** until it is appropriate to defer at the **end of the enterprise's financial year**. Therefore, **dividend income, extraordinary 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

Particulars	Amount (Rs. in lakhs)
Profit before tax (as reported)	4
Add: Dividend income (4 – 1)	3
Excess depreciation charged in 3rd quarter (due to change in method)	0
Extraordinary gain (2 – 1)	1
Cumulative loss due to change in inventory valuation (applied retrospectively) (3 – 2)	1
Subtotal	9
Less: Sales promotion expenses (80% of 15)	(12)
Less: Gain on sale of investment (occasional gain not deferred)	(5)
Adjusted Profit before tax for 3rd quarter	(8)

- Dividend income and extraordinary gains are **recognized in the same quarter** as per **AS 25**.
- Excess depreciation is **not adjusted** because AS 25 treats **change in accounting estimate prospectively**.
- Sales promotion and occasional gains are treated **in the quarter incurred**.



AS 28 IMPAIRMENT OF ASSETS

1. Illustration

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at Rs. 500 lakhs. As at that date the value in use is Rs. 400 lakhs and the net selling price is Rs. 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

(i) Recoverable amount is higher of value in use Rs. 400 lakhs and net selling price Rs. 375 lakhs.

$$\begin{aligned}\text{Recoverable amount} &= \text{Rs. 400 lakhs} \\ \text{Impairment loss} &= \text{Carried Amount} - \text{Recoverable amount} \\ &= \text{Rs. 500 lakhs} - \text{Rs. 400 lakhs} = \text{Rs. 100 lakhs.}\end{aligned}$$

(ii) Journal Entries

Rs. lakhs

	Particulars	Dr.	Cr.
(i)	Impairment loss account Dr. To Provision for Accumulated Impairment Loss Account (Being the entry for accounting impairment loss)	100	100
(ii)	Profit and loss account Dr. To Impairment loss (Being the entry to transfer impairment loss to profit and loss account)	100	100

(iii) Balance Sheet of Venus Ltd. as on 31.3.20X1

	(Rs. in lakhs)
PPE	
Asset less depreciation	500
Less: Impairment loss	(100)
	<u>400</u>

2. Illustration

From the following details of an asset

i. Find out impairment loss

ii. Treatment of impairment loss

iii. Current year depreciation

Particulars of asset:

Particulars	Amount (Rs. lakhs)
Cost of Asset	56.00
Useful Life Period	10 years
Salvage Value	Nil
Current Carrying Value	27.30
Useful Life Remaining	3 years
Recoverable Amount	12.00
Upward Revaluation Done in Last Year	14.00

Answer

According to AS 28 "Impairment of Assets", an impairment loss on an revalued asset is charged to revaluation surplus available. Any excess of loss over and above the revaluation surplus is charged to profit and loss.

Particulars	Amount (Rs.)
Current carrying amount (including revaluation amount of Rs. 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 & Loss Account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to Rs. 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 Rs. 4,00,000.

3. 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 (Rs. in lakhs)
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000

Residual value at the end of 20X6 = Rs. 1000 lakhs

Property, Plant and Equipment purchased on 1-1-20XX = Rs. 40,000 lakhs

Useful life = 8 years

Net selling price on 31-12-20X1 = Rs. 20,000 lakhs

Calculate on 31-12-20X1:

- Carrying amount at the end of 20X1
- Value in use on 31-12-20X1
- Recoverable amount on 31-12-20X1
- Impairment loss to be recognized for the year ended 31-12-20X1
- Revised carrying amount
- Depreciation charge for 20X2.

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

Answer

Calculation of value in use

Year	Cash Flow (Rs. in lakhs)	Discount as per 15%	Discounted cash flow
20X2	4000	0.870	3,480
20X3	6000	0.756	4,536
20X4	6000	0.658	3,948
20X5	8000	0.572	4,576
20X6	4000	0.497	1,988
20X6(residual)	1,000	0.497	497
			19,025

(a) Calculation of carrying amount:

Original cost = Rs. 40,000 lakhs

Depreciation for 3 years = $[(40,000 - 1000) \times 3/8]$ = Rs. 14,625 lakhs

Carrying amount on 31-12-20X1 = $[40,000 - 14,625]$ = Rs. 25,375 lakhs

(b) Value in use = Rs. 19,025 lakhs

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

Recoverable amount = Rs. 20,000 lakhs

(d) **Impairment Loss** = Rs. (25,375 - 20,000) = Rs. 5,375 lakhs

(e) **Revised carrying amount** = Rs. (25,375 - 5,375) = Rs. 20,000 lakhs

(f) **Depreciation charge for 20X2** = $(20,000 - 1000)/5$ = Rs. 3,800 lakhs



4. Illustration

X Ltd. is having a plant (asset) carrying amount of which is Rs. 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is Rs. 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (Rs. 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 Rs. 60 lakhs.

Answer

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53
31.3.20X5	20	0.683	13.66
31.3.20X6	25	0.621	15.525
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.945

If net selling price of plant on 31.3.20X1 is Rs. 60 lakhs, the recoverable amount will be higher of Rs. 121.92 lakhs (value in use) and Rs. 60 lakhs (net selling price), hence recoverable amount is Rs. 121.92 lakhs.

5. Illustration

G Ltd., acquired a machine on 1st April, 20X0 for Rs. 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at Rs. 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs. 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.

Answer

Statement Showing Impairment Loss

	(Rs. in crores)
Carrying amount of the machine as on 1st April, 20X0	7.00
Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\frac{7 \text{ crores}}{7 \text{ years}} \times 4 \text{ years}$	(4.00)
Carrying amount as on 31.03.20X4	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April, 20X4 (revalued)	5.10
Less: Depreciation for 2 years i.e. 20X4-20X5 & 20X5-20X6 $\frac{5.1 \text{ crores}}{3 \text{ years}} \times 2 \text{ years}$	(3.40)
Carrying amount as on 31.03.20X6	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.20X6:	
Balance in revaluation reserve as on 31.03.20X4	2.10
Less: Enhanced depreciation met from revaluation reserve 20X4-20X5 & 20X5-20X6 = $[(1.70 - 1.00) \times 2 \text{ years}]$	(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

6. Illustration

X Ltd. purchased a Property, Plant and Equipment four years ago for Rs. 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 Rs. 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 Rs. 67.50 lakhs and expected disposal costs are Rs. 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 Rs. 60 lakhs?

Answer

Computation of impairment loss

Particulars	Amount (Rs. lakhs)	Notes
Purchase Price of PPE	150.00	Original cost
Less: Depreciation (4 years × 10% SLM)	(60.00)	150 × 10% × 4
Carrying Amount before Revaluation	90.00	150 – 60
Less: Downward Revaluation charged to P&L	(15.00)	As per revaluation
Carrying Amount after Revaluation	75.00	90 – 15
Net Selling Price	64.50	Market value 67.50 – Disposal costs 3
Value in Use	60.00	Estimated by management
Recoverable Amount	64.50	Higher of Net Selling Price and Value in Use
Impairment Loss	10.50	75 – 64.50
Adjusted Carrying Amount (Post Impairment)	64.50	Carrying amount reduced to recoverable amount

Accounting Treatment:

- Impairment loss of **Rs. 10.50 lakhs** should be **recognized immediately in the Statement of Profit and Loss**.
- No adjustment needed for previous downward revaluation already charged to P&L

7. Illustration

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 Rs. 6,00,000. The estimated cost of destroying the asset is Rs. 70,000. How is the asset to be accounted for?

Answer

As per **AS 28 – Impairment of Assets**, an **impairment loss** arises when the **carrying amount exceeds the recoverable amount**, where recoverable amount is the **higher of net selling price and value in use**.

In this case, the **recoverable amount** is **nil**, since the **value in use is zero** and the **net selling price is negative Rs. 70,000** (due to disposal costs). Therefore, the **impairment loss** is **Rs. 6,00,000** (carrying amount – recoverable amount), which should be **recognized immediately as an expense in the Statement of Profit and Loss** as per **AS 28**.

Further, according **AS 28**, when the **estimated impairment loss exceeds the carrying amount**, a **liability** should be recognized only if required by another Accounting Standard. Consequently, the entity should recognize a **liability of Rs. 70,000 for the cost of disposal** in accordance with **AS 10 & AS 29**.



8. Illustration

A plant was acquired 15 years ago at a cost of Rs. 5 crores. Its accumulated depreciation as at 31st March, 20X1 was Rs. 4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is Rs. 25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was Rs. 30 lakhs, which is expected to decline by 20 percent by the end of the next financial year. Its value in use has been computed at Rs. 35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

- 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?
- How much will be the amount of write off for the financial year ended 31st March, 20X2?
- If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be Rs. 12 lakhs, how would you answer to questions (i) and (ii) above?
- If the value in use was zero and the enterprise were required to incur a cost of Rs. 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

Answer

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 Rs. 24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

Particulars	Amount (Rs. lakhs)
Opening Book Value as on 1.4.20X1	85.00
Less: Depreciation for FY 20X1-20X2	(25.00)
Closing Book Value as on 31.3.20X2	60.00
Estimated Net Selling Price as on 1.4.20X1	30.00
Less: Estimated decrease during year (20% of 30)	(6.00)
Estimated Net Selling Price as on 31.3.20X2	24.00
Estimated Value in Use as on 1.4.20X1	35.00
Less: Estimated decrease during year (30% of 35)	(10.50)
Estimated Value in Use as on 31.3.20X2	24.50
Recoverable Amount	24.50
ii. Impairment Loss (60-24.5) to be charged to PL	35.5
i. Carrying amount after impairment	24.50
iii. If revalued earlier	
Amount transferred to Revaluation reserve	12.00
Amount Debited to P&L	23.5

(iv) If Value in Use = 0:		
Value in use (a)	Nil	Given
Net selling price (b)	Nil / (-2.00)	After adjustment, if any
Recoverable Amount (higher of a & b)	Nil	Nil
Carrying amount (closing book value)	60.00	Original book value
Impairment loss (write-off)	60.00	Entire book value written off and charged to P&L



9. Illustration

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for Rs. 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 Rs. 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 Rs. 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 Rs. 54 crore per annum and has a carrying amount of Rs. 3.46 crore. All such machines put together could fetch a sum of Rs. 4.44 crore if disposed. Discuss the applicability of Impairment loss.

Answer

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

10. Illustration

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

Answer

Impairment of assets, as per **AS 28 – Impairment of Assets**, prescribes the procedures that an enterprise must apply to ensure that its assets are carried at no more than their **recoverable amount**. An asset is considered **impaired** when its **carrying amount exceeds the recoverable amount**, which is the higher of the **net selling price** and its **value in use**. If the carrying amount is less than or equal to the recoverable amount, the asset is not impaired. The **impairment loss** is calculated as the **difference between carrying amount and recoverable amount** and is recognized immediately in the **Statement of Profit and Loss**.

However, **AS 28 does not apply to inventories**, which are covered under **AS 2 – Valuation of Inventories**, as well as to assets arising from construction contracts (AS 7), financial assets including investments (AS 13), and deferred tax assets (AS 22), because these standards already provide specific guidance for recognizing and measuring impairment. For **inventories**, the applicable standard requires writing them down to **net realizable value**, which is effectively the recognition of impairment, ensuring that the assets are not overstated on the balance sheet.

11. Illustration

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

It is likely that the **recoverable amount** of an **individual magazine title** can be assessed. Although advertising income is influenced to some extent by other titles in the customer segment, **cash inflows from direct sales and advertising are identifiable for each title**. Further, while titles are managed by segments, decisions to **abandon titles are**



made individually. Therefore, each **individual magazine title** generates **cash inflows largely independent of other titles**, making each title a **separate cash-generating unit**.

12. Illustration

At the end of 20X0, enterprise M acquired 100% of enterprise Z for Rs. 3,000 lakhs. Z has 3 cash-generating units A, B and C with net fair values of Rs. 1,200 lakhs, Rs. 800 lakhs and Rs. 400 lakhs respectively. M recognises goodwill of Rs. 600 lakhs (Rs. 3,000 lakhs less Rs. 2,400 lakhs) that relates to Z.

At the end of 20X4, A makes significant losses. Its recoverable amount is estimated to be Rs. 1,350 lakhs. Carrying amounts are detailed below (Rs. In Lakh).

End of 20X4	A	B	C	Goodwill	Total
Net carrying amount	1300	1200	800	120	3420

Scenario A - Goodwill Can be Allocated on a Reasonable and Consistent Basis

On the date of acquisition of Z, the net fair values of A, B and C are considered a reasonable basis for a pro-rata allocation of the goodwill to A, B and C.

Allocation of goodwill at the end of 20X4:

	A	B	C	Goodwill
End of 20X0				
Net fair values	1200	800	400	2400
Pro-Rata	50%	33%	17%	100%
End of 20X4				
Net carrying amount	1300	1200	800	3300
Allocation of goodwill (Using pro rate above)	60	40	20	120
Net carrying amount (After goodwill)	1360	1240	820	3420

In accordance with the 'bottom-up' test in paragraph 78(a) of AS 28, M compares A's recoverable amount to its carrying amount after the allocation of the carrying amount of goodwill:

End of 20X4	A (Rs. In Lakh)
Carrying amount after allocation of goodwill	1360
Recoverable amount	1350
Impairment loss	10

M recognises an impairment loss of Rs. 10 lakhs for A. The impairment loss is fully allocated to the goodwill in accordance with paragraph 87 of AS 28.

Scenario B - Goodwill Cannot be Allocated on a Reasonable and Consistent Basis

There is no reasonable way to allocate the goodwill that arose on the acquisition of Z to A, B and C. At the end of 20X4, Z's recoverable amount is estimated to be Rs. 3,400 lakhs.

At the end of 20X4, M first applies the 'bottom-up' test in accordance with paragraph 78(a) of this Statement. It compares A's recoverable amount to its carrying amount excluding the goodwill.

End of 20X4	A (Rs. In Lakh)
Carrying amount	1300
Recoverable amount	1350
Impairment loss	0

Therefore, no impairment loss is recognised for A as a result of the 'bottom-up'



test.

Since the goodwill could not be allocated on a reasonable and consistent basis to A, M also performs a 'top-down' test in accordance with paragraph 78(b) of AS 28. It compares the carrying amount of Z as a whole to its recoverable amount (Z as a whole is the smallest cash-generating unit that includes A and to which goodwill can be allocated on a reasonable and consistent basis).

Application of the 'top-down' test

(Amount in Rs. lakhs)

End of 20X4	A	B	C	Goodwill	Total
Carrying amount	1300	1200	800	120	3420
Impairment loss arising from the 'bottom-up' test	0	-	-	-	0
Carrying amount after the 'bottom-up' test	1300	1200	800	120	3420
Recoverable amount	-	-	-	-	3400
Impairment loss arising from 'top-down' test	-	-	-	-	20

Therefore, M recognises an impairment loss of Rs. 20 lakhs that it allocates fully to goodwill in accordance with paragraph 87 of AS 28.



PREPARATION OF FINANCIAL STATEMENTS

Illustrations

1. 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	Rs.	Particulars	Rs.
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
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.

Solution:

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

	Schedule No. (1)	Rupees as at the end of 31st March 20X1 (2)
Equity and Liabilities		
(1) Shareholders' funds :		
(a) Share Capital	1	25,00,000



(b) Reserves and Surplus	2	7,40,000
(2) Non Current Liabilities		
(a) Long term borrowings	3	11,45,000
(3) Current Liabilities		
(a) Trade payables		2,81,000
Total		46,66,000

Assets

(1) Non current assets		
(a) PPE	4	30,05,000
(b) Intangible assets (goodwill)		2,65,000
(2) Current assets		
(a) Inventories		8,23,000
(b) Trade receivables		4,40,000
(c) Cash and bank balances	5	53,000
(d) Short term loans and advances	6	80,000
Total		46,66,000

Haria Chemicals Ltd.**Statement of Profit and Loss for the year ended 31st March, 20X1**

		Schedule	Figures	
Revenue from operations			42,68,000	
Other income		7	<u>56,000</u>	
	(A)		43,24,000	
Expenses				
Cost of materials consumed			23,19,000	
Change in inventory of finished goods	goods	8	(1,43,000)	
Employee benefit expenses		9	9,00,000	
Finance cost		10	1,71,000	
Other expenses		11	<u>4,76,000</u>	
	(B)		<u>37,23,000</u>	
Profit before tax (A – B)				6,01,000
Provision for tax				—
Profit for the period				6,01,000

Notes to Accounts

1. Share capital	Rs.
Authorised:	
Equity share capital of Rs. 10 each	<u>25,00,000</u>
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	<u>6,01,000</u>
	<u>7,40,000</u>
3. Long term Borrowings	
11% Debentures	5,00,000



Bank loans (assumed long-term)		<u>6,45,000</u>
		<u>11,45,000</u>
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
Tools & Equipment	<u>2,45,000</u>	<u>2,45,000</u>
Total	31,51,000	1,46,000
		30,05,000
5. Cash and bank balances		
Cash and cash equivalents		
Current account balance		45,000
Cash		8,000
Other bank balances		<u>Nil</u>
		<u>53,000</u>
6. Short-term loans and Advances		
Loan to directors		80,000
7. Other Income		
Rent received		46,000
Transfer fees		<u>10,000</u>
		<u>56,000</u>
8. Changes in inventory of finished goods, WIP & Stock in trade		
Opening inventory	6,80,000	
Closing inventory	<u>(8,23,000)</u>	<u>(1,43,000)</u>
9. Employee benefit expense		
Wages		9,00,000
10. Finance cost		
Interest on bank loans		1,16,000
Debenture interest		<u>55,000</u>
		<u>1,71,000</u>
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		<u>54,000</u>
		<u>4,76,000</u>



2. Illustration

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

(Figures in Rs.'000)

Particulars	Debit Rs.	Particulars	Credit Rs.
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:

- The authorised share capital of the company is 40,000 shares of Rs. 10 each.
- The company on the advice of independent valuer wish to revalue the land at Rs. 3,60,000.
- Declared dividend @ 10%. [Case i) 30th March ii) 2nd April]**
- 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.
- 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.

Solution: Illustration 1

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	500
2. Non-Current liabilities		
A Long term borrowings	3	200
3. Current liabilities		
A Trade Payables		52
B Other Current Liabilities	4	30
Total		1082
Assets		
1. Non-current assets		
A PPE (Property, Plant & Equipment)	5	880
2. Current assets		
A Inventories		86
B Trade receivables		96



C	Cash and bank balances	6	20
	Total		1082

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

Particulars	Notes	(₹ in 000)
I. Revenue from operations		700
II Other Income (WN)	7	2
III Total Revenue (I + II)		702
IV Expenses:		
Purchases of stock – in – Trade* (WN)		406
Changes in inventories		(86)
Finance Cost	8	20
Depreciation on Plant and Machinery	9	76
Other Expenses	10	120
Total Expenses		536
V. Profit (Loss) for the period (III – IV)		166

Notes to accounts

			(₹ in 000)
1. Share Capital			
Equity share capital			
Authorised:			
40,000 shares of ₹10 each			400
Issued & subscribed & called up			
30,000 shares of ₹10 each			300
2. Reserves and Surplus			
Securities Premium Account			40
General reserve			130
Revaluation reserve	(360 – 220)		140
Profit & loss (Surplus)			
Opening balance	72		
Add: Profit for the period	166	238	
Less: Interim Dividend		(18)	
Final Dividend*		(30)	190
[*If declared after 31 st March, not provided]			500
3. Long term borrowing			
10% Debentures			200
4. Other Current Liabilities			
Dividend Payable*			30
5. PPE (Tangible Assets)			
Land			
Opening balance		220	
Add: Upward Revaluation		140	
Closing balance			360
Plant and Machinery			
Cost (Working Note)		760	
Less: Accumulated Depreciation		(240)	520
Total			880
6. Cash and Cash Equivalence			
Balance with Bank			20
7. Other Income			
Gain on Sale of Plant & Machinery (WN)			2
8. Finance Cost			



	Debenture Interest		20
9.	Depreciation on Plant and Machinery		76
10.	Other Expenses		
	Factory expenses	60	
	Selling expenses	30	
	Administrative expenses	<u>30</u>	120

Note: It is Assumed that Dividend is declared prior to 31st March.

If it is assumed that Dividend is declared after the Financial year, then Final Dividend is not required to be provided for.

Working Note:

1)

Plant and Machinery Account (At Cost)

Particulars	(₹ in 000)	Particulars	(₹ in 000)
To Balance b/d	770	By Asset Disposal A/c	10
		By Balance C/d	760
	770		770

Accumulated Depreciation A/c

Particulars	(₹ in 000)	Particulars	(₹ in 000)
To Asset Disposal A/c	8	By Balance b/d	172
To Balance C/d	240	By Depreciation	76
	248		248

Asset Disposal A/c

Particulars	(₹ in 000)	Particulars	(₹ in 000)
To Plant and Machinery	10	By Accumulated Depreciation	8
To Gain on Sale of P&M	2	By Suspense	4
	12		12

2)

Adjusted Purchases	320
Closing Stock*	86
Purchases (Gross)	406

Assumed there is no stock at beginning

3. Illustration

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

Particulars	Debit	Credit
Authorized Capital - divided into 5,000 6% Preference Shares of Rs.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 Equity Capital		5,00,000 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 Coolage	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	
Stock on hand, 1st April, 2011:		
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
Sundry Creditors		42,000
Sundry Debtors	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	
Stock on 31st March, 20X2:		
Wines Cigarettes and Cigars, etc.	22,500	
Foodstuffs	16,400	

- Depreciation : Furniture and Fittings @ 5% p.a.: Land & Buildings @ 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 propose a dividend of 8% on equity shares, transferring any amount that may be required from General Reserve.
- Ignore Taxation

Solution: Illustration 2

Balance Sheet of International Hotels Ltd. as at 31st March, 20X2

Particulars		Note No.	₹
Equity and Liabilities			
1. Shareholders' funds			
i Share capital	1		13,00,000
ii Reserves and Surplus	2		1,74,745
2. Non-Current liabilities			
i Long term borrowings	3		2,00,000
3. Other Current liabilities			
i Trade Payables			42,000
ii Other Current Liabilities	4		1,07,280
Total			18,24,025
Assets			
1. Non-current assets			
i PPE (Property, Plant & Equipment)	5		9,14,985
ii Intangible Assets	6		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 Cash Equivalents	8	<u>78,580</u>
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	1,83,200
II.	Other income (Discount received)	10	3,300
III.	Total Revenue (I + II)		1,86,500
IV.	Expenses:		
	Cost of materials consumed	11	25,060
	Purchases of Stock-in-Trade	12	45,800
	Changes in inventories	13	(9,700)
	Employee benefits expense	14	29,580
	Finance costs	15	12,000
	Depreciation and Amortization expense	5	21,315
	Other Expenses	16	40,200
	Total Expenses		1,64,255
V.	Profit Before Tax (III - IV)		22,245

Notes to accounts

			(₹)
1. Share Capital			
Share capital			
Authorised:			
5,000 6% preference of ₹100			5,00,000
10,000 shares of ₹100 each			<u>10,00,000</u>
			<u>15,00,000</u>
Issued, subscribed & fully paid up			
5,000 6% preference of ₹100			5,00,000
8,000 shares of ₹100 each			<u>8,00,000</u>
			13,00,000
2. Reserves and Surplus			
Capital Reserve (100 x (90 - 40))			5,000
Securities Premium Account			
General reserve			
Opening Balance		2,00,000	
Less: Transferred to P&L		(30,255)	1,69,745
Profit & loss (Surplus)			
Opening balance	41,500		
Add: Profit for the period	22,245		
Add: Balance from General Reserve	30,255	94,000	
Less: Dividend declared		(94,000)	--
Total			1,74,745
3. Long term borrowing			
6% Debentures			2,00,000
4. Other Current Liabilities			
Dividend Payable		1,280	
Interest Payable		12,000	
Dividend Payable		94,000	1,07,280
Total			
6. Intangible Assets			
Goodwill			5,00,000
7. Inventories			
Wines, Cigarettes & Cigars, etc (Finished Goods)		22,500	
Foodstuffs (Raw Material)		16,400	
Total			38,900



8. Cash and Cash Equivalents		
Cash in hand	2,200	
Cash at bank	76,380	
Total		78,580
9. Revenue from operations		
Sale of products		
- Wines, Cigarettes, Cigars etc.	68,400	
- Food	<u>57,600</u>	1,26,000
Sale of services		
- Room Rent	48,000	
- Billiards	5,700	
- Transfer fees	700	
- Miscellaneous Receipts	<u>2,800</u>	57,200
Total		1,83,200
10. Other Income		
- Discount		3,300
11. Cost of Material Consumed		
Opening Inventory	5,260	
Add: Purchases during the year	36,200	
Less: Closing Inventory	<u>(16,400)</u>	
Total		25,060
12. Purchases of Inventory-in-Trade		
Wines, Cigarettes etc.		45,800
13. Changes in inventories of finished goods work-in-progress and Inventory-in-Trade		
Opening Inventory	12,800	
Less: Closing Inventory	<u>(22,500)</u>	(9,700)
14. Employee benefits expense		
Wages and Salaries	28,300	
Add: Wages and Salaries Outstanding	<u>1,280</u>	29,580
15. Finance costs		
Interest on Debentures (2,00,000 x 6%)		12,000
16. Other Expenses:		
- Rent Rates and Taxes	8,900	
- Laundry	750	
- Coal and Firewood	3,290	
- Carriage and Cooliage	810	
- Sundry Expenses	5,840	
- Advertising	8,360	
- Repairs	4,250	
- Preliminary Expenses	<u>8,000</u>	40,200

Note – 5: PPE (Property, Plant & Equipment)

	Assets	01/04/X1	Depreciation	31/03/X2
1.	Land and Building (2% of 8,50,000)	8,50,000	17,000	8,33,000
2.	Furniture and Fixtures. (5% of 86,300)	86,300	4,315	81,985
			21,315	9,14,985
			P&L	B/S

Working Note:**1) Equity Share Capital**

Opening Paid up 6,000 @ ₹100	₹6,00,000
2,000 @ ₹60	₹1,20,000
Called up (20 x 2) 2,000 @ 40	
Amount Received 1,900 @ 40	<u>₹76,000</u>
	₹7,96,000



Reissue of forfeited Shares @₹90 (100 × 90)	<u>₹9,000</u>
	₹8,05,000

2) Dividend Payable

- Pref shares 6% of 50 Lakh = ₹30,000
 - Equity Shares 8% of 8 Lakh = ₹64,000
- = ₹94,000

Amount Available in P&L (₹63,745)

Shortfall = ₹30,255

			(₹)
1. Share Capital			
Share capital			
Authorised, subscribed & Called up			
10,000 shares of ₹100 each (Out of above, 2,000 shares have been issued for consideration other than cash)	10,00,000		
Less: Calls in arrears	<u>(1,000)</u>		9,99,000
2. Reserves and Surplus			
General Reserve	2,10,000		
Profit & loss (Surplus)	<u>86,700</u>		2,96,700
3. Long term borrowing			
Secured			2,00,000
Term Loans			
Loan from State Financial Corporation (1,50,000 – 7,500) (Secured by hypothecation of Plant and Machinery)			1,42,500
4. Other Current Liabilities			
Interest Accrued (not due)	7,500		
Dividend Payable	<u>60,000</u>		67,500
5. Short-term provisions			
Provision for taxation			68,000
Goodwill			5,00,000
7. Inventories			
Raw Material	50,000		
Finished Goods	<u>2,00,000</u>		2,50,000
8. Trade receivables			
Amount Receivable more than 6 months	52,000		
Others (Bal. fig)	<u>1,48,000</u>		2,00,000
9. Cash and cash Equivalents			
Cash at Bank	2,47,000		
Cash in hand	<u>30,000</u>		2,77,000
- Rent Rates and Taxes	8,900		
- Laundry	750		
- Coal and Firewood	3,290		
- Carriage and Cooliage	810		
- Sundry Expenses	5,840		
- Advertising	8,360		
- Repairs	4,250		
- Preliminary Expenses	<u>8,000</u>		40,200

4. 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 notes at the foot of the Balance Sheet as may be found necessary –



		Assets (Rs.)	Liabilities (Rs.)
Equity Capital (Face value of Rs.100) Calls in Arrears		1,000	10,00,000
Land		2,00,000	
Building		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Inventory:			
Finished Goods	2,00,000		
Raw Materials	<u>50,000</u>	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:

- 2,000 equity shares were issued for consideration other than cash.
- Trade receivables of Rs.52,000 are due for more than six months.
- The cost of assets:

Building	Rs.4,00,000
Plant and Machinery	Rs.7,00,000
Furniture	Rs.62,500
- The balance of Rs.1,50,000 in the loan account with State Finance Corporation is inclusive of Rs.7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.
- Balance at Bank includes Rs.2,000 with Perfect Bank Ltd., **which is not a Scheduled Bank.**
- The company had contract for the erection of machinery at Rs.1,50,000 which is still incomplete.

Solution: Illustration 3

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

Particulars	Note No.	₹
Equity and Liabilities		
1. Shareholders' funds		
i Share capital	1	9,99,000
ii Reserves and Surplus	2	2,96,700
2. Non-Current liabilities		
i Long term borrowings	3	2,63,500
3. Other Current liabilities		
i Trade Payables		2,00,000
ii Other Current Liabilities	4	1,07,280
iii Short-term provisions	5	68,000
Total		18,94,700



Assets				
1.	Non-current assets			
	i	PPE (Property, Plant & Equipment)	6	11,25,000
2.	Current assets			
	i	Inventories	7	2,50,000
	ii	Trade receivables	8	2,00,000
	iii	Cash and Cash Equivalents	9	2,77,000
	iv.	Short-term Loans And advances		<u>42,700</u>
		Total		18,94,700

- **Notes to accounts**
- **Note – 6: PPE (Property, Plant & Equipment)**

	Assets	Cost	Accumulated Depreciation	WDV
1.	Building	4,00,000	50,000	3,50,000
2.	Plant and Machinery	7,00,000	1,75,000	5,25,000
3.	Furniture	62,500	12,500	50,000
4.	Land	2,00,000	--	2,00,000
		13,62,500	2,37,500	11,25,000

- **Note:** Estimated amount of contract remaining to be executed on capital account and not provided for ₹1,50,000. It has been assumed that the company had given this contract for purchase of machinery.

5. Illustration

Following is the trial balance of Delta limited as on 31.3.2021.

(Figures in Rs. '000)

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity share capital (shares of Rs. 10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (balance on 1.4.20)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-21)	96	Sales	1200
Cash at Bank	28	Trade payables	30
Adjusted Purchases	400	Provision for depreciation	150
Factory expenses	80	Suspense Account	10
Administrative expenses	45		
Selling expenses	25		
Debenture Interest	30		
	2455		2455

Additional Information :

- The authorized share capital of the company is 80,000 shares of Rs. 10 each.
- The company revalued the land at Rs. 9,60,000.
- Equity share capital includes shares of Rs. 50,000 issued for consideration other than cash.
- Suspense account of Rs. 10,000 represents cash received from the sale of some of the machinery on 1.4.2020. The cost of the machinery was Rs. 24,000 and the accumulated depreciation thereon being Rs. 20,000. The balance of Plant & Machinery given in trial balance is before adjustment of sale of machinery.
- Depreciation is to be provided on plant and machinery at 10% on cost.
- Balance at bank includes Rs. 5,000 with ABC Bank Ltd., which is not a Scheduled Bank.



- (vii) Make provision for income tax @30%.
 (viii) Trade receivables of Rs. 50,000 are due for more than six months.

You are required to prepare Delta Limited's Balance Sheet as at 31.3.2021 and Statement of Profit and Loss with notes to accounts for the year ended 31.3. 2021 as per Schedule III. Ignore previous year's figures & taxation.

Solution: Illustration 6

Delta Limited
Balance Sheet as at 31st March 2021

Particulars	Note No.	(₹ in '000)
Equity and Liabilities		
1. Shareholders' funds		
i Share capital	1	495.00
ii Reserves and Surplus	2	807.20
2. Non-Current liabilities		
i Long term borrowings	3	300.00
3. Other Current liabilities		
i Trade Payables		30.00
ii Short-term provisions	4	<u>163.80</u>
Total		1,796.00
Assets		
1. Non-current assets		
i PPE (Property, Plant & Equipment)	5	1,550.00
2. Current assets		
i Inventories		96
ii Trade receivables	6	120
iii Cash and Cash Equivalents	7	30
Total		1,796.00

Statement of Profit and Loss for the year ended 31st March 2021

	Particulars	Notes	(₹ in '000)
I.	Revenue from operations	8	1,200
II.	Other income (Discount received)	9	6
III.	Total Revenue (I + II)		1,206
IV.	Expenses:		
	Purchases (Adjusted)		400
	Finance costs	10	30
	Depreciation	5	80
	Other Expenses	11	150
	Total Expenses		660
V.	Profit Before Tax (III - IV)		546
VI.	Tax expenses @30%		<u>163.80</u>
VII.	Profit for the period		<u>382.20</u>

Notes to Accounts

		(₹)
1. Share Capital		
Share capital		
80,000 Shares of ₹10 each		800
subscribed & Called up		
50,000 shares of ₹10 each	500	
(Out of above, 5,000 shares have been issued for consideration other than cash)		
Less: Calls in arrears	(5)	495



2. Reserves and Surplus		
General Reserve		150.00
Securities Premium		40.00
Profit & loss (Surplus)		
Opening Balance	75.00	
Add: Profit for the period	<u>382.20</u>	<u>457.20</u>
		807.20
3. Long term borrowing		
10% Debentures		300
4. Short – term provision		
Provision for tax		163.80
5. Property, plant & equipment		
Land at cost	800	
Add: Revaluation	<u>160</u>	960
Plant and Machinery (at cost)		
Opening Balance	824	
Less: Cost of P&M sold	<u>(24)</u>	
Closing Balance (at cost)	800	
Less: Depreciation (Accumulated)		
Opening Balance	150	
Less: Disposed Off	<u>(20)</u>	
Add: Current year Depreciation (10% on 800)	<u>80</u>	
	<u>210</u>	1,550.00
6. Trade receivables		
Debits outstanding for a period exceeding six months	50	
Other debts	<u>70</u>	120
7. Cash and cash Equivalent		
- Cash at Bank scheduled banks	23	
- With others (ABC Bank Limited)	5	
Cash in hand	<u>2</u>	30
8. Revenue from Operations		
Sales		1,200
9. Other Income		
Gain on sale of Fixed asset ₹(10,000 – (24,000 – 20,000))		6
10. Finance Costs		
Debenture Interest		30
11. Other Expenses		
Factory Expenses	80	
Admin Expenses	45	
Selling Expenses	<u>25</u>	150

6. Illustration

The following balances appeared in the books of Oliva Ltd. as on 31-03-20X2.

Particulars (Dr)	₹	Particulars (Cr)	₹
Inventory (01-04-20X1) – Raw material	30,000	Sales	17,10,000
Inventory (01-04-20X1) – Finished goods	46,500	Interest	3,900
Purchases	12,15,000	Share capital	3,15,000
Manufacturing expenses	2,70,000	Secured loans – Short-term	4,500
Salaries & wages	40,200	Secured loans – Long-term	21,000
General charges	16,500	Profit & Loss A/c	48,000
Stores & spare parts consumed	45,000	Deposits (unsecured) – Short-term	1,500
Building	1,01,000	Deposits (unsecured) – Long-term	3,300



Plant & machinery	70,400	Trade payables	3,27,000
Furniture	10,200		
Motor vehicles	40,800		
Interim dividend	27,000		
Investments — Current	4,500		
Investments — Non-current	7,500		
Trade receivables	2,38,500		
Cash at bank	2,71,100		
Total (Dr)	24,34,200	Total (Cr)	24,34,200

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 20X2 and Company's Balance Sheet as on that date:

1. Inventory on 31st March, 20X1 Raw material ₹ 25,800 & finished goods ₹ 60,000.
2. Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
3. Interest accrued on Securities ₹ 300.
4. General Charges prepaid ₹ 2,490.
5. Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
6. Current maturity of long term loan is ₹ 1,000.
7. The Taxation provision of 40% on net profit is considered.

Solution: Illustration 7

Oliva Company Ltd.
Balance Sheet for the year ended 31.03.2019

Particulars	Note No.	₹
Equity and Liabilities		
1. Shareholders' funds		
i Share capital		3,15,000
ii Reserves and Surplus	1	50,430
2. Non-Current liabilities		
i Long term borrowings	2	23,300
3. Current liabilities		
i Short -term borrowings	3	6,000
ii Trade Payables		3,27,000
iii Other current liability	4	73,000
iv Short-term provisions	5	<u>19,620</u>
Total		8,14,350
Assets		
1. Non-current assets		
i PPE (Property, Plant & Equipment)	6	2,04,160
ii Non-current investments		7,500
2. Current assets		
i Current investments		4,500
ii Inventories	7	85,800
iii Trade receivables		2,38,500
iv Cash and cash equivalents		2,71,100
v Short-term loans and advances	8	2,490
vi Other current assets	9	<u>300</u>
Total		8,14,350

Oliva Company Ltd.
Statement of Profit and loss for the year ended 31.03.2019



	Particulars	Notes	(₹ in '000)
I.	Revenue from operations		17,10,000
II.	Other income (3,900 +300)		<u>4,200</u>
III.	Total Revenue (I + II)		17,14,200
IV.	Expenses:		
	Cost of materials consumed	10	12,64,200
	Changes in inventories of finished goods, work-in progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		-
	Depreciation and amortization expenses		18,240
	Other Expenses	13	<u>3,51,510</u>
	Total Expenses		16,65,150
V.	Profit Before Tax (III - IV)		49,050
VI.	Tax expense (40% of 49,050)		<u>19,620</u>
VII.	Profit for the period from continuing operations		<u>29,430</u>

Notes to accounts

1	Reserves and Surplus		
	Profit & loss (Surplus)	48,000	
	Add: Profit for the period	29,430	
	Less: Interim Dividend	<u>(27,000)</u>	50,430
2.	Long term borrowing		
	Secured loans (21,000 less current maturities 1,000)	20,000	
	Fixed Deposits: Unsecured	<u>3,300</u>	23,300
3.	Short – term borrowings		
	Secured loans	4,500	
	Fixed Deposits -Unsecured	<u>1,500</u>	6,000
4.	Other current liabilities		
	Expenses Payable (67,500 + 4,500)	72,000	
	Current maturities of longterm borrowings	<u>1,000</u>	73,000
5.	Short term provisions		
	Provision for Income tax		19,620
6.	Property, plant & equipment		
	Building	1,01,000	
	Less: Depreciation @ 2%	<u>(2,020)</u>	98,980
	Plant & Machinery	70,400	
	Less: Depreciation @10%	<u>(7,040)</u>	63,360
	Furniture	10,200	
	Less: Depreciation @10%	<u>(1,020)</u>	9,180
	Motor vehicles	40,800	
	Less: Depreciation @20%	<u>(8,160)</u>	32,640
	Total		2,04,160
7.	Inventory:		
	Raw Material	25,800	
	Finished goods	<u>60,000</u>	85,800
8.	Short term Loans & Advances		
	General Charges prepaid		<u>2,490</u>
9.	Other Current Assets:		
	Interest accrued		300
10.	Cost of material consumed		
	Opening inventory of raw Material & Stores	30,000	
	Add: Purchases	12,15,000	



	Stores & Spare parts consumed	(45,000)	
		<u>12,90,000</u>	
	Less: Closing inventory	(25,800)	12,64,200
11.	Changes in inventory of Finished Goods & WIP		
	Closing Inventory of Finished Goods	60,000	
	Less: Opening Inventory of Finished Goods	(46,500)	13,500
12.	Employee Benefit expenses		
	Salary & Wages (40,200 + 4,500)		44,700
13.	Other Expenses:		
	Manufacturing Expenses (2,70,000 + 67,500)	3,37,500	
	General Charges (16,500 – 2,490)	<u>14,010</u>	3,51,510

7. Illustration

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 (Secured by hypothecation of Plant & Machinery Repayable within one year Rs. 2,00,000)	10,50,000
Loans: Unsecured (Long term)	8,47,000
Sundry Creditors for goods & expenses (Payable within 6 months)	14,00,000
Profit & Loss Account	7,00,000
Provision for Taxation	8,16,900
	<u>1,33,63,000</u>

Debit Balances:

	Rs.
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
	<u>1,33,63,000</u>

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 Rs. 28,00,000
- (iii) Cost of Plant & Machinery Rs. 49,00,000 Cost of Furniture & Fixture Rs. 4,37,500
- (iv) Trade receivables for Rs. 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.
- (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 31st March, 20X1 as required under Schedule III to the Companies Act, 2013.

Solution:

Bose and Sen Ltd.
Balance Sheet as at 31st March, 20X1

<i>Particulars</i>		<i>Notes</i>	<i>Figures at the end of current reporting period (Rs.)</i>
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 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		
	Inventories	7	17,50,000
	a Trade receivables	8	14,00,000
	b Cash and bank balances	9	19,39,000
	c Short-term loans and advances		2,98,900
	d 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	70,00,000	



	issued for consideration other than cash)		
	Less: Calls in arrears	(7,000)	69,93,000
	Total		69,93,000
2	Reserves and Surplus		
	General Reserve	15,49,100	
	Less: Preliminary expenses Surplus	(93,100)	14,56,000
	(Profit & Loss A/c)		7,00,000
	Total		21,56,000
3	Long-term borrowings		
	Secured Term Loans		
	Loan from State Finance Corporation (Rs. 10,50,000 - Rs. 2,00,000) (Secured by hypothecation of Plant and Machinery)		8,50,000
	Unsecured		
	Bank Loan	2,00,000	
	Loan from related parties Others	1,00,000	
	Total	5,47,000	8,47,000
	Short term borrowings		16,97,000
4	Current maturities of long-term debt-loan Instalment repayable within one year		2,00,000
	Short-term provisions		
	Provision for taxation		
5	Property, plant and equipment		
	Land Buildings		8,16,900
6	Less: Depreciation Plant & Machinery		14,00,000
	Less: Depreciation	28,00,000	
		(7,50,000) (b.f.)	20,50,000
	Furniture & Fittings	49,00,000	
		(12,25,000) (b.f.)	36,75,000
		4,37,500	
	Less: Depreciation	(87,500) (b.f.)	3,50,000
	Total		74,75,000
7	Inventories Raw Material Finished goods		3,50,000
			14,00,000
			17,50,000
8	Trade receivables		
	Debts outstanding for a period exceeding six months		3,80,000
			10,20,000



	Other Debts		14,00,000
9	Total		
	Cash and bank balances		
	Cash and cash equivalents	12,11,000	12,29,000
	Cash at bank with Scheduled Banks with others	18,000	2,10,000
	Cash in hand		5,00,000
	Other bank balances		
	Bank deposits for period of 9 months		19,39,000
	Total		

8. Illustration

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 Rs.	Credit Rs.
Equity Share Capital (Face value of Rs. 100 each)			50,00,000
Call in Arrears		5,000	
Land & Building		27,50,000	
Plant & Machinery		26,25,000	
Furniture		2,50,000	
General Reserve			10,50,000
Loan from State Financial Corporation			7,50,000
Inventory:			
Raw Materials	2,50,000		
Finished Goods	10,00,000	12,50,000	
Provision for Taxation			6,40,000
Trade receivables		10,00,000	
Short term Advances		2,13,500	
Profit & Loss Account			4,33,500
Cash in Hand		1,50,000	
Cash at Bank		12,35,000	
Unsecured Loan			6,05,000
Trade payables (for Goods and Expenses)			8,00,000
Loans & advances from related parties			2,00,000
		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 Rs. 2,60,000 are due for more than 6 months.
- (iii) The cost of the Assets were:

Building Rs. 30,00,000, Plant & Machinery Rs. 35,00,000 and Furniture Rs. 3,12,500

- (iv) The balance of Rs. 7,50,000 in the Loan Account with State Finance Corporation is inclusive of Rs. 37,500 for Interest Accrued but not Due. The loan is secured by hypothecation of Plant & Machinery.

- (v) Balance at Bank includes Rs. 10,000 with Omega Bank Ltd., which is not a Scheduled



Bank.

(vi) Transfer Rs. 20,000 to general reserve is proposed by Board of directors.

(vii) Board of directors declared dividend of 5% on the paid up capital on 2nd April, 20X1.

Solution:

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

Particulars	Note No.	Rs.
Equity and Liabilities		
Shareholders' Funds		
Share Capital	1	49,95,000
Reserves and Surplus	2	14,83,500
Non-current Liabilities		
Long-term Borrowings	3	13,17,500
Current Liabilities		
Trade Payables		8,00,000
Short-term Borrowings	5	6,40,000
Other Current Liabilities (Interest accrued but not due on loans – SFC)	4	2,00,000
Short-term Provisions		37,500
Total Equity and Liabilities		94,73,500
Assets		
Non-current Assets		
Property, Plant and Equipment (PPE)	6	56,25,000
Current Assets		
Inventories	7	12,50,000
Trade Receivables	8	10,00,000
Cash and Bank Balances	9	13,85,000
Short-term Loans and Advances		2,13,500
Total Assets		94,73,500

Notes to accounts

Particulars	Rs.
1. Share Capital	
Equity Share Capital	
Issued, Subscribed & Called up: 50,000 Equity Shares of ₹100 each (Of the above, 10,000 shares have been issued for consideration other than cash)	50,00,000
Less: Calls in Arrears	(5,000)
Total	49,95,000
2. Reserves and Surplus	
General Reserve	10,50,000
Add: Current year transfer	20,000
	10,70,000
Profit & Loss Account:	
Profit for the year	4,33,500
Less: Appropriations – Transfer to General Reserve	(20,000)
	4,13,500
Total Reserves and Surplus	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 (b.f.)	(2,50,000)
	27,50,000
Plant and Machinery	35,00,000
Less: Depreciation (b.f.)	(8,75,000)
	26,25,000
Furniture	3,12,500
Less: Depreciation (b.f.)	(62,500)
	2,50,000
Total Property, Plant and Equipment	56,25,000
7. Inventories	
Raw Materials	2,50,000
Finished Goods	10,00,000
Total	12,50,000
8. Trade Receivables	
Outstanding for a period exceeding six months	2,60,000
Other Amounts	7,40,000
Total	10,00,000
9. Cash and Bank Balances	
Cash and Cash Equivalents	
Cash at Bank with Scheduled Banks	12,25,000
Cash at Bank with Others (Omega Bank Ltd.)	10,000
Cash in Hand	1,50,000
Other Bank Balances	Nil
Total	13,85,000

9. Illustration

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 Closing	2,00,000	Outstanding Expenses Provision	4,000
Stock	1,80,000	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 <u>1,10,000</u>	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:

- Closing stock is more than opening stock by Rs. 1,60,000.
- Provide to doubtful debts @ 4% on Debtors.
- Make a provision for income tax @30%.
- Depreciation expense included depreciation of Rs. 16,000 on Building and that of Rs. 24,000 on Machinery.
- The directors declared a dividend @ 25% on 2nd April, 20X2 and transfer to General Reserve @ 10%.
- Bills Discounted but not yet matured Rs. 20,000.

Solution:

Ring Ltd.

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

	Particulars	Note No.	(Rs. In lacs)
I	Revenue from operations		10,40,000
II	Other income (interest on investment)		<u>24,000</u>
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	<u>1,24,000</u>
	Total Expenses		7,60,000
V	Profit before Tax (III-IV)		3,04,000
VI	Tax Expenses @ 30%		(91,200)
VII	Profit for the period		2,12,800

Balance Sheet of Ring Ltd. as at 31ST March, 20X2

	Particulars	Note No.	Rs.
I	EQUITY AND LIABILITIES		
	(1) Shareholders' Funds		
	(a) Share Capital	1	4,00,000
	(b) Reserves and Surplus	2	3,42,800
	(2) Non-Current Liabilities		
	(a) Long-term Borrowings (14% debentures)		4,00,000
	(3) Current Liabilities		
	(a) Trade Payable (Sundry Creditors)	3	42,000
	(b) Other Current Liabilities	4	91,200
	(c) Short-Term Provisions		14,60,000
	Total		
II	ASSETS		
	(1) Non-Current Assets		
	(a) PPE	5	5,70,000
	(b) Non-current Investments		2,40,000



	(2)	Current Assets		
		(a) Inventories	6	2,26,000
		(b) Trade Receivables	7	2,40,000
		(c) Cash and bank balances		60,000
		(d) Short Term Loans and Advances (Advance Payment of Tax)		1,20,000
		(e) Other Current Assets (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 Rs. 20,000.

Notes to Accounts:

1.	Share Capital Authorised Capital 10,000 Equity Shares of Rs. 100 each Issued Capital 4,000 Equity Shares of Rs. 100 each Subscribed Capital and fully paid 4,000 Equity Shares of Rs. 100 each		<u>10,00,000</u> 4,00,000 4,00,000
2.	Reserve and Surplus General Reserve [Rs. 80,000 + Rs. 21,280] Balance of Statement of Profit & Loss Account Opening Balance Add: Profit for the period Appropriations Transfer to General Reserve @ 10%	 50,000 <u>2,12,800</u> 2,62,800 (21,280)	 <u>2,41,520</u> <u>3,42,800</u>
3.	Other Current Liabilities Unclaimed Dividend Outstanding Expenses Interest accrued on Debentures		10,000 4,000 <u>28,000</u> <u>42,000</u>
4.	Short-Term Provision Provision for Tax		91,200
5	Property, plant and equipment Buildings Less: Provision for Depreciation Plant and Equipment Less: Provision for Depreciation	5,80,000 <u>1,00,000</u> 2,00,000 <u>1,10,000</u>	 4,80,000 <u>90,000</u> <u>5,70,000</u>
6	Inventories Closing Stock of Finished Goods Loose Tools	1,80,000 <u>46,000</u>	 <u>2,26,000</u>
7	Trade Receivables		



	Sundry Debtors	2,50,000	
	Less: Provision for Doubtful Debts	<u>(10,000)</u>	<u>2,40,000</u>
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
			<u>1,24,000</u>

10. Illustration

Particulars	Amount (Rs.)	
	Debit	Credit
Equity Share Capital, fully paid shares of Rs. 50 each		80,00,000
Calls in arrear	15,000	
Land	25,00,000	
Buildings	30,00,000	
Plant & Machinery	24,00,000	
Furniture & Fixture	13,00,000	
Securities Premium		15,00,000
General Reserve		9,41,000
Profit & Loss Account		5,80,000
Loan from Public Finance Corporation (Secured by Hypothecation of Land)		26,30,000
Other Long Term Loans		22,50,000
Short Term Borrowings		4,60,000
Inventories: Finished goods	45,00,000	
Raw materials	13,00,000	
Trade Receivables	17,50,000	
Advances: Short Term	3,75,000	
Trade Payables		8,13,000
Provision for Taxation		3,80,000
Unpaid Dividend		70,000
Cash in Hand	70,000	
Balances with Banks	4,14,000	
Total	1,76,24,000	1,76,24,000

The following additional information was also provided in respect of the above balances:

- (1) 50,000 fully paid equity shares were allotted as consideration for land.
- (2) The cost of assets were:

Building	Rs. 32,00,000
Plant and Machinery	Rs. 30,00,000
Furniture and Fixture	Rs. 16,50,000

- (3) Trade Receivables for Rs. 4,86,000 due for more than 6 months.
- (4) Balances with banks include Rs. 56,000, the Naya bank, which is not a scheduled bank.
- (5) Loan from Public Finance Corporation repayable after 3 years.
- (6) The balance of Rs. 26,30,000 in the loan account with Public Finance Corporation is inclusive of Rs.1,34,000 for interest accrued but not due. The loan is secured by hypothecation of land.



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

Loan taken from Nixes Bank	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.

Solution:

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		
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	7	92,00,000
a PPE		
2 Current assets	8	58,00,000
a Inventories	9	17,50,000
b Trade receivables	10	4,84,000
c Cash and cash equivalents		3,75,000
d Short-term loans and advances 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	80,00,000	
	(Out of the above 50,000 shares have been issued for consideration other than cash)	<u>(15,000)</u>	79,85,000
2.	Less: Calls in arrears	9,41,000	
	Reserves and Surplus		
	General Reserve	<u>35,000</u>	9,76,000
	Add: Transferred from Profit and loss account Securities	5,80,000	15,00,000
	premium		
	Surplus (Profit & Loss A/c)	<u>(35,000)</u>	<u>5,45,000</u>
	Less: Appropriation to General Reserve (proposed)		<u>30,21,000</u>
3.			
	Long-term borrowings		24,96,000
	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)		
	Unsecured		
	Bank Loan (Nixes bank) 9,00,000 (Rs. 13,80,000 - Rs. 4,80,000 repayable within 1 year)		
	Loan from Directors 8,50,000		
	Others <u>20,000</u>		<u>17,70,000</u>
	Total		<u>42,66,000</u>
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 <u>2,96,000</u>		9,40,000
5.	Other current liabilities	70,000	
	Unpaid dividend	<u>1,34,000</u>	2,04,000
6.	Interest accrued but not due on borrowings		
	Short-term provisions		3,80,000
7.	Provision for taxation PPE		
	Land		25,00,000
		32,00,000	



	Buildings	(2,00,000)	30,00,000
	Less: Depreciation Plant	30,00,000	
	& Machinery Less:	(6,00,000)	24,00,000
	Depreciation Furniture &	16,50,000	
	Fittings Less:	(3,50,000)	13,00,000
	Depreciation		92,00,000
8.			
	Total	13,00,000	
	Inventories	40,00,000	
	Raw Material Finished		
	goods		
	Loose tools	5,00,000	58,00,000
9.	Trade receivables		
	Outstanding for a period exceeding six		4,86,000
	months		
	Others		12,64,000
	Total		17,50,000
10.	Cash and cash equivalents		
	Balances with banks with	3,58,000	
	Scheduled Banks with others	56,000	4,14,000
	banks		70,000
	Cash in hand		4,84,000
	Total		

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:

	(Rs.)
17,500 9% Preference shares of Rs. 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs. 10 each, fully paid up	80,00,000
General Reserves as on 1.4.20X1	25,00,000
Capital Reserves as on 1.4.20X1	3,00,000
Revaluation Reserves as on 1.4.20X1	3,50,000
Net profit for the year ended 31st March, 20X2	3,00,000
Average rate of dividend during the last five year has been 12%.	

Solution: Illustration 4

Condition I. Maximum Rate = 12% (Avg. of 3years)

Dividend Payable	
Preference shares = 17,50,000 × 9%	1,57,500
Equity Shares = 80,00,000 × 10%	8,00,000
Total Dividend	9,57,500
Surplus in P/L	3,00,000
Amount to be Withdrawn	6,57,500

Condition II.

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed **10% of paid up capital plus free reserves** i.e. ₹12,25,000 [10% of (80,00,000+17,50,000+25,00,000)]

Condition III



The balance of reserves after withdrawal

18,42,500 (₹25,00,000 - ₹6,57,500) should not fall below 15 % of its paid up capital ie.

₹14,62,500 (15% of ₹97,50,000]

Since all the three conditions are satisfied, the company can withdraw **₹6,57,500** from accumulated reserves (as per Declaration and Payment of Dividend Rules, 2014.)

2. Illustration

The following extract of Balance Sheet of X Ltd. was obtained:

Balance Sheet (Extract) as on 31st March, 20X1

Liabilities	Rs.
Authorised capital:	
20,000, 14% preference shares of Rs.100	20,00,000
2,00,000 Equity shares of Rs.100 each	<u>2,00,00,000</u>
	<u>2,20,00,000</u>
Issued and subscribed capital:	
15,000, 14% preference shares of Rs.100 each fully paid	15,00,000
1,20,000 Equity shares of Rs.100 each, Rs.80 paid-up	96,00,000
Share suspense account	20,00,000
Reserves and surplus:	
Capital reserves (Rs. 1,50,000 is revaluation reserve)	1,95,000
Securities premium	50,000
Secured loans:	
15% Debentures	65,00,000
Unsecured loans:	
Public deposits	3,70,000
Cash credit loan from SBI (short term)	4,65,000
Current Liabilities:	
Trade Payables	<u>3,45,000</u>
Assets:	Rs.
Investment in shares, debentures, etc.	75,00,000
Profit and Loss account (Debit balance)	15,25,000

Share suspense account represents application money received on shares, the allotment of which is not yet made.

You are required to compute effective capital as per the provisions of Schedule V. Would your answer differ if X Ltd. is an investment company?

Solution: Illustration 5

	Where X Ltd. Is a noninvestment company	Where X Ltd. is an investment company
Paid-up share capital –		
15,000, 14% Preference shares	15,00,000	15,00,00
1,20,000 Equity shares	96,00,000	96,00,000
Capital reserves (1,95,000 – 1,50,000)	45,000	45,000
Securities premium	50,000	50,000
15% Debentures	65,00,00	65,00,00
Public Deposits	<u>3,70,000</u>	<u>3,70,000</u>
	<u>1,80,65,000</u>	<u>1,80,65,000</u>



Less: Profit and Loss account (Dr. balance)	15,25,00	15,25,00
Investments	75,00,000	-
	<u>90,25,000</u>	<u>15,25,000</u>
Effective capital	90,40,000	1,65,40,000



CASH FLOW STATEMENT

Illustrations

1. Illustration (Direct Method – CF from operating activity – III-1)

From the following information, calculate cash flow from operating activities:

Summary of Cash Account for the year ended March 31, 20X1			
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
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 Repay 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

Solution: Illustration 1

(Direct Method – CF from operating activity – III-1)

Particulars	₹
I. Cash flow from operating Activities:	
• Cash received from Sales	1,40,000
• Cash received from Debtors	1,75,000
• Commission Received	50,000
• Purchases	(1,20,000)
• Payment to creditors	(1,57,000)
• Office & Selling Expenses	(75,000)
Cash Generated from Operations	13,000
Less: Income Tax	(30,000)
Net Cash used in Operations	(17,000)

2. Illustration (CF from Investing Activities – III – 2 : Example)

In a year the company has made sales of Rs.10,000. From the extracts given, prepare ledger accounts to arrive at money paid by or paid to debtors and creditors respectively.

Profit and Loss Account.

Debit	(Rs.)	Credit	(Rs.)
To Purchases	7,000	By Sales	
Cash – 2000		Cash – 6000	
Credit 5000		Credit – 4000	10,000
To Bad Debt	200		

Particulars	Year 1 (Rs.)	Year 2 (Rs.)
Debtors – closing	1,000	1,200
Trade payables – closing	500	600



Solution

Debtors A/c

Debit	(Rs.)	Credit	(Rs.)
To Bal b/d	1,000	By Bank (Bal. fig)	3,600
To Sales	4,000	By Bad Debts	200
		By bal C/d	1,200
	5,000		5,000

Cash flow from sales = Cash Sales + Receipts from Debtors = 6,000 + 3,600 = 9,600

Trade Payables A/c

Debit	(Rs.)	Credit	(Rs.)
To Bank (bal Fig)	4,900	By bal b/d	500
To Bal c/d	600	By Purchases	5,000
	5,500		5,500

Cash paid to Suppliers = Cash Purchases + Payments to Creditors = 2,000 + 4,900 = 6,900

3. Illustration (CF from Financing Activities- III – 3)

Following are the extracts of Balance Sheet of Ajay Ltd.:

Liabilities	31.3.20X1 (Rs.)	31.3.20X2 (Rs.)	Assets	31.3.20X1 (Rs.)	31.3.20X2 (Rs.)
Share Capital	5,00,000	5,00,000	Goodwill	1,15,000	90,000
15% Debentures	5,00,000	7,50,000			
Unpaid Interest	--	5,000	Discount on issue of Debentures	90,000	1,15,000
Profit & Loss A/c	50,000	90,000			

You are required to present the cashflow from financing activity, if Discount on issue of Debentures amounting to Rs. 10,000 has been written off during the year.

Solution: Illustration 3 (CF from Financing Activities- III – 3)

Particulars	₹
I. Cash flow from Financing Activities:	
• Proceeds From Issue of debentures	2,15,000
• Interest Paid on Debentures	(1,07,500)
Cashflow From Financing Activity	1,07,500

Workings:

15% Debenture A/c

	₹		₹
		By Balance b/d	5,00,000
		By Discount on Issue of Debentures	35,000
To Balance c/d	7,50,000	By Bank (Bal. Fig)	2,15,000
	7,50,000		7,50,000

Discount on Issue of debentures

	₹		₹
To Balance C/d	90,000	By P&L	10,000
To 15% Debentures	35,000	By Balance c/d	1,15,000
	1,25,000		1,25,000

Interest Payable, assumed issued as beginning of the year i.e. 7,50,000 × 15% = 1,12,500
Therefore, Interest Paid = 1,12,500 – 5,000 = 1,07,500



4. Illustration

The following summary cash account has been extracted from the company's accounting records:

Particulars	Amount (Rs. '000)	Amount (Rs. '000)
Balance at 1.3.20X1		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		<u>128</u>
		3,246
Payments to suppliers	2,047	
Payments for fixed assets	230	
Payments for overheads	115	
Wages and salaries	69	
Taxation	243	
Dividends	80	
Repayments of bank loan	250	<u>(3,034)</u>
Balance at 31.3.20X2		<u>212</u>

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

The company does not have any cash equivalents.

Solution 4

Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)

Particulars		₹ ('000)
I. Cash flow from operating Activities:		
• Cash receipts from customers	2,783	
• Cash payments to suppliers	(2,047)	
• Payment for overheads	(115)	
• Wages/ Salaries	(69)	
Cash generated from operations	552	
Less: Income tax paid	(243)	
Net cash from operating activities		309
II. Cash flows from investing activities		
• Sale of fixed assets	128	
• Payments for purchase of fixed assets	(230)	
Net cash used in investing activities		(102)
III. Cash flows from financing activities:		
• Proceeds from issuance of share capital	300	
• Dividend paid	(80)	
• Bank loan repaid	(250)	
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

5. Illustration

Given below is the Statement of Profit and Loss of ABC Ltd. and the relevant Balance Sheet information:



Statement of Profit and Loss of ABC Ltd. for the year ended 31st December 2013

Particulars	Rs.in lakhs
Revenue	
Sales	4150
Interest and dividend	100
Stock adjustment	20
Total Revenue(A)	4270
Expenditure	
Purchases	2400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total Expenditure (B)	3560
Profit before tax(A-B)	710
Tax Provision	(200)
Profit after tax	510
Balance of Profit and Loss account brought forward	50
Profit available for distribution	560
Appropriations:	
Transfer to general reserve	200
Proposed dividend	300
Dividend Distribution Tax	30
Total Appropriations	530
Balance	30

Relevant Balance Sheet Information:

Particulars	Closing Balance Rs. in lakhs	Opening Balance Rs. in lakhs
Trade receivables	400	250
Inventories	200	180
Trade payables	250	230
Outstanding Wages	50	40
Outstanding expenses	20	10
Advance Tax	195	180
Tax Provision-Assessed tax liability	200	180

Compute cash flow from operating activities using

1. Direct method and
2. Indirect method

Solution: Illustration 5**Cash Flow from Operating Activities (Direct Method)**

Particulars	₹ in lakhs
Cash collection from Trade receivables	4,000
Cash payment to Trade payables	(2,380)
Cash Paid towards wages	(790)
Cash expenses (200 + 10 - 20)	(190)
Cash generated from operations before Taxes	640
Less: Taxes paid - Advance tax	(195)
Cash generated from operations	445



Indirect Method

Particulars	₹ in lakhs
Net Profit Before Taxation	710
Add: Non - Cash items:	
• Depreciation	100
Add/Less: Items under other Heads	
• Less: interest and Dividend (investment cash inflow)	(100)
• Add: Interest expense (Financing cash outflow)	60
Operating Profit Before Working Capital Changes	770
Changes in working Capital:	
Increase in Inventories (180 - 200)	(20)
Increase in Trade receivables (250 - 400)	(150)
Increase in Trade payables (250 - 230)	20
Increase in outstanding Expense (20 - 10)	10
Increase in Outstanding wages (50 - 40)	10
Cash flow from operating activities before taxes	640
Less: Taxes Paid	(195)
Cash generated from operations	445

Workings:

Trade Receivable

	₹		₹
To Balance b/d	250	By Bank (Bal. fig)	4,000
To Sales	4,150	By Balance c/d	400
	4,400		4,400

Trade Payables

	₹		₹
To Bank (Bal. fig)	2380	By Balance b/d	230
To Balance c/d	250	By Purchases	2,400
	2,630		2,630

Wages Payable

	₹		₹
To Bank (Bal. fig)	790	By Balance b/d	40
To Balance c/d	50	By Wages	800
	840		840

Provision for Tax

	₹		₹
To Advance Tax	180	By P/L	200
To Balance b/d	200	By Balance c/d	180
	380		380

Advance Tax

	₹		₹
To Balance b/d	180	By Provision for Tax	180
To Bank (Bal fig)	195	By Balance c/d	195
	375		375



6. Illustration

Prepare Cash Flow Statement of M/s MNT Ltd. for the year ended 31st March, Year 1 with the help of the following information:

1. Company sold goods for cash only
2. Gross Profit Ratio was 30% for the year, gross profit amounts to Rs.3,82,500.
3. Opening inventory was less than closing inventory by Rs.35,000
4. Wages paid during the year Rs.4,92,500
5. Office & selling expenses paid during the year Rs.75,000
6. Dividend paid during the year Rs. 30,000 (including dividend distribution tax)
7. Bank loan repaid during the year Rs.2,15,000 (including interest Rs.15,000)
8. Trade payables on 31st March, Year 0 exceed the balance on 31st March Year 1 by Rs.25,000
9. Amount paid to trade payables during the year Rs.4,60,000
10. Tax paid during the year amounts to Rs.65,000 (Provision for taxation as on 31st March of Year 1 Rs.45,000)
11. Investments of Rs.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 of Year 0 for Rs.2,50,000
14. Cash and Cash equivalents on 31st March of Year 0 - Rs.2,00,000
15. Cash and Cash equivalents on 31st March of Year 1 - Rs.6,07,500

Solution: Illustration 6

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	₹	₹
I. Cash flow from Operating Activities:		
Cash Collected from Customer (Working Note 1)		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
Less: Taxes Paid		(65,000)
Net cash generated from operating activities		1,82,500
II. Investing Activities:		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash generated from investing activities		4,70,000
III. Cash flows from financing activities:		
Dividend paid (including dividend distribution tax)	(30,000)	
Bank loan repayment	(2,00,000)	
Interest on loan	(15,000)	
Net cash used in financing activities		(2,45,000)
Net increase in cash		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

Working Notes:

1. Sales

GP Ratio = 30%

=> Gross Profit / Sales = 30%

=> Sales = ₹3,82,500 / 30% = 12,75,000



7. Illustration

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.2014 from the following information:

- (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 Rs1.5 crores.
- (5) Dividend paid during the year amounted to Rs. 11.7 crores (including Dividend distribution tax) was also paid.
- (6) Investment costing Rs.12 crores were sold at a profit of Rs. 2.4 crores.
- (7) Rs. 8 crores were paid towards income tax during the year.
- (8) A new plant costing Rs. 21 crores were purchased in part exchange of an old plant. The book value of the old plant was Rs.12 crores but the vendor took over the old plant at a value of Rs.10 crores only. The balance was paid in cash to the vendor.
- (9) The following balances are also provided:

	Rs. in crores 1.4.X0	Rs. in crores 31.3.X1
Debtors	45	50
Creditors	21	23
Bank	6	-

Solution: Illustration 7

Gamma Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	₹ in crores	₹ in crores
I. Cash flow from Operating Activities:		
• Cash sales (WN 1)	81	
• Cash collected from Debtors (WN 1)	49	
• Cash purchases (20% of 55)	(11)	
• Cash payments to suppliers (WN 2)	(42)	
• Cash paid towards Admin. & Selling	(18)	
• Cash paid to employees	(22)	
Cash generated from operations before Tax	37	
Less: Income Tax Paid	(8)	
Net cash generated from operating activities		29
II. Cashflow 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 on debentures	(1.5)	
• Dividend paid	(11.7)	
Net cash used in financing activities		(20.2)
Net increase in cash and cash equivalents		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2



Working Note:

1. Cash collected from Sales

Total Sales = 135

Cash sales = 60% of 135 = 81 Crores

Credit Sales = 54

Debtors A/c (Amount collected)

(crores)

	₹		₹
To Balance b/d	45	By Bank (bal. fig)	49
To Sales	54	By Balance c/d	50
	99		99

2. Creditors A/c

	₹		₹
To Bank (bal. fig)	42	By Balance b/d	21
To Balance c/d	23	By Purchases (55x80%)	44
	65		65

3. Cash paid to Debt holders

Face value of debentures = 20 Crores

Add: Premium (10% of 20) = 2 Crores

Total amount Payable = 22 Crores

Less: Equity Shares issued = (15)

Cash paid = 7 Crores

8. Illustration

From the following Balance Sheets of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.20X1:

Balance Sheets of Mr. Zen

Liabilities	1.4.20X0	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
	18,40,000	19,76,000
Assets	1.4.20X0	1.4.20X1
Land	6,00,000	4,40,000
Plant and Machinery	6,40,000	8,80,000
Inventories	2,80,000	2,00,000
Trade receivables	2,40,000	4,00,000
Cash	80,000	56,000
	18,40,000	19,76,000

Additional information:

A machine costing Rs.80,000/- (accumulated depreciation there on 24,000/-) was sold for 40,000/-. The provision for depreciation on 1.4.20X0 was 2,00,000/- and 31.3.20X1 was 3,20,000/- The net profit for the year ended on 31.3.20X1 was 3,60,000/-.

Solution: Illustration 8

Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.20X1

Particulars	₹
(i) Cash flow from operating activities	
Net Profit (given)	3,60,000
Add: Non-Cash Depreciation	1,44,000
Add: Investment Related – Loss on sale of Plant & Machinery	16,000
Operating Profit before working capital changes	5,20,000
Adjustments working Capital	



Add: Decrease in inventory	80,000
Less: Increase in trade receivables	(1,60,000)
Add: Increase in trade payables	32,000
Net cash generated from operating activities	4,72,000
(ii) Cash flow from investing activities	
• Cash Paid to purchase of P&M	(4,40,000)
• Sale of Machinery (W.N.1)	40,000
• Cash received on Sale of land	1,60,000
Net cash used in investing activities	(2,40,000)
(iii) Cash flow from financing activities	
• Loan availed from bank	80,000
• Repayment of Mrs. Zen's Loan	(2,00,000)
• Drawings (W.N.2)	(1,36,000)
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:**Fixed Assets**

	20X0	20X1
WDV	6,40,000	8,80,000
Depreciation (Accumulated)	2,00,000	3,20,000
Cost (Gross Block)	8,40,000	12,00,000

Plant & Machinery A/c

	₹		₹
To Balance b/d	8,40,000	By Asset Disposal	80,000
To Bank (Purchase of P/M)	4,40,000		
(Bal.fig)		By Balance C/d	12,00,000
	12,80,000		12,80,000

Provision for depreciation on Plant and Machinery A/c

	₹		₹
To asset Disposal	24,000	By Balance b/d	2,00,000
To Balance c/d	3,20,000	By Depreciation (Bal.fig)	1,44,000
	3,44,000		3,44,000

Asset Disposal A/C

	₹		₹
To Plant & Machinery	80,000	By Provision for Deprecia.	24,000
		By Bank	40,000
		By P/L (Loss on sale)	16,000
	80,000		80,000

2.To find out Mr. Zen's drawings:**Capital a/c**

	₹		₹
To Bank (Drawings)	1,36,000	By Bal b/d	10,00,000
Bal. fig.			
To Balance c/d	12,24,000	By P/L	3,60,000
	13,60,000		13,60,000



9. 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:

	(Rs. In lakhs)
Net Profit	25,000
Dividend (including dividend tax) 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 Profit & Loss Account	20,000
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income on investments	2,506
Interest expenses of the year	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,081
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988

Prepare the Cash Flow Statement for the year 20X1 in accordance with AS 3.

Solution: Illustration 9

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

	(₹ in lakhs)
I. Cash flows from operating activities	
Net profit (before taxation) (25,000 + 5,000)	30,000
Add: Depreciation (Non – Cash)	20,000
Loss on sale of assets (Net)	40
Less: Profit on sale of investments	(100)
Less: Interest income on investments	(2,506)
Add: Interest expenses	10,000
Operating profit before working capital changes	57,434
Increase in working capital (Excluding cash and bank balance)	(56,081)
Cash generated from operations before Taxes	1,353
Income taxes paid	(4,248)
Net cash used in operating activities	(2,895)
II. Cash flows from investing activities	
• Sale of assets (185 – 40)	145
• Sale of investments (27,765 + 100)	27,865
• Interest income on investments *	2,506
• Purchase of fixed assets	(14,560)
• Investment in joint venture	(3,850)
• Purchase of fixed assets	(14,560)
• Expenditure on construction work-in progress	(34,740)



• Net cash used in investing activities	(22,634)
Cash flows from financing activities	
• Proceeds from calls in arrear	2
• Receipts of grant for capital projects	12
• 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)
Net cash generated from financing activities	27,514
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

* Assumed interest income fully received

10. Illustration

The following data were provided by the accounting records of Ryan Ltd. at year-end, March 31, 20X1:

Income Statement

	(Rs.)	(Rs.) Rs.
Sales		6,98,000
Cost of Goods Sold		(5,20,000)
Gross Margin		1,78,000
Operating Expenses		
(including Depreciation Expense of Rs.37,000/-)		(1,47,000)
		31,000
Other Income / (Expenses)		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	(3,000)	
		(8,000)
		23,000
Income tax		(7,000)
		<u>16,000</u>

Comparative Balance Sheets

	31st March 20X1	31st March 20X0
Assets		
Plant Assets	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
Current Assets:		
Inventory	1,44,000	1,10,000
Accounts receivable	47,000	55,000
Cash	46,000	15,000
Prepaid expenses	<u>1,000</u>	<u>5,000</u>
	<u>9,65,000</u>	<u>7,49,000</u>
Liabilities		
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000



Current liabilities:		
Accounts payable	50,000	43,000
Accrued liabilities	12,000	9,000
Income taxes payable	3,000	5,000
	9,65,000	7,49,000

Analysis of selected accounts and transactions during 20X0-X1

1. Purchased investments for Rs.78,000/-.
2. Sold investments for Rs.1,02,000/-. These investments cost Rs.90,000/-.
3. Purchased plant assets for Rs.1,20,000/-.
4. Sold plant assets that cost Rs.10,000/- with accumulated depreciation of Rs. 2,000/- for Rs.5,000/-.
5. Issued Rs.1,00,000/- of bonds at face value in an exchange for plant assets on 31st March, 20X1.
6. Repaid Rs.50,000/- of bonds at face value at maturity.
7. Issued 15,000 shares of Rs. 10/- each.
8. Paid cash dividends Rs. 8,000/-.

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

Solution: Illustration 10

Cash Flow Statement of Ryan Limited

Particulars	₹	₹
I. Cash flows from operating activities		
Net profit before taxation	23,000	
Add: Depreciation	37,000	
Add: Interest expense	23,000	
Less: Interest income	(6,000)	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Operating profit before working capital changes		68,000
Adjustments for Working Capital changes:		
Less: change in Inventory - Increase	(34,000)	
Add: Decrease in Receivable	8,000	
Add: Decrease in prepaid expenses	4,000	
Add: Increase in accounts payable	7,000	
Add: Increase in accrued liabilities	3,000	
Operating Cash flow before taxes	56,000	
Income taxes paid	(9,000)	
Net cash generated from operating activities		47,000
II. 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)
III. Cash flows from financing activities		
Proceeds from issuance of share capital (465-315)	1,50,000	
Dividends paid	(8,000)	
Repayment of bonds (2,45,000 + 1,00,000 - 2,95,000)	(50,000)	
Interest paid	(23,000)	
Net cash from financing activities		69,000



Net increase in cash and cash equivalents		31,000
Cash and cash equivalents at the beginning of the period		15,000
Cash and cash equivalents at the end of the period		46,000

Working Notes:**1. Income Tax Paid****Income Tax Paid**

	₹		₹
To Bank (Bal. fig)	9,000	By Bal b/d	5,000
To Balance c/d	3,000	By P/L (Current year Provision)	7,000
	12,000		12,000

2. Plant Assets

	₹		₹
To Balance b/d	5,05,000	By Asset Disposal	10,000
To Bonds	1,00,000	By Depreciation	7,15,000
To Bank (Bal. fig)	1,20,000		
	7,25,000		7,25,000

Accumulated Depreciation

	₹		₹
To Asset Disposal (Bank)	2,000	By Bal b/d	68,000
To Balance c/d	1,03,000	By Depreciation	37,000
	1,05,000		1,05,000

Asset Disposal

	₹		₹
To Plant Assets	10,000	By Accumulated Depreciation	2,000
		By Bank	5,000
		By P/L (Loss)	3,000
	10,000		10,000

3. Investment (at Cost)

	₹		₹
To Balance b/d	1,27,000	By Bank	1,02,000
To P/L	12,000	(90,000 + 12,000)	
To Bank (Bal. fig)	78,000	By Balance c/d	1,15,000
	2,17,000		2,17,000

4. Dividend Paid**Reserves and Surplus**

	₹		₹
To Dividend Paid (Bank) Bal.fi	8,000	By Bal b/d	1,32,000
To Balance c/d	1,48,000	By P/L (Profits for the year)	16,000
	1,48,000		1,48,000



11. Illustration

From the following Balance Sheet and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

Liabilities	31 st March, 20X1	31 st March, 20X0	Assets	31 st March, 20X1	31 st March, 20X0
Equity Share Capital	6,00,000	5,00,000	Land and Building	1,50,000	2,00,000
10% Redeemable Preference Share Capital	•	2,00,000	Plant and Machinery	7,65,000	5,00,000
Capital Redemption Reserve	1,00,000	-	Investments	50,000	80,000
Capital Reserve	1,00,000	•	Inventory	95,000	90,000
General Reserve	1,00,000	2,50,000	Trade receivables	2,50,000	2,25,000
Profit & Loss Account	70,000	50,000	Cash and Bank	65,000	90,000
9% Debentures	2,00,000	-	Voluntary Separation Payments	1,25,000	65,000
Trade payables	1,15,000	1,10,000			
Liability for Expenses	30,000	20,000			
Provision for Taxation	95,000	60,000			
Dividend Payable	90,000	60,000			
	15,00,000	12,50,000		15,00,000	12,50,000

Additional Information:

- A piece of land has been sold out for Rs.1,50,000 (Cost – Rs.1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on sale and profit on revaluation.
- On 1st April, 20X0 a plant was sold for Rs.90,000 (Original Cost – Rs.70,000 and W.D.V. – Rs.50,000) and Debentures worth Rs.1 lakh was issued at par as part consideration for plant of Rs.4.5 lakhs acquired.
- Part of the investments (Cost – Rs.50,000) was sold for Rs.70,000.
- Pre-acquisition dividend received Rs.5,000 was adjusted against cost of investment.
- Directors have declared 15% dividend for the current year.
- Voluntary separation cost of Rs.50,000 was adjusted against General Reserve.
- Income-tax liability for the current year was estimated at Rs.1,35,000.
- Depreciation @ 15% has been written off from Plant account but no depreciation has been charged on Land and Building.

Solution: Illustration 11

Particulars	₹	₹
I. Cash flows from operating activities		
Net Profit after taxation (W.N.1)	1,10,000	
Add: Provision for taxation	1,35,000	
Net Profit before taxation		2,45,000
Add/Less		
• Depreciation	1,35,000	
• Gain on Sale of Plant	(40,000)	
• Gain on Sale of Investment (70,000 – 50,000)	(20,000)	
• Interest on Debentures (9% of Debentures)	18,000	93,000



Operating Profit Before working Capital Changes		3,38,000
Increase in Inventories	(5,000)	
Increase in trade receivables	(25,000)	
Increase in trade payables	5,000	
Increase in liabilities for expenses	10,000	(15,000)
Cash generated from operations		3,23,000
Less: Taxes Paid		(1,00,000)
		2,23,000
Voluntary Separation payment		(1,10,000)
Net cash generated from operating activities		1,13,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.11)	1,50,000	
Proceeds from sale of plant (W.N.8)	90,000	
Purchase of plant (W.N.7)	(3,50,000)	
Proceeds from sale of investments (W.N.12)	70,000	
Pre-acquisition dividend received	5,000	
Purchase of investments (W.N.12)	(25,000)	
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	
Redemption of preference shares	(2,00,000)	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Payment of Interest	(18,000)	
Dividends paid	(60,000)	
Net cash used in financing activities		(78,000)
Net decrease in cash and cash equivalents		(25,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		65,000

Working Notes:**1. Net Profit****Profit and Loss Account**

	₹		₹
To Dividend Payable (15% of 6,00,000)	90,000	By Balance b/d	50,000
To balance c/d	70,000	By Profit for 20X1 (Balancing Fig.)	1,10,000
	1,60,000		1,60,000

2. General Reserve A/c

	₹		₹
To Voluntary separation cost	50,000	By Balance b/d	2,50,000
To CRR	1,00,000		
To balance c/d	1,00,000		
	2,50,000		2,50,000

3. Capital Redemption Reserve A/c

	₹		₹
		By Balance b/d	-
To balance c/d	1,00,000	By General Reserve	1,00,000
	1,00,000		1,00,000



4. Capital Reserve

	₹		₹
		By Balance b/d	-
To balance c/d	1,00,000		
	1,00,000		1,00,000

5. Voluntary Separation Cost A/c

	₹		₹
To Balance b/d	65,000	By General Reserve	50,000
To Bank (Balancing Fig.)	70,000	By Balance c/d	1,25,000
	1,75,000		1,75,000

6. Redemption of Preference shares

	₹
Face value redeemed	2,00,000
Face value of fresh issue	(1,00,000)
Balance (Transferred from free reserve to CRR)	1,00,000

7. Plant and Machinery

	₹		₹
To Balance b/d	5,00,000	By Disposal of Plant	50,000
To Debentures	1,00,000	By Depreciation (15% of 9,00,000)	1,35,000
To Bank	3,50,000	By Bal c/d	7,65,000
	9,50,000		9,50,000

8. Disposal of Plant

	₹		₹
To Plant and Machinery	50,000	By Bank	90,000
To Profit on Sale	40,000		
	90,000		90,000

9. Provision for Taxation

	₹		₹
To Bank a/c (Bal. Fig)	1,00,000	By Balance b/d	60,000
To Balance c/d	95,000	By Profit and Loss	1,35,000
	1,95,000		1,95,000

10 Land and Building A/c

	₹		₹
To Balance b/d	2,00,000	By Disposal of land	1,20,000
To Capital Reserve	70,000	By Balance c/d	1,50,000
	2,70,000		2,70,000

11. Disposal of Land

	₹		₹
To Land and Building	1,20,000	By Bank	1,50,000
To Capital Reserve	30,000		
	1,50,000		1,50,000

12. Investment a/c

	₹		₹
To Balance b/d	80,000	By Bank	70,000
		By Bank (Pre acquisition dividend)	5,000
To P&L (Gain on Sale)	20,000	By Balance c/d	50,000
To Bank (Bal. fig) - Purchases	25,000		
	1,25,000		1,25,000



12. Illustration

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2019.

	Particulars	Note	31.03.2019 (Rs.)	31.03.2018 (Rs.)
I	EQUITY AND LIABILITIES			
	(1) Shareholder's Funds			
	(a) Share Capital	1	3,50,000	3,00,000
	(b) Reserves and Surplus	2	82,000	38,000
	(2) Non-Current Liabilities			
	(3) Current Liabilities			
	(a) Trade Payables		65,000	44,000
	(b) Other Current Liabilities	3	37,000	27,000
	(c) Short term Provisions (provision for tax)		32,000	28,000
	Total ASSETS		5,66,000	4,37,000
II	(1) Non-current Assets			
	(a) Tangible Assets	4	2,66,000	1,90,000
	(b) Intangible (Goodwill)		47,000	60,000
	Non-Current Investments		35,000	10,000
	(2) Current Assets			
	(a) Inventories		78,000	85,000
	(b) Trade Receivables		1,08,000	75,000
	(c) Cash & Cash Equivalents		32,000	17,000
	Total		5,66,000	4,37,000

Note 1 : Share capital

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
Equity Share Capital	2,50,000	1,50,000
8% Preference Share Capital	<u>1,00,000</u>	<u>1,50,000</u>
Total	3,50,000	3,00,000

Note 2: Reserves and Surplus

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
General Reserve	30,000	20,000
Profit and Loss A/c	27,000	18,000
Capital Reserve	<u>25,000</u>	
Total	82,000	38,000

Note 3 : Current Liabilities

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
Dividend declared	37,000	27,000

Note 4: Tangible Assets

Particulars	31.03.2019 (Rs.)	31.03.2018 (Rs.)
Land & Building	75,000	1,00,000
Machinery	<u>1,91,000</u>	<u>90,000</u>
Total	2,66,000	1,90,000



Additional Information:

- (i) Rs. 18,000 depreciation for the year has been written off on plant and machinery and no depreciation has been charged on Land and Building.
- (ii) A piece of land has been sold out for Rs. 50,000 and the balance has been revalued, profit on such sale and revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.
- (iii) A plant was sold for Rs. 12,000 WDV being Rs. 15,000 on the date of sale (after charging depreciation).
- (iv) Dividend received amounted to Rs. 2,100 which included pre-acquisition dividend of Rs. 600.
- (v) An interim dividend of Rs. 10,000 including Dividend Distribution Tax has been paid.
- (vi) Non-current investments given in the balance sheet represents investment in shares of other companies.
- (vii) Amount of provision for tax existing on 31.3.2018 was paid during the year 2018 - 19.

Solution: Illustration 12**Cash flow Statement for the year ending 31st March, 2019**

	₹	₹
I. Cash Flow from Operating Activities		
Closing balance as per Profit and Loss Account		27,000
Less: Opening balance as per Profit and Loss Account		(18,000)
Add: Dividend declared during the year		37,000
Add: Interim dividend paid during the year		10,000
Add: Transfer to reserve		10,000
Add: Provision for Tax		32,000
Net profit before taxation		98,000
Add: Items to be added		
Depreciation	18,000	
Loss on sale of Plant	3,000	
Goodwill written off	13,000	34,000
Less: Dividend Income		(1,500)
Operating profit before working capital changes		1,30,500
Add: Decrease in Current Assets and Increase in Current Liabilities		
Decrease in Inventories	7,000	
Increase in Trade Payables	21,000	28,000
Less: Increase in Trade Receivables		(33,000)
Cash generated from operations		1,25,500
Less: Income taxes paid		(28,000)
Net Cash from operating activities		97,500
II. Cash Flows from investing activities:		
Purchase of Plant	(1,34,000)	
Sale of Land	50,000	
Sale of plant	12,000	
Purchase of investments	(25,600)	
Dividend Received	2,100	
Net cash used in investing activities		(95,500)
III. Cash Flows from Financing Activities:		
Proceeds from issue of equity share capital	1,00,000	
Redemption of preference shares	(50,000)	
Interim Dividend (inclusive of DDT) paid	(10,000)	



Final dividend (inclusive of DDT) paid	(27,000)	
Net cash from financing activities		13,000
Net increase in cash and cash equivalents		15,000
Cash and cash equivalents at beginning of period		17,000
Cash and cash equivalents at end of period		32,000

Working Notes:**1. Land and Building Account**

	₹		₹
To Balance b/d	1,00,000	By Bank (Sale)	50,000
To Capital Reserve (Profit on sale/revaluation)	25,000		
	1,25,000		1,25,000

2. Plant and Machinery Account

	₹		₹
To Balance b/d	90,000	By Depreciation A/c	18,000
To Bank A/c (Purchase)	1,34,000	By Bank A/c (sale)	12,000
		By Profit and Loss A/c (Loss on sale)	3,000
		By Balance c/d	1,91,000
	2,24,000		2,24,000

3. Investments Account

	₹		₹
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To Bank A/c (Purchase)	25,600	By Balance c/d	35,000
	35,600		35,600

13. Illustration

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

Particulars			Notes	20X1 Rs.	20X0 Rs.
Equity and Liabilities					
1	Shareholder's funds				
	(a)	Share capital	1	60,000	50,000
	(b)	Reserve & surplus	2	5,000	4,000
2	Current liabilities				
	(a)	Trade Payables		4,000	2,500
	(b)	Other current liabilities	3	-	1,000
	(c)	Short term provision (provision for tax)		1,500	1,000
		Total		70,500	58,500
Assets					
1	Non-current assets				
	(a)	Property, Plant & Equipment	4	39,500	29,000
2	Current assets				
	(a)	Current investments		2,000	1,000



Cash Flow Statements

	(b)	Inventories		17,000	14,000
	(c)	Trade receivables		8,000	6,000
	(d)	Cash & cash equivalents	5	4,000	8,500
				70,500	58,500

Notes to accounts

		20X1 Rs.	20X0 Rs.
1	Share Capital		
	Equity Shares of Rs.10 each	<u>60,000</u>	<u>50,000</u>
2	Reserve & surplus		
	Profit and Loss Account	<u>5,000</u>	<u>4,000</u>
3	Other current liabilities		
	Dividend Payable	<u>—</u>	<u>1,000</u>
4	Property, plant and equipment (at WDV)		
	Building	10,000	10,000
	Fixtures	17,000	11,000
	Vehicles	<u>12,500</u>	<u>8,000</u>
	Total	<u>39,500</u>	<u>29,000</u>
5	Cash and cash equivalents		
	Cash and Bank	<u>4,000</u>	<u>8,500</u>

The profit and loss statement for the year ended 31st March, 20X1 disclosed:

Particulars	Rs.
Profit before tax	4,500
Tax expense: Current tax	<u>(1,500)</u>
Profit for the year	3,000
Declared dividend	<u>(2,000)</u>
Retained Profit	1,000

Further information is available:

	Fixtures Rs.	Vehicles Rs.
Depreciation for the year	1,000	2,500
Disposals:		
Proceeds on disposal of vehicles	—	1,700
Written down value	—	<u>(1,000)</u>
Profit on disposal		<u>700</u>

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

Solution:

Sun Ltd.

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

	Rs.	Rs.
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	



Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid (W.N.1)	(1,000)	
Net cash generated from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of current investments	(1,000)	
Purchase of vehicles (W.N.3)	(8,000)	
Purchase of fixtures (W.N.3)	(7,000)	
Net cash used in investing activities		(14,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid (W.N.2)	(3,000)	
Net cash generated from financing activities		7,000
Net decrease in cash and cash equivalents		(4,500)
Cash and cash equivalents at beginning of period (See Note)		8,500
Cash and cash equivalents at end of period (See Note)		4,000
Note to the Cash Flow Statement		
Cash and Cash Equivalents		
	31.3.20X1	31.3.20X0
Bank and Cash	4,000	8,500
Cash and cash equivalents	4,000	8,500

Working Notes:

			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		
	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.

14. Illustration

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.20X1

	Rs.'000		Rs.'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

Solution:

X Ltd.

Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

	Rs. '000	Rs. '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

15. Illustration

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1 :

Particulars			Notes	31 st March, 20X1	31 st 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	31 st March, 20X1	31 st March, 20X0
1	Reserves and Surplus		
	General reserve	2,00,000	1,50,000
	Profit and Loss account	<u>1,00,000</u>	<u>60,000</u>
	Total	<u>3,00,000</u>	<u>2,10,000</u>
2	Long term borrowings		
	Debentures (issued at end of year)	<u>2,00,000</u>	<u>-</u>
3.	Other current liabilities		
	Dividend payable	<u>-</u>	<u>1,00,000</u>
4	Property, plant and equipment		
	Plant and machinery	7,00,000	5,00,000



	Land and building	<u>6,00,000</u>	<u>4,00,000</u>
	Net carrying value	<u>13,00,000</u>	<u>9,00,000</u>

- (i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.
(ii) At the year end, one old machine costing Rs. 50,000 (WDV Rs. 20,000) was sold for Rs. 35,000. Purchase was also made at the year end.
(iii) Rs. 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.

Solution:

**Cash Flow Statement of Grow More Ltd.
for the year ended 31st March, 20X1**

Cash Flow from Operating Activities

		Rs.
Increase in balance of Profit and Loss Account (1,00,000 – 60,000)	40,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	2,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	(1,20,000)	
Cash generated from operations	1,60,000	
Income tax paid	(50,000)	
Net Cash generated from operating activities		1,10,000

Cash Flow from Investing Activities

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

Cash Flow from Financing activities

Proceeds from issue of shares (10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	(1,00,000)	
Net cash generated from financing activities		<u>3,00,000</u>
Net decrease in cash and cash equivalents		(2,00,000)
Cash and Cash equivalents at the beginning of the year		<u>2,00,000</u>
Cash and Cash equivalents at the end of the year		<u>Nil</u>



Working Notes:**1. Provision for taxation account**

	Rs.		Rs.
To Cash (Paid)	50,000	By Balance b/d	70,000
To Balance c/d	1,00,000	By Profit and Loss A/c	80,000
	<u>1,50,000</u>	(Balancing figure)	<u>1,50,000</u>

2. Plant and Machinery account

	Rs.		Rs.
To Balance b/d	5,00,000	By Depreciation	1,25,000
To Profit and Loss A/c (profit on sale of machine)	15,000		
To Cash (Balancing figure)	3,45,000	By Cash (sale of machine)	35,000
	<u>8,60,000</u>	By Balance c/d	<u>7,00,000</u>
			<u>8,60,000</u>

16. Illustration

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

			Notes	Rs. 31 st March 20X0	Rs. 31 st March 20X1
		Equity and Liabilities			
1		Shareholders' funds			
	A	Share capital	1	16,00,000	18,80,000
	B	Reserves and Surplus	2	8,40,000	11,00,000
2		Non-current liabilities			
		Long term borrowings	3	4,00,000	2,80,000
3		Current liabilities			
	A	Other current liabilities	4	6,00,000	5,20,000
	B	Short term provision (provision for tax)		3,60,000	3,40,000
		Total		38,00,000	41,20,000
		Assets			
1		Non-current assets			
	A	Property, plant and Equipment	5	22,80,000	26,40,000
	B	Non-Current Investments		4,00,000	3,20,000
2		Current assets			
	A	Cash and Cash equivalents		10,000	10,000
	B	Other Current assets		11,10,000	11,50,000
		Total		38,00,000	41,20,000



Notes to accounts

No.	Particulars		31 st March, 20X0	31 st 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:

- The company sold one property, plant and equipment for Rs. 1,00,000, the cost of which was Rs. 2,00,000 and the depreciation provided on it was Rs.80,000.
- The company also decided to write off another item of property, plant and equipment costing Rs. 56,000 on which depreciation amounting to Rs. 40,000 has been provided.
- Depreciation on property, plant and equipment provided Rs. 3,60,000.
- Company sold some investment at a profit of Rs. 40,000.
- Debentures and preference share capital redeemed at 5% premium. Debentures were redeemed at the year end.
- 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 Rs. 2,16,000. The inventory on 31.3.20X1 was correctly valued at Rs. 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

Solution:**New Light Ltd.****Cash Flow Statement for the year ended 31st March, 20X1**

A.	Cash Flow from operating activities	Rs.	Rs.
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [Rs.3,40,000 – (Rs.2,40,000 + Rs.24,000)]	76,000	
	Transfer to general reserve	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	5,76,000	
	Adjustments for:		
	Depreciation	3,60,000	



	Loss on sale of property, plant and equipment	20,000	
	Decrease in value of property, plant and equipment	16,000	
	Profit on sale of investment	(40,000)	
	Premium on redemption of preference share capital	6,000	
	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 (Rs.5,20,000 –Rs.4,80,000)	40,000	
	Increase in other current assets [Rs.11,50,000 – (Rs. 11,10,000 + Rs.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 (Rs.1,20,000 + Rs.6,000)	(1,26,000)	
	Redemption of debentures (Rs. 1,20,000 +Rs. 6,000)	(1,26,000)	
	Dividend paid	(1,20,000)	
	Interest on debentures	(36,000)	
	Net Cash generated from financing activities		(8,000)
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

Working Notes:

1. Revaluation of inventory will increase opening inventory by Rs. 24,000. $2,16,000/90 \times 10 =$ Rs. 24,000

Therefore, opening balance of other current assets would be as follows:

$$\text{Rs. } 11,10,000 + \text{Rs. } 24,000 = \text{Rs. } 11,34,000$$



Due to under valuation of inventory, the opening balance of profit and loss account be increased by Rs. 24,000.

The opening balance of profit and loss account after revaluation of inventory will be Rs. 2,40,000 + Rs. 24,000 = Rs. 2,64,000

2. Investment Account

		Rs.			Rs.
To	Balance b/d	4,00,000	By	Bank A/c	1,20,000
To	Profit and Loss A/c (Profit on sale of investment)	40,000	By	(balancing figure being investment sold)	
				Balance c/d	3,20,000
		4,40,000			4,40,000

3. Property, Plant and Equipment Account

		Rs.			Rs.	Rs.
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

		Rs.			Rs.
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

17. Illustration

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

Particulars		Notes	Rs. 31 st March 20X0	Rs. 31 st March 20X1
1	Equity and Liabilities			



Cash Flow Statements

		Shareholders' funds		50,00,000	50,00,000
	A	Share capital Reserves		26,50,000	36,90,000
2	B	and Surplus			
		Non-current liabilities	1	-	9,00,000
		Long term borrowings			
3		Current liabilities Short-term borrowings (Bank loan)		1,50,000	3,00,000
	A			8,80,000	8,20,000
	B	Trade payables	2	4,80,000	2,70,000
	C	Other current liabilities		91,60,000	1,09,80,000
		Total			
1		Assets			
		Non-current assets		21,20,000	32,80,000
	A	Property, plant and Equipment	3		
2					
		Current assets Current Investments Inventory		11,80,000	15,00,000
	A			20,10,000	19,20,000
	B	Trade receivables	4	22,40,000	26,40,000
	C	Cash and Cash equivalents		15,20,000	15,20,000
	D	Other Current assets (Prepaid expenses)		90,000	1,20,000
	E			91,60,000	1,09,80,000
		Total			

Notes to accounts

No.	Particulars		Rs.20X0	20X1
1	Long term borrowings			
	9% Debentures (issued at the end of year)		=	<u>9,00,000</u>
	Total		=	<u>9,00,000</u>
2.	Other current liabilities			
	Dividend payable		1,50,000	-
	Liabilities for expenses		<u>3,30,000</u>	<u>2,70,000</u>
	Total		<u>4,80,000</u>	<u>2,70,000</u>
3	Property, plant and equipment			
	Plant and machinery Less:		27,30,000	40,70,000
	Depreciation Net carrying		<u>(6,10,000)</u>	<u>(7,90,000)</u>
	value Trade receivables		<u>21,20,000</u>	<u>32,80,000</u>
4	Gross amount			
	Less: Provision for doubtful debts		23,90,000	28,30,000
	Total		<u>(1,50,000)</u>	<u>(1,90,000)</u>
			<u>22,40,000</u>	<u>26,40,000</u>

Additional Information:

- (i) Net profit for the year ended 31st March, 20X1, after charging depreciation Rs. 1,80,000 is Rs. 10,40,000.



- (ii) Trade receivables of Rs. 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

Solution:

Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1

Cash flows from Operating Activities	<i>Rs.</i>	<i>Rs.</i>
Net Profit	10,40,000	
Add: Adjustment For Depreciation (Rs.7,90,000 – Rs.6,10,000)	1,80,000	
Add: Adjustment for Provision for Doubtful Debts (Rs. 4,20,000 – Rs.1,50,000)	2,70,000	
Operating Profit Before Working Capital Changes	14,90,000	
Add: Decrease in Inventories (Rs. 20,10,000 – Rs. 19,20,000)	90,000	
	15,80,000	
Less: Increase in Current Assets		
Trade Receivables (Rs. 30,60,000 – Rs.23,90,000) 6,70,000		
Prepaid Expenses (Rs. 1,20,000 – Rs.90,000) 30,000		
Decrease in Current Liabilities:		
Trade Payables (Rs. 8,80,000 – Rs. 8,20,000) 60,000		
Expenses Outstanding (Rs. 3,30,000 – Rs. 2,70,000) <u>60,000</u>	(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 (Rs. 40,70,000 – Rs. 27,30,000)	(13,40,000)	
Net Cash Used in Investing Activities		(16,60,000)
Cash Flows from Financing Activities		
Bank Loan Raised (Rs. 3,00,000 – Rs. 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:

- Bad debts amounting Rs. 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.

18. Illustration

Particulars	Note No.	31 st March, 20X2 (Rs.)	31 st March, 20X1 (Rs.)
(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	31 st March, 20X2 (Rs.)	31 st March, 20X1 (Rs.)
1. Share capital		
(a) Equity share capital	4,10,000	2,00,000
(b) Preference share capital	<u>1,50,000</u>	<u>1,00,000</u>
	<u>5,60,000</u>	<u>3,00,000</u>
2. Reserve and surplus		
Surplus in statement of profit and loss at the beginning of the year	25,000	
Add: Profit of the year	20,000	
Less: Dividend	<u>(10,000)</u>	
Surplus in statement of profit and loss at the end of the year	35,000	25,000

Additional Information:

- Dividend paid during the year Rs. 10,000
- Depreciation charges during the year Rs. 40,000.



Solution:

Fox Ltd.

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

	Rs.	Rs.
<u>Cash flows from operating activities</u>		
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)
<u>Cash flows from investing activities</u>		
Purchase of PPE	(2,10,000)	
Net cash used in investing activities		(2,10,000)
<u>Cash flows from financing activities</u>		
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:

	Rs.
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



Buy-Back Of Securities

1. Illustration

M Ltd. furnishes the following summarized balance sheet as at 31st March 2011.

Liabilities	Rs. in ('000)	Rs. in ('000)
Equity and liabilities		
Share capital:		
Authorized capital:		5,000
Issued and subscribed capital		
3,00,000 equity shares of Rs.10 each fully paid up	3,000	
20,000 9% preference shares of Rs.100 each (issued two months back for the purpose of buy back)	2,000	5,000
Reserves and surplus:		
Capital reserves	10	
Revenue reserves	4,000	
Securities premium	500	
Profit and loss account	1,800	6310
Non- current liabilities – 10% debentures		400
Current liabilities and provisions		40
Total		11,750
Assets	Rs. in ('000)	Rs. in ('000)
Fixed Assets Cost	3,000	
Less: Provision for depreciation	250	2,750
Non-current investments at cost		5,000
Current assets, loans and advances (including cash and bank balances)		4,000
Total		11,750

The company passed a resolution to buy back 20% of its equity capital @Rs.15 per shares. For this purpose, it sold its investments of Rs.30 lakhs for Rs.25 lakhs. You are required to pass necessary journal entries. [Source – ICAI]

Solution 1

Journal entries in the books of M Ltd

Date	Particulars	Dr ₹ ('000)	Cr ₹ ('000)
31 st March 2011	Bank A/c Dr Profit and Loss A/c Dr To Investment A/c (Being investment sold at a loss)	25,00 5,00	30,00
	Equity share capital A/c (60,000 x ₹10) Dr Premium on buy-back A/c Dr To Bank A/c [Note : 1] (Being buy-back of 60,000 shares at ₹50 each)	6,00 3,00	9,00
	OR Equity share capital A/c (60,000 x ₹10) Dr Premium on buyback A/c Dr To Equity share buy-back A/c	6,00 3,00 9,00	9,00



	(Being amount due on buy-back of equity shares)		9,00
	Equity share buy-back A/c Dr To Bank A/c (Being Payment made for buy-back of equity shares)		
	Securities Premium A/c Dr To premium on buy-back A/c (Being premium on buy-back written off against securities premium)	3,00	3,00

Note: 1 **No. of shares bought back**

1	Total No. of shares	3,00,000
2	% of buy-back	20%
3	No. of bought back (1 x 2)	60,000
4	Buy-back price	₹15 per share
5	Total amount paid (3 x 4)	9,00,000

Note: 2

1	Face value of shares bought back	600
2	Face value of shares issued for buy-back	2,000
3	Shortfall	0
4	Capital Redemption Reserve	No

2. Illustration

Anu Ltd. (a non-listed company) furnishes you with the following summarized balance sheet as on 31st March 2011.

	Rs. (in crores)	Rs. (in crores)
Sources of funds		
Share capital:		
Authorised		100
Issued:		
12% redeemable shares of Rs. 100 each fully paid	75	
Equity shares of Rs.10 each fully paid	25	100
Reserves and surplus:		
Capital reserves	15	
Securities premium	25	
Revenue reserves	260	300
Total		400
Application of Funds		
Fixed assets: cost	100	
Less: Provision for depreciation	(100)	Nil
Non-current investments at cost (Market value Rs 400 Cr.)		100
Current assets	340	
Less: Current liabilities (Trade Payables)	(40)	300
Total		400

The company redeemed preference shares on 1st April 2011. It also brought back 50 lakhs equity shares of Rs. 10 each at Rs.50 per shares. The payment for the above were made out of the huge bank balances, which appeared as a part of current assets. The company redeemed preference shares on 1st April 2011. It also brought back 50 lakhs equity shares of Rs. 10 each at Rs.50 per shares. The payment 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 1.04.2011 [Source ICAI]

Solution 2**(i) Journal entries in the books of Anu Ltd**

Date	Particulars	Dr ₹ (Crores)	Cr ₹ (Crores)
31 st March 2011	12% Preference share capital A/c Dr To preference shareholders A/c (Being Preference shares due for redemption)	75	75
"	Preference shareholders A/c Dr To Bank A/c (Being preference shareholders paid)	75	75
"	Revenue reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Preference share redeemed) [Note:1]	75	75
31 st March 2011	Equity share capital A/c (50 lakhs x ₹10) Dr Premium on buy-back A/c (50 lakhs x ₹40)Dr To share buy-back A/c (50 lakhs x ₹50) (Being Equity shares due for buy-back)	5 20	25
"	Share buy-back A/c Dr To Bank A/c (Being amount paid for equity share bought back)	25	25
"	Securities premium A/c Dr To Premium on buy-back A/c (Being premium on shares bought back written off against securities premium)	20	20
"	Revenue reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Equity shares bought back by debiting revenue reserve) [Note :2]	5	5

(ii) Balance sheet of Anu Ltd as at 1.4.2011

		Particulars	Notes	₹ (in crores)
1		Equity and Liabilities		
		Shareholder's funds		
	A	Share capital	1	20
	B	Reserves and Surplus	2	280
2		Current liabilities		
	A	Trade Payables		40
		Total		340
		Assets		
		Non-current assets		
1	A	Property, plant and equipment	3	-
	B	Non-Current Investments	4	100
		Current assets		
2	A	Trade receivables		140
	B	Cash and Cash equivalents	5	100
		Total		340



Notes to accounts

S.no	Particulars		₹ (in crores)
1	Share Capital Authorised, issued and subscribed share capital: 200 lakhs Equity shares of ₹10 each fully paid		20
2	Total		20
3	Reserves and Surplus Capital reserves Capital redemption reserve Securities premium Less: Utilisation for buy-back of shares Revenue Reserve Less: transfer to Capital redemption reserve	25 (20) 260 (80)	15 80 5 180
3	Total		280
4	Property, Plant and Equipment PPE: cost Less: Provision for depreciation		100 (100)
4	Net carrying value		-
5	Non-Current Investments Non-Current Investments at cost (Market value ₹400 Crores)		100
5	Cash and Cash Equivalents Cash and Cash Equivalents as on 31.3.2011 Less: Bank payment for redemption and buy-back		200 (100)
	Total		100

Note: 1

₹ (crores)

1	Face value of preference shares redeemed	75
2	Face value of shares issued for buy-back	0
3	Capital Redemption Reserve to be created (1-2)	75

Note: 2

₹(crores)

1	Face value of shares bought back	5
2	Face value of shares issued for buy-back	0
3	Capital Redemption Reserve to be created	5

3. Illustration

Dee Ltd. (a non-listed company) furnishes the following summarized balance sheet as at 31st March 2011.

Liabilities	Rs. ('000)	Rs. ('000)
Share capital: Authorised capital		30,00
Issued and subscribed capital: 2,50,000 equity shares of Rs.10 each fully paid up 2,000, 10% preference shares of Rs.100 each (issued two months back for the purpose of buy back)	25,00 2,00	



Reserves and surplus:	10,00	
Capital reserves		
Revenue reserves	30,00	
Securities premium Profit and loss account	22,00	97,00
	35,00	
Current liabilities and provision		14,00
Total		1,38,00
Assets		
Fixed assets		93,00
Investments		30,00
Current assets, loans and advances (including cash and bank balances)		15,00
Total		1,38,00

The company passed a resolution to buy back 20% of its equity capital @ Rs. 50 per shares. For this purpose, it sold all of its investment for Rs.22, 00,000.

You are required to pass necessary journal entries and prepare the balance sheet.

Solution 3

Journal entries in the books of M Ltd

Date	Particulars	Dr ₹ ('000)	Cr ₹ ('000)
31 st March 2011	Bank A/c Dr Profit and Loss A/c Dr To Investment A/c (Being investment sold at a loss)	22,00 8,00	30,00
"	Equity share capital A/c Dr Premium on buyback A/c Dr To Equity share buy-back A/c (Being amount due on buy-back of equity shares)	5,00 20,00	25,00
"	Equity share buy-back A/c Dr To Bank A/c (Being Payment made for buy-back of equity shares)	25,00	25,00
"	Securities Premium A/c Dr To premium on buy-back A/c (Being premium on buy-back written off against securities premium)	20,00	20,00
"	Revenue reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Equity shares bought back by debiting revenue reserve)	3,00	3,00

Balance Sheet of Dee Limited as at 1st April, 2011 (After buy-back of shares)

	Particulars	Notes	₹ ('000)
1	Equity and Liabilities		
	Shareholder's funds		
A	Share capital	1	22,00
	Reserves & Surplus	2	69,00
2	Non-Current liabilities		
A	Long-term borrowings		
3	Current liabilities & Provision		14,00



		Total		1,05,00
1	A	Assets		
		Non-current assets		93,00
		Property, plant and equipment		
2		Investments		12,00
		Current assets		1,05,00
		Total		

Notes to accounts

S.no	Particulars		₹ ('000)
1	Share Capital		
	Authorised, issued and subscribed share capital:		20,00
	2,50,000 Equity shares of ₹10 each fully paid		2,00
2	2,000, 19% Preference shares of ₹100 each (issued two months back for the purpose of buy-back)		
	Total		22,00
	Reserves and Surplus		
	Capital reserves		10,00
	Capital redemption reserve		3,00
	Securities premium	22,00	
	Less: Utilisation for buy-back of shares	(20,00)	2,00
	Revenue Reserve	30,00	
	Less: transfer to Capital redemption reserve	(3,00)	27,00
	Profit and loss A/c	35,00	
	Less: Loss on investment	(8,00)	27,00
	Total		69,00

4. Illustration

Perrotte Ltd. (a non- listed company) has the following capital structure as on 31.03.2011.

	Particulars	Rs. (in crores)	Rs. (in crores)
(1)	Equity shares capital (shares of Rs.10 each fully paid)		330
(2)	Reserves and surplus		
	General reserves	240	—
	Securities premium account	90	—
	Profit and loss account	90	—
	Infrastructure development reserves	180	600
(3)	Loan funds		1,800

Shareholders of Perrotte Ltd. on the recommendation of their Board of Directors, have appeared on 12.09.2011 a proposal to buy back the maximum permissible number of equity shares considering the large surplus funds available at the disposal of the company. The prevailing market value of the company's shares is Rs.25 per shares 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 reserves are created to satisfy income-tax Act requirements.

You are required to compute the maximum number of shares that can be brought back in the light of the above information and also under a situation where the loan funds of the company were Rs.1, 200 crores or Rs. 1,500 crores. Assuming that the buyback is completed by 09.12.2011, show the accounting entries in the company's books in each situation.



Solution 4

Journal entries in the books of Perrotte Ltd

Date	Particulars	Dr ₹ ('000)	Cr ₹ ('000)
31 st March 2011	Equity share capital A/c Dr Premium on buyback A/c Dr To Equity share buy-back A/c (Being amount due on buy-back of 3.75 crores equity shares of ₹10 each @ ₹30 per share)	37.5 75	112.5
"	Equity share buy-back A/c Dr To Bank A/c (Being Payment made for buy-back of equity shares)	112.5	112.5
"	Securities premium A/c Dr To Premium on buy-back A/c (Being premium on shares bought back written off against securities premium)	75	75
"	General reserve A/c Dr To Capital Redemption Reserve A/c (Being CRR created for Equity shares bought back by debiting General reserve)	37.5	37.5

Working Notes:

1. Shares Outstanding Test

	Particulars	
A	Paid up share capital	₹ 330 Crores
B	Face value per share	₹ 10
C	No. of shares(A/B)	33 Crores Shares
D	25% of Shares outstanding	8.25 Crore Shares

2. Resource Test

	Particulars	₹
A	Eq share capital (Paid up)	330 Crores
B	Preference share capital (Paid up)	0
C	Free Reserves : General Reserves - 240cr Profit and loss A/c - 90cr Securities Premium - 90cr	420 Crores
D	Shareholders funds (A+B+C)	750 Crores
E	Max. Resources that we can use for buy-back ⇒ 25% of (D)	187.5 Crores
F	Buy-back price (₹25 + 20%)	30
G	Max. No. of Shares can bought back ⇒ (E/F) = 187.5 / 30	6.25 Crore shares

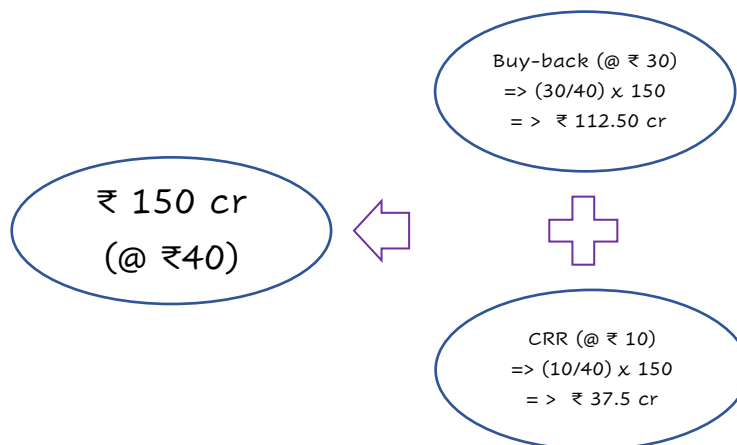
3. Post Buy-back Debt Equity Ratio Test

	Particulars	When Loan fund is		
		₹ 1,800 Crores	₹ 1,200 Crores	₹ 1,500 Crores
A	Minimum Eq Shares (Post Buy-back)	900 Cr.	600 Cr.	750 Cr.
B	Equity Before Buy-back	750 Cr.	750 Cr.	750 Cr.



	(Refer Working Note : 2)			
C	Is Buy-back possible?	No [on account of inadequate equity]	Yes	No [on account of inadequate equity]

⇒ Reduction permissible from shareholders funds on account of buy back = ₹150 cr
(including CRR)



⇒ Max. No. of shares can be bought-back = $112.5/30 = 3.75$ Crores

Summary

	Particulars	When Loan fund is		
		₹ 1,800 Crores	₹ 1,200 Crores	₹ 1,500 Crores
A	Shares Outstanding Test	8.25 cr	8.25 cr	8.25 cr
B	Resource Test	6.25 cr	6.25 cr	6.25 cr
C	Post Buy-back Debt Equity Test	0	3.75 cr	0
D	Maximum No. of shares that can be bought back (Least of A,B,C)	0	3.75 cr	0

5. Illustration

Following is the summarized Balance Sheet of Super Ltd. as on 31st March, 2018.

Liabilities	(Rs.)
Share Capital	
Equity Shares of Rs.10 each fully paid up	17,00,000
Reserves & Surplus	
Revenue Reserve	23,50,000
Securities Premium	2,50,000
Profit & Loss Account	2,00,000
Infrastructure Development Reserve	1,50,000
Secured Loan	
9% Debentures	22,50,000
Unsecured Loan	8,50,000
Current Maturities of Long-term borrowings	<u>15,50,000</u>
	<u>93,00,000</u>
Assets	
Fixed Assets	
Tangible Assets	58,50,000
Current Assets	
Current Assets	<u>34,50,000</u>



Super Limited wants to buy back 35,000 equity shares of Rs.10 each fully paid up on 1st April, 2018 at Rs. 30 per share.

Buy Back of shares is fully authorised by its articles and necessary resolutions have been passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as part of the Current Assets.

Comment with calculations, whether the Buy Back of shares by the company is within the provisions of the Companies Act, 2013.

Solution 5

Test 1 - Shares Outstanding Test

	Particulars	
A	Outstanding shares (Numbers)	1,70,000 shares
D	25% of Shares outstanding (25% x A)	42,500 shares

Test 2 - Resource Test

	Particulars	₹
A	Max Resources used $\leq$ 25% (paid up Capital + Free reserves)	
B	Paid up Capital	17,00,000
C	Free Reserves: - Revenue Reserves - P&L A/c - Securities premium (for buy-back)	23,00,000 2,00,000 2,50,000
D	Total	45,00,000
E	25% of 45,00,000	11,25,000
F	Buy-back Price	₹30 per share
G	Max. Shares that can be bought back (E / F)	37,500 Shares

Test 3 - Post Buy-back Debt Equity Ratio Test

- Loan $\leq$ 2 x Equity Shareholders Funds
- $[22,50,000 + 8,50,000 + 15,50,000] \leq 2 \times [W.N : 1]$

Working Note: 1

Debt Equity Post Buy-back

Particulars	
For ₹1 of Equity Post buy back	≤ 2 can be debt
If Eq is ₹1 If Debt is ₹1	Debt $\leq$ ₹2 Eq $\geq$ 1/2
If Buy-back is happening out of Reserves	CRR should be created
Amount of CRR	Face value of shares bought back
Present Shareholder funds (-) Capital Redemption Reserve $\rightarrow X$ (-) Amount used to Buy-back $\rightarrow Y$	45,00,000 (Refer Test 3)

- $(45,00,000 - X - Y) = \frac{1}{2} (46,50,000)$ [i.e. $\frac{1}{2}$ of debt]
- $45,00,000 - X - Y = 23,25,000$ $\rightarrow$ Eqn -1
- $Y = 3X$ $\rightarrow$ Eqn -2

Incorporate Eqn (2) in (1)



$$45,00,000 - X - Y - 3X = 23,25,000$$

$$X = 5,43,750$$

$$Y = 3X = 16,31,250$$

⇒ No. of Shares that can be Buy-back as per Test 3 = $16,31,250/3 = 54,375$

Summary

No. of Shares to be bought back (as given) → 35,000

Permitted buy back as per Companies Act: → 37,500

Lowest of

- Test 1 – 42,500
- Test 2 – 37,500
- Test 3 – 54,375

Therefore Buy-back permitted for 35,000 shares

6. Illustration

Extra Ltd. (a non-listed company) furnishes you with the following Balance Sheet as at 31st March, 20X1:

		Particulars	Notes	Rs.
		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	Rs.
1	Share Capital	
	Authorized, issued and subscribed capital:	
	Equity shares of Rs. 10 each fully paid	100
	9% Redeemable preference shares of Rs. 100 each fully paid	<u>20</u>
	Total	<u>120</u>
2	Reserves and Surplus	
	Capital reserves	8
	Revenue reserves	50
	Securities premium	<u>60</u>
	Total	<u>118</u>
3	Long term borrowings	
	10% Debentures	<u>4</u>



- (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 Rs. 10 each at Rs. 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 Rs. 2 lakhs (face value Rs. 2.20 lakhs). These debentures were cancelled on 1st April, 20X1.
- (iv) The company had 1,00,000 equity stock options outstanding on the above-mentioned date, to the employees at Rs. 20 when the market price was Rs.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.

Solution:

Date	Particulars		Debit	Credit
20X1				
1 st April	9% Redeemable preference share capital A/c	Dr.	20.00	
	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	22.00	
	To Bank A/c			22.00
	(Being payment made to shareholders)			
	Equity shares buy-back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs equity shares of Rs. 10 each bought back @ Rs. 30 per share)			
	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy-back A/c			90.00
	(Being cancellation of shares bought back)			
	Revenue reserve A/c	Dr.	50.00	
	To Capital redemption reserve A/c			50.00
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)			
	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debentures A/c			0.20
	(Being cancellation of own debentures costing Rs. 2 lakhs, face value being Rs. 2.20 lakhs and the balance being profit on cancellation of debentures)			
	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00
	To Securities premium A/c			10.00



	(Being the allotment to employees, of 50,000 shares of Rs. 10 each at a premium of 20 per share in exercise of stock options by employees)			
	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preference shares A/c			2.00
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of Extra Ltd. as at 01.04.20X1

<i>Particulars</i>			<i>Notes</i>	<i>Rs.</i>
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

<i>No.</i>	<i>Particulars</i>		<i>Rs.</i>
1	Share Capital		
	Equity shares of Rs. 10 each fully paid		100
	Less: Cancellation of bought back shares		(30)
	Add: Shares issued against ESOP		<u>5</u>
	Total		<u>75</u>
2	Reserves and Surplus		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	<u>0.20</u>	8.20
	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	<u>(50.00)</u>	-
	Securities Premium		
	Opening balance	60.00	
	Less: Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	



	Add: Shares issued against ESOP at premium	<u>10.00</u>	8.00
	Capital Redemption Reserve		<u>50.00</u>
	Total		<u>66.20</u>
3	Long term borrowings		
	10% Debentures		4.00
	Less: Cancellation of own debentures		<u>(2.20)</u>
	Total		<u>1.80</u>
4.	Other Current liabilities		
	Opening balance		70.00
	Less: Adjustment for ESOP outstanding		<u>(5.00)</u>
	Total		<u>65.00</u>
5.	Non-current investments		
	Opening balance		120.00
	Less: Investment in own debentures		<u>(2.00)</u>
	Total		<u>118.00</u>
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		<u>10.00</u>
	Total		<u>40.00</u>

7. Illustration

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 20X1:

Particulars	Rs.	Rs.
Equity Share Capital (shares of Rs. 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	<u>6,20,000</u>	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 Rs. 30 per share.

Solution:

Debt Equity Ratio Test

	Particulars	Rs.
(a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs. in crores)	21,00,000
(c)	Present equity shareholders fund (Rs. in crores)	72,80,000
(d)	Future equity shareholder fund (Rs. in crores) (See Note 2)	59,85,000 (72,80,000 - 12,95,000)
(e)	Maximum permitted buy-back of Equity (Rs. in crores) [(d) - (b)] (See	38,85,000 (by simultaneous equation)



	Note 2)	
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	Rs.
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	<u>42,80,000</u>
	<u>72,80,000</u>

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.

$$(72,80,000 - x) - 21,00,000 = y$$

$$\text{Since } 51,80,000 - x = y$$

Equation 2: (Maximum buyback/offer price for buyback X Nominal Value) = Nominal value of the shares bought –back to be transferred to CRR

$$(y/30 \times 10) = x$$

$$3x = y$$

$$x = \text{Rs. } 12,95,000 \text{ crores and } y$$

$$= \text{Rs. } 38,85,000 \text{ crores}$$

8. Illustration

SMM Ltd. has the following capital structure as on 31st March, 20X1:

	Particulars	Situation I	Situation II
(i)	Equity share capital (shares of Rs. 10 each)	1,200	1,200
(ii)	Reserves:		
	General Reserves	1,080	1,080
	Securities Premium	400	400
	Profit & Loss	200	200
	Infrastructure Development Reserve (Statutory Reserve)	320	320
(iii)	Loan Funds	3,200	6,000

The company has offered buy-back price of Rs. 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both situations and also required to pass necessary Journal Entries.

Solution:

Statement determining the maximum number of shares to be bought back

Number of shares

(in crores)

Particulars	When loan fund is	
	Rs. 3,200 crores	Rs. 6,000 crores
Shares Outstanding Test (W.N.1)	30	30
Resources Test (W.N.2)	24	24
Debt Equity Ratio Test (W.N.3)	32	Nil



Maximum number of shares that can be bought back [least of the above]	24	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is Rs.3,200 crores)

			Rs. in crores	
	Particulars		Debit	Credit
(a)	Equity shares buy-back account	Dr.	720	720
	To Bank account			
	(Being payment for buy-back of 24 crores equity shares of Rs. 10 each @ Rs. 30 per share)			
(b)	Equity share capital account	Dr.	240	480
	Premium Payable on buy-back account	Dr.	480	
	To Equity share buy-back account			
	(Being cancellation of shares bought back)			
	Securities Premium account General Reserve / Profit & Loss A/c	Dr. Dr.	400 80	
(c)	To Premium Payable on buy-back account			240
	(Being Premium Payable on buy-back account charged to securities premium and general reserve/Profit & Loss A/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 (Rs. in crores)	1,200
Free reserves (Rs. in crores) (1,080 + 400 + 200)	<u>1,680</u>
Shareholders' funds (Rs. in crores)	<u>2,880</u>
25% of Shareholders fund (Rs. in crores)	Rs. 720 crores
Buy-back price per share	Rs. 30
Number of shares that can be bought back	24 crores shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

Particulars		When loan fund is	
		Rs. 3,200 crores	Rs. 6,000 crores
(a)	Loan funds (Rs.)	3,200	6,000
(b)	Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs.) (a/2)	1,600	3,000
(c)	Present equity shareholders fund	2,880	2,880



	(Rs.)		
(d)	Future equity shareholders fund (Rs.) (see W.N.4)	2,560 (2,880-320)	N.A.
(e)	Maximum permitted buy- back of Equity (Rs.) [(d) - (b)]	960	Nil
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share	32 crore shares	Nil
	As per the provisions of the Companies Act, 2013, company	Qualifies	Does not Qualify

4. Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity - Transfer to CRR) - Minimum Equity to be maintained = Maximum Permitted Buy-Back

$$= (2,880 - x) - 1,600 = y$$

$$= 1280 - x = y \quad (1)$$

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share

$$y/30 \times 10 = x \text{ or}$$

$$3x = y \quad (2)$$

by solving the above two equations we get x= Rs. 320

y = Rs. 960

9. Illustration

KG Limited furnishes the following Balance Sheet as at 31st March, 20X1:

Particulars			Notes	Rs.
1		Equity and Liabilities		
		Shareholders' funds		
	A	Share capital Reserves and	1	1,200
	B	Surplus	2	810
2		Non-current liabilities		
		Long term borrowings		750
			3	
3		Current liabilities		
	A	Trade Payables		745
	B	Other Current Liabilities		195
				3,700
		Total		
1		Assets		
		Non-current assets		
	A		4	2,026
	B	Property, plant and equipment Non-current Investments		74
2				
	A	Current assets		600
	B			260
	C	Inventories		740
		Trade receivables		3,700
		Cash and Cash equivalents		



		Total		

Notes to accounts

No.	Particulars	Rs.
1	Share Capital	
	Authorized, issued and subscribed capital	
	Equity share capital (fully paid up shares of Rs. 10 each)	<u>1,200</u>
2	Reserves and Surplus	
	Securities premium	175
	General reserve	265
	Capital redemption reserve	200
	Profit & loss A/c	<u>170</u>
	Total	<u>810</u>
3	Long term borrowings	
	12% Debentures	<u>750</u>
4	Property, plant and equipment	
	Land and Building	1,800
	Plant and machinery	<u>226</u>
	Net carrying value	2,026

On 1st April, 20X1, the company announced the buy-back of 25% of its equity shares @ Rs. 15 per share. For this purpose, it sold all of its investments for Rs. 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 Rs. 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.

Solution:

In the books of KG Limited Journal Entries

Date	Particulars	Dr.	Cr.
20X1		(Rs. 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-back)		
	Equity shares buy-back A/c Dr.	450	
	To Bank A/c		450
	(Being the payment made on account of buy- back of 30 Lakh Equity Shares)		
April 5	General reserve A/c Dr.	265	
	Profit and Loss A/c Dr.	35	
	To Capital redemption reserve A/c		300
	(Being amount equal to nominal value of buy- back shares from free reserves transferred to capital)		



April 30	redemption reserve account as per the law)			
	Capital redemption reserve A/c	Dr.	225	
	To Bonus shares A/c (W.N.1)			225
	(Being the utilization of capital redemption reserve to issue bonus shares)			
	Bonus shares A/c	Dr.	225	
	To Equity share capital A/c			225
	(Being issue of one bonus equity share for every four equity shares held)			

Balance Sheet (After buy-back and issue of bonus shares)

Particulars			Notes	Rs.
		Equity and Liabilities		
1		Shareholders' funds		
	A	Share capital	1	1,125
	B	Reserves and Surplus	2	436
2		Non-current liabilities		
		Long term borrowings	3	750
3		Current liabilities		
	A	Trade Payables		745
	B	Other Current Liabilities		195
		Total		3,251
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	2,026
2		Current assets		
	A	Inventories		600
	B	Trade receivables		260
	C	Cash and Cash equivalents		365
		Total		3,251

Notes to accounts

No	Particulars		Rs.
1	Share Capital		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of Rs. 10 each)		<u>1,125</u>
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)	<u>136</u>
	Total		<u>436</u>
3	Long term borrowings		
	12% Debentures		<u>750</u>
4	Property, Plant and Equipment		
	Land and Building		1,800
	Plant and machinery		<u>226</u>
	Net carrying value		2,026

Working Notes:

- Amount of bonus shares = 25% of (1,200 – 300) lakhs = Rs. 225 lakhs
- Cash at bank after issue of bonus shares

Particulars	Rs. in lakhs
Cash balance as on 1 st April, 20X1	740
Add: Sale of investments	<u>75</u>
	815
Less: Payment for buy-back of shares	<u>(450)</u>
	<u>365</u>

10. Illustration

Following is the Balance Sheet of Competent Limited as at 31st March, 20X1:

		Particulars	Notes	Rs.
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
1		Assets		
		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	Rs.
1	Share Capital	
	Authorized, issued and subscribed capital:	
	Equity share capital (fully paid up shares of Rs. 10 each)	<u>12,50,000</u>
2	Reserves and Surplus	
	Securities premium	2,50,000
	Profit and loss account	1,25,000
	Revenue reserve	15,00,000



	Total		<u>18,75,000</u>
3	Long term borrowings		
	14% Debentures		18,75,000
	Unsecured Loans		<u>10,00,000</u>
	Total		<u>28,75,000</u>
4	Property, plant and equipment		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		<u>9,20,000</u>
	Net carrying value		<u>46,50,000</u>

The company wants to buy-back 25,000 equity shares of Rs. 10 each, on 1st April, 20X1 at Rs. 20 per share. Buy-back of shares is duly authorized by its articles and necessary resolution has been passed by the company towards this. The payment for buy-back of shares will be made by the company out of sufficient bank balance available shown as part of Current Assets.

Comment with your calculations, whether buy-back of shares by company is within the provisions of the Companies Act, 2013. If yes, pass necessary journal entries towards buy-back of shares and prepare the Balance Sheet after buy-back of shares.

Solution:

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 (Rs.)	12,50,000
Free reserves (Rs.) (15,00,000 + 2,50,000 + 1,25,000)	<u>18,75,000</u>
Shareholders' funds (Rs.)	<u>31,25,000</u>
25% of Shareholders fund (Rs.)	7,81,250
Buy-back price per share	Rs. 20
Number of shares that can be bought back (shares)	39,062
Actual Number of shares for buy-back	25,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	Rs.
(a)	Loan funds (Rs.) (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 (Rs.) (a/2)	22,62,500
(c)	Present equity/shareholders fund (Rs.)	31,25,000
(d)	Future equity/shareholders fund (Rs.)(see W.N.) (31,25,000 – 2,87,500)	28,37,500
(e)	Maximum permitted buy-back of Equity (Rs.) [(d) – (b)]	5,75,000
(f)	Maximum number of shares that can be bought back @ Rs. 20 per share	28,750 shares
(g)	Actual Buy-Back Proposed	25,000 Shares



Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	31,250
Resources Test	39,062

Debt Equity Ratio Test	28,750
Maximum number of shares that can be bought back [least of the above]	28,750

Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy maximum 28,750 shares on 1st April, 20X1.

However, company wants to buy-back only 25,000 equity shares @ Rs. 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 (Rs.)	Credit (Rs.)
(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 Rs. 10 each @ Rs. 20 per share)			
(b)	Equity share capital account	Dr.	2,50,000	
	Securities premium account	Dr.	2,50,000	
	To Equity shares buy-back account			5,00,000
	(Being cancellation of shares bought back)			
(c)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of M/s. Competent Ltd. as at 31st March, 20X1

	Particulars	Notes	Rs.
	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		Rs.
1	Share Capital		
	Authorized, issued and subscribed capital:		
	Equity share capital (fully paid up shares of Rs. 10 each)		<u>10,00,000</u>
2	Reserves and Surplus		
	Profit and Loss A/c		1,25,000
	Revenue reserves	15,00,000	
	Less: Transfer to CRR	<u>(2,50,000)</u>	12,50,000
	Securities premium	2,50,000	
	Less: Utilization for share buy-back	<u>(2,50,000)</u>	-
	Capital Redemption Reserves		<u>2,50,000</u>
	Total		<u>16,25,000</u>
3	Long term borrowings		
	14% Debentures		18,75,000
	Unsecured Loans		<u>10,00,000</u>
	Total		<u>28,75,000</u>
4	Property, plant and equipment		
	Land and Building		19,30,000
	Plant and machinery		18,00,000
	Furniture and fitting		<u>9,20,000</u>
	Net carrying value		<u>46,50,000</u>

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

$$(31,25,000 - x) - 22,62,500 = y$$

$$(y/20 \times 10) = x \quad \text{or} \quad 2x = y$$

by solving the above equation, we get

$$x = \text{Rs. } 2,87,500 \quad y = \text{Rs. } 5,75,000$$

11. Illustration

The following information from Balance Sheet of Z Ltd. as on 31st March ,20X1:

	Rs. Lakhs
Share Capital:	
Equity shares of Rs. 10 each Fully Paid Up	16,000
10% Redeemable Pref. Shares of Rs. 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	<u>2,000</u>
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 Rs. 20 per Share. In order to make cash available, the Company sold all the Investments for Rs. 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.

Solution:

Journal Entries in the books of Z Ltd.

	Particulars			
1	Bank A/c To Investments A/c To Profit and Loss A/c (Being investment sold on profit for the purpose of buy-back)	Dr.	5,000	4,700 300
2	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being redemption of preference share capital at premium of 10%)	Dr. Dr.	5,000 500	5,500
3	Profit and Loss A/c To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	Dr.	500	500
4	Equity Share Capital A/c Premium on buyback To Equity buy-back A/c (Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)	Dr. Dr.	1,600 1,600	3,200
5	Securities Premium A/c (1,600) To Premium on Buyback A/c (Being premium on buyback provided out of securities premium)	Dr.	1,600	1,600
7	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
8	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption)		6,600	6,600



	reserve account towards face value of preference shares redeemed and equity shares bought back)			

Balance Sheet of C Ltd. (after Redemption and Buyback)

	Particulars	Note No	Amount
	EQUITY AND LIABILITIES		Rs.
(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		<u>2,000</u>
	Total		<u>45,400</u>
(II)	ASSETS		
(1)	Non-Current Assets		
	PPE		28,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		900
	(b) Other Current Assets		<u>16,500</u>
			<u>45,400</u>

Notes to Accounts

		Rs. in Lakhs		
1.	Share Capital			
	1,440 lakh Equity Shares of Rs. 10 each Fully Paid up (160 lakh Equity Shares bought back)			14,400
2.	Reserves and Surplus			
		12,000		
	General Reserve	<u>(6,600)</u>	5,400	
	Less: Transfer to CRR Capital	2,000		
	Redemption Reserve	<u>6,600</u>	8,600	
	Add: Transfer due to buy-back of shares from Gen. res.	1,600		
		<u>(1,600)</u>		
	Securities premium			
	Less: Adjustment for premium paid on buy back	600		
		300		
	Profit & Loss A/c	<u>(500)</u>		
	Add: Profit on sale of investment		<u>400</u>	14,400
3.	Less: Adjustment for premium paid on redemption of preference shares			
				10,000
	Long-term borrowings			
	Secured			
	9 % Debentures			



Working Note:
Bank Account

	Amount		Amount
	(Rs. Lakhs)		(Rs. Lakhs)
To balance b/d	4,600	By Preference Shareholders A/c	5,500
To Investment A/c (sale Proceeds)	5,000	By Equity buy back A/c	3,200
		By Balance c/d (Balancing figure)	<u>900</u>
	<u>9,600</u>		<u>9,600</u>



ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES

Illustrations

1 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
- Final accounts method
- stock and debtors method

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Opening balance (1-1-20X1)		Bad Debts	1,000
Imprest Cash	2,000	Discount to Customers	2,000
Sundry Debtors	25,000	Remittances to H.O. (recd. by H.O.)	1,65,000
Stock: Transferred from H.O.	24,000	Remittances to H.O. (not recd. by H.O. so far)	5,000
Direct Purchases	16,000	Branch Exp. directly paid by H.O.	30,000
Cash Sales	45,000	Closing Balance (31-12-20X1)	
Credit Sales	1,30,000	Stock:	10,000
Direct Purchases	45,000	Direct Purchase Transfer from H.O.	15,000
Returns from Customers	3,000	Debtors	?
Goods sent to branch from H.O.	60,000	Imprest Cash	?
Transfer from H.O. for Petty Cash expenses	4,000	Petty Cash expenses	4,000

Solution

a. Debtors method

In the books of Buckingham Bros, Bombay Nagpur branch account

Particulars	₹	Particulars	₹	₹
To opening branch assets		By bank -remittances received from branch		
Stock (24,000+16,000)	40,000	cash	45,000	
Debtors	25,000	Cash from debtors	1,20,000	
Imprest cash	2,000	Cash in transit	5,000	1,70,000
To goods sent to branch a/c	60,000	By closing branch assets		
To creditors (direct purchases)	45,000	Stock (15,000+10,000)		25,000
To bank (sundry expenses)	30,000	Debtors (w.n 1)		24,000
To bank (petty cash expenses)	4,000	Imprest cash (w.n 2)		2,000
To net profit (transferred to general profit and loss a/c)	15,000			
	2,21,000			2,21,000

Working notes:

1. Memorandum debtors a/c

Particulars	₹	Particulars	₹
To balance b/d	25,000	By sales return	3,000
To sales	1,30,000	By bad debts	1,000
		By discount	2,000
		By cash (w.n 3)	1,25,000
		By balance c/d	24,000
	1,55,000		1,55,000



2. Memorandum petty cash

Particulars	₹	Particulars	₹
To balance b/d	2,000	By expenses (met by branch)	4,000
To transfer from H. O	4,000	By balance c/d	2,000
	6,000		6,000

$$\begin{aligned}
 3. \text{ Collection from debtors} &= \text{total remittances} - \text{cash sales} \\
 &= 1,70,000(1,65,000+5000) - 45,000 \\
 &= 125,000
 \end{aligned}$$

b. **Final accounts method**

In the books of Buckingham bros, Bombay

Nagpur branch trading and profit and loss account for the year ending 31st December, 20X1

Particulars	₹	Particulars	₹	₹
To opening stock	40,000	By sales		
To goods transferred from head office	60,000	Cash	45,000	
To purchases	45,000	Credit	1,30,000	
To gross profit c/d	52,000		1,75,000	
		Less: returns	(3000)	1,72,000
		By closing stock		25,000
	1,97,000			1,97,000
To sundry expenses	30,000	By gross profit b/d		52,000
To discounts	2,000			
To bad debts	1,000			
To petty cash expenses	4,000			
To net profit (transferred to general profit and loss a/c)	15,000			
	52,000			52,000

c. **stock and debtors method**

In the books of Buckingham bros, Bombay

Branch stock account

Particulars	₹	Particulars	₹	₹
To opening stock	40,000	By sales		
To goods transferred from head office	60,000	Cash	45,000	
To purchases	45,000	Credit	1,30,000	
To gross profit c/d	52,000		1,75,000	
		Less: returns	(3000)	1,72,000
		By closing stock		25,000
	1,97,000			1,97,000

Branch expenses a/c

Particulars	₹	Particulars	₹
To bad debts a/c	1000	By branch profit and loss account	37,000
To discount allowed	2000		
To petty cash expenses	4000		
To sundry expenses	30,000		
	37,000		37,000



Branch profit and loss account

Particulars	₹	Particulars	₹
To branch expenses	37,000	By branch stock a/c	52,000
	15,000		
	52,000		52,000

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 at the branch during the year ended December 31, 20X1.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Balances as on 1.1.20X1:		Bad Debts	600
Stock	7,000	Goods returned by customers	500
Debtors	12,600	Salaries & Wages	6,200
Petty Cash	200	Rent & rates	1,200
Goods sent from H.O.	26,000	Sundry Expenses	8,00
Goods returned to H.O.	1,000	Cash received (from Sundry Debtors)	2,800
Cash sales	17,500	Balances as on 31.12.20X1:	
Credit sales	28,500	Stock	6,500
Allowances to customers	200	Debtors	9,800
Discount to customers	1,400	Petty Cash	100

Prepare:

- Branch Account (Debtors Method),
- Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and
- Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Accounts

Solution

a. Debtors method

Branch account for the period 31st December, 20X1

Particulars	₹	₹	Particulars	₹	₹
To opening branch assets:			By bank		
Stock	7,000		Cash	17,500	
Debtors	12,600		Cash received from debtors	28,500	46,000
Petty cash	200	19,800	By goods sent to branch a/c		
To goods sent to branch a/c		26,000	(Returns to H.O)		1000
To bank:			By closing branch assets		
Salaries and wages	6200		Stock	6500	
	1200		Debtors	9800	
	800	8200	Petty cash	100	16,400
To net profit transferred to general profit and loss a/c		9400			
		63,400			63,400



(b) stock and debtors method

Delhi Branch stock account

Particulars	₹	Particulars	₹	₹
To balance b/d- Opening stock	7000	By sales:		
To goods sent to branch a/c	26,000	Cash	17,500	
To branch profit and loss a/c	19,900	Credit	28,400	
		Less: return	(500)	45,400
		By goods sent to branch a/c – return		1000
		By balance c/d – closing stock		6500
	52,900			52,900

Delhi branch debtors account

Particulars	₹	Particulars	₹
To balance b/d	12,600	By cash	28,500
To sales	28,400	By returns	500
		By allowances	200
		By discounts	1400
		By bad debts	600
		By balance c/d	9800
	41,000		41,000

Delhi branch expenses account

Particulars	₹	Particulars	₹
To salaries and wages	6200	By branch profit and loss a/c	10,500
To rent and rates	1200		
To sundry expenses	800		
To petty cash expenses (200-100)	100		
To allowance to customer	200		
To discount	1400		
To bad debts	600		
	10,500		10,500

Delhi branch profit and loss account

Particulars	₹	Particulars	₹
To branch expenses a/c	10,500	By gross profit b/d (branch stock a/c)	19,900
To net profit transferred to general profit and loss a/c	9400		
	19,900		19,900

(c) branch trading and profit and loss account

Particulars	₹	₹	Particulars	₹	₹
To stock		7000	By sales:		
To goods sent from H. O	26,000		Cash	17,500	
Less: returns	(1000)	25,000	Credit	28,400	
To gross profit c/d		19,900	Less: returns	(500)	45,400
			By closing stock		6500
		51,900			51,900
To salaries and wages		6200	By gross profit b/d		19,900



To rent and rates	1200		
To sundry expenses	800		
To petty cash expenses	100		
To allowances to customers	200		
To discounts	1400		
To bad debts	600		
To net profit	9400		
	19,900		19,900

3 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. Following further details are given for the year ended 31st December, 20X1:

Particulars	Amount (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

Particulars	Amount (Rs.)	Amount (Rs.)
Balances as on	1-1-20X1	31-12-20X1
Stock	25,000 (Cost)	28,000 (invoice price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,500

Show necessary ledger accounts in the books of the head office and determine the Profit and Loss of the Branch for the year ended 31st December, 20X1.

Solution

In the books of Harrison Branch stock account

Particulars	₹	Particulars	₹
To balance b/d - opening stock	30,000	By branch debtors (sales)	165,000
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)	2000	By balance c/d: Goods in transit	20,000
		Closing stock at branch	28,000
	2,72,000		2,72,000

Branch debtors account

Particulars	₹	Particulars	₹
To balance b/d	32,750	By bad debts written off	750
To branch stock a/c (sales)	165,000	By branch cash (balancing figure)	1,71,000
		By balance c/d	26,000
	1,97,750		1,97,750



Branch cash account

Particulars	₹	Particulars	₹
To balance b/d	5,000	By bank remittance to H. O	2,22,500
To branch stock a/c	59,000	By branch expenses (met by branch -bal.fig.)	10,000
To branch debtors	1,71,000	By balance c/d	2,500
	2,35,000		2,35,000

Branch adjustment account

Particulars	₹	Particulars	₹
To branch profit and loss a/c -gross profit (bal.fig)	39,000	By stock reserve -opening balance (25000 × 20 %)	5000
To stock reserve (48,000 × 1/6)	8,000	By goods sent to branch a/c	40,000
	47,000	By branch stock a/c	
			47,000

Branch expenses

Particulars	₹	Particulars	₹
To cash (H.O)	12,000	By branch profit and loss a/c	22,000
To branch cash	10,000		
	22,000		22,000

Branch profit and loss account

Particulars	₹	Particulars	₹
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

Particulars	₹	Particulars	₹
To branch adjustment a/c	40,000	By branch stock a/c	2,40,000
To purchase a/c - transfer	2,00,000		
	2,40,000		2,40,000

Illustration 3 (b)

Take figures from illustration 3 (a) and prepare branch account following debtors method.

Solution

In the books of Harrison
New Delhi Branch account

Particulars	₹	Particulars	₹	₹
To opening branch assets:		By stock reserve		5000
Stock	30,000	By goods sent to branch a/c		40,000
Debtors	32,750	By cash - remittance from branch:		
Cash	5000	Cash sales	59,000	
To goods sent to branch a/c (2,00,000 + 20 %)	2,40,000	Debtors (WN1)	1,63,500	2,22,500
To cash (expenses paid by H.O)	12,000	By balance c/d		26,000
To net profit transferred to general profit and loss a/c)	16,250	Debtors		48,000



To stock reserve (48,000 × 20/120)	8000	Stock (including transit – WN 2)	2500
	3,44,000		3,44,000

Working notes:

- Collection from debtors = total cash remitted – cash sales
 $= ₹ 2,25,000 - ₹ 59,000$
 $= ₹ 1,63,500$
- Closing stock = stock at branch + stock in transit (goods sent by HO – goods Received by branch)
 $= ₹ 28,000 + ₹ 20,000 (2,40,000 - 2,20,000) = ₹ 48,000$

4 Illustration

Following is the information of the Jammu branch of Best New Delhi for the year ending 31st March, 20X2 from the following:

- Goods are invoiced to the branch at cost plus 20%.
- The sale price is cost plus 50%.
- Other information:

Particulars	Amount (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

- The profit earned by the branch during the year.
- branch stock reserve in respect of unrealized profit.

Solution

In the books of Jammu branch
Trading and profit and loss account

(I)

Particulars	₹	Particulars	₹
To opening stock	2,20,000	By sales	12,00,000
To goods received by HO	1,10,000	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

Opening stock = 2,20,000 × 20/120 = 36,667

Closing Stock = ₹ 3,60,000 × 20/120 = ₹ 60,000

Working note:

	₹
Cost price	100
Invoice price	120
Sales price	150
Calculation of closing stock at invoice price	
Opening stock at invoice price	2,20,000
Goods received during the year at invoice price	11,00,000
Gross Profit (12,00,000 × 30/150)	2,40,000
Less: Sales	(12,00,000)
Closing stock	3,60,000



5 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
	₹	₹	₹
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)	1200	600	2400

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.

Solution

In the books of sell well Branch account

Particulars	₹	Particulars	₹	₹
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 (4200 × 10/110)	382	By goods sent to branch – returns		4200
To stock reserve (53,400 × 10/110)	4855	By bank a/c		1,06,000
To net profit (balancing figure – transferred to general P&L a/c)	37,363	By balance c/d		
		Stock	53,400	
		Debtors	29,000	82,400
	2,07,600			2,07,600

Working note:

Memorandum branch debtors account

Particulars	₹	Particulars	₹
To balance b/d	---	By cash / bank a/c	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

Particulars	₹	Particulars	₹
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

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 must remit all cash received into the Head Office Bank Account.



Accounting for Branches Including Foreign Branches

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:

Particulars	Amount (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.

Solution,

In the books of Hindustan industries, Mumbai

Cochin branch stock account

Particulars	₹	Particulars	₹
To balance b/d - opening stock	60,000	By bank a/c - cash sales	2,00,000
To branch debtors a/c - sales return	8,000	By branch debtors a/c - credit sales	3,60,000
To goods sent to branch a/c	6,00,000		12,000
To branch adjustment a/c (excess of selling price over invoice price)	24,000		1,20,000
	6,92,000		6,92,000

Cochin branch stock account

Particulars	₹	Particulars	₹
To goods sent to branch a/c (1/5 of ₹1,20,000 - on returns)	2400	By balance b/d (1/5 of ₹ 60,000)	12,000
To branch P&L a/c (profit on sale) - balancing figure	1,29,600	By goods sent to branch to branch a/c (1/5 of ₹ 6,00,000)	1,20,000
To balance c/d (1/5 of ₹ 1,20,000)	24,000	By branch stock	24,000
	1,56,000		1,56,000

Goods sent to branch account

Particulars	₹	Particulars	₹
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 adjustment a/c	2,400
To purchases a/c	4,70,400		6,02,400
	6,02,400		

Branch debtors a/c

Particulars	₹	Particulars	₹
To balance b/d	72,000	By bank a/c	3,20,000
To branch stock a/c	3,60,000	By branch P&L a/c - discount	6,000
		By branch P&L a/c - bad debts	4,000



Accounting for Branches Including Foreign Branches

		By branch stock – sales return	8,000
		By balance c/d	94,000
	4,32,000		4,32,000

Branch expenses a/c

Particulars	₹	Particulars	₹
To bank a/c (rent, rates & taxes)	18,000	By branch profit & loss a/c	84,000
To bank a/c (salaries & wages)	60,000		
To bank a/c (office expenses)	6,000		
	84,000		84,000

Branch profit & loss account for the year ending 31st December 20X1

Particulars	₹	Particulars	₹
To branch expenses a/c	84,000	By branch stock adjustment a/c	1,29,600
To branch debtors a/c – discount	6,000		
To branch debtors a/c – bad debts	4,000		
To net profit transferred to P&L a/c	35,600		
	1,29,600		1,29,600

7 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:

Particulars	Amount (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	?
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:

1. Outlet Stock Account.
2. Outlet Profit & Loss Account.
3. Stock Reserve Account.

Solution

Outlet stock account

Particulars	₹	Particulars	₹
To balance b/d	30,000	By sales (W.N.1)	3,60,000
To goods sent to outlet	3,24,000	By goods lost by fire (bal.fig)	18,000
To gross profit c/d	60,000	By balance c/d	36,000
	4,14,000		4,14,000



Outlet profit and loss account

Particulars	₹	Particulars	₹
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

Particulars	₹	Particulars	₹
To HO P&L a/c -transfer	6,000	By balance b/d	6,000
To balance c/d (stock reserve)	7,200	By HO P&L a/c	7,200
	13,200		13,200

Working notes:

(1)

	₹
Wholesale price 100 + 25	125
Retail price 125 + 20%	150
Gross profit at the outlet	
Wholesale price – retail price (150 -125)	25
Retail sales value = 60,000 × 150/125	3,60,000

(2) **goods lost by fire**

Opening stock + goods sent + gross profit – sales – closing stock

30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = ₹ 18,000

(3) **stock reserve**

Opening stock = 30,000 × 25/125 = ₹ 6,000

Closing stock = 36,000 × 25/125 = ₹ 7200

8 Illustration

Messrs Ram Chand & Co., Hyderabad have a branch in Delhi. The Delhi Branch deals not only in the goods from Head Office but also buys some auxiliary goods and deals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the year and open them afresh on the basis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office. The goods from the Head Office are invoiced at selling prices to give a profit of 20 per cent on the sale price. The goods sent from the branch to Head Office are at cost.

From the following, prepare Branch Trading and Profit & Loss Account and Branch Assets Account in the Head Office Books.

Debit	Amount (₹)	Credit	Amount (₹)
Head office opening balance on 1-1-16	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. 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 % on branch assets.

Solution,

In the books of M/s. Ram Chand & Co.

Delhi branch trading and profit and loss account for the year ending 31st December 20X1

Particulars	₹	₹	Particulars	₹	₹
To opening stock:			By sales		1,00,000
Head office goods (4000 × 80%)	3200		By goods received from branch		3000
Others	500	3700	By closing stock:		
To goods sent to branch (50,000 × 80%)		40,000	Head office goods (3000 × 80%)	2400	
To purchases		20,000	Others	1000	3400
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 depreciation on furniture @ 10%		500			
To net profit		30,200			
		42,700			42,700

Branch fixed assets account

Particulars	₹	Particulars	₹
To balance b/d	5,000	By Delhi branch a/c (depreciation)	500
		By balance c/d	4500
	5,000		5000

Note: furniture a/c is maintained in head office books; it is not a part of either opening or closing balance.

9 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

Particulars	Debit (Rs.)	Credit (Rs.)
Share Capital (Authorised: 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

Particulars	Debit (Rs.)	Credit (Rs.)
PPE (Property, plant & Equipment)	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:

- Cash remitted by the Branch on 31st December, 20X1, but received by the Head Office on 1st January 20X2 – Rs. 3,000.
- 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.

Solution

The balance current in the head office books [1,33,710] and head office current account in the branch books [1,29,010] do show the same balances. Its results in difference of Rs.4700 Therefore, in order to reconcile them, the following journal entries will be passed in the head office books:

Journal entries

		Dr (₹)	Cr. (₹)
20X1 Dec.,31	Cash in transit a/c Dr To branch current a/c (cash sent by the branch on 31 st dec.,20X1 but received at H.O. on 1 st Jan., 20X2)	3000	3000
	Loss by theft a/c Dr To branch a/c (stock lost in transit from H.O to branch)	1,700	1,700

The following **journal entries passed in H.O books**, given branch trail balance drawn up after preparing the branch profit and loss a/c

		Dr (₹)	Cr. (₹)
20X1 Dec.,31	Branch current a/c Dr To profit and loss a/c (branch profit for the year)	31,700	31,700
	Branch fixed assets Dr Branch stock a/c Dr Branch debtors a/c Dr Branch cash a/c Dr To branch current a/c	95,000 50,460 19,100 6,550	1,71,110
	Branch a/c Dr To branch creditors (branch creditors brought into H.O Books)	10,400	10,400



Branch current account

Particulars	₹	Particulars	₹
To balance b/d	1,33,710	By cash in transit	3,000
	31,700	By loss of theft	1,700
	10,400	By sundry branch assets	1,71,110
	1,75,810		1,75,810

Profit and loss account for 20X1

Particulars	₹	Particulars	₹
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

10 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.

1. A Profit & Loss account for (i) H.O. (ii) the branch (iii) the entire business.
2. Balance Sheet as on 31st Dec., 20X1 for the entire business.

Particulars	Head Office		Branch Office	
	Debit (₹)	Credit (₹)	Debit (₹)	Credit (₹)
Raw materials purchased	35,000			
Direct wages	1,08,500			
Factory overheads	39,000			
Stock on 1-1-20X1				
Raw materials	1,800			
Finished goods	13,000		9,200	
Debtors	37,000			
Cash	22,000		1,000	
Administrative Salaries	13,900		4,000	
Salesmen Salaries	22,500		6,200	
Other administrative & selling overheads	12,500		2,300	
Inter-unit accounts	5,000			2,000
Capital		50,000		
Sundry Creditors		13,000		
Provision for unrealized profit in stock		1,200		
Sales		2,00,000		65,200
Goods sent to Branch		46,000		
Goods received from H.O.			44,500	
	3,10,200	3,10,200	67,200	67,200

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



the branch books. It is the company's policy to adjust items in transit in the books of the recipient.

2. The stock of raw materials held at the H.O. on 31st Dec., 20X1 was valued at Rs. 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 was no opening or closing stock of work-in-progress.
- Branch employees are entitled to a bonus of Rs.156 under a bilateral agreement.

Solution:

In the books of KP
Trading and profit & loss account for the year ending 31st December, 20X1

Particulars	H.O (₹)	Branch (₹)	Total (₹)	Particulars	H.O (₹)	Branch (₹)	Total (₹)
To opening stock	13,000	9200	22,200	By sales	2,00,000	65,600	2,65,200
To material consumed (W.N.1)	34,500	—	34,500	By goods sent to branch	46,000	—	—
To wages	1,08,500	—	1,08,500	By closing stock including transit (W.N.2)	15,000	9,560 (bal.fig)	24,560
To factory overheads	39,000	—	39,000				
To goods from H.O.		46,000					
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 December., 20X1

Particulars	H.O (₹)	Branch (₹)	Total (₹)	Particulars	H.O (₹)	Branch (₹)	Total (₹)
Capital	50,000	—	50,000	Fixed assets	—	—	—
Profit:				Current assets:			
H.O 17,053				Raw material	2300		2300
Branch <u>6,904</u>	23,957	—	23,957	Finished goods	15,000	9,560	23,313
Trade creditors		13,000	13,000	[24,560 – 1247(stock reserve)]	37,000	—	37,000
Bonus payable		156		Debtors	22,000	1,000	23,000
H.O account		10,404		Cash	1500	—	1500
Stock reserve (W.N.4)	1,247						



				Cash in transit Branch a/c (W.N.5)	10,404		
	88,204	10,560	87,113		88,204	10,560	87,113

Working notes:

1. Material consumed = Opening raw material + raw material consumed – Closing raw material

$$= 1,800 + 35,000 - 2,300 = 34,500$$

2. Closing stock at head office

Particulars	₹	₹
Opening stock		13,000
Total factory cost		
Material consumed	34,500	
Wages	1,08,500	
Factory overhead	39,000	1,82,000
Cost of goods sold		
Sales	2,00,000	
Less: gross profit (30% on sales)	60,000	(1,40,000)
Stock transferred to branch	46,000*100/115	(40,000)
Closing stock		15,000

3. Gross profit of branch = sales × 30% = 19,560

4. closing stock reserve = 9,560 × 15/115 = 1,247

Charge to profit and loss account = 1247 – 1200 (existing) = 47

5. branch account

Branch profit + inter unit account = 6904 + 5000 = 10,404

11 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:

Particulars	Amount in ₹	Amount in ₹
Stock on 1st Jan., 20X2	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account	-	5,99,150
	36,31,400	36,31,400

Stock on 31st December, 20X2 was 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.

Solution:

In the books of English firm (head office in New York)
Chennai branch profit and loss account for the year ended 31st December, 20X2

Particulars	\$	Particulars	\$
To opening stock	4,500	By sales	46,875
To purchases a/c	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	To gross profit c/d	23,625
To rent, rates and taxes	2125		
To exchange translation loss	2,000		
To net profit c/d	17,500		
	23,625		23,625

Balance sheet of Chennai Branch as on 31st December, 20X2

Liabilities	\$	\$	Assets	\$
Head office a/c	13,400		Furniture	1,750
Add: net profit	17,500	30,900	Closing stock	12,500
Trade creditors		10,000	Trade debtors	15,000
Bills payable		3,500	Bills receivable	4000
			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

Particulars	Dr. ₹	Cr. ₹	Conversion principle	Conversion rate	Dr. \$	Cr. \$
Stock on 1 st Jan ,20X2	2,34,000		Opening	52	4500	
Purchases & sales	15,62,500	23,43,750	Average	50	31,250	46,875
Debtors and creditors	7,65,000	5,10,000	Closing	51	15,000	10,000
Bills receivable and bills payable	2,04,000	1,78,500	Closing	51	4,000	3,500
Salaries and wages	1,00,000		Average	50	2000	
Rent, rates and taxes	1,06,250		Average	50	2125	
Furniture	91,000		Actual	-	1750	
Bank a/c	5,68,650		Closing	51	11,150	
New York account		5,99,150				13,400
Exchange translation loss (bal.fig)					2000	
	36,31,400	36,31,400			73,775	73,775

12 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:



Particulars	Bombay In ₹ (000)		Sydney In Australian Dollars (000)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.20X1)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available:

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:

Particulars	1 A \$ = Rs.	Applicability
Opening rate	20	Opening stock
Closing rate	24	Closing stock; all monetary items
Average rate	22	Purchases; Sales; Etc.,
For Fixed Assets	18	Fixed assets

Solution

In the books of S&M Ltd.

Sydney branch trial balance (in rupees) as on 31st march ,20X2

Particulars	Australian Dollars (‘000)		Conversion principle	Conversion rate	INR ₹ (000)	
	Dr.	Cr.		1 A \$ = Rs.	Dr.	Cr.
Plant and machinery (cost)	200	-	Fixed asset	18	3600	-
Plant and machinery depreciation reserve	-	130	Fixed asset	18	-	2340
Debtors /creditors	60	30	Closing	24	1440	720
Stock (1.4.20X1)	20	-	Opening	20	400	
Cash and bank balances	10	-	Closing	24	240	
Purchases/sales	20	-	Average	22	440	2706
Goods received from H. O	5	-	Actual	-	100	
Wages / salaries	45	-	Average	22	990	
Rent	12	-	Average	22	264	
Office expenses	18	-	Average	22	396	
Commission receipts	-	100	Average	22		2200
H.O. current a/c		7	Actual	-		120



	390	390		7870	8086
Exchange loss (bal.fig)	-			216	
				8086	8086

13 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:

Particulars	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:

- 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.
- Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st March, 20X2.
- 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.

Solution

In the books of M/S. Carlin Mumbai branch trial balance in (US \$) as on 31st march ,20X2

Particulars	US \$		Conversion principle	Conversion rate	INR ₹	
	Dr.	Cr.			Dr.	Cr.
Stock on 1.4.20X1	3,00,000	-	Opening	40	7500	-
Purchases and sales	8,00,000	12,00,000	Average	41	19,512.20	29,268.29
Sundry debtors and creditors	4,00,000	3,00,000	Closing rate	42	9523.81	7142.86



Accounting for Branches Including Foreign Branches

Bills of exchange	1,20,000	2,40,000	Closing	42	2857.14	5714.29
Wages and salaries	5,60,000	-	Average	41	13,658.54	-
Rent, rates and taxes	3,60,000	-	Average	41	8780.49	-
Sundry charges	1,60,000	-	Average	41	3902.44	-
Computers	2,40,000	-	Actual	-	6000.00	-
Bank balance	4,20,000	-	Closing	42	10,000.00	-
New York Office a/c	-	16,20,000	Actual	-	-	39,609.18
	33,60,000	33,60,000			81,734.62	81,734.62

Trading and profit & loss account for the year ended 31st March ,20X2

Particulars	US \$	Particulars	US \$
To opening stock	7500.00	By sales	29,268.29
To purchases	19,512.20	By closing stock	10,000.00
To wages and salaries	13,658.54	By gross loss c/d	1402.45
	40,670.74		40,670.74
To gross loss c/d	1402.45	By net loss	17,685.38
To sundry charges	8780.49		
To depreciation on computers (US \$6000 × 0.6)	3600.00		
	17,685.38		17,685.38

Balance sheet of Mumbai branch as on 31st March, 20X2

Liabilities	US \$	US \$	Assets	US \$	US \$
New York office a/c	39,609.18		Computers	6000.00	
Less: net loss	(17,685.38)	21,923.80	Less: depreciation	(3600.00)	2400.00
Sundry creditors		7142.86	Closing stock		10,000.00
Bills payable		5714.29	Sundry debtors		9523.81
			Bank balance		10,000.00
			Bills receivable		2857.14
		34,780.95			34,780.95

14 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.

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).

Solution:

**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		
To Direct Expenses	3,83,275		
To Gross Profit c/d	5,97,075		
	53,17,350		53,17,350
To Manager's Salary	24,000	By Gross Profit b/d	5,97,075
To General Expenses	24,000	By Branch Profit transferred	53,032
To Depreciation:			
Furniture @10% 2,150			
Plant & Machinery @ 15% (W.N.3) 1,36,500	1,38,650		
To General Manager's Commission @ 10% (i.e., 4,63,457 × 1/11)	42,132		
To Net profit	4,21,325		
	6,50,107		6,50,107

Working Notes:

(1) Memorandum Branch Debtors Account

	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
 $3,07,250 \times 15\% + 6,02,750 \times 15\% = \text{Rs.} 1,36,500$

15 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.

Cav	Head Office		Branch	
	Dr.	Cr.	Dr.	Cr.
	Rs.	Rs.	Rs.	Rs.
Share Capital		1,50,000		
Fixed Assets	75,125		18,901	
Current Assets	1,21,809		23,715	(Note 3)
Current Liabilities		34,567		9,721
Stock Reserve, 1st Jan., 20X1				
(Note 2)		693		
Revenue Account		43,210		10,250
Branch Account	31,536			
Head Office Account				22,645
	2,28,470	2,28,470	42,616	42,616

You are required to record the following in the appropriate ledger accounts in both sets of books

Solution:

H.O. Books Branch Account

20X1		Rs.	20X1		Rs.
Dec. 31	To Balance b/d	31,536	Dec. 31	By Cash in transit By	3,500
		31,536		Balance c/d	28,036
					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	746	Jan. 1	By Balance b/d	693
	(4,565+3,641) x 10/110			By Revenue A/c (b.f.)	53
		746			746

Revenue Account

20X1		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			



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

16 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
General Expenses	1,600	Cash paid to Creditors	60,000
Fire Insurance (paid for one year)	3,200	Building Account (further payment)	4,000
Remittance to H.O.	38,400	Cash in Hand	1,600
		Cash at Bank	28,000

Set out the Head Office Account in Delhi books and the Branch Balance Sheet as on 30-9-20X1. Also give journal entries in the Delhi books.



Solution:

Journal Entries

20X1		Dr.	Cr.
30 Sept.		Rs.	Rs.
Salary Advance A/c	Dr.	2,000	
To Salaries A/c			2,000
(The amount paid as advance adjusted by debit to Salary Advance Account)			
Prepared Insurance A/c (3,200 x 6/12)	Dr.	1,600	
To Fire Insurance A/c			1,600
(Six months premium transferred to the Prepaid Insurance A/c)			
Head Office Account	Dr.	88,400	
To Purchases A/c			48,000
To Wages A/c			20,000
To Salaries A/c (6,400 – 2,000)			4,400
To General Expenses A/c			1,600
To Fire Insurance A/c (3,200 x 6/12)			1,600
To Manager's Salary A/c			4,800
To Discount Allowed A/c			8,000
(Transfer of various revenue accounts (Dr.) to the H.O. Account for closing the accounts)			
Sales Accounts	Dr.	2,40,000	
Discount Earned A/c	Dr.	1,200	
To Head Office A/c			2,41,200
[Revenue accounts (Cr.) transferred to H.O.]			
Head Office Account	Dr.	4,000	
To Building Account			4,000
(Transfer of amounts spent on building extension to H.O. A/c)			

Head Office Account

20X1		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
		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 <u>28,000</u>	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

17 Illustration

Widespread invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding 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.

Solution:

In the Head Office Books
Branch Account for the year ended 31st March, 20X2

	Rs. '000		Rs. '000
To Balance b/d		By Balance b/d	180
Cash in hand	10	Stock reserve Rs. 1,080 x 1/6	
Trade debtors	384		
Stock	1,080		
Furniture and fittings	500		
To Goods sent to branch A/c	13,200	By Goods sent to branch A/c (Returns to H.O.)	72
To Bank A/c (Payment for furniture)	100	Goods sent to branch A/c (Loading on net goods sent to branch – (Loading on net goods sent to branch – 13128 X 1/6	2,188
To Balance c/d Stock reserve 1470 X 1/6	245	Bank A/c (Remittance from branch to H.O.) (W.N.5)	11,700
To Net profit transferred to General P/L account	1,096	Balance c/d	
		Cash in hand	10
		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

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%) + (100 x 16% x 3/12)]	84
To Bank	100	By Balance c/d	516
	600		600

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	<u>2,842</u>	By Balance b/d	<u>10</u>
	<u>12,552</u>		<u>12,552</u>

18 Illustration

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 branch Rs. 1 lac for centralized services for which the branch has not passed the entry.

You are required to:

- Pass Journal Entries in the books of the Branch to make the necessary adjustments
- Prepare Final Accounts of the Branch including Balance Sheet, and
- Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance.

Solution:

Books of Branch Journal Entries

		(Rs. in lacs)	
		Dr.	Cr.
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 20X2)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) Trading and Profit & Loss Account of the Branch for the year ended 31st March, 20X2

	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 (centralised 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



Accounting for Branches Including Foreign Branches

Add: Goods in transit	10		Less: Depreciation	(2)	18
Head Office Expenses			Stock in hand		62
Net Profit	1		Goods in Transit		10
Outstanding Expenses			Debtors		20
	24	115	Cash at bank and in hand		8
		3			
		118			118

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		
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				118
(Incorporation of different assets at the branch in H.O. books)				
Branch		Dr.	3	
To Branch Outstanding Expenses				3
(Incorporation of Branch Outstanding Expenses in H.O. books)				

19 Illustration

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

Solution:

Bangalore Branch Stock Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d	4,50,000	By Goods sent to branch A/c (Returns)	90,000
Goods sent to branch A/c	45,00,000	By Bank A/c (Cash sales)	15,00,000
To Branch debtors A/c	60,000	By Branch debtors A/c	27,00,000



Accounting for Branches Including Foreign Branches

(Returns)		(credit sales)	
To Branch adjustment A/c (Surplus over invoice price)*	<u>1,80,000</u>	By Balance c/d	9,00,000
	<u>51,90,000</u>		<u>51,90,000</u>

*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
	<u>11,52,000</u>	By Branch stock A/c	<u>1,80,000</u>
			<u>11,52,000</u>

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)	<u>2,67,000</u>		
	<u>9,72,000</u>		<u>9,72,000</u>

Branch Expenses Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Bank A/c (Rent, rates & taxes)	1,35,000	By Branch profit and loss A/c (Transfer)	6,30,000
To Bank A/c (Salaries, wages & bonus)	4,50,000		
To Bank A/c (Office expenses)	<u>45,000</u>		
	<u>6,30,000</u>		<u>6,30,000</u>

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	60,000



		(Sales returns)	<u>7,05,000</u>
	<u>32,40,000</u>	By Balance c/d (bal. fig.)	<u>32,40,000</u>

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	<u>35,28,000</u>		
	45,00,000		45,00,000

20 Illustration

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.O. plus 80%)	9,54,000	
Sales	27,81,000	9,50,000
Office expenses	90,000	8,500
Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 20X1.

Solution:

Trading and Profit and Loss A/c For the year ended 31st March 20X1

	Head office 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	44,000	-			



Reserve (W.N.3)					
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 $[37,35,000 \times 100/180]$	(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 $[9,50,000 \times 180/200]$	(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 $\times$ 80/180	Rs. 44,000

21 Illustration

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	<u>29,26,000</u>	By Balance c/d	<u>8,60,000</u>
	<u>37,36,000</u>		<u>37,36,000</u>

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:

1 st January, 20X1	\$ 1.00	=	Rs. 46
31 st December, 20X1	\$ 1.00	=	Rs. 48
Average	\$ 1.00	=	Rs. 47



Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

- (i) Prepare the Branch Trading & Profit & Loss A/c in dollars.
- (ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Solution:

In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars) for the year ended 31st December, 20X1

Particulars	\$	Particulars	\$
To Opening stock	11,200	By Sales	84,000
To Goods from H.O.	64,000	By Closing stock (W.N.2)	8,000
To Gross profit c/d	16,800		
	92,000		92,000
To Expenses	5,000	By Gross profit b/d	16,800
To Depreciation (24,000 x 10%)	2,400		
To Manager's commission (W.N.1)	470		
To Net profit c/d	8,930		
	16,800		16,800

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 Less: Depreciation	9,60,000 (96,000)	8,64,000
To Net profit	4,90,240	By Closing stock		3,84,000
To Creditors	1,63,200	By Debtors		2,30,400
To Outstanding commission	22,560	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 × Rs. 48 = Rs. 22,560	

2. Calculation of closing stock

	\$
Opening stock	11,200
Add: Goods from head office	<u>64,000</u>
	75,200
Less: Cost of goods sold (at invoice price)	
i.e. $\frac{100}{125} \times 84,000$	<u>(67,200)</u>
Closing stock	<u>8,000</u>
Closing stock in Rupees = \$8,000 × Rs. 48 = Rs. 3,84,000.	

Note: Manager is entitled to commission on profits earned at the end of the year.



Illustrations

1. Illustration

Let us consider the draft balance sheet of X Ltd as on 31 March 2011

Liabilities	₹ ('000)	Asset	₹ ('000)
Share Capital: Equity Shares of ₹10 each	75,00	Land & Building	50,00
14% Preference Shares of ₹100 each	25,00	Plant & Machinery	45,00
General Reserve	12,50	Furniture	10,50
12% Debentures	40,00	Investments	5,00
Trade payables and Current liabilities	20,00	Inventory	23,00
		Trade Payables	24,00
		Cash & Bank	15,00
		Balance	
	172,50		172,50

Other information:

- Y Ltd. takes over X Ltd. on 10th April 20X1
- Debenture holders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.
- 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value ₹100 each)
- Intrinsic value per share of X Ltd is ₹20 and that of Y Ltd. is ₹30. Y Ltd wil issue equity shares to satisfy equity shareholders of X Ltd. on the basis of intrinsic value. The nominal value of each equity shares of Y Ltd is ₹10.

Compute the Purchase consideration

Solution 1

Purchase consideration

Paid to	Paid in what form	Workings	Amount
Preference shareholders of X	Preference share of Y	No. of shares (X) = (25,000 @ 100) + 25% = 30,00,000 Value of shares = ₹100 No. of shares given = (30,00,000 ÷ 100) = 30,000 shares	= 30,000 x 100 = ₹ 30,00,000
Equity shareholders of X	Equity shares of Y	No. of shares in X = 7,50,000 @ 10 <u>Value per share (Intrinsic) = ₹20</u> Total value = ₹15,00,000 (7,50,000 x ₹20) Value of shares of Y = ₹30 No. of shares given = 5,00,000 shares (15,00,000 ÷ 30)	= 5,00,000 x ₹10 (FV) = ₹ 5,000
		Total	₹ 80,00,000

Note: Debentures settlement is not relevant for purchase consideration computation.



2. Illustration

S Ltd is absorbed by P Ltd. The draft balance sheet of S Ltd is as under:

Liabilities	₹	Assets	₹
Share Capital:		Sundry Assets	13,00,000
2000 7% Preference Shares of ₹100 each (fully paid up)	2,00,000		
5000 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		
	13,00,000		13,00,000

P Ltd. has agreed:

- to issue 9% Preference Shares of ₹100 each, in the ratio of 3 shares of P Ltd. for 4 preference shares of S Ltd.
 - to issue to the debenture-holders in S Ltd 8% Mortgage Debentures at ₹96 in lieu of 6% Debentures in S Ltd. which are to be redeemed at a premium of 20 %;
 - to pay ₹20 per share in cash and to issue six equity shares of ₹100 each (Market Value ₹125) in lieu of every five shares held in S Ltd.;
- You are required to calculate purchase consideration.

Solution 2

Purchase consideration

Paid to	Paid in what form	Workings	Amount
Preference shareholders of S	Preference share of P	2,000 shares $\times \frac{3}{4} \times ₹100$ (Issue price assumed) = 1,500 shares	= 1,500 $\times$ ₹100 = ₹1,50,000
Equity shareholders of S	Equity shares of P	5,000 $\times \frac{6}{5} \times ₹125$	= ₹7,50,000
	Cash	5,000 shares $\times$ 20	= ₹1,00,000
	Total		₹ 10,00,000

Note: Debentures settlement is not relevant for purchase consideration computation.

3. Illustration

Y Ltd decided to absorb X Ltd. The draft balance sheet of X Ltd is as follows:

Liabilities	₹	Assets	₹
3000 Equity Shares of ₹100 each fully paid up	3,00,000	Net Assets	2,90,000
Preference Share Capital	60,000	P&L Dr Bal	70,000
	3,60,000		3,60,000

Y Ltd agrees to take over the net assets of X Ltd and equity shares in X Ltd for purposes of absorption is valued at ₹70. Y Ltd agrees to pay ₹ 60,000 in cash for payment to preference shareholders. Equity shares will be issued at value of ₹ 120 each.

Calculate purchase consideration to be paid by Y Ltd and show how will it be discharged.



Solution 3

Purchase consideration

Paid to	Paid in what form	Workings	Amount
Preference shareholders of X	Cash	-	60,000
Equity shareholders of S	Equity shares of P	= $\frac{3,000 \text{ shares} \times ₹70}{₹120} = 1,750$ Shares	= $1,750 \times ₹120$ = ₹2,10,000
Total			₹ 2,70,000

4. Illustration

Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04.2014. Following is the Draft Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3.2014

Liabilities	Neel (₹)	Gagan (₹)	Assets	Neel (₹)	Gagan (₹)
Capital	7,75,000	8,55,000	P & M	4,85,000	6,14,000
Current Liabilities	6,23,500	5,57,600	Building	7,50,000	6,40,000
			Current Assets	1,63,500	1,58,600
	13,98,000	14,12,600		13,98,500	14,12,600

Following is the additional information:

- The authorised capital of the new company will be ₹ 25, 00,000 divided into 1, 00,000 equity shares of ₹ 25 each.
- Liabilities of Neel Ltd. includes ₹ 50,000 due to Gagan Ltd. for the purchases made. Gagan Ltd. made a profit of 20% on sale to Neel Ltd.
- Neel Ltd. had purchased goods costing ₹10,000 from Gagan Ltd. All these goods are included in the current asset of Neel Ltd. as at 31st March 2014.
- The assets of Neel Ltd. and Gagan Ltd. are to be revalued as

	Neel ((₹)	Gagan (₹)
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

- The purchase consideration is to be discharged as under:
Issue 24,000 equity shares of ₹25 each fully paid up in the proportion of their profitability in the preceding 2 years.
- Profits for the preceding 2 years are given below:

	Neel (₹)	Gagan (₹)
Ist year	2,62,800	2,75,125
IInd year	2,12,200	2,49,875
Total	4,75,000	5,25,000

- Issue 12% preference shares of Rs. 10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as on 31.3.2014 after revaluation of assets of Neel Ltd. and Gagan Ltd. respectively.
- You are required to compute the
 - equity and preference shares to be issued to Neel Ltd. and Gagan Ltd.,
 - Purchase consideration.

Solution 4

(i)

No. of shares		
	Neel	Gagan
Equity shares (W.N.1)	11,400	12,600



Preference share (W.N.2)	56,000	61,600

Working Note: 1**Equity shares issued**

Particulars	Amount(₹)
Total no. of shares	24,000
Distribution ratio	475 : 525
No. of shares to Neel	$= (475/475+525) \times 24,000$
	$= 11,400$ shares
No. of shares to Neel	$= (525/475+525) \times 24,000$
	$= 12,600$ shares

Working Note: 2**Net assets worth**

Particulars	Neel	Gagan
Plant & Machinery	5,52,500	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)
Net assets	8,40,000	9,24,000
8% of Net assets (This should be the amount of preference dividend)	67,200	73,920
Face value of preference shares	₹10	₹10
Dividend rate	12%	12%
No. of preference shares to be issued	$67,200 \div 1.2$ 56,000 shares	$73,920 \div 1.2$ 61,600 shares

(ii) Purchase consideration

Paid to	Paid in what form	Workings	Amount
Shareholders of Neel	Equity shares of new company	11,400 shares x ₹ 25	2,85,000
	Preference shares of new company	56,000 shares x ₹10	5,60,000
			8,45,000
Shareholders of Gagan	Equity shares of new company	12,600 shares x ₹25	3,15,000
	Preference shares of new company	61,600 shares x ₹10	6,16,000
			9,31,000
Total			17,76,000

5. Illustration

Consider the following summarized balance sheets of X Ltd. and Y Ltd.
Balance Sheet as on 31st March, 20X1



Liabilities	X (Rs)	Y (Rs)	Assets	X (Rs)	Y (Rs)
Equity Share Capital (₹10 each)	50,00	30,00	Land & Buildings	25,00	15,50
14% Preference Share Capital (₹100 each)	22,00	17,00	Plant & Machinery	32,50	17,00
General Reserve	5,00	2,50	Furniture & fittings	5,75	3,50
Export Profit Reserve	3,00	2,00	Investments	7,00	5,00
Invest. Allowance Reserve		1,00	Inventory	12,50	9,50
Profit & Loss A/c	7,50	5,00	Trade receivables	9,00	10,30
13% Debentures (₹100 each)	5,00	3,50	Cash & Bank	7,25	5,20
Trade Payables	4,50	3,50			
Other Current Liabilities	2,00	1,50			
	99,00	66,00		99,00	66,00

X Ltd. takes over Y Ltd. on 1st April, 20X1. X Ltd. discharges the purchase consideration as below:

- Issued 3, 50,000 equity shares of ₹10 each at par to the equity shareholders of Y Ltd.
- Issued 15% preference shares of ₹100 each to discharge the preference shareholders of Y Ltd. at 10% premium.
- The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the balance sheet of X Ltd. after amalgamation on the assumption that the amalgamation is in the nature of purchase.

Solution 5

Purchase consideration

Paid to	Paid in what form	Workings ('000)	Amount ('000)
Equity shareholders of Y	Equity share of X	350 x 10	3,500
Preference shareholders of Y	15% Preference share of X	$1700 + (10\% \times 1700)$ $= 1870$ $\Rightarrow 18,700 \text{ shares of ₹ 100 each.}$	1,870
Total			5,370

Journal entries

Date	Particulars	Dr ₹('000)	Cr ₹ ('000)
1)	Land & Buildings Dr	1,550	
	Plant & Machinery Dr	1,700	
	Furniture & Fittings Dr	350	
	Investments Dr	500	
	Inventory Dr	950	
	Trade receivables A/c Dr	1,030	
	Cash & Bank A/c Dr	520	
	To Debt liability A/c		350
	To Trade payables A/c		350
	To Other current liability		150
	To Business Purchase A/c		5370
	To Capital Reserve (Bal.Fig)		380



	(Being incorporation of assets and liability taken over from Y Ltd and Bal. fig of capital reserve computed)		
2)	Liquidator of Y Ltd A/c Dr To Eq. Share Capital A/c To Preference share capital A/c (Being settlement of liquidator)	5,370	3,500 1,870
3)	Debenture liability A/c Dr To 13% Debenture A/c (Being 13% Debenture issued to settle debenture liability taken over)	350	
4)	Amalgamation adjustment A/c Dr To Export profit reserve A/c To Investment allowance reserve A/c (Being incorporation of statutory reserves)	300	200 100

**Balance sheet of X Ltd as at 1.4.2011
(After Amalgamation)**

Particulars			Notes	₹ ('000)
1		Equity and Liabilities		
		Shareholder's 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		9,925
1		Non-current assets		1,200
	A	Property, plant and equipment	4	
	B	Non-current investments	5	2,200
2		Current assets		1,930
	A	Inventories		1,245
	B	Trade receivables		
	C	Cash and Cash equivalents		
		Total		16,500

Notes to accounts

S.no	Particulars	₹ ('000)
1	Share Capital	
	• Equity share capital: 8,50,000 Equity Shares of ₹10 each	8,500
	• Preference share capital: 18,700, 15% Preference share of ₹100 each 22,000, 14% Preference share of ₹100 each	1,870 2,200
	Total	12,570
2	Reserve and Surplus	
	Capital Reserve	380



	General Reserve	500
	Amalgamation adjustment Reserve	(300)
	Export Profit Reserve	500
	Investment Allowance Reserve	100
	Profit and Loss A/c (Surplus)	750
Total		
3	<u>Long Term Borrowings</u>	1,930
	Secured Loans	
	8,500,13% Debentures of ₹100 each	
Total		850
4	<u>Property, plant and Equipment</u>	850
	Land & Buildings	
	Plant & Buildings	4,050
	Furniture & Fittings	4,950
Total		925
		9,925

6. Illustration

The following are the summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March 2011:

Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
Share Capital: Equity Shares of Rs 10 each	6,00,000	3,00,000	Fixed assets	7,00,000	2,50,000
10% preference shares of Rs. 100 each	2,00,000	1,00,000	Investment	80,000	80,000
Reserves and surpluses	3,00,000	2,00,000	Current asset: Inventory	2,40,000	3,20,000
12% debentures	2,00,000	1,50,000	Trade receivable	4,20,000	2,10,000
Current liabilities: Trade payables	2,50,000	1,50,000	Cash at bank	1,10,000	40,000
	15,50,000	9,00,000		15,50,000	9,00,000

Details of Trade receivables and trade payables are as under:

Particulars	P Ltd	Q Ltd
Trade receivables: Debtors	3,60,000	1,90,000
Bills receivables	60,000	20,000
Total	4,20,000	2,10,000
Trade Payable: Sundry Creditors	2,20,000	1,25,000
Bills payable	30,000	25,000
Total	2,50,000	1,50,000

Fixed Assets of both the companies are to be revalued at 15% above book value. Inventory in Trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid. Preference dividend having been already paid. After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

- 8 Equity Shares of Rs 10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.
- 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of Rs 100 each at par in P Ltd.
- 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%.



4. Rs. 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses.
5. Sundry Creditors of Q Ltd. include Rs. 10,000 due to P Ltd.

Prepare Journal Entries in books of P Ltd and Statement showing consideration payable by P Ltd.

Solution 6

(a) Journal entries in the books of P Ltd (Before Amalgamation)

Date	Particulars	Dr (₹)	Cr (₹)
31 st March 2011	Fixed Asset A/c Dr To Revaluation Reserve (Being upward revaluation of fixed asset)	1,05,000	1,05,000
"	Reserves and Surplus Dr To Bank A/c (Being Equity dividend paid)	60,000	60,000
"	Business Purchase A/c Dr To Liquidator of Q Ltd (Being Business purchased)	4,90,000	4,90,000
"	Property, Plant and Equipment Dr Inventory Dr Debtors Dr Bills Receivables Dr Investment Dr Cash at Bank Dr To Provision for Bad Debts To Sundry Creditors To 12% Debentures in Q Ltd To Bills Payables To Business Purchase A/c To Capital Reserve (Bal.Fig) (Being incorporation of assets & liabilities of Q Ltd.)	2,87,500 3,04,000 1,90,000 20,000 80,000 10,000	9,500 1,25,000 1,62,000 25,000 4,90,000 80,000
"	Liquidator of Q Ltd Dr To Equity share capital A/c To Securities premium A/c To 10% Preference share capital A/c To Securities premium A/c (Being settlement of purchase consideration to Liquidator)	4,90,000	4,00,000 0 90,000 0
"	12% Debentures in Q Ltd Dr Discount on Issue of Debentures Dr 12% Debentures (Being settlement of debenture liability)	1,62,000 18,000	1,80,000
"	Sundry Creditors of Q Ltd Dr To Sundry Debtors of P Ltd (Being mutual indebtedness cancelled)	10,000	10,000
"	Capital reserve A/c Dr To Bank A/c (Being liquidation expenses paid)	30,000	30,000

(b) Statement of Consideration payable by P Ltd.

Paid to	Paid in what form	Workings	Amount ('000)
		6 → 8	



Equity shareholders of Q	Equity share of P	30,000 → X = 40,000 shares	= 40,000 shares x ₹10 = ₹4,00,000
Preference shareholders of Q	10% Preference share of P	[1,00,000 – 10% x 1,00,000] ÷ ₹100 = 900 shares	= 900 shares x ₹100 = ₹90,000
Total			4,90,000

7. Illustration

The following are the summarized Balance Sheets of A Ltd. and B Ltd. as on 31.3.2011:

Liabilities	A Ltd.	B Ltd.
Share capital:		
Equity shares of Rs. 100 each fully paid up	2,000	—
Reserves	1,000	—
10% debentures	500	—
Loans from bank	250	450
Bank overdrafts	—	50
Trade payables	300	300
Total	4,050	1,800
Assets		
Tangible assets / fixed assets	2,700	850
Investments	700	—
Trade receivables	400	150
Cash at bank	250	—
Accumulated loss	—	800
Total	4,050	1,800

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

1. Banks agreed to waive off the loan of Rs. 60 thousand of B Ltd.
2. B Ltd. will reduce its shares to Rs.10 per share and then consolidate 10 such shares into one share of Rs. 100 each (new share).
3. Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.
4. Trade payables of B Ltd. includes Rs. 100 thousand payable to A Ltd.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger.

Solution 7

Journal entries in the books of B Ltd

Date	Particulars	Dr ₹('000)	Cr ₹('000)
31 st March 2011	Loan from Bank A/c Dr To Capital reduction A/c (Being loan waived off partly as per the scheme)	60	60
"	Equity share capital A/c (₹100) Dr To Equity share capital A/c (₹10) To Capital reduction A/c (Being reduction in Eq. share capital from 100 to 10 each as per the scheme)	1,000	100 900
"	Equity share capital A/c (₹10) Dr Equity share capital A/c (₹100)	100	100



	(Being consolidation of 10 Equity share of ₹10 each into one Equity share of ₹100 each)		
"	Capital reduction A/c Dr To Profit and loss A/c To Capital reserve A/c (Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve A/c)	960	800 160
"	Business Purchase A/c Dr To Liquidator of A Ltd (Being business of A Purchased)	2,000	2,000
"	Property, Plant and Equipment A/c Dr Trade receivables A/c Dr Investment A/c Dr Cash at Bank A/c Dr To Trade payables A/c To Loan from Bank A/c To Liquidator of A Ltd A/c To Business Purchase A/c (Being incorporation of Assets and liabilities & Reserves of A)	2,700 700 400 250	300 250 500 2,000
"	Liquidator of A Ltd A/c Dr To Equity share capital A/c (Being settlement of Liquidator of A Ltd. By allotment of 20,00 new Equity shares)	2,000	2,000
"	Trade payables A/c To Trade receivables A/c (Being mutual indebtedness set off)	100	100

Capital Reduction A/c

Particulars	₹('000)	Particulars	₹('000)
To Profit and loss A/c	800	By Loan from Bank	60
To Capital reserve A/c (B.f)	160	By Eq. share capital	900
	960		960



Balance sheet of X Ltd as at 1.4.2011

Particulars			Notes	₹ ('000)
1		Equity and Liabilities		
		Shareholder's 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
	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

Purchase consideration

Paid to	Paid in what form	Workings	Amount ('000)
Equity shareholders of A	Equity share of B	$= 20,00,000 \div 100$ $= 20,000 \text{ Eq. shares}$ in A 1 share of A → 1 share of B Therefore, 20,000 Eq. shares in B	$= 20,000 \text{ shares} \times$ $₹ 100$ $= 20,00,000$

Notes to Account

S.no	Particulars	₹ ('000)
1	<u>Share Capital</u>	
	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	<u>Reserve and Surplus</u>	
	Capital Reserve	160
	General Reserve	1,000
	Total	1,160
3	<u>Long Term Borrowings</u>	
	10% Debentures	
	Loan from Banks (250+450-60)	500
	Total	640
4	<u>Short term borrowings</u>	
	Bank overdraft	1,140
		50



8. Illustration

Super express ltd. and fast express ltd. Were in competing. They decided to form a new company named super-fast express ltd. The summarized balance sheets of both companies were as under:

Super express Ltd.

Liabilities	Amount	Assets	Amount
20,000 equity shares of Rs. 100 each	20,00,000	Building	10,00,000
Provident fund	1,00,000	Machinery	4,00,000
Trade payables	60,000	Inventory	3,00,000
Insurance reserves	1,00,000	Trade receivables	2,40,000
		Cash at bank	2,20,000
		Cash in hand	1,00,000
	22,60,000		22,60,000

Fast express Ltd.

Liabilities	Amount	Assets	Amount
10,000 equity shares of Rs. 100 each	10,00,000	Goodwill	1,00,000
Employees profit sharing account	60,000	Building	6,00,000
Trade payables	40,000	Machinery	5,00,000
Reserves account	1,00,000	Inventory	40,000
surplus	1,00,000	Trade receivables	40,000
		Cash at bank	10,000
		Cash in hand	10,000
	13,00,000		13,00,000

The assets and liabilities of both the companies were taken over by the new company at their book value. The companies were allotted equity shares of Rs 100 each in lieu of purchase consideration amounting to Rs. 30,00,0000(20,00,000 for super-fast express ltd. and 10,00,000 for fast express ltd.)

Prepare opening balance sheet for super-fast express ltd

Solution

Particulars			Notes	₹ ('000)
1		Equity and Liabilities		
		Shareholder's funds		
	A	Share capital	1	30,00
	B	Reserves and Surplus	2	3,60
2		Non-Current liabilities		
	A	Other Long term liabilities	3	1,00
3		Current liabilities		
	A	Trade Payables		1,00
		Total		35,60



1		Assets		
		Non-current assets		
	A	Property, plant and equipment	4	25,00
	B	Intangible assets	5	1,00
2		Current assets		
	A	Inventories		3,40
	B	Trade receivables		2,80
	C	Cash and Cash equivalents	6	3,40
		Total		35,60

Notes to accounts

S.no	Particulars	₹ ('000)
1	<u>Share Capital</u> 30,000 Equity Shares of ₹100 each	30,00
2	<u>Reserve and Surplus</u> General Reserve Surplus Insurance reserve Employee profit sharing account	1,00 1,00 1,00 60
3	Total	3,60
	<u>Long Term Liabilities</u> Provident fund	1,00
4	<u>Property, Plant and Equipment</u> Building Machinery	16,00 9,00
5	Total	25,00
6	<u>Intangible asset</u> Goodwill	1,00
	<u>Cash and cash equivalents</u> Balances with banks Cash on hand	2,30 1,10
	Total	3,40

Note: 1

Purchase consideration

Paid to	Paid in what form	Workings	Amount
Equity shareholders of Super Express Ltd	Equity share of Super Fast Express Ltd	20,000 Equity shares of ₹ 100 each	20,00,000
Equity shareholders of Fast Express Ltd	Equity share of Super Fast Express Ltd	10,000 Equity shares of ₹ 100 each	10,00,000
	Total		30,00,000



9. Illustration

The following were the summarized balance sheets of P Ltd. And V Ltd. As on 31 March, 2012

Liabilities	P Ltd. (in lakhs)	V Ltd. (in lakhs)
Equity share capital (fully paid shares of Rs. 10 each)	15,000	6,000
Securities premium	3,000	—
Foreign project reserve	—	310
General reserves	9,500	3,200
Profit and loss account	2,870	825
12% debentures	—	1,000
Trade payables	1,200	463
Provisions	1,830	702
Total	33,400	12,500

Assets	P Ltd. (in lakhs)	V Ltd. (in lakhs)
Land and building	6,000	—
Plant and machinery	14,000	5,000
Furniture, fixtures and fittings	2,304	1,700
Inventory	7,862	4,041
Trade receivables	2,120	1,100
Cash at bank	1,114	609
Cost of issue of debentures	—	50
Total	33,400	12,500

All the bills receivables held by V Ltd were P Ltd.'s Acceptances

On 1st April 2012, 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 Rs. 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 payables	120	
Creditors	1,080	463
Total	1,200	463
Trade receivables		
Trade receivables	2,120	1,020
Bills receivables	—	80
Total	2,120	1,100

Expenses of amalgamation to Rs 1 lakh were borne by P Ltd. You are required to:

1. Pass journal entries in the books of P Ltd. and
2. Prepare P Ltd.'s balance sheet immediately after the merger.

Solution 9



Purchase consideration

Paid to	Paid in what form	Workings	Amount ('in lakhs)
Equity shareholders of V Ltd.	Equity share from P Ltd	900 shares of ₹10 each	900 × 10 9,000

Journal entries in the books of P Ltd

Date	Particulars	Dr ₹(in lakhs)	Cr ₹(in lakhs)
31 st March 2011	Business Purchase A/c Dr To Liquidator of V Ltd (Being Business purchased)	9,000	9,000
"	Property, Plant and Equipment Dr Furniture & Fittings Dr Inventory Dr Debtors Dr Bills Receivables Dr Cash at Bank Dr	5,000 1,750 4,041 1,020 80 609	
	To Foreign Project Reserve To General reserve (3,200 – 3,000) To Profit and loss A/c (825) To Liability for 12% debentures To Creditors To Provisions To Business Purchase A/c (Being incorporation of assets, liabilities and reserves from V Ltd.)		310 200 825 1,000 463 702 9,000
"	Liquidator of V Ltd Dr To Equity share capital A/c (Being settlement of Liquidator of V Ltd.)	9,000	9,000
"	Goodwill A/c Dr To Bank A/c (Being liquidation expenses paid)	1	1
"	Profit and loss A/c Dr To Goodwill A/c (Being liquidation expense incurred by P Ltd.)	1	1
	Liability for 12% Debentures A/c Dr To 13% Debentures A/c (Being settlement of debenture liability)	1,000	1,000
"	Bills payable A/c Dr To Bills receivable A/c (Being mutual indebtedness cancelled)	80	80

Balance sheet of P Ltd as at 1st April, 2011 (after merger)

	Particulars	Notes	₹ (in lakhs)
1	Equity and Liabilities		
	Shareholder's funds		
A	Share capital	1	24,000
B	Reserves and Surplus	2	16,654
2	Non-Current liabilities		
A	Long-term borrowings	3	1,000
3	Current liabilities		
A	Trade Payables (1,543 + 40)		1,583



	B	Short term provisions		2,532
		Total		
1		Assets		
		Non-current assets		
	A	Property, plant and equipment	4	
2		Current assets		
	A	Inventories		
	B	Trade receivables		45,769
	C	Cash and Cash equivalents		
		Total		29,004
				11,903
				3,140
				1,722
				45,769

Notes to accounts

S.no	Particulars	₹ (in lakhs)
1	Share Capital	
	24 crores equity shares of ₹10 each	24,000
	(Of the above shares, 9 crores shares have been issued for consideration other than cash)	24,000
2	Reserve and Surplus	
	General Reserve	9,700
	Securities premium	3,000
	Foreign project reserve	310
	Profit and Loss A/c	3,644
		16,654
3	Total	
	Long Term Borrowings	1,000
	13% Debentures (Secured)	
4	Property, Plant and Equipment	
	Land & Building	6,000
	Plant & Machinery	19,000
	Furniture and Fittings	4,004
		29,004
5	Total	
	Cash and Cash equivalent	
	P Ltd -1,114	
	V Ltd - 609	
	Less : Paid - (1)	1,722

10. Illustration

The following is the summarised Balance Sheet of A Ltd as at 31.3 2012:

Liabilities	₹	Asset	₹
14,000 Equity shares of ₹100 each fully paid	14,00,000	Sundry Assets	18,00,000
General Reserve	10,000	Discount on issue of debentures	10,000
10% Debentures	2,00,000	P&L a/c	90,000
Trade Payables	2,40,000		



Bank Overdraft	50,000		
	19,00,000		19,00,000

'R' Ltd agreed to take over the business of 'A' Ltd. Calculate purchase consideration under Net Assets method on the basis of the following:

- (i) The market value of 75% of the sundry assets is estimated to be 12% more than the book value and that of the remaining 25% at 8% less than the book value.
 (i) The liabilities are taken over at book values. There is an unrecorded liability of ₹25,000.

Solution 10

Purchase consideration (Net asset method)

Particulars	Amount
Sundry Assets : 18 lakhs x 75% x 1.12	15,12,000
18 lakhs x 25% x 0.92	4,14,000
Discount on issue of debentures and P&L Dr balance have no market value, Hence ignored.	0
Less: 10% Debentures	(2,00,000)
Trade payables	(2,40,000)
Bank OD	(50,000)
Unrecorded liability	(25,000)
Net Asset value settlement as Purchase consideration	14,11,000

11. Illustration

Following is the Balance Sheet of X Co. Ltd. as at 31st March 2015:

Balance Sheet as at 31st March, 2015			
Liabilities	Rs.	Assets	Rs.
Equity share capital (Rs. 100 each)	15,00,000	Land and building	10,00,000
11% Pref. share capital	5,00,000	Plant and machinery	7,00,000
General reserve	3,00,000	Furniture and fittings	2,00,000
Trade Payables	2,00,000	Stock in trade	3,00,000
		Sundry debtors	2,00,000
		Cash in hand and at bank	1,00,000
	25,00,000		25,00,000

Y Co. Ltd. agreed to take over X Co. Ltd. on the following terms:

- (i) Each equity share in X Co. Ltd. for the purpose of absorption is to be valued at Rs.80.
 (i) Equity shares will be issued by Y Co. Ltd. by valuing its each equity share of Rs.100 each at Rs.120 per share.
 (ii) 11% Preference shareholders of X Co. Ltd. will be given 11% redeemable debentures of Y Co. Ltd. at equivalent value.
 (iv) All the Assets and Liabilities of X Co. Ltd. will be recorded at the same value in the books of Y Co. Ltd.
 (a) Calculate Purchase consideration.
 (b) Pass Journal entries in the books of Y Co. Ltd. for absorbing X Co. Ltd.

Solution 11



A)

Journal entries (Purchase method)

Date	Particulars	Dr ₹	Cr ₹
31 st March 2011	Business Purchase A/c Dr To Liquidator of X Ltd (Being Business purchased)	17,00,000	17,00,000
"	Land & Buildings A/c Dr Plant & Machinery A/c Dr Furniture & Fittings A/c Dr Stock in trade A/c Dr Sundry Debtors A/c Dr Cash in hand & at bank A/c Dr To Trade payables To Business Purchases A/c To Capital reserve A/c (Being incorporation of assets and liabilities and balance transferred to capital reserve)	10,00,000 7,00,000 2,00,000 3,00,000 2,00,000 1,00,000	2,00,000 17,00,000 6,00,000

Amalgamation in the nature of Merger:

Shareholders funds (equity & preference) = ₹ 20 lakhs
Purchase consideration = (₹ 17 lakhs)
Shortfall (transferred to Capital reserve) = ₹ 3 lakhs

B)

Journal entries in the nature of merger

Date	Particulars	Dr ₹	Cr ₹
31 st March 2012	Land & Buildings A/c Dr Plant & Machinery A/c Dr Furniture & Fittings A/c Dr Stock in trade A/c Dr Sundry Debtors A/c Dr Cash in hand & at bank A/c Dr To Trade payables A/c To Business Purchase A/c To General reserve A/c To Capital reserve A/c (Being incorporation of assets and liabilities and balance transferred to capital reserve)	10,00,000 7,00,000 2,00,000 3,00,000 2,00,000 1,00,000	2,00,000 17,00,000 3,00,000 3,00,000
31 st March 2012	Settlement entry Liquidator of X A/c Dr To Equity share capital A/c To Securities Premium A/c To 11% debenture A/c (Being settlement of liquidator)	17,00,000	10,00,000 2,00,000 5,00,000

12. Illustration

Draft Balance Sheets are given as on 31st March, 20X1:

Liabilities	Best (Rs)	Better (Rs)	Assets	Best (Rs)	Better (Rs)
Share Capital: Shares of ₹100, each fully paid	20	10	Fixed Assets	25	15
Reserve and Surplus	10	8	Investments	5	-
Other Liabilities	20	2	Current Assets	20	5
	50	20		50	20



- (a) Better Limited issued bonus shares on 1st April, 20X1, in the ratio of one share for every two held, out of Reserves and Surplus.
- (b) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.
- (c) The value of shares in Best Ltd. was considered to be ₹150 and the shares in Better Ltd. were valued at ₹100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.
- (d) Liabilities of Better Ltd. included ₹1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet. Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 20X1 after the takeover.

Solution 12**Working Note: 1****Purchase consideration**

Paid to	Paid in what form	Workings	Amount ('in lakhs)
Equity shareholders of Better	Equity share from Best	No. of shares in Better $[10,000 + 10,000 \times \frac{1}{2}]$ $= 15,000$ shares Value per share $\rightarrow$ ₹100 Total worth $\rightarrow$ Total worth $(15,000 \times 100)$ $\rightarrow 15,00,000$ Value per share of Best Ltd. = 150	$= \underline{15,00,000}$ 150 $= 10,000 \text{ shares} \times ₹150$ $= ₹15,00,000$

Working Note: 2

Particulars	Amount
No. of shares in Better Ltd. before bonus issue	10,000
Bonus ratio	1 : 2
No. of Bonus shares issued	5,000
Total shares of Better Ltd after Bonus	15,000

Realisation A/c

Particulars	₹	Particulars	₹
To Fixed Assets	15,00,000	By Other liabilities	2,00,000
To Current Assets	5,00,000	By Best Ltd.	15,00,000
		By Equity share holders (B.f)	3,00,000
		[loss]	
	20,00,000		20,00,000

Equity share holders A/c

Particulars	₹	Particulars	₹
To Investment in Eq. shares of Best	15,00,000	By Share capital A/c (10+5)	15,00,000
To Realisation A/c	3,00,000	By Reserves & Surplus	3,00,000
	18,00,000		18,00,000



Journal entries in the books of Best Ltd. (Purchase method)

Date	Particulars	Dr ₹	Cr ₹
31 st March 2011	Business Purchase A/c Dr To Liquidators of Better Ltd A/c (Being Business Purchased)	15,00,000	15,00,000
"	Fixed Asset A/c Dr Current Asset A/c Dr To Liabilities A/c To Business Purchase A/c To Capital Reserve A/c (Bal. Fig) (Being incorporation of assets and liabilities from Better)	15,00,000 5,00,000	2,00,000 15,00,000 3,00,000
"	Liquidator of Better A/c Dr To Equity share capital A/c To Securities Premium A/c (Being settlement of liquidator by issuing shares Face value ₹100 & securities premium of ₹50 each)	15,00,000	10,00,000 5,00,000
"	Trade Payables A/c Dr To Trade Receivables A/c (Being inter-company balance cancelled)	1,00,000	1,00,000
"	Profit and Loss A/c Dr To Stock/ Inventory A/c (Being unrealised Profit in closing stock eliminated)	10,000	10,000

Balance sheet of Best Ltd. (After absorption)

		Particulars	Notes	₹ (in lakhs)
1		Equity and Liabilities		
		Shareholder's funds		
	A	Share capital	1	30,00,000
	B	Reserves and Surplus	2	7,90,000
2		Current liabilities		21,00,000
		Total		68,90,000
		Assets		
1		Non-current assets		
	A	Property, plant and equipment		
		Tangible assets	3	40,00,000
		Non-current investments		5,00,000
2		Current assets	4	23,90,000
		Total		68,90,000



Notes to accounts

S.no	Particulars	₹
1	Share Capital	
	Equity share capital	24,000
	Issued and subscribed (30,000 shares @100 each including, 10,000 shares issued for consideration other than cash)	24,000
2	Reserve and Surplus	
	Capital Reserve (30,000 – 10,000)	2,90,000
	Securities premium	5,00,000
	Other Reserves and Surplus	10,00,000
3	Tangible Assets	17,90,000
	Capital Reserve (3,00,000 – 10,000)	
	Securities premium	25,00,000
4	Current Assets	15,00,000
	Current Asset	40,00,000
	Intercompany adjustment	
	Unrealised profit on inventory	25,00,000
		(1,00,000)
		(10,000)
		23,90,000

13. Illustration

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies on the date of amalgamation was as under:

Liabilities	K Ltd ₹	L Ltd ₹	Assets	K Ltd ₹	L Ltd ₹
Share Capital Equity			Goodwill	80,000	-
Shares of ₹100 each	8,00,000	3,00,000			
7% Preference Share of ₹100 each	4,00,000	3,00,000	L& B	4,50,000	3,00,000
5% Debentures	2,00,000	-	P&M	6,20,000	5,00,000
General Reserve	-	1,00,000	F&F	60,000	20,000
Profit and Loss a/c	3,71,375	97,175	Tr. Receivables	2,75,000	1,75,000
Trade payables	1,00,000	2,10,000	Stores & inventory	2,25,000	1,40,000
Secured Loans	-	2,00,000	Cash at bank	1,20,000	55,000
			Cash in hand	41,375	17,175
	18,71,375	12,07,175		18,71,375	12,07,175

The following is the scheme of amalgamation

- The assumption of liabilities of both the Companies by new company.
 - Issue of 5 Preference shares of ₹20 each in LK Ltd. @ ₹18 paid up at premium of ₹4 per share for each preference share held in both the Companies.
 - 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.



- iv. Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.
- v. The assets and liabilities are to be taken at book values except for inventory and trade receivables for which provisions at 2% and 2 1/2 % respectively to be raised.
- vi. The trade receivables of K Ltd. include ₹20,000 due from L Ltd.
- vii. 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

Solution 13**In the Books of K Ltd.****Realisation Account**

Particulars	₹	Particulars	₹
To Goodwill	80,000	By 5% Debentures	2,00,000
To Land & Building	4,50,000	By Trade payables	1,00,000
To Plant & Machinery	6,20,000	By LK Ltd.	15,60,000
To Furniture & Fittings	60,000	(Purchase consideration)	51,375
To Trade Receivables	2,75,000	By Equity shareholders A/c	
To Stores & Inventory	2,25,000	(loss)	
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 Realisation A/c (loss)	51,375	By Share capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit & Loss A/c	3,71,375
To Cash	64,000		
	11,71,375		11,71,375

7% Preference Shareholders Account

Particulars	₹	Particulars	₹
To Preference Shares in LK Ltd.	4,40,000	By Share Capital	4,00,000
		By Realization A/c	40,000
	4,40,000		4,40,000

LK Ltd. Account

Particulars	₹	Particulars	₹
To Realisation A/c	15,60,000	By Equity Shares in LK Ltd.	
		For Equity 10,56,000	
		Preference	14,96,000
		4,40,000	64,000
	15,60,000	By Cash A/c	15,60,000



In the Books of L Ltd.

Realisation Account

Particulars	₹	Particulars	₹
To Land & Building	3,00,000	By Trade payables	2,10,000
To Plant & Machinery	5,00,000	By Secured Loans	2,00,000
To Furniture & Fittings	20,000	By LK Ltd.	7,90,000
To Trade Receivables	1,75,000	(Purchase consideration)	37,175
To Inventory Stores	1,40,000	By Equity shareholders A/c	
To Cash at Bank	55,000	(loss)	
To Cash in hand	17,175		
To Preference Shareholders (excess payment)	30,000		
	12,37,175		12,37,175

Equity Shareholders Account

Particulars	Y	Particulars	Y
To Realisation A/c (loss)	37,175	By Share capital	3,00,000
To Equity Shares in LK Ltd.	3,96,000	By Realisation A/c	97,175
To Cash	64,000	By Reserve	1,00,000
	4,97,175		4,97,175

7% Preference Shareholders Account

Particulars	Y	Particulars	Y
To Preference Shares in LK Ltd.	3,30,000	By Share Capital	3,00,000
		By Realization A/c	30,000
	3,30,000		3,30,000

LK Ltd. Account

Particulars	Y	Particulars	Y
To Realisation A/c	7,90,000	By Equity Shares in LK Ltd.	
		For Equity	
		3,96,000	7,26,000
		Preference	64,000
	7,90,000	<u>3,30,000</u>	7,90,000
		By Cash A/c	

Working Note: 1

Purchase Consideration

Paid to	Paid in what form	Workings	Amount
Preference shareholders of K	Preference Shares of LK	4,000 x 5 = 20,000 Preference shares of LK Worth ₹ 22 per share	20,000 x 22 = 4,40,000
	Preference Shares of LK	3,000 x 5 = 15,000 Preference shares of LK	15,000 x 22 = 3,30,000



Preference shareholders of L		Worth ₹ 22 per share	
Equity shareholders of K	Equity shares of LK	8,000 x 6 x 22	10,56,000
Equity shareholders of L	Equity shares of LK	3,000 x 6 x 22	3,96,000
Equity shareholders of K	CASH	WN: 2	64,000
Equity shareholders of L	CASH	WN: 2	64,000
Total			₹ 2,70,000

Working Note: 2**Net asset value**

Particulars	K	L
• Goodwill • Land & Buildings • Plant & Machinery • Furniture & Fittings • Trade Receivables • Stores & Inventory • Cash @ Bank • Cash in hand	80,000 4,50,000 6,20,000 60,000 2,68,125 2,20,500 1,20,000 41,375	0 3,00,000 5,00,000 20,000 1,70,625 1,37,200 55,000 17,175
Less:		
• 5% Debentures • Trade Receivables • Secured Loan	(2,00,000) (1,00,000) 0	0 (2,10,000) (2,00,000)
Net Assets for all Shareholders	15,60,000	7,90,000
Less:		
• Settlement to Preference shareholders in the form of preference shares of LK Ltd. • Settlement to Equity shareholders in the form of Equity shares of LK Ltd.	(4,40,000) (10,56,000)	(3,30,000) (3,96,000)
Cash settlement to Equity Shareholders	64,000	64,000

14. Illustration

The financial position of two companies Hari Ltd. and Vayu Ltd. as on 31st March, 20X1 was as under:

Liabilities	Hari Ltd	Vayu Ltd	Assets	Hari Ltd	Vayu Ltd
	₹	₹		₹	₹
Share Capital: Eq. Shares of ₹10 each	10,00,000	3,00,000	Goodwill	50,000	25,000



9% Pref. Shares of ₹100 each	1,00,000	-	Building	3,00,000	1,00,000
10% Pref. Shares of ₹100 each	-	1,00,000	Machinery	5,00,000	1,50,000
General Reserve	70,000	70,000	Inventories	2,50,000	1,75,000
Retirement Gratuity fund	50,000	20,000	Tr. Receivables	2,00,000	1,00,000
Trade payables	1,30,000	80,000	Cash at bank	50,000	20,000
	13,50,000	5,70,000		13,50,000	5,70,000

Hari Ltd. absorbs Vayu Ltd. on the following terms:

- 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hari Ltd.
- Goodwill of Vayu Ltd. is valued at Rs. 50,000, Buildings are valued at Rs. 1, 50,000 and the Machinery at Rs. 1, 60,000.
- Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.
- Equity Shareholders of Vayu Ltd. will be issued Equity Shares @ 5% premium. Prepare necessary Ledger Accounts to close the books of Vayu Ltd. and show the acquisition entries in the books of Hari Ltd. Also draft the Balance Sheet after absorption as at 31st March, 20X1.

Solution 14

In the Books of Vayu Ltd.

Realisation Account

Particulars	₹	Particulars	₹
To Goodwill	25,000	By Retirement Gratuity	20,000
To Building	1,00,000	By Trade Payables	80,000
To Machinery	1,50,000	By Hari Ltd.	5,30,000
To Inventory	1,75,000	(Purchase Consideration)	
To Trade Receivable	1,00,000		
To Cash	20,000		
To Preference shareholders (Premium on Redemption)	10,000		
To Equity Shareholders (Profit on Realization)	50,000		
	6,30,000		6,30,000

Equity Shareholders A/c

Particulars	₹	Particulars	₹
To Equity Shares of Hari Ltd.	4,20,000	By Share Capital	3,00,000
		By General Reserve	70,000
		By Realization A/c (Profit on Realization)	50,000
	4,20,000		4,20,000

Preference Shareholders A/c

Particulars	₹	Particulars	₹
To 9% Preference shares of Hari Ltd	1,10,000	By Preference Share Capital	3,00,000
		By Realization A/c	70,000
			50,000



	4,20,000	(Premium on Redemption of Preference Shares)	4,20,000

Hari Ltd. Account

Particulars	₹	Particulars	₹
To Realisation A/c	5,30,000	By 9% Preference share	1,10,000
		By Equity Shares	4,20,000
	5,30,000		5,30,000

Journal Entries in the books of Hari Ltd
Amalgamation in the nature of Purchase

S.no	Particulars	Dr ₹	Cr ₹
1	Business Purchase A/c Dr To Liquidator A/c (Being business purchased)	5,30,000	5,30,000
2	Goodwill A/c Dr 50,000 Building A/c Dr 1,50,000 Machinery A/c Dr 1,60,000 Inventory A/c Dr 1,57,500 Trade Receivable A/c Dr 1,00,000 Cash at Bank A/c Dr 20,000 To Retirement A/c 20,000 To Trade payables A/c 80,000 To Provision for doubtful debt A/c 7,500 To Business purchase A/c 5,30,000 (Being incorporation assets liabilities from Vayu Ltd)		
3	Liquidator of Vayu Ltd A/c Dr 5,30,000 To 9% Preference share capital A/c 1,10,000 To Securities Premium on Preference Shares - To Equity shares capital A/c 4,00,000 To Securities premium on equity shares 20,000 (Being settlement of liquidator)		

Balance sheet of Hari Ltd. as at 31st March, 20X1 (after absorption)

Particulars		Notes	₹ (in lakhs)
1	Equity and Liabilities		
	Shareholder's funds		
A	Share capital	1	16,10,000
B	Reserves and Surplus	2	90,000
2	Non-Current liabilities		
A	Long-term borrowings	3	70,000
3	Current liabilities		
A	Trade Payables		2,10,000
B	Short term provisions		7,500
	Total		19,87,500
	Assets		
1	Non-current assets		
A	Property, plant and equipment	4	11,10,000



2	B	Intangible assets	5	1,00,000
		Current assets		
	A	Inventories		4,07,500
	B	Trade receivables	6	3,00,000
	C	Cash and Cash equivalents		70,000
		Total		19,87,500

Notes to accounts

S.no	Particulars	₹ (in lakhs)
1	<u>Share Capital</u>	
	Equity share capital	14,00,000
	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)	
	Preference share capital	2,10,000
	2,100 9% Preference Shares of ₹100 each (Out of above 1,100 Preference Shares were issued in consideration other than cash)	
		16,10,000
2	<u>Reserve and Surplus</u>	
	General Reserve	20,000
	Securities premium	70,000
		90,000
3	Total	
	<u>Long Term Borrowings</u>	70,000
	Retirement Gratuity fund	70,000
4	<u>Short term provisions</u>	7,500
	Provisions for Doubtful Debts*	
5	<u>Property, plant and equipment</u>	
	Building	4,50,000
	Machinery	6,60,000
		11,10,000
6	Intangible Assets	1,00,000
	Goodwill	3,00,000
7	Trade Receivables	

*Short term provisions can alternatively be deducted from trade receivables.

Working Note: 1

Purchase consideration

Paid to	Paid in what form	Workings	Amount
Preference shareholders of Vayu	9% Preference share of Hari	1,00,000 + 10% (1,00,000) = 1,10,000	1,100 Preference share X ₹100 = 1,10,000
Equity shareholders of Vayu	Equity shares of Hari	WN: 2	4,20,000
	Total		5,30,000



Working Note: 2

Intrinsic Value

Particulars	Amount
• Goodwill	50,000
• Building	1,50,000
• Machinery	1,60,000
• Inventory	1,57,500
• Trade receivables	92,500
• Cash at Bank	20,000
Less:	
• Retirement gratuity	(20,000)
• Trade payables	(80,000)
⇒ Net Asset value attributable to all Shareholders	5,30,000
Less: Settlement to Preference shareholders	(1,10,000)
Settlement to Equity shareholders	4,20,000

15. Illustration

The following is the summarised balance sheet of A Ltd as at 31st March, 20X5.

Liabilities	₹	Assets	₹
8,000 equity shares of ₹100 each	8,00,000	Building	3,40,000
10% Debentures	4,00,000	Machinery	6,40,000
Loan from A	1,60,000	Inventory	2,20,000
Trade payables	3,20,000	Tr. receivables	2,60,000
General Reserve	80,000	Bank	1,36,000
		Goodwill	1,30,000
		Share issue expenses	34,000
	17,60,000		17,60,000

B Ltd agrees to absorb A Ltd on the following conditions:

- B Ltd would take over all assets except bank balance at book value less 10%.
- Goodwill is to be valued at four years purchase of super profits, assuming that the normal rate of return will be 8 % on the combined amount of share capital and general reserve.
- B Ltd is to take over trade payables at book value.
- The purchase consideration is to be paid in cash to the extent of ₹6,00,000 and the balance is fully paid equity shares of ₹100 each at ₹125 per share.
- The average profit is ₹1,24,400.
- Liquidation expenses amounted to ₹16,000.
- B Ltd sold prior to 31 March 20X5, goods costing ₹1,20,000 to A Ltd for ₹1,60,000. ₹1,00,000 worth of goods are still in inventory of A Ltd on 31st March 20X5.
- Trade payables of A Ltd include ₹40,000 still due to B Ltd.

Show the necessary Ledger Accounts to close the books of A Ltd and prepare Balance Sheet of B Ltd as at 1st April 20X5 after the takeover.

Solution 15



In the books of A Ltd

Realisation Account

Particulars	₹	Particulars	₹
To Building A/c	3,40,000	By 10% Debentures	4,00,000
To Machinery	6,40,000	By Loan from A	1,60,000
To Inventory	2,20,000	By Trade Payables	3,20,000
To Trade Receivables	2,60,000	By B Ltd (Purchase Consideration)	12,10,000
To Goodwill	1,30,000	By Equity Shareholders	76,000
To Bank (Debt + Loan)	5,60,000	By Equity Shareholders (Bal.fig – Loss)	
To Bank (Exp)	16,000		
	21,66,000		21,66,000

Bank A/c

Particulars	₹	Particulars	₹
To Balance B/d	1,36,000	By Realisation A/c	3,00,000
To B Ltd (PC in Cash)	6,00,000	By Realisation A/c (Debt + Loan)	70,000
		By Realisation (Exp)	50,000
		By Equity Shareholders	1,60,000
		By Equity Shareholders (Bal. fig)	
	7,36,000		7,36,000

Equity Shareholders A/c

Particulars	₹	Particulars	₹
To Share issue expenses	34,000	By Realisation A/c	3,00,000
To Investment in Equity shares	6,10,000	By Realisation A/c (Debt + Loan)	70,000
of B Ltd	76,000	By Realisation (Exp)	50,000
To Realisation Loss	1,60,000	By Equity Shareholders	1,60,000
To Cash / Bank		By Equity Shareholders (Bal. fig)	
	8,80,000		8,80,000

In the books of B Ltd.

Balance sheet as on 1st April 20X5

Particulars			Notes	₹ (in lakhs)
1		Equity and Liabilities		
		Shareholder's funds		
	A	Share capital	1	4,88,000
	B	Reserves and Surplus	2	1,07,000
2		Current liabilities	3	2,80,000
	A	Trade Payables		6,00,000
	B	Short term borrowings- Bank overdraft		
		Total		14,75,000
1		Assets		
		Non-current assets		
	A	Fixed Assets:		
		Tangible assets	4	8,82,000
		Intangible assets	5	2,16,000



2		Current assets		
	A	Inventories	6	1,83,000
	B	Trade receivables	7	1,94,000
	C	Cash and Cash equivalents		
		Total		14,75,000

Notes to Accounts

Sr.no	Particulars	₹	₹
1	Share capital Equity share capital 4,880 Equity shares of ₹100 each (Shares have been issued for consideration other than cash)		4,88,000
2	Reserves and Surplus Securities Premium Profit and loss A/c Less: Unrealised profit Total	1,22,000 (15,000)	1,07,000
3	Trade payables Opening balance Less: Inter-company transaction cancelled upon amalgamation	3,20,000 40,000	2,80,000
4	Tangible assets Building Machinery	3,06,000 5,76,000	8,82,000
5	Intangible assets Machinery		2,16,000
6	Inventories Opening balance Less: Cancellation upon amalgamation	1,98,000 (15,000)	1,83,000
7	Trade receivable Opening balance Less: Inter-company transaction cancelled upon amalgamation	2,34,000 40,000	1,94,000

Working note 1

Goodwill Valuation

Particulars	₹
Share capital	8,00,000
General reserves	80,000
Capital employed	8,80,000
Normal Expected Profit (8% of 8,80,000) (A)	70,400
Average Profit of this Co. (B)	1,24,400
Super profit (A) – (B)	54,000
No. of years of purchase	4
Goodwill	2,16,000

Working note 2

Net asset value

Particulars	₹
Building 90%	3,06,000
Machinery 90%	5,76,000
Inventory 90%	1,98,000



Trade Receivables 90%	2,34,000
Goodwill	2,16,000
Bank → Net taken over	0
Less: Trade Payables	(3,20,000)
Net assets of A taken over by B	12,10,000

Working note 3**Purchase Consideration**

Paid to	Paid in what form	Workings	Amount
Preference shareholders of A	Cash	-	6,00,000
	Equity shares of B Ltd.	WN: 2 = 12,10,000 – 6,00,000 = 6,10,000	= 4,880 shares x ₹125 = 6,10,000
	Total		12,10,000

Working Note: 4**Unrealised Profit**

- Profit made by B on sale to A ⇒ 40,000
- If Selling price is 1,60,000 → Profit is 40,000
1,00,000 → ? = **25,000**
- ⇒ Selling price of B is cost to A, In Inventory cost of ₹ 1,00,000, ₹ 25,000 is the profit earned by B.
- ⇒ But all inventory is taken over by B at 10% less than book value ⇒ 10% x 1,00,000 = 10,000 should be reduced.
- ⇒ Inventory is taken over at 90,000, This inventory of A Ltd taken over by B has unrealised profit earned by B.
 - Amount of unrealised profit = 25,000 – 10,000
= 15,000
- ⇒ This is reduced from stock and corresponding from P&L A/c

16. Illustration

The following is the summarised balance sheet of Mars Ltd as at 31st March, 2012

Liabilities	₹	Assets	₹
Share Capital:		Fixed Assets:	
1,00,000 Equity shares of ₹10 each fully paid up	10,00,000	Land and building	7,64,000
Reserve and Surplus:		Current Assets:	
Capital reserve	42,000	Stock	7,75,000
Contingency reserve	2,70,000	Sundry Debtors 1,60,000	1,52,000
Profit & Loss a/c	2,52,000	Less: Prov. for D. debts (8,000)	30,000
Current liabilities & Prov.:		Bills receivable	3,29,000
Bills payable	40,000	Cash at bank	
Sundry Creditors	2,26,000		
Prov. for Income tax	2,20,000		
	20,50,000		20,50,000

On 1st April 2011, Jupiter Limited agreed to absorb Mars Limited. Jupiter Ltd will take over the assets at the following values

Land and building	₹10,80,000
Stock	₹7,70,000
Bills receivable	₹30,000



The following terms were agreed upon.

- Purchase consideration: 4,100 fully paid 10% preference shares of ₹100 will be issued and the balance sheet will be settled by issuing equity shares of ₹10 each at ₹8 paid up.
- Liquidation expenses are to be reimbursed by Jupiter Ltd to the extent of ₹5,000.
- Sundry debtors realised ₹ 1,50,000. Bills payable were settled for ₹38,000. Income tax authorities fixed the taxation liability at ₹2,22,000 and the same was paid.
- Creditors were finally settled with cash remaining after meeting liquidation expenses amounting to ₹8,000.

You are required to:

- Calculate the number of equity shares and preference shares to be allotted by Jupiter Ltd
- Prepare the Realisation a/c, Bank a/c, Equity shareholders a/c and Jupiter Ltd's a/c in the books of Mars Ltd.

Solution 16

In the books of Mars Ltd

Realisation Account

Particulars	₹	Particulars	₹
To Land & Buildings	7,64,000	By Trade Payables	2,66,000
To Inventory	7,75,000	By Provision for Tax	2,20,000
To Trade receivables	1,90,000	By Jupiter (P.C)	18,80,000
To Bank (Exp)	8,000	By Bank (exp)	5,000
To Bank (B/P)	38,000	By Bank (Trade	1,50,000
To Bank (Tax)	2,22,000	Receivables)	8,000
To Bank (Creditors)	2,16,000	By Provision for doubtful	
To Equity shareholders (B.f)	3,16,000	debts	
	25,29,000		25,29,000

Bank A/c

Particulars	₹	Particulars	₹
To Balance b/d	3,29,000	By Realisation (exp)	8,000
To Realisation (exp)	5,000	By Realisation (B/P)	38,000
To Realisation (Debtors)	1,50,000	By Realisation (Tax)	2,22,000
		By Realisation (Trade	2,16,000
		payables)	
	4,84,000		4,84,000

Equity Shareholders A/c

Particulars	₹	Particulars	₹
To Investment in Preference shares	4,10,000	By Equity share capital	10,00,000
Of Jupiter	14,90,000	By Capital Reserve	42,000
To Investment in Equity shares		By Contingency Reserve	2,70,000
Of Jupiter		By P&L	2,52,000
	18,80,000	By Realisation A/c	3,16,000
			18,80,000

Jupiter Ltd

Particulars	₹	Particulars	₹
To Realisation A/c	18,80,000	By Investment Preference share	4,10,000
			14,70,000



	18,80,000	By Investment in Equity share of Jupiter	18,80,000

Working note: 1**Net assets taken over**

	₹
Land & Building	10,80,000
Stock	7,70,000
Bills receivable	30,000
Total assets taken over by Jupiter Ltd	18,80,000

Working Note: 2

Paid in	Working	(₹)
Equity Shares	1,83,750 x 8	14,70,000
Preference shares	4,100 x ₹100	4,10,000
		18,80,000

17. Illustration

Wye Ltd. acquires the business of Zed Ltd. whose balance sheet as at 31st March, 20X1 is as under:

		Particulars	Notes	Rs.
1		Equity and Liabilities		
		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)		<u>12,000</u>
				<u>16,90,000</u>
1		Assets		
	A	Non-current assets		
	B	Property, Plant and Equipment	4	10,00,000
		Intangible assets	5	2,90,000
2		Current assets		
	A	Inventories		1,50,000
	B	Trade receivables		1,80,000
	C	Cash and Cash equivalents		<u>70,000</u>
				<u>16,90,000</u>
		Total		

Notes to accounts:

		Rs.
1	Share Capital	
	Equity Share capital (Rs. 100 each)	8,00,000



	6% Preference Share capital (Rs. 100 each)	<u>4,00,000</u>
		<u>12,00,000</u>
2	Reserves and Surplus	
	Capital reserve	1,00,000
	Profit and loss A/c	50,000
	Workmen compensation reserve (Expected liability Rs. 5,000)	<u>8,000</u>
		<u>1,58,000</u>
3	Long-term borrowings	
	6% Debentures	<u>2,00,000</u>
		<u>2,00,000</u>
4	Property, Plant and Equipment	
	Land and Building	4,00,000
	Plant and machinery	<u>6,00,000</u>
		<u>10,00,000</u>
5	Intangible assets	
	Goodwill	2,40,000
	Patents	<u>50,000</u>
		<u>2,90,000</u>

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts:

- Rs. 2,00,000 7% Debentures (Rs. 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth Rs. 105.
- For each preference share in Zed Ltd. Rs. 10 in cash and one 9% preference share of Rs. 100 each in Wye Ltd.
- For each equity share in Zed Ltd. Rs. 20 in cash and one equity share in Wye Ltd. of Rs. 100 each having the market value of Rs. 140.
- Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of Rs. 10,000. Actual expenses amounted to Rs. 12,500.

Wye Ltd. valued Land and building at Rs. 5,50,000 Plant and Machinery at Rs. 6,50,000 and patents at Rs. 20,000 of Zed Ltd for the purpose of amalgamation.

Solution:

Purchase Consideration

	Rs.	Form
(i) Preference Shares: Rs. 10 per share 40,000		Cash
Preference shares <u>4,00,000</u>	4,40,000	Preference shares
(ii) Equity shares: Rs. 20 per share 1,60,000		Cash
8,000 equity shares in		
Wye Ltd. @ Rs. 140 <u>11,20,000</u>	<u>12,80,000</u>	Equity shares
<u>17,20,000</u>		

Steps to close the Books of the Vendor Company

- Open Realization Account and transfer all assets at book value.

Exception: If cash is not taken over by the purchasing company, it should not be transferred.

Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realization Account.

The journal entry in the above case is:



		Rs.	Rs.
Realization A/c	Dr	16,20,000	
To Sundries —			
Goodwill			2,40,000
Land & Building			4,00,000
Plant & Machinery			6,00,000
Patents			50,000
Inventory			1,50,000
Trade receivables			1,80,000
(Transfer of assets to Realization Account on sale of business to Wye Ltd)			

2. Transfer to the Realization Account the liabilities which the purchasing company is to take over. In case of the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is not required (i.e., the reserve portion) should be treated as profit. Accordingly, the following entry will be recorded:

		Rs.	Rs.
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.

		Rs.	Rs.
Wye Ltd.	Dr.	17,20,000	
To Realization A/c			17,20,000
(Amount receivable from Wye Ltd. for sale of business)			

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company. Thus —

Cash	Dr.	2,00,000	
9% Preference shares in Wye Ltd.	Dr.	4,00,000	
Equity shares in Wye Ltd.	Dr.	11,20,000	
To Wye Ltd.			17,20,000
(Receipt of purchase consideration from the purchase company)			

5. Expenses of liquidation have to be dealt with according to the circumstances of each case.

(a) If the vendor company has to bear and pay them:

Realization Account should be debited and Cash Account credited.

(b) If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:

(i) It may be ignored in the books of the vendor company.

(ii) If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed:

(a) Debit Purchasing company and credit Cash Account when expenses are paid by the vendor company; and



(b) Debit Cash Account and credit purchasing company (on the expenses being reimbursed).

In the above mentioned case Wye Ltd. has to pay maximum of Rs. 10,000 only whereas, the amount spent is Rs. 12,500. Hence Rs. 2,500 is to be borne by Zed Ltd.; the entries required will be :

		Rs.	Rs.
Wye Ltd.	Dr.	10,000	
Realization A/c	Dr.	2,500	
To Cash A/c			12,500
(Liquidation expenses out of which Rs. 10,000 is payable by Wye Ltd.)			

		Rs.	Rs.
Cash A/c	Dr.	10,000	
To Wye Ltd.	Dr.		10,000
(Account reimbursed by Wye Ltd. for expense)			

6. Liabilities not assumed by the purchasing company, have to be paid off. On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realization Account. Zed Ltd. shall pass the following entries in this respect:

		Rs.	Rs.
Interest Outstanding	Dr	12,000	
To Debenture holders A/c			12,000
(Amount due to debenture holders for debentures interest)			

		Rs.	Rs.
Debenture holders A/c	Dr	12,000	
To Cash A/c			12,000
(Debenture holders paid cash Rs. 12,000 for outstanding interest)			

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realization Account. Thus –

		Rs.	Rs.
6% Pref. Share Capital A/c	Dr	4,00,000	
Realization A/c	Dr	40,000	
To Preference Shareholders A/c			4,40,000
(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)			

8. Pay off preference shareholders by debiting them and crediting whatever is given to them. The entry in the above case is :

		Rs.	Rs.
Preference shareholders A/c	Dr.	4,40,000	
To Cash A/c			40,000
To 9% Preference shares in Wye Ltd.			4,00,000
(Cash and preference shares in Wye Ltd. given to preference shareholders)			

9. Transfer equity share capital and account representing profit or loss (including the balance in Realization Account) to Equity Shareholders Account. This will



determine the amount receivable by the equity shareholders. Zed Ltd. shall pass the following entries in this regard :

		Rs.	Rs.
Equity Share Capital A/c	Dr.	8,00,000	
Capital Reserve A/c	Dr.	1,00,000	
Profit and Loss A/c	Dr.	50,000	
Workmen's Compensation Reserve A/c	Dr.	3,000	
Realization A/c	Dr.	3,82,500	
To Equity Shareholders A/c			13,35,500
(Various accounts representing capital and profit transferred to Equity Shareholders Account)			

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them. Hence:

		Rs.	Rs.
Equity Shareholders A/c	Dr	13,35,500	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c (W.N.2)			2,15,500

Working Notes

1. Realization Account

	Rs.		Rs.
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	<u>3,82,500</u>		
	<u>20,45,000</u>		<u>20,45,000</u>

2. Cash Account

To Balance b/d	70,000	By Realization	2,500
To Wye Ltd. (consideration for amalgamation)	2,00,000	By Wye Ltd.	10,000
To Wye Ltd. (liquidation expenses reimbursed)	10,000	By Debenture-holders	12000
		By Preference shareholder	40000
		By Equity Shareholder (B/F)	<u>215500</u>
	<u>280000</u>		<u>280000</u>

18. Illustration

The following Balance Sheets are given as at 31st March, 20X1:

		Particulars	Rs. Best Ltd. (in lakhs)	Rs. Better Ltd. (in lakhs)
1		Equity and Liabilities Shareholders' funds		
	A	Share capital	20	10
	B	(shares of Rs. 100 each, fully paid)	10	8



2		Reserves and Surplus	<u>20</u>	<u>2</u>
		Current liabilities	<u>50</u>	<u>20</u>
1		Total		
	A	Assets	25	15
	B	Non-current assets	5	-
2		Property, Plant and Equipment	<u>20</u>	<u>5</u>
		Non-current investments	<u>50</u>	<u>20</u>
		Current assets		
		Total		

The following further information is given:

- Better Limited issued bonus shares on 1st April, 20X1, in the ratio of one share for every two held, out of Reserves and Surplus.
- 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.
- The value of shares in Best Ltd. was considered to be Rs. 150 and the shares in Better Ltd. were valued at Rs. 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.
- Liabilities of Better Ltd., included Rs. 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of Rs. 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 20X1 after the takeover.

Solution:

LEDGER OF BETTER LIMITED

Property, Plant and Equipment (PPE) Account

	Rs.		Rs.
To Balance b/d	15,00,000	By Realization A/c (transfer)	15,00,000

Current Assets Account

	Rs.		Rs.
To Balance b/d	5,00,000	By Realization A/c (transfer)	5,00,000

Liabilities Account

	Rs.		Rs.
To Realization A/c	15,00,000	By Balance b/d	15,00,000

Realization Account

	Rs.		Rs.
To PPE A/c	15,00,000	By Liabilities A/c	2,00,000
Current Assets A/c	5,00,000	Best Limited (Purchase Consideration)	15,00,000
		Shareholders' A/c (Loss on Realization)	3,00,000
	20,00,000		20,00,000

Share Capital Account

	Rs.		Rs.
To Sundry shareholders		By Balance b/d	10,00,000
A/c - (transfer)	15,00,000	" Reserves & Surplus A/c	
		(Bonus issue)	<u>5,00,000</u>
	<u>15,00,000</u>		<u>15,00,000</u>



Reserves & Surplus Account

	Rs.		Rs.
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
" Sundry Shareholders	<u>3,00,000</u>		
	<u>8,00,000</u>		<u>8,00,000</u>

Best Ltd.

To Realization A/c - Purchase		By Shares in Best Ltd	15,00,000
Consideration	<u>15,00,000</u>		
	<u>15,00,000</u>		<u>15,00,000</u>

Shares in Best Ltd.

	Rs.		Rs.
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
Share in Best Ltd.	<u>15,00,000</u>	By Reserves & Surplus A/c	<u>3,00,000</u>
	<u>18,00,000</u>		<u>18,00,000</u>

Journal of Best Ltd.

		Dr.	Cr.
20X1		Rs.	Rs.
Apr. 1 Property, Plant and Equipment A/c	Dr.	15,00,000	
Current Assets A/c	Dr.	5,00,000	
To Liabilities A/c			2,00,000
To Liquidator of Better Ltd.			15,00,000
To Capital Reserve A/c			3,00,000
(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of Rs. <u>15,00,000 as per agreement dated</u>)			
Liquidator of Better Ltd.	Dr.	15,00,000	
To Share Capital A/c			10,00,000
To Securities Premium A/c			5,00,000
(Discharge of Purchase consideration by the issue of equity shares of Rs. 10,00,000 at a premium of Rs. 50 per share as per agreement)			
Trade payables A/c	Dr.	1,00,000	
To Trade receivables A/c			1,00,000
(Amount due from Better Ltd., and included in its creditors taken over, cancelled against own Trade receivables)			
Capital Reserve A/c	Dr.	10,000	
To Current Asset (Stock) A/c			10,000
(Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account. 20% on sale value of Rs.50,000 shall be			



eliminated as unrealized profit)		

Working Note :

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at Rs. 100 per share Rs. 15,00,000

Purchase consideration has been discharged by Best Ltd. by the issue of shares for Rs. 10,00,000 at a premium of Rs. 5,00,000. This gives the value of Rs. 150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	Notes	Rs.
		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

			Rs.
1	Share Capital		
	Equity share capital		
	Issued & Subscribed		
	30,000 shares of Rs. 100 (of the above 10,000 shares have been issued for consideration other than cash)		30,00,000
	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

19. Illustration

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 Rs. 4,00,000 divided into 80,000 equity shares of Rs. 5 each. On 31st March, 20X3 the respective information of Sun and Neptune were as follows:

	Sun (Rs.)	Neptune (Rs.)
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 (Rs.)	Neptune (Rs.)
Property, Plant and Equipment	7,10,000	3,90,000
Current Assets	2,99,500	1,57,750

(b) The debtors and creditors include Rs. 43,350 owed by Sun to Neptune.

The purchase consideration is satisfied by issue of the following shares and debentures.

(i) 60,000 equity shares of Jupiter Ltd. to Sun and Neptune in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

	Sun (Rs.)	Neptune (Rs.)
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:

- Compute the amount of debentures and shares to be issued to Sun and Neptune.
- A Balance sheet of Jupiter Ltd. showing the position immediately after amalgamation.

Solution:

(1) Computation of Amount of Debentures and Shares to be issued:

	Sun	Neptune
(i) Average Net Profit		
Rs. (4,49,576-2,500+3,77,924)/3		= 2,75,000
Rs. (2,73,900+3,42,100+3,59,000)/3		= 3,25,000

(ii) Equity Shares Issued

(a) Ratio of distribution

Sun:	Neptune
275	325

(b) Number

Sun :	27,500
Neptune:	<u>32,500</u>
	<u>60,000</u>

(c) Amount

27,500 shares of Rs. 5 each	=	1,37,500
32,500 shares of Rs. 5 each	=	1,62,500

(iii) Capital Employed (after revaluation of assets)	Rs.	Rs.
Property, plant and equipment	7,10,000	3,90,000
Current Assets	<u>2,99,500</u>	<u>1,57,750</u>
	10,09,500	5,47,750
Less: Current Liabilities	<u>(5,97,000)</u>	<u>(1,80,250)</u>
	<u>4,12,500</u>	<u>3,67,500</u>
(iv) Debentures Issued		
8% Return on capital employed	33,000	29,400



15% Debentures to be issued to provide equivalent income:

Sun: $33,000 \times 100 / 15 = 2,20,000$

Neptune: $29,400 \times 100 / 15 = 1,96,000$

**Balance Sheet of Jupiter Ltd.
As at 31st March 20X3 (after amalgamation)**

Particulars	Note No	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	64,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	4,16,000
(3) Current Liabilities		
(a) Other current liabilities		7,33,900
Total		15,13,900
II. Assets		
(1) Non-current assets		
(a) PPE		11,00,000
(2) Current assets		
(a) Other current assets		4,13,900
Total		15,13,900

Notes to Accounts

		Rs.
1	Share Capital	
	Authorized	
	80,000 Equity Shares of Rs. 5 each	4,00,000
	Issued and Subscribed	
	60,000 Equity Shares of Rs. 5 each	<u>3,00,000</u>
	(all the above shares are allotted as fully paid-up pursuant to a contract without payment being received in cash)	
2	Reserve and Surplus	
	Capital Reserve	<u>64,000</u>
3	Long-term borrowings	
	Secured Loans	
	15% Debentures	<u>4,16,000</u>

Working Notes:

		Sun	Neptune	Total
		Rs.	Rs.	Rs.
(1)	Purchase Consideration			
	Equity Shares Issued	1,37,500	1,62,500	3,00,000
	15% Debentures Issued	2,20,000	1,96,000	4,16,000
		3,57,500	3,58,500	7,16,000
(2)	Capital Reserve			
(a)	Net Assets taken over			



	Property, plant & equipment	7,10,000	3,90,000	11,00,000
	Current Assets	2,99,500	1,14,400*	4,13,900
		10,09,500	5,04,400	15,13,900
	Less: Current Liabilities	(5,53,650**)	(1,80,250)	(7,33,900)
		4,55,850	3,24,150	7,80,000
(b)	Purchase Consideration	3,57,500	3,58,500	7,16,000
(c)	Capital Reserve [(a) - (b)]	<u>98,350</u>		
(d)	Goodwill [(b) - (a)]		<u>34,350</u>	
(e)	Capital Reserve [Final Figure(c) -(d)]			64,000

* $1,57,750 - 43,350 = 1,14,400$

** $5,97,000 - 43,350 = 5,53,650$

20. Illustration

The following information from Balance Sheet of X Ltd. as at 31st March, 20X1:

	Rs.
4,000 Equity shares of Rs. 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:

- 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.
- Y Ltd. is to take over trade payables at book value.
- The purchase consideration is to be paid in cash to the extent of Rs. 3,00,000 and the balance in fully paid equity shares of Rs. 100 each at Rs. 125 per share.

The average profit is Rs. 62,200. The liquidation expenses amounted to Rs. 8,000. Y Ltd. sold prior to 31st March, 20X1 goods costing Rs. 60,000 to X Ltd. for

Rs. 80,000. Rs. 50,000 worth of goods are still in Inventory of X Ltd. on 31st March, 20X1.

Trade payables of X Ltd. include Rs. 20,000 still due to Y Ltd.

Show the necessary Ledger Accounts to close the books of X Ltd. and prepare the Balance Sheet of Y Ltd. as at 1st April, 20X1 after the takeover.

Solution:

Books of X Limited

Realisation Account

		Rs.			Rs.
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.)	<u>8,000</u>			
		<u>8,03,000</u>			<u>8,03,000</u>

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	<u>80,000</u>
		<u>3,68,000</u>			<u>3,68,000</u>
10% Debentures Account					
To	Bank	<u>2,00,000</u>	By	Balance b/d	<u>2,00,000</u>
		<u>2,00,000</u>			<u>2,00,000</u>
Loan Account					
To	Bank	<u>80,000</u>	By	Balance b/d	<u>80,000</u>
		<u>80,000</u>			<u>80,000</u>
Share Issue Expenses Account					
To	Balance b/d	<u>17,000</u>	By	Equity shareholders	<u>17,000</u>
		<u>17,000</u>			<u>17,000</u>
General Reserve Account					
To	Equity shareholders	<u>40,000</u>	By	Balance b/d	<u>40,000</u>
		<u>40,000</u>			<u>40,000</u>
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 Rs. 125 each)	<u>3,05,000</u>
		<u>6,05,000</u>			<u>6,05,000</u>
Equity Shares in Y Ltd. Account					
To	Y Ltd.	<u>3,05,000</u>	By	Equity shareholders	<u>3,05,000</u>
		<u>3,05,000</u>			<u>3,05,000</u>
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	<u>80,000</u>			
		<u>4,40,000</u>			<u>4,40,000</u>

Y Ltd

Balance Sheet as on 1st April, 20X1 (An extract)

	Particulars	Notes	Rs.
1	Equity and Liabilities		
	Share capital		
a	Reserves and Surplus	1	2,44,000
b	Current liabilities	2	53,500
2	Trade Payables		
a		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

			Rs.
1	Share Capital		
	Equity share capital		
	2,440 Equity shares of Rs. 100 each (Shares have been issued for consideration other than cash)		2,44,000
	Total		2,44,000
2	Reserves and Surplus (an extract)		
	Securities Premium		61,000
	Profit and loss account		
	Less: Unrealised profit	(7,500)	(7,500)
	Total		53,500
3	Trade payables		
	Opening balance	1,60,000	
	Less: Inter-company transaction cancelled upon amalgamation	(20,000)	1,40,000
4	Property, Plant and Equipments		
	Buildings		1,53,000
	Machinery		2,88,000
	Total		4,41,000
5	Intangible assets		
	Goodwill		1,08,000
6	Inventories		
	Opening balance	99,000	
	Less: Cancellation of profit upon amalgamation	(7,500)	91,500
7	Trade receivables		
	Opening balance	1,17,000	
	Less: Intercompany transaction cancelled upon amalgamation	(20,000)	97,000

Working Notes:

1. Valuation of Goodwill	Rs.
Average profit	62,200
Less: 8% of Rs. 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)	<u>1,17,000</u>
Total Assets	7,65,000
Less: Trade payables	<u>(1,60,000)</u>
Net Assets	<u>6,05,000</u>
Out of this Rs. 3,00,000 is to be paid in cash and remaining i.e., (6,05,000 – 3,00,000) Rs. 3,05,000 in shares of Rs. 125. Thus, the number of shares to be allotted $3,05,000/125 = 2,440$ shares.	
3. Unrealised Profit on Inventory	Rs.
The Inventory of X Ltd. includes goods worth Rs. 50,000 which was sold by Y Ltd. on profit. Unrealized profit on this Inventory will be $[20,000/80,000 \times 50,000]$	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 Rs. 50,000.	<u>(5,000)</u>
Amount of unrealized profit	<u>7,500</u>



Illustrations

1. Illustration

The Balance Sheet of A & Co. Ltd. as on 31-12-2011 is as follows:

Assets	₹	₹
Fixed Assets:		
Freehold property	4,25,000	
Plant	50,000	
Patent	37,500	
Goodwill	1,30,000	6,42,500
Traded Investments (at cost)		55,000
Current Assets:		
Trade receivables	4,85,000	
Inventory	4,25,000	9,10,000
Profit and Los Account		5,35,000
Total		21,42,500
Liabilities		
Share Capital:		
4,000 6% Cumulative Preference Shares of ₹100 each	4,00,000	
75,000 Equity Shares of ₹10 each	7,50,000	11,50,000
6% Debentures (Secured on Freehold Property)	3,75,000	
Accrued Interest	22,500	3,97,500
Current Liabilities:		
Bank Overdraft	1,95,000	
Trade payables	3,00,000	
Directors' Loans	1,00,000	5,95,000
Total		21,42,500

The Court approved a Scheme of re-organisation to take effect on 1-1-2011, whereby:

- The Preference shares to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.
- Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹2 each to be allotted for the remaining quarter.
- Accrued interest on debentures to be paid in cash.
- 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.
- Patents and Goodwill to be written off.
- Inventory to be written off by ₹ 65,000.
- Amount of ₹68,500 to be provided for bad debts.
- Remaining freehold property to be re-valued at ₹ 3,87, and 500.
- Trade Investments be sold for ₹ 1,40,000.
- Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹ 2 each and as to 5% in cash, and balance 5% being waived.
- There were capital commitments totaling ₹ 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.
- Ignore taxation and cost of the scheme.

You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the Scheme

Solution 1

❖ Process for Internal Capital reduction:

- Written confirmation from the stakeholders for the alteration /rearrangement to be made.
 - Special resolution has to be passed.



- Court should approve the scheme of Internal Capital reduction passed wide Special resolution by the company.
- Court ensures the stakeholders have given willing freely.

(i)

Journal entries in the books of A & Co Ltd

Date	Particulars	Dr ₹	Cr ₹
1 st Jan 2011	6% Preference share capital (₹100) A/c Dr To Capital Reduction A/c To 6% Preference share capital (₹75) A/c (Being reduction Preference share capital as per the scheme from ₹100 to ₹75)	4,00,000	1,00,000 3,00,000
"	Equity share capital (₹10) A/c Dr To Capital Reduction A/c To Equity share capital (₹2) A/c (Being reduction Equity share capital as per the scheme from ₹10 to ₹2)	7,50,000	6,00,000 1,50,000
"	Capital Reduction A/c Dr To Equity share capital A/c (Being arrears of preference dividend satisfied by the issue of equity shares, 25% of the amount due, ₹96,000)	24,000	24,000
"	Freehold Property A/c Dr To Capital Reduction A/c (Being appreciation in the value of the property) [Note: 1]	82,500	82,500
"	6% Debentures A/c Dr To Freehold Property A/c (Being claims of debenture holders, in part, in respect of principal discharged by transfer of freehold property vide scheme of Reconstruction)	1,20,000	1,20,000
"	Interest Payable A/c Dr To Bank A/c (Being Debenture interest paid)	22,500	22,500
"	Bank A/c Dr To 8% Debentures A/c (Being 8% Debentures issued for cash)	1,30,000	1,30,000
"	Bank A/c Dr To Investment A/c To Capital Reduction A/c (Being Investment sold on profit)	1,40,000	55,000 85,000
"	Director's Loan A/c Dr To Bank A/c To Capital Reduction A/c To Equity share capital A/c (Being director's loan discharged by issue of equity shares of ₹90,000, Cash payments of ₹5,000 and surrender of ₹5,000, vide the scheme of reconstruction)	1,00,000	90,000 5,000 5,000



"	Capital Reduction A/c	Dr	8,48,500	
	To Patent A/c			37,500
	To Goodwill A/c			1,30,000
	To Inventory A/c			65,000
	To Provision for Doubtful Debts A/c			68,500
	To Bank A/c			12,500
	To profit and Loss A/c			5,35,000
	(Being goodwill, patents, profit and loss written off, and value of stock reduced and provisions for doubtful debts and payment			

(ii)

Balance sheet of A & Co. Ltd. (And Reduced) as at 1.4.2011

Particulars			Notes	₹
1		Equity and Liabilities		
		Shareholder's funds		
	A	Share capital	1	5,64,000
2		Non-Current liabilities		
	A	Long-term borrowings	2	3,85,00
3		Current liabilities		
	A	Trade Payables		3,00,000
	B	Short term borrowings	3	68,500
		Total		13,17,500
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	4,37,500
	B	Intangible assets	5	-
2		Current assets		
	A	Inventories		3,60,000
	B	Trade receivables		4,85,000
	C	Cash and Cash equivalents		35,000
		Total		13,17,500

Notes to accounts

S.no	Particulars		₹
1	<u>Share Capital</u>		
	Equity share capital: 1,32,000 Equity shares of ₹2 each (of the above 57,000 shares have issued for consideration other than cash) Preference share capital: 4,000, 6% preference share capital of ₹75 each		2,64,000
	Total		3,00,000
2	<u>Long term borrowings</u>		
	Secured		
	6% Debentures		2,55,000
	8% Debentures		1,30,000
3	Total		3,85,000



4	Short term provisions Provision for doubtful debts		68,500 -
5	Property, Plant and Equipment		
	Freehold property Add: Appreciation under the scheme of Capital reduction Less: Disposed of	4,25,000 82,500 (1,20,000)	3,82,500 50,000
	Plant		
	Net carrying value		4,37,500
	Intangible assets		
	Goodwill Less: written off under the scheme of Capital reduction	1,30,000 (1,30,000)	-
	Net carrying value		NIL
	Patent Less: written off under the scheme of Capital reduction	37,500 (37,500)	
	Net carrying value		NIL

2. Illustration

Given below is the summarized balance sheet of Rebuilt Ltd. as on 31.3.2011:

Liabilities	Amount	Assets	Amount
Authorized and issued capital:		Building at cost less depreciation	4,00,000
12,000, 7% Preference shares of ₹ 50 each (Note: Preference dividend is in arrear for five years)	6,00,000	Plant at cost less depreciation	2,68,000
15,000 Equity shares of ₹ 50 each	7,50,000	Trademarks and goodwill at cost	3,18,000
Loan	5,73,000	Inventory	4,00,000
Trade payables	2,07,000	Trade receivables	3,28,000
Other liabilities	35,000	Profit and loss A/c	4,51,000
	21,65,000		21,65,000

The Company is now earning profits short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders.

A summary of the scheme is as follows:

- (i) The equity shareholders have agreed that their ₹50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.
- (ii) The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.
- (iii) Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.
- (iv) 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 (i) above.
- (v) Of the cash received by the issue of new shares, ₹2,00,000 is to be used to reduce the loan due by the company



(vi) The equity share capital cancelled is to be applied:

- to write off the debit balance in the profit and loss A/c; and
- to write off ₹ 35,000 from the value of plant.

(vii) 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.

Solution 2

Journal entries in the books of Rebuilt Ltd

Date	Particulars	Dr ₹	Cr ₹
31 st March 2011	Equity share capital (₹50) A/c Dr To Capital Reduction A/c To Equity share capital (₹2.5) A/c (Being Equity capital reduced to nominal value of ₹2.50 each)	7,50,000	37,500 7,12,500
"	Bank A/c Dr To Equity share capital A/c (Being 3 right shares against each share was issued and subscribed)	1,12,500	1,12,500
"	7% Preference share capital (₹50) A/c Dr Capital Reduction A/c Dr To 5% Preference share capital (₹10) A/c To Equity share capital (₹50) A/c (Being reduction Preference share capital as per the scheme from ₹100 to ₹75)	6,00,000 60,000	4,80,000 1,80,000
"	Loan A/c Dr To 5% Preference share capital A/c To Equity share capital A/c (Being loan to the extent of ₹1,50,000 converted share capital)	1,50,000	1,20,000 30,000
"	Bank A/c Dr To Equity share capital A/c (Being shares subscribed by the directors)	1,00,000	1,00,000
"	Loan A/c Dr To Bank A/c (Being loan repaid)	82,500	82,500
"	Capital Reduction A/c Dr To profit and Loss A/c To Plant A/c To Trademarks and Goodwill A/c (Being losses and assets written off to the extent required)	6,52,500	4,51,500 35,000 1,66,500



Balance sheet of Rebuilt Ltd. (And Reduced) as at 31.3.2011

Particulars			Notes	₹
1		Equity and Liabilities		
		Shareholder's funds		
	A	Share capital	1	10,60,000
2		Non-Current liabilities		
	A	Long-term borrowings	2	2,23,000
3		Current liabilities		
	A	Trade Payables		2,07,000
	B	Other Current liabilities	3	35,000
		Total		15,25,000
		Assets		
1		Non-current assets		
	A	Property, plant and equipment	4	6,33,000
	B	Intangible assets	5	1,51,500
2		Current assets		
	A	Inventories		4,00,000
	B	Trade receivables		3,28,000
	C	Cash and Cash equivalents		12,500
		Total		15,25,000

Notes to accounts

S.no	Particulars		₹
1	<u>Share Capital</u>		
	<u>Authorized capital:</u>		
	65,000 Preference shares of ₹10 each	6,50,000	
	3,00,000 Equity shares of ₹2.50 each	<u>7,50,000</u>	14,00,000
	<u>Issued, subscribed and paid up:</u>		
	1,80,000 equity shares of ₹2.50 each	4,60,000	
	60,000, 5% Preference shares of ₹10 each	<u>6,00,000</u>	10,60,000
	Total		24,60,000
2	<u>Property, Plant and Equipment</u>		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	<u>2,33,000</u>	6,33,000
3	<u>Intangible assets</u>		
4	Trademarks and Goodwill		1,51,500
	Cash and cash equivalents		
	Bank (1,12,500+1,00,000-2,00,000)		12,500

3. Illustration

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

Liabilities	Rs.	Assets	Rs.
Equity shares of Rs. 100 each	2,00,00,000	PPE	2,50,00,000
6% Cumulative Preference Shares of Rs. 100 each	1,00,00,000	Investments (Market Value Rs.19,00,000)	20,00,000



5% Debentures of Rs.100 each	80,00,000	Current Assets	2,00,00,000
Sundry Creditors	1,00,00,000	P&L A/C	12,00,000
Provision for taxation	2,00,000		
Total	4,82,00,000	Total	4,82,00,000

Accounting for Reconstruction of Companies - CA Inter Advanced Accounting Question Bank 55

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 is 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. PPE are to be written down by 20%.
- V. Current assets are to be revalued at ₹ 90,00,000.
- VI. Investments are to be brought to their market value.
- VII. One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.
- VIII. The taxation liability is to be settled at ₹ 3,00,000.
- IX. It is decided to write off the debit balance of Profit & Loss A/c.

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

Solution 3:

Journal Entries in the books of Vaibhav Ltd.

		Rs.	Rs.
(i)	Equity share capital (Rs. 100) A/c Dr. To Equity Share Capital (Rs. 40) A/c To Capital Reduction A/c (Being conversion of equity share capital of Rs. 100 each into Rs.40 each as per reconstruction scheme)	2,00,00,000	80,00,000 1,20,00,000
(ii)	6% Cumulative Preference Share capital (Rs. 100) A/c Dr. To 6% Cumulative Preference Share Capital (Rs. 60)A/c To Capital Reduction A/c (Being conversion of 6% cumulative preference shares capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)	1,00,00,000	60,00,000 40,00,000
(iii)	5% Debentures (Rs. 100) A/c Dr. To 6% Debentures (Rs. 70) A/c To Capital Reduction A/c (Being 6% debentures of Rs. 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)	80,00,000	56,00,000 24,00,000
(iv)	Sundry Creditors A/c Dr. To Equity Share Capital (Rs. 40) A/c To Capital Reduction A/c (Being a creditor of Rs. 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of Rs. 40 each in full settlement of his dues as per reconstruction scheme)	40,00,000	24,00,000 16,00,000
(v)	Provision for Taxation A/c Dr. Capital Reduction A/c Dr. To Liability for Taxation A/c (Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)	2,00,000 1,00,000	3,00,000



(vi)	Capital Reduction A/c	Dr.	199,00,000	
	To P & L A/c			12,00,000
	To Fixed Assets A/c To Current Assets A/c To Investments A/c			50,00,000
	To Capital Reserve A/c (Bal. fig.)			110,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)			1,00,000
				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. (After Reconstruction) as on 31.3.2014

Particulars	Notes	Rs.
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	164,00,000
b Reserves and	2	26,00,000
2 Surplus Non-current liabilities Long-term	3	56,00,000
3 borrowings Current liabilities		60,00,000
Trade Payables(1,00,00,000 less 40,00,000) Total		3,06,00,000
Assets		
1 Non-current assets		
a Fixed assets		
Tangible assets	4	200,00,000
b Investments	5	19,00,000
2 Current assets	6	87,00,000
Total		3,06,00,000

Notes to accounts

	Rs.
1. Share Capital	
Equity share capital	
Issued, subscribed and paid up	
2,60,000 equity shares of Rs. 40 each (of the above 60,000 shares have been issued for consideration other than cash)	1,04,00,000
Preference share capital	
Issued, subscribed and paid up	
1,00,000 6% Cumulative Preference shares of Rs. 60 each	60,00,000
Total	1,64,00,000



2. Reserves and Surplus		
Capital Reserve		<u>26,00,000</u>
3. Long-term borrowings		
Secured		
6% Debentures	2,50,00,000	<u>56,00,000</u>
4. Tangible assets	(50,00,000)	
Fixed Assets		<u>2,00,00,000</u>
Adjustment under scheme of reconstruction	20,00,000	
5. Investments	(1,00,000)	<u>19,00,000</u>
Adjustment under scheme of reconstruction		
6. Current assets	2,00,00,000	
Adjustment under scheme of reconstruction	<u>110,00,000</u>	<u>87,00,000</u>
	90,00,000	
Taxation liability paid	<u>(3,00,000)</u>	

Working Note:**Capital Reduction Account**

To Liability for taxation A/c	1,00,000	By Equity share capital	1,20,00,000
To P & L A/c	12,00,000	By 6% Cumulative preferences Share capital	40,00,000
To Fixed Assets	50,00,000	By 5% Debentures	24,00,000
To Current assets	110,00,000	By Sundry creditors	16,00,000
To Investment	1,00,000		
To Capital Reserve (Bal. fig.)			
	<u>26,00,000</u>		
	<u>2,00,00,000</u>		<u>2,00,00,000</u>

4. Illustration

Following is the summary balance sheet of ABC Ltd as at 31st March 2011:

Assets	Amt (Rs)	Liability	Amt (Rs)
Share Capital: 2,00,000 Equityshares of ₹ 10 each fully paid up	20,00,000	Fixed Assets: P&M	9,00,000
6000 8% Preference shares of ₹100 each	6,00,000	F&F	2,50,000
9% Debentures	12,00,000	Patents & Copyrights	70,000
Bank OD	1,50,000	Investments (at costs)(MV- ₹55,000)	68,000
Trade Payables	5,92,000	Inventory	14,00,000
		Trade Receivables	14,39,000
		Cash & Bank	10,000
		P&L a/c	4,05,000
	45,42,000		45,42,000

The following scheme of internal reconstruction was agreed upon.

- Preference shareholders would give up 30% of their capital in exchange of allotment of 11% Debentures to them.
- Debenture holders having charge on P&M would accept P&M in full settlement of their dues



- iii. Inventory equal to ₹ 5 lacs book value will be taken by trade payables in full settlement of their dues
- iv. Investments to be reduced to market price
- v. Company would issue 11% Debentures for ₹3 lacs and augment its working capital requirement after settlement of bank overdraft
- Pass necessary journal entries and draft a balance sheet after reconstruction

Solution 4

Journal entries in the books of ABC Ltd

Date	Particulars	Dr ₹	Cr ₹
31 st March 2011	8% Preference share capital A/c Dr To 11% Debentures A/c To Capital reduction A/c (Being 30% reduction in liability of Preference share capital as per the scheme and issue of 11% debentures)	6,00,000	4,20,000 1,80,000
"	9% Debentures A/c Dr To Plant and machinery A/c To Capital reduction A/c (Being settlement of debenture holders by allotment of plant and machinery)	12,00,000	9,00,000 3,00,000
"	Trade payables A/c Dr To Inventory A/c To Capital reduction a/c (Being settlement of creditors by giving Inventories)	5,92,000	5,00,000 92,000
"	Bank A/c Dr To 11% Debentures A/c (Being fresh issue of debentures)	3,00,000	3,00,000
"	Bank overdraft A/c Dr To Bank A/c (Being settlement of bank overdraft)	1,50,000	1,50,000
"	Capital Reduction A/c Dr To Investment A/c To profit and Loss A/c To Capital reserve A/c (Being decrease in investment and profit and loss A/c (Dr.bal.); and balance of capital reduction account transferred to capital reserve)	5,72,000	13,000 4,05,000 1,54,000

Capital Reduction A/c

	₹		₹
To Investment A/c	13,000	By Preference share capital	1,80,000
To Profit and loss A/c	4,05,000	A/c	3,00,000
To Capital reserve A/c	1,54,000	By 9% Debentures holders A/c	92,000
	5,72,000	By Trade payables A/c	5,72,000



Balance sheet of Rebuilt Ltd. (And Reduced) as at 31.3.2011

Particulars		Notes	₹
1	<u>Equity and Liabilities</u>		
	Shareholder's funds		
A	Share capital	1	20,00,000
B	Reserves and Surplus	2	1,54,000
2	Non-Current liabilities		
A	Long-term borrowings	3	7,20,000
	Total		15,25,000
1	<u>Assets</u>		
A	Non-current assets	4	2,50,000
B	Property, plant and equipment	5	70,000
C	Intangible assets	6	55,000
2	Current assets		
A	Inventories (₹14,00,000 - ₹5,00,000)		9,00,000
B	Trade receivables		14,39,000
C	Cash and Cash equivalents [Note: 1]		1,60,000
	Total		15,25,000

Note: 1 - Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid
= ₹10,000 + ₹ 3,00,000 – ₹1,50,000 = ₹ 1,60,000

Notes to accounts

S.no	Particulars	₹
1	Share Capital 2,00,000 Equity shares of ₹10 each fully paid up	20,00,000
2	Reserves and Surplus Capital reserves	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 Capital reduction (9,00,000) • Furniture & fixtures	- 2,50,000
5	Intangible assets Patents & copyrights	70,000
6	Non-Current Investments Investments (₹ 68,000 - ₹13,000)	55,000

5. Illustration

Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June 2012:

Liabilities	₹	Assets	₹
6,000 shares of ₹ 60 each,		Property, machinery and Plant (Cost ₹3,90,000) Estimated at	1,50,000
₹30 paid up		Cash in hand of the receiver	2,70,000



First debentures	3,00,000	Charged under debentures	4,20,000
Second debentures	6,00,000	Uncalled capital	1,80,000
Unsecured trade payables	4,50,000	Sub-Total	6,00,000
		Deficiency	7,50,000
	13,50,000		13,50,000

The following scheme is proposed:

- A holds the first debentures for ₹3, 00,000 and second debentures for ₹3, 00,000. He is also an unsecured creditor for ₹ 90,000. B holds second debentures for ₹3, 00,000 and is an unsecured trade payable for ₹ 60,000.
- The following scheme of reconstruction is proposed:
- A is to cancel ₹ 2,10,000 of the total debt owing to him, to bring ₹ 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.
- B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.
- In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of ₹ 7.50 each, fully paid against their claim for each share of ₹ 60. The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.
- Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus making the shares of ₹ 7.50 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

Solution 5

Journal entries in the books of Repair Ltd

Date	Particulars	Dr ₹	Cr ₹
31 st March 2011	First debentures A/c Dr Second debentures A/c Dr Unsecured creditors A/c Dr To A's A/c (Being A's total liability ascertained)	3,00,000 3,00,000 90,000	6,90,000
"	A's A/c Dr To Capital reduction A/c (Being cancellation of debt upto ₹2,10,000)	2,10,000	2,10,000
"	Bank A/c Dr To A's A/c (Being cash received in course of settlement)	30,000	30,000
"	A's A/c [Note: 1] Dr First debentures A/c (Being liability of A, discharged against first debentures)	5,10,000	5,10,000
"	Second debentures A/c Dr Unsecured creditors A/c Dr To B's A/c (Being B's liability ascertained)	3,00,000 60,000	3,60,000
"	B's A/c [Note: 2] Dr To Bank A/c To Capital reduction A/c (Being B's liability discharged)	3,60,000	90,000 2,70,000



"	Unsecured trade payables A/c [Note: 3] Dr To Equity share capital A/c To Loan A/c (unsecured) To Capital reduction A/c (Being settlement of unsecured creditors)	3,00,000	1,12,500 75,000 1,12,500
"	Share call A/c Dr To share capital A/c (Being final call money due)	1,80,000	1,80,000
"	Bank A/c Dr To share call A/c (Being final call money received)	1,80,000	1,80,000
"	Share capital A/c (Face value ₹60) Dr To share capital A/c (Face value ₹7.50) To Capital reduction A/c (Being share capital reduced to ₹7.50 each)	3,60,000	45,000 3,15,000
"	Capital reduction A/c Dr To Profit and Loss A/c (Being Capital reduction surplus used to write off losses)	8,70,000	8,70,000

Note: 1

A	1 st Debentures ₹	2 nd Debentures ₹	Creditors ₹
Opening Balance	3,00,000	3,00,000	90,000
Total			6,90,000
Less : Cancelled			(2,10,000)
To be settled			4,80,000
Add: Fresh introduction of cash			30,000
New debt			5,10,000

Note: 2

B	2 nd Debentures ₹	Creditors ₹
Before adjustment	3,00,000	60,000
Total		3,60,000
Less : To be paid in cash		(90,000)
Amount to be transferred to Capital reduction		2,70,000

Note: 3

Unsecured Trade payables	₹
Balance given	4,50,000
Less: A	(90,000)
Less: B	(60,000)
	3,00,000
25% postponed (Unsecured Trade payables in Balance sheet)	(75,000)



(i)	2,25,000
No. of shares to be issued $(2,25,000 \div 60) \times 4$	15,000
Total Value of shares to be issued $(15,000 \times 7.5)$ =>(ii)	1,12,50+ .00
Transferred to Capital reduction A/c (i) - (ii)	1,12,500

6. Illustration

The Summarized Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows:

Liabilities	₹	Assets	₹
Authorized and subscribed capital:		Fixed Assets :	
10,000 Equity shares of ₹ 100 each fully paid	10,00,000	Machineries	1,00,000
Unsecured Loans :		Current assets :	
12% Debentures	2,00,000	Inventory	3,20,000
Accrued interest	24,000	Trade receivables	2,70,000
Current liabilities		Bank	30,000
Trade payables	72,000	Profit and loss account	6,00,000
Provision for income tax	24,000		
	13,20,000		13,20,000

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

- Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.
- 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.
- Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹10 each, fully paid up.
- 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.
- 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.
- Balance of profit and loss account to be written off.
- The shares surrendered and not re-issued shall be cancelled.

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

Solution 6

Journal entries in the books of Revise Ltd

Date	Particulars	Dr ₹	Cr ₹
31 st March 2011	Equity Share capital (₹100) A/c Dr To Share capital (₹10) A/c To Share surrender A/c (Being sub division of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)	10,00,000	5,00,000 5,00,000



"	12% Debentures A/c Interest payables A/c To Capital reduction A/c (Transferred 75% of the claims of the debentures holders to capital reduction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)	Dr Dr	1,50,000 18,000	1,68,000
	Trade payables A/c To Capital reduction A/c (Transferred claims of trade payables to Capital reduction account, 50% of which is being clear reduction and equity are being issued in consideration of the balance)	Dr	72,000	72,000
	Share Surrender A/c To 12% Preference share capital A/c To Equity share capital A/c To Capital reduction A/c (Issued preference and equity shares to discharge the claims of the debentures holders and trade payables respectively as per scheme and the balance in share surrender account is being transferred to capital reduction account)	Dr	5,00,000	1,00,000 36,000 3,64,000
	Capital reduction A/c To Profit and Loss A/c To Capital Reserve A/c (Being debit balance of P&L A/c adjusted against capital reduction and the balance in latter is transferred to capital reserves)	Dr	6,04,000	6,00,000 4,000

Balance sheet of Revise Ltd. (And Reduced) as at 31.3.2011

Particulars			Notes	₹
1		<u>Equity and Liabilities</u>		
		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
				15,25,000
		Total		
1		<u>Assets</u>		
	A	Non-current assets	6	1,00,000
		Property, plant and equipment		
2		Current assets		
	A			
	B	Inventories		3,20,000
	C	Trade receivables		2,70,000
		Cash and Cash equivalents		30,000



		Total		15,25,000

Notes to accounts

S.no	Particulars	₹
1	<u>Share Capital</u>	
	• Equity share capital: Issued Capital: 53,600 Equity Shares of ₹10 each	5,36,000
	• Preference share capital: (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
		<u>6,36,000</u>
	Total	
2	<u>Reserve and Surplus</u>	
3	Capital Reserve	<u>4,000</u>
	<u>Long Term Borrowings</u>	
	Unsecured Loans	<u>50,000</u>
4	12% Debentures	
	Other current liabilities	<u>6,000</u>
5	Interest payable on debentures	
	Short-term provisions	<u>24,000</u>
6	Provisions for Income-tax	
	Property, plant and Equipment	<u>1,00,000</u>
	Machinery	

Working note:

Capital Reduction A/c

	₹		₹
To Profit and loss A/c	6,00,000	By Debentures A/c	1,68,000
To Capital reserve A/c	4,000	By Trade payables A/c	72,000
			3,64,000
	<u>6,04,000</u>		<u>6,04,000</u>

Share Surrender A/c

	₹		₹
To 12% Preference share capital A/c	1,00,000	By Equity share capital A/c	5,00,000
To Equity share capital A/c	36,000		
To Capital reduction A/c (bal.fig)	3,64,000		
	<u>5,00,000</u>		<u>5,00,000</u>

7. Illustration

Vaibhav Ltd. gives the following ledger balances as at 31st March 20X1:

	Rs.
Property, Plant and Equipment	2,50,00,000
Investments (Market-value Rs. 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 Rs. 100 each	2,00,00,000
6%, Cumulative Preference Shares of Rs. 100 each	1,00,00,000
5% Debentures of Rs. 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 Rs. 40 each.
- (ii) All preference shares are reduced to Rs. 60 each.
- (iii) The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 70 each for every debenture held by them.
- (iv) Property, Plant and Equipment is to be written down by 20%.
- (v) Current assets are to be revalued at Rs. 90,00,000.
- (vi) Investments are to be brought to their market value.
- (vii) One of the creditors of the company to whom the company owes Rs. 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of Rs. 40 each in full and final settlement of his claim.
- (viii) The taxation liability is to be settled at Rs. 3,00,000.
- (ix) It is decided to write off the debit balance of Profit & Loss A/c.

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

Solution:

Journal Entries in the books of Vaibhav Ltd.

		Rs.	Rs.
(i)	Equity share capital (Rs. 100) A/c Dr.	2,00,00,000	
	To Equity Share Capital (Rs. 40) A/c		80,00,000
	To Capital Reduction A/c		1,20,00,000
	(Being conversion of equity share capital of Rs. 100 each into Rs.40 each as per reconstruction scheme)		
(ii)	6% Cumulative Preference Share capital (Rs. 100) A/c Dr.	1,00,00,000	
	To 6% Cumulative Preference Share Capital (Rs. 60)A/c		60,00,000
	To Capital Reduction A/c		40,00,000
	(Being conversion of 6% cumulative preference shares capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)		
(iii)	5% Debentures (Rs. 100) A/c Dr.	80,00,000	
	To 6% Debentures (Rs. 70) A/c		56,00,000
	To Capital Reduction A/c		24,00,000
	(Being 6% debentures of Rs. 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Sundry Creditors A/c Dr.	40,00,000	
	To Equity Share Capital (Rs. 40) A/c		24,00,000



	To Capital Reduction A/c		16,00,000
	(Being a creditor of Rs. 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of Rs. 40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	2,00,000	
	Capital Reduction A/c Dr.	1,00,000	
	To Liability for Taxation A/c		3,00,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)		
(vi)	Capital Reduction A/c Dr.	199,00,000	
	To P & L A/c		12,00,000
	To Property, Plant and Equipment A/c		50,00,000
	To Current Assets A/c		110,00,000
	To Investments A/c		1,00,000
	To Capital Reserve A/c (Bal. fig.)		26,00,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, PPE, Current Assets, Investments and the Balance transferred to Capital Reserve)		
(vii)	Liability for Taxation A/c Dr.	3,00,000	
	To Current Assets (Bank A/c)		3,00,000
	(Being the payment of tax liability)		

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

	Particulars	Notes	Rs.
	Equity and Liabilities		
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

		Rs.
1.	Share Capital	
	Equity share capital	
	Issued, subscribed and paid up	



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

Working Note:**Capital Reduction Account**

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

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 31st March 20X1 is as follows-

		Particulars	Notes	Rs.
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)		<u>5,000</u>
				<u>5,05,000</u>
1		Assets		
		Non-current assets		
	A	Property, Plant Equipment Intangible assets	4	3,35,000
	B		5	50,000
	C	Non-current investments	6	40,000
2		Current assets		
	A	Inventories		30,000
	B	Trade receivables		<u>50,000</u>
				<u>5,05,000</u>

Notes to accounts:

1	Share Capital		Rs.
	Equity share capital:		
	20,000 Equity Shares of Rs. 10 each		2,00,000
	Preference share capital:		
	15,000 8% Cumulative Preference Shares of Rs. 10 each (preference dividend has been in arrears for 4 years)		<u>1,50,000</u>
			<u>3,50,000</u>
2	Reserves and surplus		
	Profit and loss account (debit balance)		<u>(70,000)</u>
			<u>(70,000)</u>
3	Long-term borrowings		
	<u>Secured</u>		
	10% Debentures (secured on the freehold property)		<u>50,000</u>
			<u>50,000</u>
4	Property, Plant and Equipment		
	Freehold property		1,20,000
	Leasehold property		85,000
	Plant and machinery		<u>1,30,000</u>
			<u>3,35,000</u>
5	Intangible assets		
	Goodwill		<u>50,000</u>
			<u>50,000</u>
6	Non-current investments		
	Non-Trade investments at cost		<u>40,000</u>
			<u>40,000</u>

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

- The preference shares were reduced to Rs. 2.5 per share, and the equity shares to Rs. 1 per share.
- One new equity share of Rs. 1 was issued for the arrears of preferred dividend for past 4 years.
- The debenture holders took over the freehold property at an agreed figure of Rs. 75,000 and paid the balance to the company after deducting the amount due to them.
- Plant and Machinery was written down to Rs. 1,00,000.



- v. Non-trade Investments were sold for Rs. 32,000.
- vi. Goodwill and obsolete stock (included in the value of inventories) of Rs. 10,000 were written off.
- vii. A contingent liability of which no provision had been made was settled at Rs. 7,000 and of this amount, Rs. 6,300 was recovered from the insurance.

You are required (a) to show the Journal Entries, necessary to record the above transactions in the company's books and (b) to prepare the Balance Sheet, after completion of the scheme.

Solution:

Journal entries in the books of Recover Ltd

Particulars		Dr.	Cr.
		Rs.	Rs.
8% Cumulative Preference share capital (Rs. 10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (Rs.2.5) A/c			37,500
To Reconstruction (Rs. 7.5) A/c			1,12,500
(Preference shares being reduced to shares of Rs. 2.5 per share and remaining transferred to reconstruction account as per internal reconstruction scheme)			
Equity share capital A/c (Rs.10)	Dr.	2,00,000	
To Equity Share capital A/c (Rs. 1)			20,000
To Reconstruction A/c (Rs. 9)			1,80,000
(Equity shares reduced to Rs. 1 per share with the remaining amount transferred to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	48,000	
To Equity share capital A/c			48,000
(Equity shares of Rs. 1 issued in lieu of the arrears of preference dividend for 4 years as a part of the internal reconstruction scheme)			
10% Debentures A/c	Dr.	50,000	
Interest payable on debentures A/c	Dr.	5,000	
Bank A/c	Dr.	20,000	
Reconstruction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the reconstruction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Reconstruction A/c	Dr.	8,000	
To Investments A/c			40,000



(Investments sold at a loss debited to reconstruction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Reconstruction A/c	Dr.	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingency payment amount)			
Reconstruction A/c	Dr.	70,000	
To Profit and loss A/c			70,000
(Accumulated losses written off to reconstruction account as a part of the internal reconstruction scheme)			
Reconstruction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in reconstruction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 20X1 (and reduced)

		Particulars	Notes	Rs.
		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		<u>90,000</u>
		Total		<u>3,06,300</u>
		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	<u>51,300</u>
		Total		<u>3,06,300</u>



Notes to accounts:

1	Share Capital	<i>Rs.</i>
	Equity share capital	
	68,000 Equity Shares of Rs. 1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of Rs. 2.5 each	<u>37,500</u>
		<u>1,05,500</u>
2	Reserves and surplus	
	Capital reserve	<u>30,800</u>
3	Property, Plant and Equipment	
	Leasehold property	85,000
	Plant and machinery	<u>1,00,000</u>
		<u>1,85,000</u>
4	Cash and cash equivalents	
	Bank A/c (20,000+32,000-7000+6,300)	<u>51,300</u>

9. Illustration

Green Limited had decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the Balance Sheet of the Company as at 31.3.20X1 before reconstruction:

		Particulars	Notes	Rs.
		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		<u>5,00,000</u>
		Total		<u>65,00,000</u>
		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		<u>65,00,000</u>

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	<u>Authorized share capital</u>	
	1,50,000 Equity shares of Rs. 50 each	<u>75,00,000</u>
	<u>Issued, subscribed and paid up capital</u>	
	50,000 Equity Shares of Rs. 50 each	25,00,000
	1,00,000 Equity shares of Rs. 50 each, Rs. 40 paid up	<u>40,00,000</u>
		<u>65,00,000</u>
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
	Rs.	Rs.
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 Rs. 50 shares	3,00,000	2,00,000
Partly paid up shares (Rs. 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:

- 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 Rs. 20 each.
- Mr. X is to cancel Rs. 7,00,000 of his total debt (other than share amount) and to pay Rs. 2 lakhs to the company and to receive new 14% First Debentures for the balance amount.
- Mr. Y is to cancel Rs. 3,00,000 of his total debt (other than equity shares) and to accept new 14% First Debentures for the balance.
- The amount thus rendered available by the scheme shall be utilised in writing off of Goodwill, Profit and Loss A/c Loss and the balance to write off the value of computers.

You are required to draw the Journal Entries to record the same and also show the Balance Sheet of the reconstructed company.

Solution:

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 Rs. 10 per share on 1,00,000 equity shares called up as per reconstruction scheme)		
Equity Share Capital Account (Rs. 50)	Dr. 75,00,000	
To Equity Share Capital Account (Rs. 20)		30,00,000
To Capital Reduction Account		45,00,000
(Reduction of equity shares of Rs. 50 each to shares of Rs. 20 each as per reconstruction scheme)		
12% First Debentures Account	Dr. 3,00,000	
12% Second Debentures Account	Dr. 7,00,000	
Trade payables Account	Dr. 2,00,000	
To X		12,00,000



(The total amount due to X, transferred to his account)			
Bank Account	Dr.	2,00,000	
To X			2,00,000
(The amount paid by X under the reconstruction scheme)			
12% First Debentures Account	Dr.	2,00,000	
12% Second Debentures Account	Dr.	3,00,000	
Trade payables Account	Dr.	1,00,000	
To Y			6,00,000
(The total amount due to Y, transferred to his account)			
Y A/c	Dr.	6,00,000	
To 14% First Debentures Account			3,00,000
To Capital Reduction Account			3,00,000
(The amount due to Y discharged by issue of 14% first debentures)			
X A/c	Dr.	14,00,000	
To 14% First Debentures Account			7,00,000
To Capital Reduction Account			7,00,000
(The cancellation of Rs. 7,00,000 out of total debt of Mr. X and issue of 14% first debentures for the balance amount as per reconstruction scheme)			
Capital Reduction Account	Dr.	55,00,000	
To Goodwill Account			20,00,000
To Profit and Loss Account			20,00,000
To Computers Account			15,00,000
(The balance amount of capital reduction account utilised in writing off goodwill, profit and loss account, and computers— Working Note)			

Balance Sheet of Green Limited (and reduced) as at 31st March, 20X1

	Particulars	Notes	Rs.
	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		<u>2,00,000</u>
	Total		<u>42,00,000</u>
	Assets		
1	Non-current assets		
a	Property, plant and equipment	3	30,00,000
2	Current assets		
	Cash and cash equivalents		<u>12,00,000</u>
	Total		<u>42,00,000</u>

Notes to accounts

		Rs.
1.	Share Capital	
	Equity share capital	
	Issued, subscribed and paid up	
	1,50,000 equity shares of Rs. 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

	Rs.		Rs.
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

10. Illustration

The following is the Balance Sheet of Weak Ltd. as at 31.3.20X1:

		Particulars	Notes	Rs.
1		Equity and Liabilities		
		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	<u>1,00,000</u>
		Total		<u>2,35,00,000</u>
		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		<u>1,00,00,000</u>
		Total		<u>2,35,00,000</u>

Notes to accounts

		Rs.
1	Share Capital	
	Equity share capital	
	1,00,000 Equity Shares of Rs. 100 each	1,00,00,000
	50,000, 12% Cumulative Preference shares of Rs. 100 each	<u>50,00,000</u>
		<u>1,50,00,000</u>
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	<u>(6,00,000)</u>
		<u>(6,00,000)</u>



3	Long-term borrowings	
	40,000, 10% debentures of Rs.100 each	<u>40,00,000</u>
		<u>40,00,000</u>
4	Short term provisions	
	Provision for taxation	<u>1,00,000</u>
		<u>1,00,000</u>
5	Non-current investments	
	Investments (market value of Rs. 9,50,000)	<u>10,00,000</u>
		<u>10,00,000</u>

The following scheme of reorganization is sanctioned:

- (i) All the existing equity shares are reduced to Rs. 40 each.
- (ii) All preference shares are reduced to Rs. 60 each.
- (iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 70 each for every debenture held by them.
- (iv) One of the creditors of the company to whom the company owes Rs. 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of Rs. 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 Rs. 45,00,000.
- (vii) The taxation liability of the company is settled at Rs. 1,50,000.
- (viii) Investments to be brought to their market value.
- (ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

Solution:

Journal Entries in the books of Weak Ltd.

			Rs.	Rs.
(i)	Equity share capital (Rs. 100) A/c	Dr.	1,00,00,000	
	To Equity Share Capital (Rs. 40) A/c To Capital Reduction A/c			40,00,000
	(Being conversion of equity share capital of Rs. 100 each into Rs. 40 each as per reconstruction scheme)			60,00,000
(ii)	12% Cumulative Preference Share capital (Rs. 100) A/c Dr.	Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (Rs. 60) A/c			30,00,000
	To Capital Reduction A/c			20,00,000
	(Being conversion of 12% cumulative preference share capital of Rs. 100 each into Rs. 60 each as per reconstruction scheme)			
(iii)	10% Debentures A/c	Dr.	40,00,000	
	To 12% Debentures A/c To Capital Reduction A/c			28,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)			12,00,000
(iv)	Trade payables A/c	Dr.	20,00,000	



	To Equity Share Capital A/c			12,00,000
	To Capital Reduction A/c			8,00,000
	(Being a creditor of Rs. 20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of Rs. 40 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	1,00,000	
	Capital Reduction A/c	Dr.	50,000	
	To current assets(bank A/c) A/c			1,50,000
	(Being liability for taxation settled)			
(vi)	Capital Reduction A/c	Dr.	99,00,000	
	To P & L A/c			6,00,000
	To Property, plant and equipment A/c			37,50,000
	To Current Assets A/c			55,00,000
	To Investments A/c			50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, plant and equipment, Current Assets, Investments through capital reduction account)			
(vii)	Capital Reduction A/c	Dr.	50,000	
	To capital Reserve A/c			50,000
	(Being balance in capital reduction account transferred to capital reserve account)			

Balance Sheet of Weak Ltd. (and reduced) as at 31.3.20X1

Particulars		Notes	Rs.
	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

		Rs.	Rs.
1.	Share Capital		
	Equity share capital		



	Issued, subscribed and paid up		
	1,30,000 equity shares of Rs. 40 each		52,00,000
	Preference share capital		
	Issued, subscribed and paid up		
	50,000 12% Cumulative Preference shares of Rs. 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

	Rs.		Rs.
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative	
To Property, plant		preference share capital	20,00,000
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

11. Illustration

The following is the Balance Sheet of X Ltd. as at 31st March, 20X1:

		Particulars	Notes	Rs.
		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
		Short term borrowings - Bank		<u>6,00,000</u>
	B	overdraft		
		Total		<u>36,60,000</u>
		Assets		
1		Non-current assets		



2	A	Property, plant and equipment		
	B	Intangible assets	4	30,00,000
		Current assets	5	90,000
	a	Inventories		
	b	Trade receivables		2,60,000
	C	Cash and cash equivalents		2,80,000
		Total		<u>30,000</u>
				<u>36,60,000</u>

Notes to accounts

		Rs.
1	Share capital	
	24,000 Equity Shares of Rs. 100 each	24,00,000
	12,000, 10% Preference Shares of Rs. 100 each	<u>12,00,000</u>
	Total	<u>36,00,000</u>
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	(14,40,000)
		<u>(14,40,000)</u>
3	Long-term borrowings	
	10% debentures	<u>6,00,000</u>
		<u>6,00,000</u>
4.	Property, plant and Equipment	
	Land and Building	12,00,000
	Plant and Machinery	<u>18,00,000</u>
		<u>30,00,000</u>
5	Intangible assets	
	Goodwill	<u>90,000</u>
		<u>90,000</u>

On the above date, the company adopted the following scheme of reconstruction:

- (i) The equity shares are to be reduced to shares of Rs. 40 each fully paid and the preference shares to be reduced to fully paid shares of Rs. 75 each.
- (ii) The debenture holders took over Inventories and Trade receivables in full satisfaction of their claims.
- (iii) The Land and Building to be appreciated by 30% and Plant and machinery to be depreciated by 30%.
- (iv) The debit balance of profit and loss account and intangible assets are to be eliminated.
- (v) Expenses of reconstruction amounted to Rs. 5,000.

Give journal entries incorporating the above scheme of reconstruction and prepare the reconstructed Balance Sheet.

Solution:

In the books of X Ltd. Journal Entries

31 st March, 20X1			Rs.	Rs.
(i)	Equity Share Capital A/c (Rs. 100)	Dr.	24,00,000	
	To Equity Share Capital A/c (Rs. 40)			9,60,000
	To Capital Reduction A/c			14,40,000
	(Being 24,000 equity shares of Rs. 100 each)			



	reduced to Rs. 40 each fully paid up)			
(ii)	10% Preference Share Capital A/c (Rs. 100)	Dr.	12,00,000	
	To 10% Preference Share Capital A/c (Rs. 75)			9,00,000
	To Capital Reduction A/c			3,00,000
	(Being 12,000 Preference shares of Rs. 100 each reduced to Rs. 75 each fully paid up)			
(iii)	10% Debentures A/c	Dr.	6,00,000	
	To Inventories A/c			2,60,000
	To Trade receivables A/c			2,80,000
	To Capital Reduction A/c			60,000
	(Being debenture holders given Inventories and Trade receivables in full settlement of their claims)			
(iv)	Land & Building A/c	Dr.	3,60,000	
	To Capital Reduction A/c			3,60,000
	(Being Land & Building appreciated by 30%)			
(v)	Capital reduction A/c	Dr.	5,000	
	To Cash A/c			5,000
	(Being expenses of reconstruction paid)			
(vi)	Capital Reduction A/c	Dr.	20,70,000	
	To Goodwill A/c			90,000
	To Profit and Loss A/c			14,40,000
	To Plant & Machinery A/c			5,40,000
	(Being various losses written off, assets written down through Capital Reserve A/c)			
(vii)	Capital Reduction	Dr.	85,000	
	To Capital Reserve A/c (Bal. Fig.)			85,000
	(Being balance in Capital Reduction A/c transferred to Capital Reserve A/c)			

Balance Sheet (And Reduced) of X Ltd. as at 31st March, 20X1

	Particulars	Notes No.	Rs.
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	18,60,000
b	Reserves and Surplus	2	85,000
2	Current liabilities		
a	Trade Payables		3,00,000
b	Short term borrowings		6,00,000
	Total		28,45,000
	Assets		
1	Non-current assets		
a	Property, plant and equipment	3	28,20,000
2	Current assets		
	Cash and cash equivalents (30,000 - 5,000)		25,000
	Total		28,45,000



Notes to accounts

1.	Share Capital		Rs.
	Equity share capital		
	24,000 equity shares of Rs. 40 each fully paid up		9,60,000
	Preference share capital		
	12,000, 10% Preference shares of Rs. 75 each fully paid up		9,00,000
	Total		18,60,000
2.	Reserves and Surplus		
	Capital Reserve		85,000
3.	Property, plant and Equipment		
	Land and Building	15,60,000	
	Plant and Machinery	12,60,000	
	Total		28,20,000

12. Illustration

Sustain Limited is incurring losses due to adverse market conditions. It decided to reorganize its capital structure.

The summarized **Balance Sheet of the company as on 31st March, 2024** is as follows:

Balance Sheet of Sustain Limited as on 31st March, 2024

Particulars	Notes	₹
1. Shareholders' Fund		
(a) Share Capital	1	10,00,000
(b) Reserves and Surplus	2	(2,50,000)
2. Non-current liabilities		
Long-term borrowings	3	4,50,000
3. Current liabilities		
(a) Trade Payables		1,30,000
(b) Short-term borrowings – Bank Overdraft		65,000
(c) Other Current Liabilities (Interest payable on Debentures)		45,000
(d) Short-term provisions (Provision for Income Tax)		1,00,000
Total		15,40,000
Assets		₹
1. Non-current assets		
(a) Property, Plant & Equipment	4	8,50,000
(b) Intangible assets	5	60,000
(c) Non-current investments	6	2,80,000
2. Current assets		
(a) Inventories		1,20,000
(b) Trade receivables		2,30,000
Total		15,40,000

1.1 Notes to Accounts

1. Share Capital

Particulars	₹
Equity Share Capital	
50,000 Equity shares of ₹10 each fully paid	5,00,000
25,000 Equity shares of ₹10 each, ₹8 paid up	2,00,000



Preference Share Capital	
30,000 8% Cumulative Preference shares of ₹10 each <i>(Preference dividend has been in arrears for 3 years)</i>	3,00,000
Total Share Capital	10,00,000

2. Reserves and Surplus

Particulars	₹
Profit and Loss Account (Debit Balance)	(2,50,000)

3. Long-term Borrowings

Particulars	₹
10% Debentures of ₹100 each (Secured)	4,50,000

4. Property, Plant and Equipment

Particulars	₹
Freehold property	1,00,000
Plant and machinery	7,50,000
Total	8,50,000

5. Intangible Assets

Particulars	₹
Goodwill	60,000

6. Non-current Investments

Particulars	₹
Non-trade investments at cost	2,80,000

Scheme of Reconstruction

Subsequent to approval by the court and all interested parties, the following scheme of reconstruction was agreed:

1. Uncalled capital is to be called up in full and such shares and other fully paid-up equity shares are to be reduced to ₹5 per share.
2. Preference shareholders will accept a reduction of ₹2.50 per share; in exchange, the rate of dividend is increased to 9%.
3. Preference shareholders will forgo their claim of dividend for one year and one equity share of ₹5 each is to be issued for the remaining arrears of dividend.
4. Mr. X holds 10% debentures for ₹2,50,000 and is also a creditor for ₹50,000. He agreed to cancel 50% of his total debt (including interest), pay ₹20,000 to the company, and receive new 12% debentures for the balance amount.
5. The remaining claim of debenture holders (including interest) is to be reduced to 60%. In consideration, debenture holders are to receive new 9% preference shares at new face value.
6. Taxation liability is to be settled at ₹1,20,000.
7. Market value of non-current investments is ₹2,50,000. Investments are to be brought to market value.
8. Inventory equal to ₹1,00,000 (book value) will be taken over by remaining creditors in full settlement of their claim.
9. A bad debt provision of 2% is to be created on trade receivables.
10. Plant and machinery is to be written down by 20%.
11. The company will further issue 12% debentures sufficient to pay off bank overdraft and other outstanding liabilities and maintain cash/bank balance at ₹85,000.
12. The amount available by the scheme shall be utilised to write off goodwill, debit balance of Profit and Loss Account, and balance inventory.



You are required to:

- (a) Show the journal entries necessary to record the above transactions in the company's books, and
 (b) Prepare a note showing the revised share capital structure after completion of the scheme.

Solution

No.	Particulars	Debit (₹)	Credit (₹)
1	Bank Account Dr.	50,000	
	To Equity Share Capital Account		50,000
	Balance of ₹2 per share on 25,000 equity shares called up		
2	Equity Share Capital (₹10) Account Dr.	7,50,000	
	To Equity Share Capital (₹5) Account		3,75,000
	To Capital Reduction Account		3,75,000
	Reduction of equity shares of ₹10 each to shares of ₹5 each as per reconstruction scheme		
3	8% Cumulative Preference Share Capital (₹10) A/c Dr.	3,00,000	
	To 9% Cumulative Preference Share Capital (₹7.5) A/c		2,25,000
	To Capital Reduction A/c		75,000
	Being Preference shares of ₹10 each reduced by ₹2.5 each per share by changing the rate of dividend from 8% to 9% and the balance transferred to Capital Reduction A/c.		
4	Capital Reduction A/c Dr.	48,000	
	To Preference share dividend payable A/c		48,000
	Being arrear of Preference share dividend payable for one year		
5	Preference share dividend payable A/c Dr.	48,000	
	To Equity Share Capital (₹5) A/c		48,000
	Being Equity Shares of ₹5 each issued against arrears of 2 years Preference Share dividend (W.N.1)		
6	10% Debentures Account Dr.	2,50,000	
	Interest on Debentures Outstanding A/c Dr.	25,000	
	Trade payables Account Dr.	50,000	
	To Mr. X		3,25,000
	The total amount due to X, transferred to his account		
7	Bank Account Dr.	20,000	
	To Mr. X		20,000
	The amount paid by X under the reconstruction scheme		
8	Mr. X Dr.	3,45,000	
	To 12% Debentures Account		1,82,500
	To Capital Reduction A/c		1,62,500
	The cancellation of 50% of the total debt of Mr. X and the issue of 12% new debentures for the balance amount as per the reconstruction scheme		
9	10% Debentures A/c Dr.	2,00,000	
	Interest on Debentures Outstanding A/c Dr.	20,000	
	To 9% Cumulative Preference Share Capital A/c		1,32,000
	To Capital Reduction A/c		88,000
	Being 9% preference share capital issued to 10% debenture-holders for 60% of their claims. The balance is transferred to capital reduction account as per the reconstruction scheme		
10	Provision for Tax A/c Dr.	1,00,000	
	Capital Reduction A/c		20,000
	To Bank A/c		1,20,000
	Being payment of tax liability in full settlement		



11	Trade payables A/c (1,30,000 – 50,000) Dr.	80,000	
	Capital reduction A/c		20,000
	To Inventory A/c		1,00,000
	Being settlement of creditors by giving inventory		
12	Capital reduction A/c Dr.	1,84,600	
	To Investment A/c		30,000
	To Provision for bad debt A/c (2,30,000 × 2%)		4,600
	To Plant & Machinery (7,50,000 × 20%)		1,50,000
	Investment brought to their market value, Plant & machinery is written down by 20% & Provision for Bad debts of 2% created under the scheme of reconstruction		
13	Bank A/c Dr.	2,00,000	
	To 12% Debentures A/c		2,00,000
	New 12% debentures issued to pay off bank overdraft and maintain cash balance		
14	Bank Overdraft Dr.	65,000	
	To Bank A/c		65,000
	Bank overdraft paid		
15	Capital reduction A/c Dr.	4,27,900	
	To Goodwill A/c		60,000
	To Profit and loss A/c		2,50,000
	To Inventory		20,000
	To Capital reserve A/c		97,900
	Being goodwill and profit and loss account (Dr. bal.), balance inventory; and balance of capital reduction account transferred to capital reserve		

Note showing Share Capital

Particulars	Amount (₹)
Equity Share Capital	
Issued, subscribed and paid up:	
84,600 Equity Shares of ₹5 each (75,000 + 9,600)	4,23,000
9% Cumulative Preference Share Capital	
47,600 Preference Shares of ₹7.50 each (30,000 + 17,600)	3,57,000
Total Share Capital	7,80,000

Working Notes

Number of shares to be issued for dividends

Particulars	Amount (₹)
Preference Share Capital	3,00,000
Rate of dividend	8%
Period of arrears	2 years
Arrears of dividend (3,00,000 × 8% × 2)	48,000
Face value per equity share	₹5
Number of equity shares issued (48,000 ÷ 5)	9,600 shares

Cash/Bank Account

Debit	Amount (₹)	Credit	Amount (₹)
To Uncalled Capital	50,000	By Bank Overdraft	65,000
To Mr. X	20,000	By Tax	1,20,000
To 12% Debentures A/c (Balancing figure)	2,00,000	By Balance c/d	85,000
Total	2,70,000	Total	2,70,000



Number of preference shares

Particulars	
Amount of claim settled by issue of preference shares	₹1,32,000
Face value per preference share	₹7.50
Number of preference shares issued ($1,32,000 \div 7.5$)	17,600 shares



CONSOLIDATED FINANCIAL STATEMENTS

1. Illustration

From the following data, determine in each case:

- Minority interest at the date of acquisition and at the date of consolidation.
- Goodwill or Capital Reserve.

#	Subsidiary Company	% shares owned	Cost	Date of acquisition (1.1.20X6)		Consolidation Date(31.12.20X6)	
				Share Capital (Rs.)	P&L A/c (Rs.)	Share Capital (Rs.)	P&L A/c (Rs.)
1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
3	C	80%	56,000	50,000	20,000	50,000	20,000
4	D	100%	1,00,000	50,000	40,000	50,000	55,000

- Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be Rs. 2, 00,000 in each case.

Solution

Determination of Goodwill or Capital Reserve on date of acquisition

Goodwill/Capital Reserve	A	B	C	D
1 FV of Consideration	1,40,000	1,04,000	56,000	1,00,000
2 Value of NCI				
Stake held by NCI	10%	15%	20%	–
FV of Net Assets				
Share Capital	1,00,000	1,00,000	50,000	50,000
Retained Earnings	50,000	30,000	20,000	40,000
3 Total [FV of Net Assets]	1,50,000	1,30,000	70,000	90,000
4 Value of NCI (% x Net Assets)	15,000	19,500	14,000	–
5 Total [1+4]	1,55,000	1,23,500	70,000	1,00,000
Goodwill (5 > 3)	5,000	–	–	10,000
Capital Reserve (5 < 3)	–	6,500	–	–
Analysis of Reserves				
RE as on 31.3.X2	70,000	20,000	20,000	56,000
RE on DOA (31.3.X1)	50,000	30,000	20,000	40,000
Post acquisition RE	20,000	(10,000)	–	16,000
Stake held by Parent	90%	85%	80%	100%
Post acquisition reserves attributable				
Owners of Holding	18,000	(8,500)	–	16,000
NCI	2,000	(1,500)	–	–
NCI Balance on DOA [2]	15,000	19,500	14,000	–
Add/(Less) Post Acq RE	2,000	(1,500)	–	–
NCI Balance on DOC	17,000	18,000	14,000	–
Alternatively: NCI % x (ESC + RE)	17,000	18,000	14,000	–

Reserves in consolidated balance sheet



	A	B	C	D
Retained earnings of Parent	2,00,000	2,00,000	2,00,000	2,00,000
Add: Post acquisition RE from sub	18,000	(8,500)	–	15,000
Total	2,18,000	1,91,500	2,00,000	2,15,000

2. Illustration

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

	H Ltd.	S Ltd.
	Rs.	Rs.
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 Rs. 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

Solution

- Percentage of holding by H Ltd. in S Ltd.
 Total shares in S Ltd. = 25,000
 Held by H Ltd = 20,000 = 80%
 Minority Interest = 20%

2. Cost of Control

		Rs.
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)

3. Minority Interest

20% of Equity Share Capital (2,50,000 X 20%)	2,00,000
20% of P&L (1,00,000 X 20%)	20,000
	70,000

4. Consolidated reserves

Profit & Loss A/C of H Ltd.	2,00,000
Post acquisition profits (H Ltd. Share)	0
Capital reserve	60,000
	2,60,000

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

	Note No	Amount (Rs.)
I EQUITY AND LIABILITIES		
1 Shareholder's Fund		
(a) Share Capital	1	5,00,000
(b) Reserve and Surplus	2	2,60,000
2 Minority interest Current	3	
3 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

1. Share Capital		
(50,000 Shares of Rs.10 each)		5,00,000
2. Trade payables		
H Ltd.	1,75,000	
S Ltd.	50,000	2,25,000
3. PPE		
H Ltd.	5,00,000	
S Ltd.	3,00,000	8,00,000
4. Current Assets		
H Ltd.	1,55,000	
S Ltd.	1,00,000	2,55,000

3. 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. (Rs.)	Anushka Ltd. (Rs.)
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



	Particulars	(Rs.)	Virat Ltd. (Rs.)	Anushka Ltd. (Rs.)
1.	Share capital			
	60,000 equity shares of Rs. 10 each fully paid up		6,00,000	--
	40,000 equity shares of Rs. 10 each fully paid up		--	4,00,000
	Total		6,00,000	4,00,000
2.	Reserves and Surplus			
	General Reserve		1,00,000	1,00,000
	Total		1,00,000	1,00,000
3.	Non-current investments			
	Shares in Anushka Ltd		3,20,000	--

Solution:

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd.**as at 31st March, 20X1**

	Particulars	Note	Amount (Rs.)
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	Rs.	Rs.



1. Share capital		
60,000 equity shares of Rs.10 each fully paid up		<u>6,00,000</u>
2. Reserves and Surplus		
General Reserve	1,00,000	
Add: General reserve of Anushka Ltd (80%) Total	<u>80,000</u>	
Minority interest		<u>1,80,000</u>
3. 20% share in Anushka Ltd (WN 3)		<u>1,00,000</u>
4 Long term borrowings		
Long term borrowings of Virat	2,00,000	
Add: Long term borrowings of Anushka Total	<u>1,00,000</u>	<u>3,00,000</u>
5. Trade payables		
Trade payables of Virat	1,00,000	
Add: Trade payables of Anushka	<u>1,00,000</u>	
Total		<u>2,00,000</u>
6. Property, Plant and Equipment (PPE)		
PPE of Virat Ltd	4,00,000	
Add: PPE of Anushka Ltd	<u>3,00,000</u>	
Total		<u>7,00,000</u>
7. Inventories		
Inventories of Virat Ltd	1,60,000	
Add: Inventories of Anushka Ltd	<u>2,00,000</u>	
Total		<u>3,60,000</u>
8. Trade receivables		
Trade receivables of Virat Ltd	80,000	
Add: Trade receivables of Anushka Ltd	<u>1,40,000</u>	
Total		<u>2,20,000</u>
9 Cash and cash equivalents		
Cash and cash equivalents of Virat Ltd	40,000	
Add: Cash and cash equivalents of Anushka Ltd	<u>60,000</u>	
Total		<u>1,00,000</u>

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: 31 st March, 20X1	

2. Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of Rs.1,00,000 will be Revenue.

3. Consolidation of Balances

1. Computation of Goodwill or Capital reserve		
Cost of Investment		3,20,000
Less: Share in Net Assets		
Equity Share capital (80% of 4,00,000)	3,20,000	
Pre Acquisition profits	0	3,20,000
		Nil
2. Minority interest		
On date of acquisition		
Equity share capital (20% of 4,00,000)		8,00,000
Post acquisition profits (20% of 1,00,000)		20,000
		1,00,000
3. Consolidation Reserves		
Virat Ltd. P&L		1,00,000
Share in post acquisition Profit		80,000
		1,80,000

4. Illustration

From the following summarized balance sheets of H Ltd. and its subsidiary S Ltd. drawn up at 31st March 20X7, prepare a consolidated balance sheet as at that date, having regard to the following:

- Reserves and Profit and Loss Account of S Ltd. stood at Rs. 25,000 and Rs. 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April 20X6.
- Machinery (Book value Rs. 1,00,000) and Furniture (Book value Rs. 20,000) of S Ltd. were revalued at Rs. 1,50,000 and Rs. 15,000 respectively on 1st April 20X6 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Summarised Balance Sheet of H Ltd. & S Ltd. as on 31st March 20X7 (In Rs.)

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
Shareholders' Funds			Non-current Assets		
Share Capital (Shares of ₹100 each)	6,00,000	1,00,000	Fixed Assets		
			Machinery	3,00,000	90,000
			Furniture	1,50,000	17,000
Reserves	2,00,000	75,000	Other Non-current Assets	4,40,000	1,50,000
Profit & Loss Account	1,00,000	25,000	Non-current Investments		
Trade Payables	1,50,000	57,000	Shares in S Ltd. (800 shares @ ₹200 each)	1,60,000	—
Total	10,50,000	2,57,000	Total	10,50,000	2,57,000



Solution

**Consolidated Balance sheet of H Ltd. and its Subsidiary S Ltd.
as on 31st March, 20X7**

Particulars	Notes	₹
Equity and Liabilities		
Shareholders' Funds		
Share Capital	1	6,00,000
Reserves and Surplus	2	3,44,000
Minority Interest (WN: 5)	3	48,150
Current Liabilities		
Trade Payables	4	2,07,000
Total		11,99,750
Assets		
Non-Current Assets		
Property, Plant & Equipment	5	5,97,750
Intangible Assets	6	12,000
Other Non-Current Assets	7	5,90,000
Total		11,99,750

Notes to accounts

S. No.	Particulars	₹ ('000)
1	Reserves and Surplus	
	Reserves	2,00,000
	Add: 4/5th share of S Ltd.'s Post-acquisition reserve (WN: 2)	40,000
	Profit and Loss A/c	
	Add: 4/5th share of S Ltd.'s Post-acquisition profits (WN: 2)	1,00,000
		+4,000
	Total Reserves and Surplus	3,44,000
2	Trade Payables	
	H Ltd.	1,50,000
	S Ltd.	57,000
	Total Trade Payables	2,07,000
3	Tangible Assets – Machinery	
	H Ltd.	3,00,000
	S Ltd.	1,00,000
	Add: Appreciation (Revaluation on 01/04/x6)	50,000
	Less: Depreciation x6-x7	(15,000)
	Total - Machinery	4,35,000
	Furniture	
	H Ltd.	1,50,000
	S Ltd.	17,000
	Less: Decrease in value (Downward Revaluation)	(5,000)
	Depreciation reversal	750
	Total Furniture	1,62,750
	Total PPE	5,97,750
4	Intangible Assets	
	Goodwill (WN: 4)	12,000
5	Other Non-current Assets	
	H Ltd.	4,40,000
	S Ltd.	1,50,000
	Total Other Non Current Assets	5,90,000

Working Note: 1

Analysis of Profit



Particulars	Pre- Acqn	Post-Acqn Reserves	Post-Acqn P&L	Total
Reserves	25,000	50,000		75,000
Profit and loss	15,000	-	10,000	25,000
	40,000	50,000	10,000	
Time Adjustment	-	-	-	
Revaluation (WN: 2)				
Machinery	50,000		(5,000)	
Furniture	(5,000)		+750	
	85,000	50,000	5,750	
80% H :	68,000 (Cost of control)	40,000 (C.Reserves)	4,600 (C.P&L)	
20% MI :	17,000	10,000	1,150	

Working Note: 2**Revaluation****Machinery**

On Date of Acquisition:

- Book value → 1,00,000
- Market value → 1,50,000
- Revaluation gain → 50,000 – fully Pre

Depreciation on Book value for the year:

- Before revaluation : 10% of 1,00,000 = 10,000
- After revaluation : 10% of 1,50,000 = 15,000
- Additional depreciation = 5,000 – fully

Post**Furniture**

- Revaluation loss = 5,000

Depreciation Saving:

- Before Revaluation → 20,000 × 15% = 3,000
- After Revaluation → 15,000 × 15% = 2,250
- Savings in Depreciation → 750

Working Note: 3**Cost of Control**

Particulars	₹
Investment	1,60,000
80% Eq. share capital	(80,000)
Analysis of profit (Tr)	(68,000)
Goodwill	12,000

Working Note: 4**Minority Interest**

Particulars	₹
Equity Share Capital	20,000
Analysis of Profit	17,000
	10,000
	1,150
Total	48,150

Working Note: 5**Consolidated Reserves A/c and Profit and loss A/c**

Particulars	P & L	Reserves
Holding Company	1,00,000	2,00,000
Analysis of profit	4,600	40,000
	1,04,600	2,40,000

5. Illustration

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March 20X1 at a cost of Rs.70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March 20X1:

Balance sheet of Zed Ltd. as on 31st March 20X1:

Particulars	Rs. In Lakhs
Fixed Assets	120
Investments	55
Current Assets	70
Loans & Advances	15
15% Debentures	90
Current Liabilities	50

The following revaluations have been agreed upon (not included in the above figures):

- Fixed Assets Up by 20%
- Investments Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31 st March 20X1. Exe Ltd. purchased the shares of Zed Ltd. @ Rs.20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

Solution

Cost of Control

Particulars	₹ in lakhs	₹ in lakhs
Investments	70	
Less: Pre Acq. Dividend (70 lakhs/20 X 2)	7	
Total		63
70% of Equity Share Capital	35	
Analysis of Profit	61.95	96.95
Capital Reserve		33.95

Working Note: 1

Holding Company : Exe Ltd.
 Subsidiary Company : Zed Ltd.
 Holding % : 70%
 Investment : ₹ 70,00,000
 Date of Consolidation : 31st March, 20X1

Working Note: 2

Investment : ₹ 70,00,000
 Value per share : ₹ 20
 No. of Equity shares : 3,50,000
 Percentage of Holding : 70%
 Total no. of shares ZED Ltd. : 5,00,000
 Assumption : Face value per share is ₹10
 Share capital of Zed Ltd. ∴ ₹ 50,00,000



Working Note: 3

Balance sheet of Zed Ltd. as on 31st March, 20X1
(After Revaluation)

Liabilities	₹ (in lakhs)	Assets	₹(in lakhs)
Equity Share Capital [WN: 2]	50	Fixed Asset (120 X 120%)	144
Reserve & Surplus (Bal. Fig)	88.5	Investment (55 X 90%)	49.5
15% Debentures	90	Current Asset	70
Current liabilities	50	Loan & Advances	15
	278.5		278.5

Working Note: 4

Analysis of Profit

Particulars	Pre-Acquisition	Post-Acquisition	31.3.X1 Total
Reserve & Surplus	70		70
Revaluation Surplus	18.5		18.5
Total	88.5	0	
Add: Dividend paid (50 lakhs x 20%)	10		
Time Adjustment			
Less: Dividend Paid	10		
	88.5	0	
Holding Co. EXE Ltd. (70%)	61.95		
Minority Interest (30%)	26.55		

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.

Solution

	`	`
Assets		
Property, Plant and Equipment	70,00,000	
Less: Value written off (70 lakhs x 10%)	(7,00,000)	
	63,00,000	
Investments at Market Value	60,00,000	
Current Assets	68,00,000	
Loans and Advances	22,00,000	2,13,00,000
Less: Liabilities		



Trade Payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x ` 20 per share	1,20,00,000	
Less: Pre-acquisition dividend: 6,00,000 shares x ` 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		19,20,000

7. Illustration

H Ltd. acquired 3,000 shares in S Ltd., at a cost of Rs. 4, 80,000 on 1.7.20X6. The capital of S Ltd. consisted of 5,000 shares of Rs.100 each fully paid. The Profit & Loss Account of this company for 20X6 showed an opening balance of Rs.1,25,000 and profit for the year was Rs. 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.

Solution

Journal entries

Date	Particulars	Dr ₹	Cr ₹
1)	Bank A/c Dr To Dividend received A/c (Being dividend for 20X6 received)	1,20,000	1,20,000
2)	Dividend received A/c Dr To Profit and Loss A/c To Investment in S A/c (Being dividend received transferred to Profit and loss A/c & Investment A/c in 1 : 1 ratio considering Pre & Post Acqn Dividend)	1,20,000	60,000 60,000

Working Note: 1

- Holding company → H
- Subsidiary company → S

Particulars	₹ in lakhs
1) No. of shares acquired in S	3,000
2) Total No. of shares in S	5,000
3) Holding ratio (1 ÷ 2)	60%
4) P&L as on 1.1.16	1,25,000
5) P&L for the year (Profit)	3,00,000
6) Closing P&L before dividend	4,25,000
7) Dividend %	40%
8) Share capital of S	5,00,000
9) Dividend amount (7 x 8)	2,00,000
10) Dividend received by H (3 x 9)	1,20,000

8. Illustration

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

	Rs. '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	5,620	1,100
Inventory	1,900	4,150
Trade Receivables	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:

- Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands brought forward from the previous year.
- The General Reserve balance is brought forward from the previous year.
- 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.

Solution:

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: ($\frac{1}{4}$)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500
	(Cost of Control)	(Post-acquisition Profits)

Calculation of Minority Interest:

Particulars	₹
Paid-up Equity Share Capital ($₹ 50,00,000 \times \frac{1}{4}$)	12,50,000
Paid-up Preference Share Capital	10,00,000
Share in Reserves:	
Profit & Loss Account: $₹ 17,90,000 \times \frac{1}{4}$	4,47,500
General Reserve: $₹ 8,00,000 \times \frac{1}{4}$	2,00,000
Minority Interest	28,97,500

Calculation of Goodwill/Capital Reserve

	₹	₹
Cost of Investment in Subsidiary:	46,87,500	
$₹ 50,00,000 \times 75\% \times 125\%$ (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



9. Illustration

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January 20X6 for Rs.1, 40,000. The issued capital of ABC Ltd., on 1st January 20X6 was Rs. 1, 00,000 and the balance in the Profit & Loss Account was Rs.60, 000.

During the year ended 31st December 20X6, ABC Ltd. earned a profit of Rs.20, 000 and at year end, declared and paid a dividend of Rs.30, 000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. What is the amount of minority interest as on 1st January, 20X6 and 31st December 20X6?

What would be your answer if the dividend paid is Rs. 15,000?

Solution

- Total dividend paid is Rs.30,000 (Rs.20,000 out of post-acquisition profits and balance out of pre-acquisition profits i.e. 1 : 2 – Pre : Post), hence dividend received by XYZ .
- XYZ Ltd's share of dividend = Rs.30,000 x 80% = Rs.24,000
- Dividend received by XYZ credited to P&L = Rs.30,000 x 2/3 x 80% = Rs.16,000.

In the books of XYZ Ltd.

Particulars	Debit(₹)	Credit(₹)
Bank A/c Dr	24,000	
To Investment A/c		8,000
To Profit and loss A/c		16,000

(Dividend received from ABC Ltd credited to P&L A/c and Investment A/c being out of pre & post-acquisition profit – as explained above)

Working Note: 1**Analysis of Profit**

Particulars	Pre- Acqn	Post- Acqn	Total
Profit and loss	60,000	(10,000) (Bal.Fig)	50,000
Add: Dividend	-	30,000	
	60,000	20,000	
Time Adjustment	-	-	
Less: Dividend Paid	(10,000)	(20,000)	
	50,000	0	
XYZ (80%)	40,000 (Cost of Control)	0	
Minority Interest	10,000	0	

Working Note: 2**Minority Interest**

Particulars	1.01.20X6	31.12.20X6
Equity share capital 20% of 1,00,000	20,000	20,000
Analysis of Profit (Tr)	20% of 60,000 =12,000	10,000 + 0
	32,000	30,000

10. Illustration

A Ltd. acquired 1,600 ordinary shares of Rs. 100 each of B Ltd. on 1st July 20X6. On 31st December 20X6 the summarized balance sheets of the two companies were as given below:

Liabilities	A Ltd. (₹)	B Ltd. (₹)	Assets	A Ltd. (₹)	B Ltd. (₹)



Capital (Shares of ₹100 each fully paid)	5,00,000	2,00,000	Land & Buildings	1,50,000	1,80,000
Reserves	2,40,000	1,00,000	Plant & Machinery	2,40,000	1,35,000
Profit & Loss A/c	57,200	82,000	Investment in B Ltd. (at cost)	3,40,000	–
Bank Overdraft	80,000	–	Inventory	1,20,000	36,400
Trade Payables	47,100	17,400	Trade Receivables	59,800	40,000
			Cash	14,500	8,000
Total	9,24,300	3,99,400	Total	9,24,300	3,99,400

The Profit & Loss Account of B Ltd. showed a credit balance of Rs.30, 000 on 1st January, 20X6 out of which a dividend of 10% was paid on 1st August 20X6; A Ltd. credited the dividend received to its Profit & Loss Account.

The Plant & Machinery which stood at Rs. 1, 50,000 on 1st January 20X6 was considered as worth Rs. 1, 80,000 on 1st July 20X6; 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 on 31st December 20X6

Solution

Consolidated Balance sheet of A Ltd. and its Subsidiary B Ltd. as on 31st December, 20X6

		Particulars	Notes	₹
1		Equity and Liabilities		
		<u>Shareholder's funds</u>		
	A	Share capital	1	5,00,000
	B	Reserves and Surplus	2	3,08,800
2		<u>Minority Interest</u> (WN: 5)		83,600
3		<u>Current liabilities</u>		
	A	Trade Payables	3	64,500
	B	Short term borrowings	4	80,000
		Total		10,36,900
1		Assets		
	A	<u>Non-current Assets</u>		
		• Property, Plant & Equipment	5	7,41,000
		• Intangibles assets	6	17,200
2		<u>Current Assets</u>		
	A	• Inventories	7	1,56,400
	B	• Trade receivables	8	99,800
	C	• Cash & Cash equivalents (Cash)	9	22,500
		Total		10,36,900

Notes to accounts

S.no	Particulars		₹
1	Share Capital 5,000 shares of Rs.100 each		5,00,000
2	Reserves and Surplus Reserves Profit and Loss (WN: 8)	2,40,000 <u>68,800</u>	3,08,800
3	Trade Payables A Ltd. 47,100 B Ltd. 17,400		64,500



4	Short term borrowings Bank overdraft		80,000
5	Tangible Assets Land and Building (1,50,000 + 1,80,000) Plant & Machinery (WN: 7)	3,30,000 <u>4,11,000</u>	7,41,000
6	Intangible Assets Goodwill (WN: 6)		17,200
7	Inventories A Ltd. B Ltd.	1,20,000 <u>36,400</u>	1,56,400
8	Trade Receivables A Ltd. 59,800 B Ltd. 40,000		99,800
9	Cash & Cash equivalents A Ltd. B Ltd.	14,500 8,000	22,500

Working Note: 1

Holding company => A
 Subsidiary company=> B
 Holding ratio => $1,600/2,000 \times 100 = 80\%$
 Date of Acquisition => 1.07.20X6

Working Note: 2**Revaluation**

Particulars	₹
1) Book value on 1.01.20X6	1,50,000
2) Less: 6 Months depreciation @10% P.a	(7,500)
3) Book value on 1.07.20X6	1,42,500
4) Market value on 1.07.20X6	1,80,000
5) Revaluation Gain (4) – (3)	37,500
6) Depreciation for 1 st 6 months	7,500
7) Depreciation for 2 nd 6 months (without revaluation)	7,500
8) Depreciation for 2 nd 6 months (with revaluation) $= 1,80,000 \times 10\% \times 6/12$	9,000
9) Additional depreciation (8) – (7)	1,500

Working Note: 3**Analysis of Profit**

Particulars	Pre- Acqn	Post-Acqn Reserves	Post-Acqn P&L	Total
Reserves	1,00,000 (Assumed)	-	-	1,00,000
Profit and loss	30,000	-	52,000 (B.f)	82,000
Add Back: Dividend	-	-	20,000	
	1,30,000	0	72,000	
Time Adjustment	36,000	-	(36,000)	



(72,000 x 6/12)				
➤	1,66,000	-	36,000	
Less: Dividend	(20,000)	-		
➤	1,46,000	-	36,000	
Revaluation	37,500	-	(1,500)	
➤	1,83,500		34,500	
H : 80%	1,46,800 (Cost of control)		27,600 (C.P&L)	
MI : 20%	36,700		6,900	

Working Note: 4**Cost of Control**

Particulars	₹
Investment	3,40,000
(-) Pre- Acquisition Dividend	(16,000)
(A)	3,24,000
80% Equity share capital	1,60,000
Analysis of profit (Tr)	1,46,800
(B)	3,06,800
(B) Goodwill (A) -	17,200

Working Note: 5**Minority Interest**

Particulars	₹
20% Equity Share Capital	40,000
Analysis of Profit	36,700
	6,900
Total	83,600

Working Note: 6**Consolidated Reserves and Profit & Loss**

Particulars	P & L	Reserves
A	57,200	2,40,000
Less: Rect. Of Dividend	(16,000)	
Analysis of Profit	27,600	0
Total	68,800	2,40,000

11. Illustration

The following summarised Balance Sheets of H Ltd. And its subsidiary S Ltd. Were prepared as on 31st March, 20X7

Particulars	H Ltd. (Rs.)	S Ltd. (Rs.)
Equity and Liabilities		
Shareholders' Funds		
Equity Share Capital (fully paid up shares of Rs. 10 each)	12,00,000	2,00,000



Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	<u>3,22,000</u>	<u>1,23,000</u>
Total	<u>22,37,000</u>	<u>5,43,000</u>
	H Ltd. (Rs.)	S Ltd. (Rs.)
Assets		
Non-Current Assets		
Fixed Assets		
Machinery	<u>6,40,000</u>	<u>1,80,000</u>
Furniture	<u>3,75,000</u>	<u>34,000</u>
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ Rs. 20 each	<u>3,20,000</u>	<u>-</u>
Current Assets		
Inventories	<u>2,68,000</u>	<u>62,000</u>
Trade Receivables	<u>4,70,000</u>	<u>2,35,000</u>
Cash and Bank	<u>1,64,000</u>	<u>32,000</u>
Total	<u>22,37,000</u>	<u>5,43,000</u>

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 20X6. 2769 On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at Rs. 50,000 and Rs. 30,000 respectively.

Machinery (book value Rs. 2,00,000) and Furniture (book value Rs. 40,000) of S Ltd. were revalued at Rs. 3,00,000 and Rs. 30,000 respectively on 1st April, 20X6 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: Machinery 10% and Furniture 15%).

Trade Payables of H Ltd. include Rs. 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing Rs. 55,000 purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet as at 31st March, 20X7

Solution

Working Note: 1

Analysis of Profit

Particulars	Pre- Acqn	Post- Acqn	Total
1) General Reserves	50,000	1,05,000 (B.f)	1,55,000
2) Profit and loss	30,000	35,000 (B.f)	65,000
3) Revaluation (WN: 2)	(10,000)	-	
4) Depreciation Revaluation (WN:2)	-	(10,000) +1,500	
5) Unrealised Gain (WN: 3)		(5,000)	
	1,70,000	1,26,500	
H's 80%	1,36,000 (Cost of control)	1,01,200 (C. P&L)	
Minority Interest 20%	34,000	25,300	

Working Note: 2

Revaluation



Particulars		Machinery	Furniture
1) Book value		2,00,000	40,000
2) Revalued Amount		3,00,000	30,000
3) Revaluation Gain / (Loss) (fully pre-acqn adjustment)		1,00,000	(10,000)
4) Depreciation rate		10%	15%
5) Depreciation (fully post)	Charge:	10% x 1,00,000 = 10,000	15% x 10,000 = 1,500
	Savings		

Working Note: 3

- $10/110 \times 55,000 = 5,000$
- ₹ 5,000 is profit made by S, unrealised, therefore reduced from AOP of S.
- It is given that it is a post-acquisition transaction, so reduced from post-acquisition profit only.
- ₹ 35,000 of inter-company balance is eliminated from receivables and payables.

Working Note: 4**Cost of Control**

Particulars		₹
Investment	(A)	3,20,000
80% Equity share capital		1,60,000
Analysis of profit (Tr)		1,36,000
	(B)	2,96,000
	Goodwill (A) –	24,000
(B)		

Working Note: 5**Minority Interest**

Particulars		₹
20% Equity Share Capital		40,000
Analysis of Profit		34,000
		25,300
	Total	99,300

Working Note: 6**Consolidated Reserves and Profit & Loss**

Particulars		₹
Reserves of H		4,35,000
Profits of H		2,80,000
Analysis of Profit (WN: 1)		1,01,200
	Total	8,16,000

Consolidated Balance sheet of H Ltd. and its Subsidiary S Ltd.**As at 31st March, 20X6**

Particulars			Notes	₹
1		Equity and Liabilities		
		<u>Shareholder's funds</u>		
	A	Share capital		12,00,000
	B	Reserves and Surplus	1	8,16,200
2		<u>Minority Interest</u> (WN: 5)	2	99,300
3		<u>Current liabilities</u>		
	A	Trade Payables		4,10,000
		Total		25,25,500



1	A	Assets		
		<u>Non-current Assets</u>		
		Fixed Assets		
		• Tangible assets	3	13,10,500
		• Intangibles assets	4	24,000
2	A B C	<u>Current Assets</u>		
		• Inventories		3,25,000
		• Trade receivables		6,70,000
		• Cash & Cash equivalents (Cash at Bank)		1,96,000
		Total		25,25,500

Notes to accounts

S.no	Particulars		₹
1	Share capital (1,20,000 equity shares of Rs.10 each)		12,00,000
2	Reserves and Surplus		
	General Reserve	4,35,000	
	(+) AOP	84,000	
	Profit and loss	2,80,000	
	(+) AOP	21,200	
	(-) Unrealised Profit	(4,000)	8,16,200
3	Trade Payables		
	H Ltd.	3,22,000	
	S Ltd.	1,23,000	
	Inter Co. transaction	(35,000)	4,10,000
4	Tangible Assets		
	• <u>Machinery</u>		
	H Ltd.	6,40,000	
	S Ltd.	1,80,000	
	(+) Appreciation	1,00,000	
	(-) Depreciation	(10,000)	9,10,000
	• <u>Furniture</u>		
	H Ltd.	3,75,000	
	S Ltd.	34,000	
	(-) Decrease in value	(10,000)	
	(+) Depreciation	1,500	4,00,500
			13,10,500
5	Intangible assets - Goodwill		24,000
6	Inventory		
	H Ltd.	2,68,000	
	S Ltd.	62,000	
	(-) Unrealised Profit	(5,000)	3,25,000
7	Trade Receivables		
	H Ltd.	4,70,000	
	S Ltd.	2,35,000	
	Inter Co. transaction	(35,000)	6,70,000
8	Cash and Bank		
	H Ltd.	1,64,000	
	S Ltd.	32,000	1,96,000

12. Illustration

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

		Rs.



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

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

	P Ltd.	Q Ltd.
	Rs.	Rs.
Equity shares of Rs. 10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	–
Pre-incorporation profits	–	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	–
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of

Rs. 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 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.

Solution:

Shareholding pattern

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

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

(a) Before issue of bonus shares

(i)	Cost of control/capital reserve	Rs.	Rs.
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (Share Capital)	10,50,000	
	Capital profits (W.N.)		(11,13,000)
	Cost of control (i.e., Goodwill)	<u>63,000</u>	<u>87,000</u>
(ii)	Minority Interest		Rs.



	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		<u>6,79,500</u>
			<u>11,56,500</u>
(iii)	Consolidated profit and loss account – P Ltd.		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		<u>15,85,500</u>
			<u>31,60,500</u>

(b) Immediately after issue of bonus shares

(i)	Cost of control/capital reserve	Rs.	Rs.
	Face value of investments (Rs. 10,50,000 + Rs. 5,25,000)	15,75,000	
	Capital Profits (W.N.)	<u>63,000</u>	16,38,000
	Less: Investment in Q Ltd.		<u>(12,00,000)</u>
	Capital reserve		<u>4,38,000</u>
(ii)	Minority Interest		Rs.
	Share Capital (Rs. 4,50,000 + Rs. 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		<u>4,54,500</u>
			<u>11,56,500</u>
(iii)	Consolidated Profit and Loss Account – P Ltd.		Rs.
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		<u>10,60,500</u>
			<u>26,35,500</u>

Working Note:**Analysis of Profits of Q Ltd.**

	Capital Profits (Pre-acquisition)	Revenue Profits (Post-acquisition)	
	<u>(Before and after issue of bonus shares)</u> Rs.	Before Bonus Issue Rs.	After Bonus Issue Rs.
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.20X1	<u>60,000</u>		
	<u>90,000</u>		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			<u>(7,50,000)</u>
			11,55,000
Profit for period of 1st April, 20X1 to 31 st March, 20X3 (Rs. 4,20,000 – Rs. 60,000)		<u>3,60,000</u>	<u>3,60,000</u>
		<u>22,65,000</u>	<u>15,15,000</u>
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500



Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

13. Illustration

On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Particulars	Note No.	H Ltd. (Rs. in Lacs)	S Ltd. (Rs. 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) Other current liabilities (Dividend payable)		1,200	
(c) Short term provisions	4	855	394
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. (Rs. in lacs)	S Ltd. (Rs. in lacs)
1.	Share Capital		
	Authorized share capital	<u>15,000</u>	<u>6,000</u>
	Equity shares of Rs. 10 each, fully paid up		
	Issued and Subscribed:		
	Equity shares of Rs. 10 each, fully paid up	12,000	4,800
2.	Reserves and surplus		
	General Reserve	2,784	1,380
	Profit and Loss Account:	<u>2,715</u>	<u>1,620</u>
	Total	<u>5,499</u>	<u>3,000</u>
3.	Trade Payables		
	Creditors	1,461	854
	Bills Payable	<u>372</u>	<u>160</u>



		<u>1,833</u>	<u>1,014</u>
4.	Short term provisions		
	Provision for Taxation	855	394
5.	Property, plant and equipment		
	Land and Buildings	2,718	-
	Plant and Machinery	4,905	4,900
	Furniture and Fittings Total	<u>1,845</u>	<u>586</u>
		<u>9,468</u>	<u>5,486</u>
6.	Trade receivables		
	Debtors	2,600	1,363
	Bills Receivable	<u>360</u>	<u>199</u>
	Total	<u>2,960</u>	<u>1,562</u>
7.	Short term loans and advances		
	Sundry Advances	520	--

The following information is also provided to you:

- 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 Rs. 3,000 lakh and Rs. 1,200 lakh respectively.
- 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.
- 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.
- 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 Rs. 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.
- On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for Rs. 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

Solution:

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	Note No.	(Rs. in Lacs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) Minority Interest [W.N.6]		3,120
(3) Current Liabilities		
(a) Trade payables	3	2,802
(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		27,530
II. Assets		
(1) Non-current assets		
Property, Plant and Equipment	6	14,954
(2) Current assets		
(a) Inventories	7	5,885



(b) Trade receivables	8	4,477
(c) Short term loans and advances	9	520
(d) Cash and cash equivalents	10	1,694
Total		27,530

Notes to Accounts

		(Rs. in lacs)	(Rs. in lacs)
1.	Share Capital		
	Authorized share capital		<u>15,000</u>
	Equity shares of Rs.10 each, fully paid up		
	Issued and Subscribed:		<u>12,000</u>
	Equity shares of Rs. 10 each, fully paid up Total		<u>12,000</u>
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 <u>20</u>	<u>2,947</u>	
	<u>(380)</u>		
	2,335		
	Add: Share in S Ltd.'s Revenue profits <u>612</u>		<u>7,159</u>
3.	Total		
	Trade payables		
	Creditors	2,315	
	H Ltd. 1,461		
	S Ltd. <u>854</u>		
	Bills Payable		
	H Ltd. Rs. 372		
	S Ltd. <u>Rs. 160</u>		
	Rs. 532	<u>487</u>	2,802
4.	Less: Mutual owing Rs.		
	<u>(45)</u>		
	Short term provisions		
	Provision for Taxation	855	
		<u>394</u>	
	H Ltd.		1,249
5.	S Ltd.		
	Total		



	Other current liabilities			1,200
	Dividend payable			
	H Ltd.			
6.	Property, plant and equipment			
	Land and Buildings			
	H Ltd.		2,718	
	Plant and Machinery			
	H Ltd.	Rs. 4,905		
	S Ltd.	Rs. <u>4,900</u>	9,805	
	Furniture and Fittings			
	H Ltd.	Rs. 1,845		
	S Ltd.	Rs. <u>586</u>	<u>2,431</u>	
	Total			14,954
7.	Inventories			
	Stock			
	H Ltd.		3,949	
	S Ltd.		<u>1,956</u>	
			5,905	
	Less: Unrealized profit		<u>(20)</u>	5,885
8.	Trade receivables			
	Debtors			
	H Ltd.	Rs. 2,600		
	S Ltd.	Rs. <u>1,363</u>	3,963	
	Bills Receivable			
	H Ltd.	Rs. 360		
	S Ltd.	Rs. <u>199</u>		
		Rs. 559		
	Less: Mutual Owing	Rs. <u>(45)</u>	<u>514</u>	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/ Rs. 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

Rs. in lakhs			Rs. in lakhs		
To	Bonus to equity		By	Balance b/d	3,000
	shareholders (WN-8)	1,800	By	Profit and Loss A/c	180
To	Balance c/d	<u>1,380</u>		(Balancing figure)	_____
		<u>3,180</u>			<u>3,180</u>

2. S Ltd.'s Profit and Loss Account

Rs. in lakhs			Rs. in lakhs		
To	General Reserve		B	Balance b/d	1,200
	[WN 1]	180	y		
			B	Net Profit for the	
To	Dividend paid		y	year*	1,200
	(20% on Rs.3,000 lakhs)	600		(Balancing figure)	
To	Balance c/d	<u>1,620</u>			_____
		<u>2,400</u>			<u>2,400</u>

*Out of Rs. 1,200 lakhs profit for the year, Rs. 180 lakhs has been transferred to reserves.

3. Distribution of Revenue profits

	Rs. in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60% (General Reserve Rs. 108 + Profit and Loss Account Rs. 612)	(720)

Share of Minority Shareholders (40%)	<u>480</u>

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

4. Calculation of Capital Profits

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

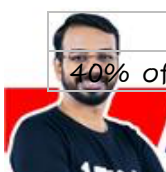
H Ltd.'s share = 60% of Rs. 1,800 lakhs = Rs. 1,080 lakhs
Minority interest = Rs. 1,800 – Rs. 1,080 = Rs. 720 lakhs

5. Calculation of capital reserve

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

6. Calculation of Minority Interest

	Rs. in lakhs
40% of share capital (40% of Rs. 4,800)	1,920



Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	<u>720</u>
	<u>3,120</u>

7. Unrealized profit in respect of inventory
Rs. 100 lakhs X 25 / 125 = Rs. 20 lakhs

8. Computation of bonus to equity shareholders

Rs. In lakhs

Shares as on 31 March 20X1 including bonus share
issued on 1 January 20X1 4,800

Or we can say these are $1 + \frac{3}{5}$ or $\frac{8}{5}$

i.e. Shares before bonus issue should have been $4,800 / (\frac{8}{5}) = 3,000$
Accordingly, bonus issue would be $(4,800 - 3,000) = 1,800$

14. Illustration

Subsidiary B Ltd. provides the following balance sheet:

Particulars	Note No.	20X0 (Rs.)	20X1 (Rs.)
I. Equity and Liabilities			
1. Shareholder's Funds			
a. Share Capital	1	5,00,000	5,00,000
a. Reserves and Surplus	2	2,86,000	7,14,000
(2) Current Liabilities			
(a) Short term borrowings	3	--	1,70,000
(b) Trade Payables		4,90,000	4,94,000
(c) Short-term provisions	4	3,10,000	4,30,000
Total		15,86,000	23,08,000
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	5	2,72,000	2,24,000
(b) Non-current Investment			4,00,000
(2) Current assets			
(a) 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 (Rs.)	20X1 (Rs.)
1.	Share capital 5,000 equity shares of Rs.10 each, fully paid up	<u>5,00,000</u>	<u>5,00,000</u>
2.	Reserves and Surplus General Reserves	<u>2,86,000</u>	<u>7,14,000</u>
3.	Short term borrowings Bank overdraft	--	<u>1,70,000</u>
4.	Short term provisions Provision for taxation	<u>3,10,000</u>	<u>4,30,000</u>
5.	Property, plant and equipment Cost	3,20,000	3,20,000
	Less: Depreciation	<u>(48,000)</u>	<u>(96,000)</u>
	Total	<u>2,72,000</u>	<u>2,24,000</u>



6.	Other current Assets		
	Prepaid expenses	<u>72,000</u>	<u>48,000</u>

Also consider the following information:

(a) B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accounting year.

(b) A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by Rs.12,000 at the end of 20X0 and Rs. 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 Rs. 60,000 in 20X0 and Rs. 30,000 in 20X1, being part of initial advertising expenditure of Rs. 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.

Solution

Working Note: 1

Particulars	₹
General Reserve	
Balance as on 31.12.20X1	7,14,000
Less: Reduction in value of inventory	(34,000)
Add: Reversal of Prov. For bad debts	9,000
Less: Adv. Expenses written off	(30,000)
Total	6,59,000

Working Note: 2

Particulars	₹
Provision for doubtful debts	
Closing balance of TR (This represents 99%)	8,91,000
99% → 8,91,000	
100% → ?	
Total value of TR	9,00,000
Provision	9,000

Notes to Accounts

Restated Balance sheet of B Ltd. as at 31st December, 20X1

	Particulars	Notes	₹
1	Equity and Liabilities		
	<u>Shareholder's funds</u>		
A	Share capital	1	5,00,000
B	Reserves and Surplus	2	6,59,000
2	<u>Current liabilities</u>		
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
1	Assets		
A	<u>Non-current Asset</u>	5	2,24,000



2	B	Property, Plant and Equipment Non-current Investment		4,00,000
	A	<u>Current Assets</u>	6	7,08,000
	B	Inventories	7	9,00,000
	C	Trade receivables		3,000
	D	Cash & Cash equivalents (Cash at Bank)	8	18,000
		Other current assets		22,53,000
		Total		

S.no	Particulars		₹
1	Share Capital 5,000 shares of Rs.10 each, fully paid up		<u>5,00,000</u>
2	Reserves and Surplus General Reserves (WN: 1)		<u>6,59,000</u>
3	Short term borrowings Bank Overdraft		<u>1,70,000</u>
4	Short term provisions Provision for Taxation		<u>4,30,000</u>
5	Property Plant and Equipment Cost Less: Depreciation Total	3,20,000 (96,000)	<u>2,24,000</u>
6	Inventory Actual Inventory Less: Change in method of valuation Total	7,42,000 (34,000)	<u>7,08,000</u>
7	Trade Receivables Actual trade receivables Add: Adjustment for provision Total	8,91,000 <u>9,000</u>	<u>9,00,000</u>
8	Other current Assets Prepaid expenses		<u>48,000</u>

15. Illustration

Given below are the Profit & Loss Accounts of H Ltd. and its subsidiary S Ltd. for the year ended 31st March 20X7:

	H Ltd. (Rs. in lacs)	S Ltd. (Rs. In lacs)
Incomes:		
Sales and other income	5,000	1,000
Increase in Inventory	1,000	200
	6,000	1,200
Expenses:		
Raw material consumed	800	200
Wages and Salaries	800	150
Production expenses	200	100
Administrative Expenses	200	100
Selling and Distribution Expenses	200	50
Interest	100	50
Depreciation	100	50



	2,400	700
Profit before tax	3,600	500
Provision for tax	1,200	200
Profit after tax	2,400	300
Dividend paid	1,200	150
Balance of Profit	1,200	150

Other Information:

- H Ltd. sold goods to S Ltd. of Rs.120 lakhs at cost plus 20%.
 - Inventory of S Ltd. includes such goods valuing Rs.24 lakhs.
 - Administrative expenses of S Ltd. include Rs.5 lakhs paid to H Ltd. as consultancy fees.
 - Selling and distribution expenses of H Ltd. include Rs.10 lacs paid to S Ltd. as commission.
 - H Ltd. holds 80% of equity share capital of Rs.1, 000 lacs in S Ltd. prior to 2015-20X6. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 2015-20X6.
- Prepare a Consolidated Profit and Loss Account.

Solution

Consolidated Profit and Loss A/c

Particulars	Note No.	₹ in lacs
I. Revenue from operations	1	5,865
II. Total revenue		5,865
III. Expenses		
• Cost of material purchased/consumed	3	1,180
• Changes of Inventories of finished goods	2	(1,196)
• Employee benefit expense	4	950
• Finance cost	6	150
• Depreciation and amortization expenses	7	150
• Other expenses	5	535
➤ Total Expenses		1,769
IV. Profit before Tax (II – III)		4,096
V. Tax Expenses	8	1,400
VI. Profit After Tax (Profit transferred to Consolidated Balance Sheet Profit After tax)		2,696

Notes to accounts

S.no	Particulars	H Ltd	S Ltd	Adjustments	Total
1	Revenue from operations	5,000	1,000	(120) Inter Co Sales (5) Cons. Fee (H to S) (10) Comm (S to H)	5,865
2	Increase in Inventory	1,000	200	(4) Unrealised profits	1,996
3	- Cost of Material purchased / consumed Raw material consumed - Production expenses (Direct Costs)	800 200	200 100	(120) Inter Co. Sales	880 300
4	Employee Benefits & Expenses Wages & Salaries	800	150		950
5	Other expenses:				295



	Administration Expenses	200	100	(5) Cons. Fee (H to S)	240
	Selling & Distribution expenses	200	50	(10) Comm. (S to H)	535
6	Finance Cost – Interest	100	50		150
7	Depreciation & Amortisation	100	50		150
8	Provision for Tax	1,200	200		1,400

16. Illustration

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

Particulars	Chand Ltd (Rs.)	Sitara Ltd. (Rs.)
Equity Share Capital	20,00,000	6,00,000
Finished Goods Inventory as on 01.04.20X3	4,20,000	3,01,000
Finished Goods Inventory as on 31.03.20X4	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 Rs. 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 Rs. 1,75,000 to Sitara Ltd. at a profit of 20% on selling price. Inventory of Sitara Ltd. includes goods of Rs. 70,000 received from Chand Ltd.
- Selling and Distribution expenses of Sitara Ltd. include Rs. 21,250 paid to Chand Ltd. as brokerage fees.
- General and Administrative expenses of Chand Ltd. include Rs. 28,000 paid to Sitara Ltd. as consultancy fees.
- Sitara Ltd. used some resources of Chand Ltd., and Sitara Ltd. paid Rs. 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.

Solution:

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.	Rs.
Revenue from operations	1	50,03,250
Other Income	2	<u>1,81,000</u>
Total revenue (I)		<u>51,84,250</u>
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	<u>8,43,250</u>
Total expenses (II)		<u>41,33,250</u>
Profit before tax (II-III)		<u>10,51,000</u>

Notes to Accounts:

			Rs.	Rs.
1.	Revenue from operations			
	Sales and other operating revenues Chand Ltd.		33,25,000	
	Sitara Ltd.		<u>19,07,500</u>	
			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)	
			<u>(21,250)</u>	50,03,250
2.	Brokage received by Chand Ltd. from Sitara Ltd.			
	Other Income Dividend income:	1,68,000		
	Chand Ltd. Sitara Ltd.	43,750		
		<u>(50,000)</u>		1,61,750
	Less: Dividend realized from Sitara Ltd. (5,00,000 x 10%)			
	Other Non-operating Income Chand Ltd.	35,000		
	Sitara Ltd.	10,500		
	Loss on sale of investment Sitara Ltd.	(26,250)	<u>19,250</u>	1,81,000
3.	Cost of material purchased/consumed			
	Chand Ltd. Sitara Ltd.	13,93,000		
		<u>4,72,500</u>		
		18,65,500		
	Less: Purchases by Sitara Ltd. From Chand Ltd.	<u>(1,75,000)</u>	16,90,500	
	Direct expenses (Production) Chand Ltd.			
	Sitara Ltd.	3,15,000		
		<u>1,40,000</u>	<u>4,55,000</u>	21,45,500
4.	Changes (Increase) in inventories of finished goods			
	Chand Ltd. Sitara Ltd.			
			4,37,500	



			<u>75,250</u>	
	Less: Unrealized profits Rs. 7,00,00 x 20/100		5,12,750	
			<u>(14,000)</u>	4,98,750
5.	Employee benefits and expenses Wages and salaries:			
	Chand Ltd. Sitara Ltd.		13,30,000	
	Finance cost Interest:		<u>2,45,000</u>	15,75,000
6	Chand Ltd.			
	Sitara Ltd.		17,500	
			<u>5,250</u>	22,750
7.	Depreciation			
	Chand Ltd.		31,500	
	Sitara Ltd.		<u>14,000</u>	45,500
8.	Other expenses			
	General & Administrative expenses:			
	Chand Ltd.	2,80,000		
	Sitara Ltd.	<u>1,22,500</u>		
		4,02,500		
	Less: Consultancy fees received by Sitara Ltd. from Chand Ltd.	<u>(28,000)</u>	3,74,500	
	Royalty:			
	Sitara Ltd.	5,000		
	Less: Received by Chand Ltd. Selling and distribution Expenses:	<u>(5,000)</u>	Nil	
	Chand Ltd.	3,32,500		
	Sitara Ltd.	<u>1,57,500</u>		
		4,90,000		
	Less: Brokerage received by Chand Ltd. from Sitara Ltd.	<u>(21,250)</u>	<u>4,68,750</u>	8,43,250

17. Illustration

A Ltd acquired 70% of equity shares of B Ltd. As on 1st January 2010 at a cost of Rs.10,00,000 when B Ltd. had an equity share capital of Rs.10,00,000 and reserves and surplus of Rs.80,000. Both the companies follow calendar year as the accounting year.

In the four consecutive years., B Ltd. fared badly and suffered losses of Rs.2,50,000; Rs.4,00,000; Rs.5,00,000 and Rs.1,20,000 respectively.

Thereafter in 2014, B Ltd. experienced turnaround and registered an annual profit of 50,000. In the next two years. i.e. 2015 and 20X6, B Ltd. recorded annual profits of Rs.1, 00,000 and Rs.1, 50,000 respectively.

Show the minority interests and cost of control at the end of each year for the purpose of consolidation

Solution

Minority Interest

2010	
⇒ 30% Eq. share capital (30% x 10,00,000)	= 3,00,000
⇒ 30% Profit [Pre: 80,000	= (51,000)



Post: (25,000)]	
Minority Interest	2,49,000
2011	
⇒ 30% Eq. share capital	= 3,00,000
⇒ 30% Profit [-1,70,000 -4,00,0000]	= (1,71,000)
Minority Interest	1,29,000
2012	
⇒ 30% Eq. share capital	= 3,00,000
⇒ 30% Profit [-5,70,000 - 5,00,000]	= (3,21,000)
	(21,000)
❖ Minority Interest is 0 ❖ Minority Interest should be Zero or Positive, not negative. ❖ This 21,000 is adjusted against Holding Co's share → R&S of Holding Co	
2013	
⇒ 30% Eq. share capital	= 3,00,000
⇒ 30% Profit [-10,70,000 - 1,20,000]	= (3,57,000)
	(57,000)
❖ Minority Interest is 0 ❖ In 2012, 21,000 of loss was already adjusted against Holding Co. ❖ In 2013, 57,000 - 21,000 = 36,000 should be adjusted. ❖ Cumulative adjustment = 57,000	
2014	
⇒ 30% Eq. share capital	= 3,00,000
⇒ 30% Profit [-11,90,000 - 50,000]	= (3,42,000)
	(42,000)
❖ Minority Interest is 0 ❖ Reduction accumulated Loss of Minority = 57,000 - 42,000 = 15,000. ❖ 50,000 of Profit x 30% =15,000 → This Profit will go towards Holding Co's share as Holding Co absorbed ₹57,000 loss of Minority Interest in earlier years ❖ Balance of such loss => - 57,000 + 15,000 = -42,000	



2015 ⇒ 30% Eq. share capital ⇒ 30% Profit [-11,40,000 – 1,00,000]	= 3,00,000 = (3,12,000)
	(12,000)
❖ Minority Interest is 0 ❖ 30,000 of reduction of overall loss attributable to minority is because of profit earned in 2015. = 30% x 1,00,000 = 30,000 ❖ Loss to be settled with Holding Company Opening balance: (42,000) Adjusted in 2015: <u>+30,000</u> (12,000)	
20X6 ⇒ 30% Eq. share capital ⇒ 30% Profit [– 10,40,000 + 1,50,000]	= 3,00,000 = (2,67,000)
Minority Interest	33,000

Working Note: 1

Holding company => A
Subsidiary company=> B
Holding ratio => 1,600/2,000 x 100 = 80%
Date of Acquisition => 1.07.20X6

Working Note: 2**Cost of control**

Investment => 10,00,000
70% ESC => (7,00,000)
70% Pre-Acq Profit => (56,000)
(70% of 80,000)
Goodwill 2,44,000

18. Illustration

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of Rs. 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:

- 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 Rs. 30 lakhs, Rs.40 lakhs and Rs. 65 lakhs.
- The actual cost of the shares to the foreign company was Rs.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
- 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 31.3.20X1 was Rs 1, 00, 00,000. It was decided to write down fixed assets by Rs. 1, 75,000. Current liabilities of VR Ltd. as on the same date were Rs. 20, 00,000. The paid-up share capital of VR Ltd was Rs.20, 00,000 divided into 2, 00,000 equity shares of Rs. 10 each.

Compute the goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.



Solution

Cost of Control

Particulars	₹ in lakhs
Paid Earlier (46%) [2,00,000 x 46% x 17]	15.64
Purchase Consideration for 54%	64.8
A	80.44
Assets	100
(-) Reduction	(1.75)
(-) Liabilities	(20)
B	78.25
Goodwill (A - B)	2.19

Working Note: 1

- Holding company – Variety
- Subsidiary company – VR
- Variety owns 46% of VR shares purchased @ ₹17 each
No. of shares already held = 2,00,000 x 46% = 92,000

Working Note: 2

Computation of purchase consideration & settlement

15% of the capitalised value of yield is the worth of the company

- 1) Yield = 40% of 3 years avg Pre-tax profit
= 40% {(30+40+65) ÷ 3}
= **18 lakhs**
- 2) 15 lakhs yield → 100 lakhs worth
18 lakhs yield → **X**
→ **X = 18 x 100/15 = 120 lakhs**
- 3) No. of Equity shares of VR is 2 lakhs
- 4) Value per share [2) ÷ 3)] = ₹60
- 5) 100% of VR → ₹ 120 worth
54% of VR → **X**
→ **X = 54/100 x 120 lakhs = ₹ 64.8 lakhs**
- 6) Gain made by Foreign company
Selling price → 64.8 lakhs
(-) Purchase price → (5.4 lakhs)
Gain on sale → **59.4 lakhs**
- 7) Tax @ 30% on (6) = 17.82 lakhs
- 8) Net proceeds due to foreign company (5) – (6) = ₹46.98 lakhs
- 9) 50% paid in cash = ₹23.49 lakhs
- 10) 50% remains as loan → 23.49 lakhs.

19. Illustration

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (Rs. In 000)		Y Limited (Rs. In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of Rs. 100 each)		2,000		400
7% Preference share capital		-		400
Reserves		600		200
6% Debentures		400		400
Trade Receivables/Trade Payables	160	180	100	120
Profit & Loss A/c balance		40		30
Purchases /Sales	1,000	1,800	1,200	1,900



Wages and Salaries	200		300	
Debenture Interest	24		24	
General Expenses	160		120	
Preference share dividend up to 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
Fixed Assets	2,200		1,580	
Total	5,027	5,027	3,450	3,450

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being Rs. 1,20,000, one fourth of such goods were still lying-in inventory at the end of the year.

Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Fixed Assets.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021.

Solution

Working Note: 1

Profit and loss for Y Ltd

Particulars	Amount	Amount ('000)
Revenue from operations		1,900
Less: Expenses		
Cost of Material consumed	1,200	
Wages and Salaries	300	
General Expenses	120	
Debenture Interest	24	
Depreciation [15% of 1,580]	237	
Total Expenses		(1,881)
Profit for the year		19
Less: Preference dividend		
Paid:	14	
Payable: [400 x 7% /2]	14	(28)
Profit available to Equity share holders		(9)

Minority share	20%	-1.80
Balance attributable to group		-7.20
Pre-acquisition loss	3/12	-1.80
Post-acquisition loss		-5.40

Profit of Subsidiary (9,000)

	Pre-acquisition	Post-acquisition
Total	(2,250)	(6,750)
Minority Interest	(450)	(1,350)
Group's share	(1,800)	(5,400)

Working Note: 2

Preference dividend = 28,000

	Pre-acquisition	Post-acquisition
Total	7,000	21,000
Outside the Group	3,500	10,500
Within the Group	3,500	10,500



Consolidated Statement of Profit and Loss A/c

Particulars	Note No.	₹ ('000)
I. Revenue from operations	1	<u>3,580</u>
II. Total revenue		<u>3,580</u>
III. Expenses		
• Cost of material purchased/consumed	2	2,080
• Employee benefit expense	3	500
• Finance cost	4	48
• Depreciation	5	457
• Other expenses	6	<u>280</u>
➤ Total Expenses		<u>3,365</u>
IV. Profit before Tax (II – III)		<u>215</u>
V. Less: Preference Dividend		
• Outside the Group		(14)
• Adjusted to Cost of Investment		-3.50
• Add: Minority Share of Losses		1.80
• Add: Pre acquisition Losses to be Tr. to Investment		1.80
• Less: Unrealised Profit on unsold Inventory [1,20,000 x 25/125 x ¼]		-6.00
VI. Balance transferred to Consolidated Balance Sheet		195.10

Notes to Financial Statements

S.no	Particulars		₹ ('000)
1	Revenue from Operations:		
	X Ltd.	1,800	
	Y Ltd.	1,900	
	Intra Group Sales	(120)	3,580
2	Cost of Material Purchased / Consumed		
	X Ltd.	1,000	
	Y Ltd.	1,200	
	Less: Intra Group Purchase	(120)	2,080
3	Employee Benefit Expenses		
	Wages and Salaries:		
	X Ltd.	200	
	Y Ltd.	300	500
4	Finance Cost		
	Debenture:		
	X Ltd.	24	
	Y Ltd.	24	48
5	Depreciation		
	X Ltd. [2,200 x 10%]	220	
	Y Ltd. [1,580 x 15%]	237	457
6	Other Expenses		
	General Reserve		
	X Ltd.	160	
	Y Ltd.	120	280



Illustration 1

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000.

Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

Paid up Equity Share Capital	₹ 10,00,000
Securities Premium	₹ 1,00,000
Reserve & Surplus	₹ 5,00,000

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. Should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

Answer

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹	₹
Investment in B Ltd. (A)		15,00,000
Equity Shares	10,00,000	
Security Premium	1,00,000	
Reserves & Surplus	5,00,000	
Net Assets	16,00,000	
45% of Net Asset (B)		7,20,000
Goodwill (A-B)		7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 x 45%)	1,35,000
Less: Dividend paid (1,00,000 x 45%)	(45,000)
Carrying Amount of Investment	15,90,000

Illustration 2

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Answer

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April 1	4,80,000	
	5,20,000	
Add: Goodwill		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 April 1	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 April 1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹ 4,00,000 + ₹ 5,00,000) restricted to 4,80,000	(4,80,000)	
Add: Goodwill		1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.)	
Carrying Amount of Investment	Nil

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

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

Illustration 3

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

Answer

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

a. Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or;

b. It operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor.

In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

Illustration 4

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

Answer

An investor should discontinue the use of the equity method from the date that:

a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.



From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Illustration 5

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

- Separate financial statements of Bright Ltd. as on 31-03-20X2;
- Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;
- What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

Answers

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

Illustration 6

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000
Fixed Assets	5,00,000
Investments	2,00,000
II. Current Assets	3,00,000
	10,00,000

During the year ended 31.3.20X2 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.



(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

- Goodwill if any on acquisition of B Ltd.'s shares.
- How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?
- How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

Answer

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

(i) Calculation of Goodwill

(₹ in lakhs)

Amount paid towards acquisition of stake in B Ltd.	3.00	
Less: Pre-acquisition dividend (₹ 5,00,000 x 40% x 25%)	<u>0.50</u>	
Cost of Investment in B Ltd.	2.50	
Less: Share in the value of Equity of B Ltd. as at the date of Investment [25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs)]		<u>(2.50)</u>
Goodwill		<u>NIL</u>

(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	<u>(0.50)</u>	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd..		
Cost of Investment in B Ltd	2.5	
Share of profit for year 20X1 – 20X2	<u>1.75</u>	
	4.25	
Add: Goodwill	<u>NIL</u>	4.25

Working Notes:

- Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
- B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
- Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.

Illustration 7 (AS 21 & 23)

On **1st February, 2024**, Best Ltd. acquired **80% Equity shares of Cool Ltd.** for **₹14,80,000**.

On **31st March, 2024**, Best Ltd. also acquired **25% Equity shares of Good Ltd.** for **₹3,80,000**.

The following are the balances extracted from the books of **Best Ltd., Cool Ltd., and Good Ltd.** as on **31st March, 2024**:

Particulars	Best Ltd. (₹)	Cool Ltd. (₹)	Good Ltd. (₹)
Equity Shares of ₹100 each fully paid	30,00,000	20,00,000	10,00,000
Securities Premium	—	2,20,000	—
9% Debentures	6,30,000	—	2,40,000

General Reserve	2,69,000	84,000	1,20,000
Profit & Loss Account (Credit Balance)	3,26,000	2,70,000	50,000
Investments	17,50,000	6,10,000	–
Property, Plant, and Equipment	18,90,000	18,14,000	12,10,000
Current Assets	9,65,000	5,60,000	2,25,000
Trade Payable (Including Bills Payable)	3,80,000	4,10,000	25,000
Sales and other income	56,00,000	38,00,000	27,00,000
Raw material consumed	36,50,000	31,20,000	22,30,000
Wages and Salaries	5,07,000	4,01,000	2,69,000
Production expenses	1,35,000	1,06,000	98,000

Additional Information

- The Profit and Loss account of **Cool Ltd.** showed a credit balance of **₹30,000** on **1st April, 2023**.
- The **General Reserve** balance is brought forward from the previous year.
- On **31st March, 2024**, all the bills payable in **Cool Ltd.'s** balance sheet were acceptances in favour of **Best Ltd.** However, on that date, **Best Ltd. held only ₹3,00,000 of these acceptances in hand**, the rest having been endorsed in favour of its creditor.
- Best Ltd.** purchased goods costing **₹5,00,000** from **Cool Ltd.** on **1st June, 2023** at a price of **₹6,50,000**. The entire goods remain unsold with **Best Ltd.** at the end of the financial year.
- Best Ltd.** is preparing **Consolidated Financial Statements** for the year ending **31.03.2024**.

You are required to calculate:

- Trade Payable (Consolidated)
- Current Assets (Consolidated)
- Minority Interest
- Goodwill / Capital Reserve on the acquisition of **Cool Ltd.'s** shares
- Goodwill / Capital Reserve on the acquisition of **Good Ltd.'s** shares
- Profit & Loss Account (Consolidated)
- General Reserve (Consolidated)
- Revenue from Operations (Consolidated)
- Cost of material purchased / consumed (Consolidated)

Solution

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		20,00,000
General Reserve (Opening)		84,000
Securities Premium		2,20,000
P&L balance as on 1-4-2023 (Pre-acq.)		30,000
Current year profit (2,70,000 – 30,000)	2,40,000	
→ Pre-acquisition profit (10/12 × 2,40,000)	2,00,000	2,00,000
→ Post-acquisition profit (2/12 × 2,40,000)	40,000	
Net Assets at date of acquisition (1-2-2024)		25,34,000
Best Ltd.'s share (80%)		20,27,200
Cost of investment		(14,80,000)
Capital Reserve on acquisition of Cool Ltd.		5,47,200
Minority Interest on Date of Acquisition 20%	20% × 25,34,000	5,06,800

Trade Payables & Current Assets

Particulars	Trade Payables	Current Assets
Best Ltd.	3,80,000	9,65,000
Add: Cool Ltd.	4,10,000	5,60,000
Less: Elimination	(3,00,000)	(3,00,000)
Total	4,90,000	12,25,000

Minority Interest – Cool Ltd.

Particulars	Amount (₹)
Date of Acquisition	5,06,800
Add: Share in Current Profit 20% of 40,000	8,000
Total	5,14,800

Goodwill / Capital Reserve on Acquisition of Good Ltd.

Particulars	Amount (₹)
Purchase Consideration	3,80,000
Less: Share Capital (10,00,000 × 25%)	2,50,000
Less: General Reserve (1,20,000 × 25%)	30,000
Less: Profit & Loss balance (50,000 × 25%)	12,500
Goodwill	87,500

Profit and Loss Account (Consolidated)

Particulars	Amount (₹)
Best Ltd.	3,26,000
Add: Post-acquisition profit of Cool Ltd. $\{[(2,70,000 - 30,000) \times 2/12] \times 80\%\}$	32,000
Total	3,58,000

General Reserve (Consolidated)

Particulars	Amount (₹)
Best Ltd.	2,69,000

Revenue (Consolidated)

Particulars	Amount (₹)
Revenue of Best Ltd.	56,00,000
Add: Revenue of Cool Ltd. $(38,00,000 \times 2/12)$	6,33,333
Total	62,33,333

Cost of Materials Purchased / Consumed (Consolidated)

Particulars	Amount (₹)
Raw material of Best Ltd.	36,50,000
Add: Raw material of Cool Ltd. $(31,20,000 \times 2/12)$	5,20,000
Total	41,70,000



Illustration 1

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied the materials for ₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture. Mr. C met all other expenses of advertising, labour and other incidental expenses which turnout to be ₹ 9,00,000. On 30.06.20X1 each of the venturer agreed to take away one flat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along with the interest and net proceeds were shared by the partners equally. You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

Answer**Draft Consolidated Profit & Loss Account**

Particulars	₹	₹	Particulars	₹	₹
To Purchase of Land:		60,00,000	By Sale of Flats:	40,00,000	
Mr. A			Mr. A	20,00,000	
To Registration Fees:		60,000	Mr. B	10,00,000	70,00,000
Mr. A		9,50,000	Mr. C		
To Materials:			By Flats taken by Venturers:	10,00,000	
Mr. B		9,00,000	Mr. A	10,00,000	
To Other Expenses:			Mr. B	10,00,000	30,00,000
Mr. C		2,00,000	Mr. C		
To Bank Interest:					
Mr. A	6,30,000				
To Profits:	6,30,000				
Mr. A	6,30,000	18,90,000			
Mr. B		1,00,00,000			1,00,00,000
Mr. C					

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
	10,00,000	By Land & Building	10,00,000
To Bank:(Purchase of Land)	60,000	By Bank (Received from Mr. B)	14,20,000
To Bank (Registration Fees)	2,00,000		4,70,000
To Bank (Bank Interest)	6,30,000	By Bank (Received from Mr. C)	
To Profit on JV	68,90,000		68,90,000

In the Books of Mr. B**Joint Venture Account**

Particulars	₹	Particulars	₹
To Purchases (Material Supplied)	4,50,000	By Bank (Sale of Flats)	20,00,000
	5,00,000	By Land & Building	10,00,000
To Bank (Materials)	6,30,000		
To Profit on JV	14,20,000		
To Bank (Paid to Mr. A)	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		
	<u>20,00,000</u>		<u>20,00,000</u>

Illustration 2

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehicles of ₹ 9,00,000 to be depreciated @ 20% p.a. They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year. You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

Answer

Consolidated Balance Sheet

		Note	(₹)
I	Equity and liabilities Shareholders' funds: Share Capital	1	<u>71,40,000</u> <u>71,40,000</u>
II	Assets Non-current Assets Property, Plant and Equipment:	2	<u>71,40,000</u> <u>71,40,000</u>

Notes to Accounts

			(₹)
1.	Share capital A Ltd. B Ltd. C Ltd.	23,80,000 23,80,000 23,80,000	71,40,000
2.	Property, Plant and Equipment Land & Building: A Ltd. B Ltd. C Ltd. Plant & Machinery: A Ltd. B Ltd. C Ltd. Computers: A Ltd. B Ltd. C Ltd. Vehicles: A Ltd. B Ltd. C Ltd.	 3,80,000 3,80,000 3,80,000 17,00,000 17,00,000 17,00,000 60,000 60,000 60,000 2,40,000 2,40,000 2,40,000	 11,40,000 51,00,000 1,80,000 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

Particulars	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense	20,000	
	Land & Building	3,00,000	
	Plant & Machinery	40,000	
	Computers	60,000	4,20,000
	Vehicles		
2.		4,00,000	
	Land & Building	(20,000)	3,80,000
	Less: Depreciation		
		20,00,000	
	Plant & Machinery	(3,00,000)	17,00,000
	Less: Depreciation		
		1,00,000	
	Computers	(40,000)	60,000
	Less: Depreciation	3,00,000	
		(60,000)	
	Vehicles		2,40,000
	Less: Depreciation		23,80,000

In the Books of B 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

Particulars	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense	20,000	
	Land & Building	3,00,000	
	Plant & Machinery	40,000	
	Computers	60,000	4,20,000
	Vehicles		
2.		4,00,000	
	Land & Building	(20,000)	3,80,000
	Less: Depreciation		
		20,00,000	
	Plant & Machinery	(3,00,000)	17,00,000
	Less: Depreciation		
		1,00,000	
	Computers	(40,000)	60,000
	Less: Depreciation	3,00,000	
		(60,000)	
	Vehicles		2,40,000
	Less: Depreciation		23,80,000



In the Books of C 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

Particulars	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense	20,000	
	Land & Building	3,00,000	
	Plant & Machinery	40,000	
	Computers	60,000	4,20,000
	Vehicles		
2.		4,00,000	
	Land & Building	(20,000)	3,80,000
	Less: Depreciation		
		20,00,000	
	Plant & Machinery	(3,00,000)	17,00,000
	Less: Depreciation		
		1,00,000	
	Computers	(40,000)	60,000
	Less: Depreciation	3,00,000	
		(60,000)	
	Vehicles		2,40,000
	Less: Depreciation		23,80,000

Illustration 3

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd. agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributed equally. A

Ltd. invested 49% of total capital but has equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	Dr. (₹)	Cr. (₹)
Purchases	9,00,000	
Other Expenses	3,06,000	
Sales		13,05,000
Property, Plant and Equipment	6,00,000	
Current Assets	2,00,000	
Unsecured Loans		1,00,000
Current Liabilities		4,01,000
Capital		

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

Answer

Consolidated Profit & Loss Account

Particulars	Note No.	(₹)
Revenue from operations	1	13,05,000



Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000
Other expenses	3	3,06,000
Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

		Note No.	(₹)
I	Equity and liabilities		
	1. Shareholders' funds:		
	Share Capital	5	4,01,000
	Reserves and Surplus	6	1,99,000
	2. Non-current liabilities		
	Long term borrowings	7	2,00,000
	3. Current Liabilities	8	1,00,000
			<u>9,00,000</u>
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
			<u>9,00,000</u>

Notes to Accounts

	Particulars		(₹)
1.	Revenue from operations		
	Sales:		
	A Ltd.	7,25,000	
	B Ltd.	<u>5,80,000</u>	
2.	Purchases		13,05,000
	A Ltd.	5,00,000	
	B Ltd.	<u>4,00,000</u>	
3.	Other expenses		9,00,000
	A Ltd.	1,70,000	
	B Ltd.	<u>1,36,000</u>	
4.	Closing Inventory		3,06,000
	A Ltd.	50,000	
	B Ltd.	<u>50,000</u>	
5.	Share Capital		1,00,000
	A Ltd.	1,96,490	
	B Ltd.	<u>2,04,510</u>	
6.	Reserves and Surplus		4,01,000
	Profit & Loss Account:		
	A Ltd.	99,500	
	B Ltd.	<u>99,500</u>	
7.	Long Term Borrowings		1,99,000
	Unsecured Loans:		
	A Ltd.	1,00,000	
	B Ltd.	<u>1,00,000</u>	
8.	Current Liabilities		2,00,000
	A Ltd.	50,000	
	B Ltd.	<u>50,000</u>	
9.	Property, Plant and Equipment		1,00,000
	A Ltd.	3,00,000	
	B Ltd.	<u>3,00,000</u>	
10.	Inventories		6,00,000



11.	A Ltd.	50,000	1,00,000
	B Ltd.	<u>50,000</u>	
	Other Current Assets		
	A Ltd.	1,00,000	
	B Ltd.	<u>1,00,000</u>	
			2,00,000

Illustration 4

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	A Ltd.	B Ltd.	C Ltd.
Share Capital	10,00,000	7,50,000	5,00,000
Reserve & Surplus	18,00,000	16,00,000	12,00,000
Loans	3,00,000	4,00,000	2,00,000
Current Liabilities	4,00,000	2,50,000	1,00,000
Property, Plant and Equipment	30,50,000	26,25,000	19,50,000
Investment in JV	2,50,000	2,50,000	-
Current Assets	2,00,000	1,25,000	50,000

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

Answer

Balance Sheet of A Ltd.

		Note No.	(₹)
I	Equity and liabilities		
	1. Shareholders' funds:		
	Share Capital		10,00,000
	Reserves and Surplus	1	24,00,000
	2. Non-current liabilities	2	4,00,000
	3. Current Liabilities	3	4,50,000
	TOTAL		<u>42,50,000</u>
II	Assets		
	Non-current Assets		
	Property, Plant and Equipment:	4	40,25,000
	Equipment:	5	2,25,000
	Current Assets		<u>42,50,000</u>

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	18,00,000	
	C Ltd.	<u>6,00,000</u>	24,00,000
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	3,00,000	
	C Ltd.	<u>1,00,000</u>	4,00,000
3.	Current Liabilities:		
	A Ltd.	4,00,000	
	C Ltd.	<u>50,000</u>	4,50,000
4.	Property, Plant and Equipment:		
	A Ltd.	30,50,000	
	C Ltd.	<u>9,75,000</u>	40,25,000
5.	Current Assets:		
	A Ltd.	2,00,000	
	C Ltd.	<u>25,000</u>	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	Equity and liabilities		
	1. Shareholders' funds:		
	Share Capital		7,50,000



II	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	3,00,000
	TOTAL		<u>37,50,000</u>
	Assets		
	Non-current Assets		
	Property, Plant and	4	36,00,000
	Equipment:	5	1,50,000
	Current Assets		<u>37,50,000</u>

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	16,00,000	
	C Ltd.	<u>6,00,000</u>	22,00,000
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	4,00,000	
	C Ltd.	<u>1,00,000</u>	5,00,000
3.	Current Liabilities:		
	A Ltd.	2,50,000	
	C Ltd.	<u>50,000</u>	3,00,000
4.	Property, Plant and Equipment:		
	A Ltd.	26,25,000	
	C Ltd.	<u>9,75,000</u>	36,00,000
5.	Current Assets:		
	A Ltd.	1,25,000	
	C Ltd.	<u>25,000</u>	1,50,000

Illustration 5

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

Answer

Proportionate consolidation method of accounting is to be followed except in the following cases:

- Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or

- joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investee is treated as investment according to AS 13.

Illustration 6

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

Answer

A venturer should discontinue the use of the proportionate consolidation method from the date that:

- It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.
- The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe longterm restrictions that significantly impair its ability to transfer funds to the venturers.

From the date of discontinuing the use of the proportionate consolidation method,

- 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.
- 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.

Illustration 7

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to reassess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years. Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

Answer

As per para 26 of AS 27 “Financial Reporting of Interests in Joint Ventures”, in a venturer’s separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 ‘Accounting for Investments’.

As per para 17 of AS 13 “Accounting for Investments”, long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee’s assets and results and the expected cash flows from the investment. The type and extent of the investor’s stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1-20X2 i.e., more than a year, it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. ‘losses incurred to the company’ may lead to diminution in the value of the shares while the other indicator that ‘the company has positive expected cash flows from its business plans’ does not lead to decline in the value of shares.

Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

