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(AIR 1,4,2)

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AIR 1,4 & 2 in CA

What Our Students have to say....

Pooja

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...

akhila

Crystal clear Thank you sir for such an amazing classes

Jayashree

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

Daniel Philip

Very nice lectures and great explanation sir thank you lots!

	INDEX	
#	Chapter	Page No
1	Applicability of Accounting Standards	1.1 - 1.2
2	AS-1 Disclosures of Accounting Policies	2.1 - 2.5
3	AS-2 Inventories	3.1 - 3.18
4	AS-10 Property, Plant & Equipment	4.1 - 4.14
5	AS-12 Government Grants	5.1 - 5.14
6	AS-16 Borrowing Costs	6.1 - 6.16
7	AS-26 Intangible Assets	7.1 - 7.10
8	AS-19 Leases	8.1 - 8.11
9	AS-29 Provisions, Contingent Liabilities & Assets	9.1 - 9.10
10	AS-15 Employee Benefits	10.1 - 10.2
11	AS-9 Revenue Recognition	11.1 - 11.10
12	AS-7 Construction Contracts	12.1 - 12.12
13	AS-13 Accounting Investments	13.1 - 13.14
14	AS-11 Foreign Exchange	14.1 - 14.16
15	AS-22 Income Taxes	15.1 - 15.11
16	AS-4 Contingencies & Events after balance sheet date	16.1 - 16.8
17	AS-5 P&L, Prior Period Items & Change in A/c Policy	17.1 - 17.7
18	AS-17 Segment Reporting	18.1 - 18.7
19	AS-18 Related Parties Disclosures	19.1 - 19.3
20	AS-20 Earnings Per Share	20.1 - 20.14
21	AS-24 Discontinuing Operations	21.1 - 21.5
22	AS-23 Accounting for Associates for CFS	22.1 - 22.2
23	AS-25 Interim Financial Reporting	23.1 - 23.2
24	AS-28 Impairment of Assets	24.1 - 24.1
25	Preparation of Financial Statements	25.1 - 25.102
26	Cash flow Statements (AS-3)	26.1 - 26.15
27	Buy Back of Securities	27.1 - 27.31
28	Accounting for Branches	28.1 - 28.38
29	Amalgamation of Companies (AS-14)	29.1 - 29.63
30	Internal Reconstruction	30.1 - 30.34
31	Consolidation (AS-21)	31.1 - 31.55

APPLICABILITY OF ACCOUNTING STANDARDS

ILLUSTRATIONS

#1.Illustration | May 2025, 4 Marks |

What are Accounting Standards? Explain the objectives of "Accounting Standards" in brief, also state the advantages of setting Accounting Standards.

Answer:

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

Following are the objectives of Accounting Standards:

- a) Accounting Standards harmonize the diverse accounting policies and practices followed by different companies in India.
- b) Accounting Standards facilitates the preparation of financial statements and make them comparable.
- c) Accounting Standards give a sense of faith and reliability to the users.

The main advantage of setting accounting standards are as follows:

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

#2.Illustration | Sep 2025, RTP |

As per the revised scheme effective from accounting periods commencing on or after April 1, 2024, classify non-company entities for the purpose of applicability of Accounting Standards. Briefly explain the criteria for each category.

Answer:

The revised scheme for applicability of Accounting Standards to Non- company entities shall come into effect in respect of accounting periods commencing on or after April 1, 2024, which is as under:

1. For the purpose of applicability of Accounting Standards, Non- company entities are classified into two categories, viz., Micro, Small and Medium Sized Entities (MSMEs) and Large entities.
2. Micro, Small and Medium Sized Entity (MSME) means, a non- company entity:
 - I. whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
 - II. which is not a bank, financial institution or an insurance company;
 - III. whose turnover (excluding other income) does not exceed two hundred and fifty crore rupees in the immediately preceding accounting year;
 - IV. which does not have borrowings in excess of fifty crore rupees at any time during the immediately preceding accounting year; and
 - V. which is not a holding or subsidiary of an entity which is not a micro, small and medium-sized entity.

Explanation.- For the purposes of this clause, a non-company entity shall qualify as a Micro, Small and Medium Sized entity, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

Large entity is a non-company entity that is not an MSME.

The terms 'Small and Medium Enterprise' and 'SME' used in Accounting Standards shall be read as 'Micro, Small and Medium size entity' and 'MSME', respectively. Further, the terms Level II, Level III and Level IV

entities used in Accounting Standards shall be read as 'Micro, Small and Medium Sized Entity' and Level I entity shall be read as a 'Large' entity.

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AS – 1 Disclosure of Accounting Policies

ILLUSTRATIONS

#1.Illustration | Nov 2023, 5 Marks |

Discuss Disclosure requirements in following cases as per AS 1.

- (i) Accountant of A Ltd. charges a probable loss of losing a suit in books of accounts and also disclosed the same fact in financial statements. The probability of losing the suit is 25%.
- (ii) Accountant of A Ltd. capitalized all the revenue expenses of repair and maintenance during the year to Plant & Machinery and is also disclosing the same as company policy in financial statements.
- (iii) A Ltd. has followed accrual basis of accounting since incorporation. The chief accountant also disclosed this fact in financial statements.
- (iv) A Ltd. was providing for after sales expenses @ 2% of sales for covering expenses during the warranty period. Now A Ltd. observes that actual after sales expenses were much less as compared to provision because of better technology used in manufacturing of the products. Now, the Board of A Ltd. decides to account for these expenses as and when they occur. Sales during the period are Rs. 50 crores.

Answer:

- (i) In this case, accountant of company created a provision for damages of probability of losing a suit by a charge against profits. Unless the probability of losing the suit is more than probability of not losing it, there should not be any creation of provision for such probable losses. So there is no need to charge such loss against profit and disclosing the same in financial statements.
- (ii) Repairs and maintenance are revenue expenditure and should not be added to the value of assets, as these expenses do not increase the capacity of asset. Hence such expenses should be charged to profit & loss statement.
Further the chief accountant also disclosed its policy of adding repairs to value of assets by way of notes to accounts. As per AS 1 disclosure is not a method to correct the wrong treatments. So the contention of chief accountant is wrong.
- (iii) Accrual is one of the Fundamental accounting assumptions. If fundamental accounting assumptions are followed properly then no specific disclosure is required. Disclosure is required only when there is deviation and the company is not following fundamental accounting assumptions. So the company need not disclose this in financial statements.
- (iv) As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Accordingly, the notes on accounts should properly disclose the change and its effect.

Note: So far, the company has been providing 2% of sales for meeting after sales expenses during the warranty period. Now the company has improved the quality of its products with better technology and has been observing that actual expenses are very less than the provision, Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by Rs.1 crore than would have been the case if the old policy were to continue.

#2.Illustration | Nov 2018, 5 Marks |

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months up to 31.03.2017. The company now wants to make provision based on technical evaluation during the year ending 31.03.2018.

Total value of stock Rs.120 lakhs

Provision required based on technical evaluation Rs.3.00 lakhs.

Provision required based on 12 months no issues Rs.4.00 lakhs.

You are requested to discuss the following points in the light of Accounting Standard AS1:

- i. Does this amount lead to change in accounting policy?
- ii. Can the company change the method of accounting?

Answer

Accounting policies are the **specific principles, bases, conventions, rules and practices** applied by an entity in **preparing and presenting financial statements**. When an IFRS Standard or IFRS Interpretation specifically applies to a transaction, other event or condition, an entity must apply that Standard.

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

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from Rs.4 lakhs to Rs.3 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2017 -18 in the following manner:

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

#3. Illustration | Dec 2021, 5 Marks |

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

Total value of stock Rs. 133.75 lakhs

Provision required based on technical evaluation Rs.4.00 lakhs

Provision required based on 12 months not issued Rs.5.00 lakhs.

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

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

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

Answer

Accounting policies are the **specific principles, bases, conventions, rules and practices** applied by an entity in **preparing and presenting financial statements**. When an IFRS Standard or IFRS Interpretation specifically applies to a transaction, other event or condition, an entity must apply that Standard.

i.

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

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

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

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

The company may disclose the change in accounting policy in the following manner:

"The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2020-21, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs.9000"

#4.Illustration | Sep 2025, RTP |

Lion Ltd., engaged in manufacturing and construction contracts, prepares its financial statements for the year ended 31st March 2025. The company follows historical cost for fixed assets, FIFO for inventory valuation, and percentage of completion method for revenue recognition in construction contracts. During the year, the management changes:

- The inventory valuation method from FIFO to Weighted Average due to volatility in raw material prices.
- The depreciation method from Straight Line Method (SLM) to Written Down Value (WDV) citing better reflection of asset usage.

The company discloses the change in inventory method in notes, but does not disclose the change in depreciation method, stating that it is not material.

Additionally, the company has not disclosed its accounting policy on recognition of government grants, though it has received a significant subsidy this year.

You are required to:

- Identify and explain violations (if any) of AS 1 in the above case.
- Critically evaluate whether "materiality" can be used as a justification for non-disclosure of a change in accounting policy.
- Justify, would the change from FIFO to Weighted Average be treated as a change in accounting estimate or accounting policy under AS 1?

Answer:

As per AS 1 "Disclosure of Accounting Policies", the following requirements are relevant:

- All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
- Any change in an accounting policy which has a material effect should be disclosed along with the nature and reasons for such change.
- If the effect of such change is not ascertainable wholly or in part, the fact should be indicated.

Application to Lion Ltd.:

1. Change in Inventory Valuation Method (FIFO to Weighted Average): This is a change in accounting policy. The company has disclosed the change in the notes to accounts along with justification, which is in line with the disclosure requirements of AS 1, provided the impact of the change is also disclosed or indicated as unascertainable if applicable.
2. Change in Depreciation Method (SLM to WDV): As per AS 10 (Revised), a change in the method of depreciation is considered a change in accounting estimate. However, AS 1 also requires disclosure of material items affecting financial statements. Depreciation affects key financial figures such as profit, asset value, and return ratios. Even if the change is classified as an estimate, if it has a material effect, disclosure is warranted. The company's decision not to disclose the change on the grounds of immateriality may not be appropriate unless supported by clear quantitative evidence.
3. Non-Disclosure of Accounting Policy for Government Grants: Lion Ltd. has received a significant subsidy during the year but has not disclosed its accounting policy for government grants. As per AS 1, all significant accounting policies, including those for government grants, should be disclosed. Hence, non-disclosure amounts to a violation of AS 1.
 - (a) Evaluation of "Materiality" as Justification for Non-Disclosure
AS 1 emphasizes that accounting policies that are significant and changes that materially affect the financial statements should be disclosed.
 - Materiality is assessed in terms of the potential of an item or change to influence economic decisions of users.
 - Change in the method of depreciation affects not only profit and loss but also asset values and tax liabilities. Thus, even if the quantitative impact appears small, its qualitative impact (e.g., on comparability and trend analysis) may be significant.
 - Therefore, the company's reliance on "materiality" as a justification for non-disclosure is not valid unless there is concrete evidence showing the impact is indeed immaterial both quantitatively and qualitatively.
 - (c) Nature of Change from FIFO to Weighted Average

The change from FIFO to Weighted Average should be treated as a change in accounting policy and not a change in accounting estimate under AS 1, and its nature and financial impact should be properly disclosed in the financial statements.

#5.Illustration | May 2025, RTP |

What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'.

Answer:

The term “Accrual” has been explained in the AS 1 on Disclosure of Accounting Policies, as “Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate”

Reasons for Accrual Basis of Accounting

1. Accrual basis of accounting, attempts to record the financial effects of the transactions, events, and circumstances of an enterprises in the period in which they occur rather than recording them in the period(s) in which cash is received or paid by the enterprise.
2. Receipts and payments of the period will not coincide with the buying producing or selling events and other economic events that affect entity performance.
3. The goal of Accrual basis of accounting is to follow the matching concept of income and expenditure so that reported net income measures an enterprise’s performance during a period instead of merely listing its cash receipts and payments.
4. Accrual basis of accounting recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in the future.
5. Important point of difference between accrual and accounting based on cash receipts and outlay is in timing of recognition of revenues, expenses, gains and losses.

#6.Illustration | Jan 2025, RTP |

ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2023.

The company wants to provide during the year ending 31.3.2024 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?

Answer:

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made. In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from Rs. 3.5 lakhs to Rs. 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2023-24:

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

AS – 2 Valuation of Inventories

ILLUSTRATIONS

#1.Illustration | Sep 2024, 4 marks |

"In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred."

Provide examples of such costs as per AS 2 (Revised) 'Valuation of Inventories.

Answer:

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- Abnormal amounts** of wasted materials, labour, or other production costs;
- Storage costs**, unless the production process requires such storage.
- Administrative overheads** that do not contribute to bringing the inventories to their present location and condition.
- Selling and distribution costs.**

#2.Illustration | May 2024, 7 marks |

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

Purchase of Raw Material for manufacturing process of

30,000 units	Rs. 3,50,000
Wages paid	Rs. 1,60,000
Fixed overheads	Rs. 1,20,000
Variable overheads	Rs. 60,000
Output:	
Polyester (P)	12,500 Units
Nylon (N)	10,000 Units
Fiber (F)	3,200 Units
Closing Inventory:	
Polyester (P)	1,600 Units
Nylon(N)	400 Units

Average market price of Polyester and Nylon is Rs. 100 and Rs. 60 per unit respectively, by-product Fiber is sold @Rs. 40 per unit. There is a profit of

Rs. 8,000 on sale of by-product after incurring separate processing expenses of

Rs. 10,000 and packing charges of Rs. 9,000. Rs. 5,000 was realized from sale of scrap.

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

Answer:

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

Determination of value of closing inventory of Polyester and Nylon

	Polyester	Nylon
Closing inventory in units	1,600 units	400 units
Cost per unit	Rs. 31.14	Rs. 18.68
Value of closing inventory	Rs. 49,824	Rs. 7,472

Working Notes

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

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

2. Calculation of cost of conversion for allocation between joint products Polyester and Nylon

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

Determination of "basis for allocation" and allocation of joint cost to Polyester and Nylon

	Polyester	Nylon
Output in units (a)	12,500 units	10,000 units
Sales price per unit (b)	Rs. 100	Rs. 60
Sales value (a x b)	Rs. 12,50,000	Rs. 6,00,000
Total value (12,50,000 + 6,00,000) = 18,50,000		
Joint cost of Rs. 5,76,000 allocated in the ratio of 12,50,000 : 6,00,000	Rs. 3,89,189	Rs. 1,86,811
Cost per unit [c/a]	Rs. 31.14	Rs. 18.68

#3.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.

Answer:

Cost of closing inventory is shown below:

(i)

	Rs.
Sale value of opening stock and purchases (Rs. 20,000 + Rs. 1,47,000) x 1.10	1,83,700
Sales	(1,54,000)
Sale value of unsold stock	29,700
Less: Gross Margin (Rs. 29,700 / 1.10) x 0.10	(2,700)
Cost of closing inventory	27,000

(ii)

Closing stock at cost (250 X Rs. 300) (i)	75,000
Net Realizable value of closing stock (Rs. 280* x 250) (ii)	70,000
Value of closing stock [lower of (i) and (ii)]	70,000

#4. Illustration | May 2019, 5 marks |

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

You are required to:

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

Answer

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

Calculation of Abnormal Loss:

- Material used 16,000 MT @ Rs. 190 = Rs. 30,40,000

Normal Loss (5% of 16,000 MT) 800 MT (included in calculation of cost of inventories)

Net quantity of material = 15,200 MT

Abnormal Loss in quantity (950 - 800) = 150 MT

Abnormal Loss Rs.30,000

[150 units @ Rs.200 (30,40,000/15,200)]

ii. Amount of Rs.30,000 (Abnormal loss) will be charged to the Profit and Loss statement.

The **normal loss** will be included in **determining the cost of inventories (finished goods) at the year end.**

#5.Illustration | Nov 2019, 5 marks |

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

- i. 800 units of raw material A (purchased @ Rs.140 per unit). Replacement cost of raw material "A" as on 31st March, 2019 is Rs.190 per unit.
- ii. 650 units of partly finished goods in the process of producing X and cost incurred till date Rs.310 per unit. These units can be finished next year by incurring additional cost of Rs.50 per unit.
- iii. 1,800 units of finished product X and total cost incurred Rs.360 per unit. Expected selling price of product X is Rs.350 per unit.

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

Answer

Inventory is the accounting of items, component parts and raw materials that a company either uses in production or sells

As per **AS 2 (Revised) "Valuation of Inventories"**, **materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost.**

However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, **the replacement cost of the materials may be the best available measure of their net realizable value.**

In the given case, selling price of product X is Rs.350 and total cost per unit for production is Rs.360.

Hence the valuation will be done as under:

- i. 800 units of raw material will be valued at cost Rs.140.per unit
- ii. 650 units of partly finished goods will be valued at Rs.300 per unit i.e. lower of cost (310) or Net realizable value (300) (Estimated selling price 350 per unit less additional cost of 50).
- iii. 1,800 units of finished product X will be valued at NRV of Rs.350 per unit since it is lower than cost Rs.360 of product X.

#3. Illustration | Jan 2021, 5 Marks |

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

- i. 900 units of Raw Material X (purchases @ Rs.100 per unit). Replacement cost of Raw Material X as on 31.03.2019 is Rs.80 per unit

- ii. 400 units of partly finished goods in the process of producing P. Cost incurred till date is Rs.245 per unit. These units can be finished next year by incurring additional cost of Rs.50 per unit.
- iii. 800 units of finished goods P and total cost incurred is Rs.295 per unit.

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

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

Answer

Inventory is the accounting of items, component parts and raw materials that a company either uses in production or sells

As per **AS 2 (Revised) "Valuation of Inventories"**, materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost.

However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, **the replacement cost of the materials may be the best available measure of their net realizable value.**

In the given case, selling price of product P is Rs.266 (280-5%) and total cost per unit for production is Rs.295.

Hence the valuation will be done as under:

- i. 900 units of raw material X will be written down to replacement cost as market value of finished product is less than its cost, hence valued at Rs.80 per unit.
- ii. 400 units of partly finished goods will be valued at 216 per unit i.e., lower of cost (245) or Net realizable value (216) (Estimated selling price Rs.266 per unit less additional cost of Rs.50).
- iii. 800 units of finished product P will be valued at NRV of Rs.266 per unit since it is lower than cost Rs.295.

#4. Illustration | July 2021, 5 Marks |

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

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

The plant has a capacity to produce 30,000 Units of finished product per annum. However, the actual production of finished products during the year 2020-21 was 20,400 Units. Due to a fall in the market

demand, the price of the finished goods in which the raw material has been utilized is expected to be sold @ Rs.40 per unit. The replacement cost of the raw material was Rs.19 per kilogram. You are required to ascertain the value of closing inventory as at 31st March, 2021 as per AS 2.

Answer

Statement Showing the Computation of Value of Closing Inventory Value of Closing Finished Goods

Particulars	Amount (Rs.)
Cost of Raw Material consumed (20,400 units X Rs.20 per kg)	4,08,000
Direct Labour	3,06,000
Fixed Overheads (3,00,000/30,000 x 20,400)	2,04,000
Cost of Production	9,18,000
Cost of Closing Inventory of Finished Goods per unit (Rs. 9,18,000/20,400)	45
Net Realizable Value (NRV) per unit	40

Since net realizable value is less than cost, closing inventory of Finished Goods will be valued at Rs.40 per unit

Value of Closing Raw Materials

As NRV of finished goods is less than its cost, the relevant raw material will be valued at its replacement cost, which is the best available measure of its NRV i.e. @ Rs. 19 per kg.

Therefore, value of closing inventory would be as under:

Finished Goods 2,400 units @ Rs.40/- per unit	Rs. 96,000
Raw Materials 1,800 kg @ Rs.19/- per kg	Rs. 34,200
Total	<u>Rs.1,30,200</u>

Working Note:

Calculation of raw material consumed during the year

Particulars	Unit (Kg)
Opening Inventory	2,200
Purchases	20,000
Less: Closing Inventory	(1,800)
Raw Material Consumed	20,400

#5.Illustration | May 2019, 1 Mark |

State Whether TRUE or FALSE with reason.

"As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price."

Answer

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

AS 2 : Valuation of Inventories

RTP

#1.Illustration | Sep 2025 |

The following information is available for Zing Ltd. for the year 2024-25:

Raw Material:

Closing Stock	700 units	
Cost price	Rs. 35 per unit	
Replacement cost	Rs. 20 per unit	
Finished product:	FP 1	FP 2
Production (units)	3,000	1,600
Closing stock (units)	500	300
Material consumed		Rs. 3,20,000
Direct labour		Rs. 1,60,000
Direct expenses		Rs. 78,000

Fixed overhead for the year was Rs. 95,000, which includes godown rent of Rs. 15,000. Godown is used for storing finished products.

Besides 2 main products, 1000 units of a by-product (BY) also emerged in the production process which was sold @ Rs. 12 per unit after incurring an expense of Rs. 2,500. Rs. 4,800 was realized from sale of scrap. The average market price of FP1 is Rs. 160 per unit and FP2 is Rs. 100 per unit.

Calculate the value of closing stock of Zing Ltd. as per AS 2.

Answer:

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

(i) Calculation of net realizable value of by-product, BY

		Rs.
Selling price of by-product BY	(1,000 units x Rs. 12 per unit)	12,000
Less: Separate processing charges of by-product BY		(2,500)
Net realizable value of by-product BY		<u>9,500</u>

(ii) Calculation of cost of conversion for allocation between joint products FP1 and FP2

	Rs.	Rs.
Raw material consumed		3,20,000
Direct labour		1,60,000
Direct expenses		78,000
Fixed overhead (95,000 – 15,000)		<u>80,000</u>
		6,38,000
Less: NRV of by-product BY (See calculation 1)	(9,500)	
Sale value of scrap	<u>(4,800)</u>	<u>(14,300)</u>
Joint cost to be allocated between FP 1 and FP 2		<u>6,23,700</u>

(iii) Determination of "basis for allocation" and allocation of joint cost to FP 1 and FP 2

	FP 1	FP 2
Output in units (a)	3,000	1,600
Sales price per unit (b)	Rs. 160	Rs. 100
Sales value (a x b)	Rs. 4,80,000	Rs. 1,60,000
Ratio of allocation	3	1
Joint cost of Rs. 6,23,700 allocated in the ratio of 3:1 (c)	<u>Rs. 4,67,775</u>	<u>Rs. 1,55,925</u>
Cost per unit [c/a]	Rs.155.93	Rs.97.45

(iv) Determination of value of closing inventory of Finished Products FP1 and FP2

	FP 1	FP 2
Closing inventory in units	500	300
Cost per unit	Rs. 155.93	Rs. 97.45
Value of closing inventory (finished goods)	Rs. 77,965	Rs. 29,235

Determination of value of closing stock of raw material

	FP 1Rs.	FP 2Rs.
Cost price	155.93	97.45
Sales price	160	100

Since both finished goods FP 1 and FP 2 are sold above cost, raw material will be valued at cost i.e. Rs. 35 per unit (ie) Rs. 24,500 (700 units x Rs. 35)

(i) Total value of closing inventory

(a) Finished products:

FP 1 Rs. 77,965
 FP 2 Rs. 29,235
 Rs. 1,07,200

(b) Raw material Rs. 24,500
 Rs. 1,31,700

#2.Illustration | May 2025 |

From the following information provided by LMN Ltd. for the year 2024, you are required to compute the closing inventory:

Raw Material A

Closing balance: 700 units

	Rs. per unit
Cost price including GST	280
ITC available	25
Freight inward	35
Handling charges	20
Replacement cost	200

Finished Goods B

Closing balance: 1,800 units

	Rs. per unit
Material consumed	280
Direct labour	80

Total fixed overhead for the year was Rs. 3,60,000 on a normal capacity of 36,000 units, while actual production has been 30,000 units.

Calculate the value of closing stock when:

- (i) Net Realisable Value of Finished Goods B is 500 per unit
- (ii) Net Realisable Value of Finished Goods B is 380 per unit

Answer:

When Net Realisable Value of Finished Goods B is Rs.500 per unit

Value of Closing Stock:

Valuation Base	Method	Qty.	Rate (Rs.)	Amount (Rs.)
Raw Material A	Cost	700	310	2,17,000
Finished Goods B	Cost	1,800	410	<u>7,38,000</u>
Total Value of Closing Stock				9,55,000

When Net Realisable Value of Finished Goods B is Rs. 380 per unit

Since NRV of finished goods B is less than its cost (Rs. 410, as per W.N.), raw material A is to be valued at replacement cost, and finished goods B is to be valued at NRV.

Value of Closing Stock:

Valuation Base	Basis	Qty.	Rate (Rs.)	Amount (Rs.)
Raw Material A	Replacement Cost	700	200	1,40,000
Finished Goods B	Net Realisable Value	1,800	<u>380</u>	<u>6,84,000</u>
Total Value of Closing Stock				8,24,000

Working Note:

Statement Showing Calculation of Cost of Raw Material A and Finished Goods B

Raw Material A

	Amount (Rs.)
Cost Price (280 - 25)	255
Add: Freight Inward	35
Add: Handling Charges	<u>20</u>
Total Cost	<u>310</u>

Finished Goods B

	Amount (Rs.)
Materials Consumed	280
Direct Labour	80
Variable Overheads	40
Fixed Overheads (Rs.3,60,000 / 36,000 units)	<u>10</u>
Total Cost	<u>410</u>

#3.Illustration | May 2018 |

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

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

Answer

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

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

#4.Illustration | Nov 2018 |

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

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

Additional Information:

- (i) Total fixed overhead for the year was 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 Rs. 2,400 units.

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

- (i) Net realizable value of Chemical Y is Rs. 800 per unit
- (ii) Net realizable value of Chemical Y is Rs. 600 per unit

Answer

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

NRV is greater than the cost of Finished Goods Y i.e. Rs. 660 (Refer W.N.) Hence, Raw Material and Finished Goods are to be valued at cost.

Value of Closing Stock:

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

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

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

Value of Closing Stock:

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

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	Rs.
Cost Price	380
Add: Freight Inward Unloading charges	40
Cost	<u>20</u>
	440
Chemical Y	Rs.
Materials consumed	440
Direct Labour	120

Variable overheads	80
Fixed overheads (Rs.4,00,000/20,000 units)	20
Cost	660

#5.Illustration | May 2019 |

On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is Rs. 530. The unit can be finished in 2017-18 by an additional expenditure on 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, 2017 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi finished form and its NRV is zero without processing it further.

Answer

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

#6.Illustration | Nov 2019 |

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

Answer

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

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

#7.Illustration | May 2020 |

Particulars		Kg.	Rs.
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

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

Answer

Calculation of cost for closing inventory

Particulars	Rs.
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead 75,000 x 10,200 15,000	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	Rs. 22.50
Net Realisable Value per unit	Rs. 20.00

Since net realisable value is less than cost, closing inventory will be valued at Rs. 20. As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. Rs. 9.50.

Therefore, **value of closing inventory:**

Finished Goods (1,200 x 20) Rs. 24,000

Raw Materials (900 x 9.50) Rs. 8,550

Rs. 32,550

#8.Illustration | Nov 2020 |

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

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

Additional Information:

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

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

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

Answer

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

Value of Closing Stock:

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

Working Note:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	Rs.
Cost Price	400
Add: Freight Inward	40
Cost	440
Chemical Y	Rs.
Materials consumed	440

Direct Labour	120
Variable overheads	80
Fixed overheads (Rs.4,00,000/25,000 units)	16
Cost	656

#9.Illustration | May 2021 |

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

Details of cost for these products are:

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

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

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

Answer

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

Product – A

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

Product – B

Material cost	Rs. 45 x 800 = 36,000	
Wages cost	Rs. 35 x 800 = <u>28,000</u>	
Total cost		Rs. 64,000
Realizable value (800 x 70)		Rs. 56,000

Hence inventory value of Product-B	Rs. 56,000
Total Value of closing inventory i.e. Product A + Product B (18,000+ 56,000)	Rs. 74,000

#10. Illustration | Nov 2021 |

- a) "In determining the cost of inventories, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred". Provide examples of such costs as per AS 2 'Valuation of Inventories'.
- b) On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2021 on weighted Average Basis.

Details of Purchases:

Date of purchase	Unit (Nos.)	Purchase cost per unit (Rs.)
01-03-2021	20	108
08-03-2021	15	107
17-03-2021	30	109
25-03-2021	15	107

Details of issue of Inventory:

Date of Issue	Unit (Nos.)
03-03-2021	10
12-03-2021	20
18-03-2021	10
24-03-2021	20

Net realizable value of inventory as on 31st March, 2021 is Rs. 107.75 per unit. You are required to compute the value of Inventory as per AS 2?

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

Answer

- a) As per **AS 2 "Valuation of Inventories"**, certain costs are excluded from the cost of the inventories and are recognised as expenses in the period in which incurred. Examples of such costs are: (a) **abnormal amount of wasted materials, labour, or other production costs**; (b) **storage costs, unless those costs are necessary in the production process prior to a further production stage**; (c) **administrative overheads that do not contribute to bringing the inventories to their present location and condition**; and (d) **selling and distribution costs**.

- b) Net Realisable Value of Inventory as on 31st March, 2021

$$= \text{Rs. } 107.75 \times 20 \text{ units} = \text{Rs. } 2,155$$

Value of inventory as per Weighted Average basis Total units purchased and total cost:

01.03.2021 Rs. 108 x 20 units = Rs. 2160

08.3.2021 Rs. 107 x 15 units = Rs. 1605

17.03.2021 Rs. 109 x 30 units = Rs. 3270

25.03.2021 Rs. 107 x 15 units = Rs. 1605

Total 80 units = Rs. 8640

Weighted Average Cost = Rs. 8640/80 units =

Rs.108 Total cost = Rs. 108 x 20 units = Rs. 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2021 is, Cost or Net Realisable value whichever is lower i.e. Rs. 2,155.

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

#11. Illustration | May 2022 |

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

- (a) 100 coats, which had cost Rs. 2,200 each and normally sold for Rs. 4,000 each. Owing to a defect in manufacture their NRV was determined at 50% of their normal selling price.
- (b) Shirts which had cost Rs. 50,000, their net realizable value at Balance sheet date was Rs. 55,000. Commission @ 10% on sales is payable to agents.

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

Answer

Valuation of closing stock

	Rs.
Closing stock at cost	4,50,000
Less: Adjustment for 100 coats (Working Note 1)	<u>(20,000)</u>
Value of inventory	<u>4,30,000</u>

Working Notes:

1. Adjustment for Coats Rs.

Cost included in Closing Stock 2,20,000

NRV of Coats 2,00,000

Adjustment to be made as NRV is less than Cost 20,000

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

1FIN by IndigoLearn

AS – 10 Plant, Property & Equipment ILLUSTRATIONS

#1.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.

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

Answer:

- (i)
 - (i) 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.
 - (ii) These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
 - (iii) The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised)
 - (iv) Therefore, these costs cannot be capitalized.
- (ii) Computation of cost of land.

Particulars		Rs.	Rs.
Purchase Price	250 hectares x Rs. 25,000 per hectares		62,50,000
Stamp Duty and Registration Charges	5% of Rs. 62,50,000		3,12,500
Legal and Consultancy Fees			4,75,000
Demolition Expenses (Net Salvage of Income)	Rs. 12,60,000 x (100/105)	37,85,000 (12,00,000)	<u>25,85,000</u>
Cost of Land			96,22,500

#2.Illustration | May 2025, 4 Marks |

A machine was acquired by Zest Ltd. on 01/04/2019 for Rs. 60 lakhs. It had a useful life of 6 years. The machine is depreciated on straight line basis and does not carry any residual value. On 01/04/2022, the carrying value of the machine was reassessed at Rs. 36 lakhs.

The surplus arising out of the revaluation being credited to revaluation reserve.

For the year ended March 2024, conditions indicating an impairment of the existed machine and the amount recoverable ascertained to be Rs. 9 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 Zest Ltd. The company had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Answer:

(a) Statement Showing Impairment Loss

(Rs. in lakhs)	
Carrying amount of the machine as on 1 st April, 2019	60
Depreciation for 3 years i.e. 2019-2020 to 2021-2022 [$\frac{60 \text{ Lakh}}{6 \text{ years}} \times 3 \text{ years}$]	(30)
Carrying amount as on 31.03.2022	30
Add: Upward Revaluation (credited to Revaluation Reserve account)	<u>6</u>
Carrying amount of the machine as on 1 st April, 2022 (revalued)	36
Less: Depreciation for 2 years i.e. 2022-2023 & 2023-2024 [$\frac{36 \text{ Lakh}}{3 \text{ years}} \times 2 \text{ years}$]	<u>(24)</u>
Carrying amount as on 31.03.2024	12
Less: Recoverable amount	<u>(9)</u>
Impairment loss	<u>3</u>
Less: Balance in revaluation reserve as on 31.03.2024: 6	
Less: Enhanced depreciation met from revaluation reserve 2022-2023 & 2023-2024 = $[(12 - 10) \times 2 \text{ years}]$	<u>(4)</u>
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	<u>(2)</u>
Impairment Loss to be debited to profit and loss account	<u>1</u>

#3.Illustration | Nov 2018, 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".

Answer

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

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

#4.Illustration | Nov 2020, 5 Marks |

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

- (i) Machinery purchased for Rs.10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is Rs.10 lakhs.
- (ii) Land for Rs.50 lakhs.
- (iii) A Machinery is constructed for Rs.5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.
- (iv) Machinery purchased on 1st April, 2017 for Rs.50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only.

Answer

	Particulars	Amt Rs.
(i)	Machinery purchased on 1/4/15 for Rs.10 lakhs (having residual value of Rs.10 lakhs) Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) Reason: Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (5,00,000/10) Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.	50,000
(iv)	Machinery having revised useful life Reason	15,000

WDV as on 1 st April 2019	30,000 [50,000 – 50,000/5 x 2]
Remaining useful life	2 years
Depreciation for 2019-20	30,000/2 = 15,000

#5.Illustration | July 2021, 5 Marks |

A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs.2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of Rs.35,000 per month. The machinery was purchased for Rs.1,27,50,000 and a sum of Rs. Rs.2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fees of Rs.37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited.

Answer

Statement Showing the Computation of the amount at which the Machinery should be capitalized in the books of A Limited

Particulars		Amount (Rs.)
Purchase cost of machinery	Given	1,27,50,000
Add: Site Preparation Cost	Given	2,10,000
Architect's Salary	Specific / Attributable overheads for 4 months (Rs. 35,000 x 4)	1,40,000
Initial Delivery Cost	Transportation	2,12,500
Professional Fees for Installation	Engineer's Fees	37,500
Total Cost of Machinery to be capitalized		1,33,50,000

AS 10: Property, Plant and Equipment RTP ILLUSTRATIONS

#1.Illustration | Sep 2025 |

Precision Tools Ltd. provides the following details related to its fixed assets for the year ended 31st March 2025:

The company purchased a machine for Rs. 12,00,000 on 1st October 2024. The following expenses were also incurred:

Freight and insurance: Rs. 60,000 Erection charges: Rs. 40,000

Testing Cost: Raw materials used Rs. 25,000, Wages Rs.10,000, Sale of finished goods from testing production Rs. 8,000.

On 1st December 2024, it replaced the motor of an old machine with a new one costing Rs.1,20,000, improving the output capacity by 15%. The old motor had a Cost of Rs.50,000 and Accumulated Depreciation of Rs. 35,000.

On 15th March 2025, the company shifted a machine from one factory to another. It incurred the following:

Dismantling cost: Rs.12,000 Transport and installation: Rs.18,000

Loss due to damage in transit: Rs.6,000

You are required to calculate the amount to be capitalized for each of the above cases as per AS 10.

Answer:

As per AS 10, Property, Plant and Equipment, the cost of an item of PPE includes:

- (a) Purchase price including import duties and non-refundable taxes,
- (b) Directly attributable costs to bring the asset to working condition (e.g., transport, installation, trial run),
- (c) Any trial run net costs (i.e., cost – recoverable proceeds).

Particulars	Amount (Rs.)
Purchase Price	12,00,000
Freight & Insurance	60,000
Erection Charges	40,000
Net Cost of Testing (25,000 + 10,000 – 8,000)	27,000
Cost of Machinery	13,27,000

Recognition of Motors Replacement

Particulars	Rs.
Cost of Motors	50,000
Less: Depreciation	35,000
Carrying Amount of Motors	15,000

Accounting: The company should derecognize the existing Carrying Amount of Motors replaced of Rs. 15,000. Further, the acquisition cost of new motors of Rs. 1,20,000 would be capitalized as a separate component.

Costs of relocating or reorganising part or all of the operations of an enterprise are not included in the carrying amount of an item of PPE. Hence Costs of relocation of Rs. 36,000 (12,000 +18,000 +6,000) of PPE are not capitalized. Thus, entire expense to be charged off to Profit and Loss A/c.

Thus, total capitalization (net off derecognition) = 14,32,000 (13,27,2000 +1,20,000-15,000).

#2.Illustration | May 2025 |

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.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

Answer:

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		Rs.
Purchase Price	Given (Rs. 158,34,000 x 100/ 112)	1,41,37,500
Add: Site Preparation Cost	Given	1,41,870
Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x 3)	1,35,000
Initial Delivery Cost	Transportation	55,770
Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset		1,45,00,140

#3.Illustration | Jan 2025 |

MS Ltd. has acquired a heavy machinery at a cost of Rs. 1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is Rs. 45,00,000. The discount rate assumed is 5%.

Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used?

Answer:

The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset. The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement Rs. 45,00,000 can be used as an indication (usually by discounting) of the likely cost, six years previously.

Statement showing cost of new turbine and machine after 6th year

			Rs.
Cost of machines recognized on purchase			1,00,00,000
Less: Depreciation charged for 6 years	$[(1,00,00,000 / 10) \times 6]$		(60,00,000)
			40,00,000
Less: Current cost of turbine to be derecognized:			
Cost of Turbine before 6 years	$[45,00,000 \times \{1 / (1.05)^6\}]$	33,57,900	
Less: Depreciation for 6 years	$[(33,57,900 / 10) \times 6]$	(20,14,740)	(13,43,160)
Add: Cost of new turbine to be recognised			45,00,000
Revised carrying amount of machine			71,56,840

#4.Illustration | May 2018 |

In the year 2016-17, an entity has 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	Rs. 20,00,000
Roof	25	Rs. 10,00,000
Lifts	20	Rs. 5,00,000
Fixtures	10	Rs. 5,00,000
Remainder of building	50	Rs. 50,00,000
		<u>Rs. 90,00,000</u>

You are required to **calculate depreciation** for the year 2016-17 as per componentization method.

Answer

Statement showing amount of depreciation as per Componentization Method

Component	Depreciation (Per annum) (Rs.)
Land	Nil
Roof	40,000
Lifts	25,000
Fixtures	50,000
Remainder of Building	<u>1,00,000</u>
	<u>2,15,000</u>

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognized as a new component.

#5.Illustration | Nov 2018 |

ABC Ltd. is installing a new plant at its production facility. It provides you the following information:

	Rs.
Cost of the plant (cost as per supplier's invoice)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial Operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000

Consultants used for advice on the acquisition of the plant	6,50,000

You are required to compute the costs that can be capitalised for plant by ABC Ltd., in accordance with AS 10: Property, Plant and Equipment.

Answer

According to AS 10 on Property, Plant and Equipment, the costs which will be capitalized by ABC Ltd.:

	Rs.
Cost of the plant	31,25,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants' fees	6,50,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Total cost of Plant	46,60,000

Note: Operating losses before commercial production amounting to Rs. 3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

#6.Illustration | May 2019 |

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

1.	Cost of the plant (cost per supplier's invoice plus taxes)	Rs. 50,00,000
2.	Initial delivery and handling costs	Rs. 4,00,000
3.	Cost of site preparation	Rs. 12,00,000
4.	Consultants used for advice on the acquisition of the plant	Rs. 14,00,000
5.	Interest charges paid to supplier of plant for deferred credit	Rs. 4,00,000
6.	Estimated dismantling costs to be incurred after 7 years	Rs. 6,00,000
7.	Operating losses before commercial production	Rs. 8,00,000

Please advise Preet Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

Answer

According to AS 10 (Revised), these costs can be capitalised:

1.	Cost of the plant	Rs. 50,00,000
2.	Initial delivery and handling costs	Rs. 4,00,000
3.	Cost of site preparation	Rs. 12,00,000
4.	Consultants' fees	Rs.14,00,000
5.	Estimated dismantling costs to be incurred after 7 years	Rs. 6,00,000

		Rs. 86,00,000

Note: Interest charges paid on “Deferred credit terms” to the supplier of the plant (not a qualifying asset) of Rs. 4,00,000 and operating losses before commercial production amounting to Rs. 8,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

#7.Illustration | Nov 2019 |

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.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

Answer

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		Rs.
Purchase Price	Given (Rs. 158,34,000 x 100/112)	1,41,37,500
Add: Site Preparation Cost	Given	1,41,870
Technician's Salary	Specific/Attributable overheads for 3 months (See Note) (45,000 x3)	1,35,000
Initial Delivery Cost	Transportation	55,770
Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset		1,45,00,140

#8.Illustration | May 2020 |

- Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?
- Entity A purchased an asset on 1st January 2016 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 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.
- The following items are given to you:

ITEMS

- (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);
- (2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training);
- (3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management
- (4) Costs of opening a new facility or business, such as, inauguration costs;
- (5) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "Property, Plant and Equipment", classify the above items under the following heads:

HEADS

- (i) Purchase Price of PPE
- (ii) Directly attributable cost of PPE or
- (iii) Cost not included in determining the carrying amount of an item of PPE.

Answer

- a) **The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.** Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.
- b) **The entity has charged depreciation using the straight-line method at Rs. 10,000 per annum i.e. (1,00,000/10 years). On 1st January 2020, the asset's net book value is [1,00,000 – (10,000 x 4)] = Rs. 60,000.** The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. **Consequently, it should charge depreciation for the next 4 years at Rs. 15,000 per annum i.e. (60,000 / 4 years).** Depreciation is recognized even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.
- c)
 - (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE".
 - (2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.
 - (3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE

- (4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.
- (5) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

#9.Illustration | Nov 2020 |

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs. 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs. 45,000 per month.

The machine was purchased at Rs. 1,58,00,000 and Rs. 50,000 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.

You are required to ascertain the amount at which the Machinery should be capitalized under AS 10.

Answer

Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		Rs.
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000
Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for Installation	Architect's Fees	30,000
Total Cost of Asset		1,61,55,000

#10. Illustration | May 2021 |

You are required to give the correct accounting treatment for the following in line with provisions of AS 10:

- a) Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this period, including expenditure related to construction and remodelling costs (Rs. 18 lakhs), salaries of staff (Rs. 2 lakhs) who will be preparing the store before its opening and related utilities costs (Rs. 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?
- b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/

development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)?

Answer

a) AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

- it is probable that future economic benefits associated with the item will flow to the entity; and
- the cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

b) In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

#11. Illustration | Nov 2021 |

A property costing Rs. 10,00,000 is bought on 1.4.2020. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 25 years.

The estimated residual value in 25 years' time, based on current year prices, is:

Case (a) Rs. 10,00,000

Case (b) Rs. 9,00,000

You are required to compute the amount of depreciation charged for the year ended 31.3.2021.

Answer

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be Rs. 9,00,000 and the depreciable amount is, therefore, Rs. 1,00,000.

Annual depreciation (on a straight line basis) will be Rs. 4,000

$[(10,00,000 - 9,00,000) \div 25]$.

#12. Illustration | May 2022 |

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
4. Inauguration costs for the factory
5. Professional fees charged by consulting engineer for the installation process
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs
8. Cost of site preparation.

Answer

Included in Cost:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
5. Professional fees charged by consulting engineer for the installation process
8. Cost of site preparation

Excluded from Cost:

4. Inauguration costs for the factory
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs

#13. Illustration | Nov 2022 |

RS Ltd. has acquired a heavy plant at a cost of Rs. 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e. the Boiler has become obsolete (which was acquired at price of Rs. 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is Rs. 60,00,000.

Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year?

Answer

Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The cost old boiler should be de-recognized and the new boiler will be added .

Statement showing cost of new boiler and machine after year 2

Original cost of plant	Rs. 2,00,00,000
Less: Accumulated depreciation $[(2,00,00,000 / 10) \times 2]$	<u>Rs. 40,00,000</u>
Carrying value of the plant after two years	Rs. 1,60,00,000
Less: Current Cost of Old Boiler to be derecognized	
Less: WDV of Boiler (replaced) after 2 years (50,00,000/10 x 8)	<u>40,00,000</u>
	1,20,00,000
Add: Cost of new Boiler to be recognized	<u>60,00,000</u>
Revised carrying amount of Plant	1,80,00,000

AS – 12 Accounting for Government Grants ILLUSTRATIONS

#1.Illustration | Nov 2023, 5 Marks |

A Ltd. purchased a Machinery for Rs. 75 Lakhs. Government Grant received towards this Machinery is Rs. 10, Lakhs. Residual Value of Machinery at the end of useful life of 6 Years is Rs. 5 Lakhs.

Asset is shown in Balance Sheet at net of grant.

At the beginning of the 3rd year, an amount becomes refundable to the extent of Rs. 8 Lakhs due to non-compliance of certain conditions of grant.

You are required to give necessary Journal entries for the 1st year and the 3rd year in the books of A Ltd.

Answer:

Journal Entries in the Books of A Ltd.

Year	Particulars		Rs. in lakhs (Dr.)	Rs. in lakhs (Cr.)
1	Machinery Account To Bank Account (Being machinery purchased)	Dr.	75	75
	Bank Account To Machinery Account (Being grant received from the government reduced from the cost of machinery)	Dr.	10	10
	Depreciation Account (W.N.1) To Machinery Account (Being depreciation charged on Straight Line method (SLM))	Dr.	10	10
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	Dr.	10	10
	Machinery Account To Bank Account (Being government grant on machinery partly refunded which increased the cost of fixed asset)	Dr.	8	8
	Depreciation Account (W.N.2) To Machinery Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	Dr.	12	12
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 3)	Dr.	12	12

Working Notes:

1. Depreciation for Year 1

	Rs. in lakhs
Cost of the Machinery	75
Less: Government grant received	(10)
	65
Depreciation (65 - 5) / 6	10

2. Depreciation for Year 3

	Rs. in lakhs
Cost of the Machinery	75
Less: Government grant received	(10)
	65
Less: Depreciation for the first two years	20
	45
Add: Government grant refundable	8
	53
53-5	
Depreciation for the third year [4]	12

#2.Illustration | May 2018, 5 Marks |

On 01.04.2014, XYZ Ltd. received Government grant of Rs.100 Lakhs for an acquisition of new machinery costing Rs.500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method.

The company had to refund the entire grant in 2nd April, 2017 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant.

How do you deal with the refund of grant to the Government in the books of XYZ Ltd., as per AS 12?

Answer

According to **AS 12 "Accounting for Government Grants"**, the **amount refundable** in respect of a **grant related to a specific fixed asset** (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be **recorded by increasing the book value of the asset, by the amount refundable**. Where the **book value is increased, depreciation** on the **revised book value** should be provided **prospectively over the residual useful life of the asset**.

Date	Particulars	Rs. In Lakhs
1st April, 2014	Acquisition cost of machinery (500 – 100)	400.00
31st March, 2015	Less: Depreciation @ 20%	(80)
1st April, 2015	Book value	320.00
31st March, 2016	Less: Depreciation @ 20%	(64)
1st April, 2016	Book value	256.00

31st March, 2017	Less: Depreciation @ 20%	(51.20)
1st April, 2017	Book value	204.80
2nd April, 2017	Add: Refund of grant	100.00
	Revised book value	304.80

Depreciation @ 20% on the revised book value amounting Rs.304.80 lakhs is to be provided prospectively over the residual useful life of the asset

#3.Illustration | Nov 2020, 5 Marks |

On 1st April, 2016, Mac Ltd. received a Government Grant of Rs.60 lakhs for acquisition of machinery costing Rs.300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non-compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20.

Answer

Date	Particulars	Rs.in lakhs
1st April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to Rs. 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253
(Being depreciation transferred to Profit and Loss Account amounting to Rs. (2.916 + 19.337= 22.253))			

#4.Illustration | Jan 2021, 5 Marks |

Darshan Ltd. purchased a Machinery on 1st April, 2016 for Rs. 130 lakhs (Useful life is 4Years). Government grant received is Rs. 40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at Rs. 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

You are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 & 31st March, 2020. Darshan Ltd. follows straight line method for charging depreciation.

Answer

As per **AS 12 "Accounting for government grants"**, grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Amount of depreciation and grant to be recognized in the profit and loss account each year
Depreciation per year:

	Rs.in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year (70lakhs/4)	17.50

Rs.17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year :

40 lakhs /4 years = Rs.10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

#5.Illustration | July 2021, 5 Marks |

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

- Rs.120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.
- Rs.15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.
- Rs.25 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants".

Answer

- As per **AS 12 "Accounting for Government Grants"**, where the **government grants are in the nature of promoters' contribution** i.e., they are given with **reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof**, the grants are treated as **capital reserve** which can be **neither distributed as dividend nor considered as deferred income.** |

In the given case, **the subsidy received from the Central Government** for setting up an industrial undertaking in Medak is **neither in relation to specific fixed asset nor in relation in revenue.** Thus, the amount of **Rs.120 Lacs should be credited to capital reserve.**

(Note: Subsidy for setting up an industrial undertaking is considered to be in the nature of promoter's contribution)

- ii. As per **AS 12 'Accounting for Government Grants'**, two methods of presentation in financial statements of grants related to **specific fixed assets** are regarded as acceptable alternatives –
- The **grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value**. The **grant is thus recognised in the profit and loss statement** over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, **the asset is shown in the balance sheet at a nominal value**.
 - Grants** related to **depreciable asset 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.
- In the given case, **Rs.15 Lacs was received as grant from the Central Government for installation of Effluent Treatment Plant**. Since the grant was received for a fixed asset, either of the above methods can be adopted.
- iii. **Rs.25 lacs received from State Government for providing medical facilities to its workmen during the pandemic is a grant received in nature of revenue grant**. Such grants are generally presented as a **credit in the profit and loss statement, either separately or under a general heading such as "Other Income"**. Alternatively, Rs.25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

#6.Illustration | May 2019, 1 Mark |

State Whether TRUE or FALSE with reason.

"As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve."

Answer

True: When grants in the nature of promoters' contribution becomes refundable, in part or in full to the government on non-fulfilment of some specified conditions, the relevant amount refundable to the government is reduced from the capital reserve.

AS 12: Accounting for Government Grants RTP ILLUSTRATIONS

#1.Illustration | Sep 2025 |

Zenith Industries Ltd., a manufacturing company, is expanding its operations and has recently undertaken two major initiatives involving government assistance.

- The company received a sum of Rs. 65 lakhs from the local authority to develop medical facilities for its employees at its newly built township near the factory premises.
- Additionally, it received Rs. 82 lakhs as a subsidy from the Central Government for establishing a new production unit in a notified backward area. This subsidy has been classified as one in the nature of promoters' contribution, intended to support the long-term development of the enterprise.

You are required to explain how the above transactions should be accounted for in the books of Zenith Industries Ltd. in accordance with Accounting Standard (AS) 12 "Government Grants".

Answer:

- (i) In the books of Zenith Industries Ltd Rs. 65 lakhs received from the local authority for providing medical facilities to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, Rs. 65 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.
- (ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of Rs. 82 lakhs should be credited to capital reserve.

#2.Illustration | May 2025 |

XYZ Limited has set-up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 75 crore received Rs. 15 crore as subsidy from the Government in January 2024. The company wants to treat this receipt as an item of revenue and thereby reduce the losses for the year ended on 31st March, 2024.

Keeping in view the relevant Accounting Standard, examine whether this action is justified or not?

Answer:

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution,

i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs.

The correct treatment is to credit the subsidy to Capital Reserve. Therefore, the accounting treatment followed by the company is not proper.

#3.Illustration | Sep 2024 |

Energy Ltd. has acquired a generator on 1.4.2023 for Rs. 100 lakh. On 2.4.2023, it applied to Indian Renewable Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 2024 after the accounts for 2023-2024 were finalized. The company has not accounted for the subsidy for the year ended 31.3.2024.

State

- I. Is this a prior period item?
- II. How should the subsidy be accounted in the accounting year 2024-2025?

Answer:

- (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2023-2024 by not recognising the subsidy?

The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that -

- (i) the enterprise will comply with the conditions attached to them and

(ii) the subsidy will be received.

Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2024 after approval of accounts, non-recognition of grant in 2023-2024 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant. Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2023-2024.

- (ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life. Alternatively, the same may be treated as 'deferred income' and allocated over the remaining useful life in the proportion in which depreciation is charged.

#4.Illustration | May 2018, Nov 2022 |

D Ltd. acquired a machine on 01-04-2012 for Rs. 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:

Particulars	Rs.
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2012-13- to 2014-15 on Straight Line Method)	<u>12,00,000</u>
	8,00,000
Less: Grant received	<u>(16,00,000)</u>
Balance	<u>(8,00,000)</u>

You are required to **explain** how should the company deal with this asset in its accounts for 2015-16?

Answer

From the above account, **it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the Rs. 16,00,000 that has been received, Rs. 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.**

The balance **Rs. 8,00,000 may be credited to P&L A/c**, since already the cost of the asset to the tune of **Rs. 12,00,000 had been debited to P&L A/c** in the earlier years by way of depreciation charge, and **Rs. 8,00,000 transferred to P&L A/c** now would be partial recovery of that cost.

There is no need to provide depreciation for 2015-16 or 2016-17 as the depreciable amount is now Nil.

#5.Illustration | Nov 2019 |

A specific government grant of Rs. 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Dairy plant of Rs. 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was

credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was Rs. 10.50 lakhs and written down value of plant was Rs. 66.50 lakhs.

- (i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017 -18 in profit and loss account?
- (ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of Rs. 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12.

Answer

As per para 21 of **AS 12, 'Accounting for Government Grants'**, "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

- (i) In this case the **grant refunded is Rs. 15 lakhs and balance in deferred income is Rs. 10.50 lakhs, Rs. 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18.** There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.
- (ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of **AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable.** Where the **book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.** Therefore, in this case, **the book value of the plant shall be increased by Rs. 15 lakhs. The increased cost of Rs. 15 lakhs of the plant should be amortized over 7 years (residual life).** Depreciation charged during the year 2017-18 shall be $(56+15)/7$ years = Rs. 10.14 lakhs presuming the depreciation is charged on SLM.

#6.Illustration | May 2019 |

Viva Ltd. received a specific grant of Rs. 30 lakhs for acquiring the plant of Rs. 150 lakhs during 2014-15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was Rs. 21 lakhs and written down value of plant was Rs. 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

Answer

As per **AS-12, 'Accounting for Government Grants'**, "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is Rs. 30 lakhs and balance in deferred income is Rs. 21 lakhs, Rs. 9 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

#7.Illustration | Nov 2019 |

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

Answer

As per **AS 12 "Accounting for Government Grants"**, where the government grants are in the nature of promoters' contribution, *i.e.*, they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking *i.e.* **subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect** thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be **recognized as capital reserve** which can be neither distributed as dividend nor considered as deferred income.

#8.Illustration | May 2020, Nov 2020 |

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

- (i) Rs. 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.
- (ii) Rs. 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area.
- (iii) Rs. 10 Lakhs Grant received from the Central Government on installation of anti - pollution equipment.

Answer

- i. Rs. 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, Rs. 35 lakhs may be deducted in reporting the related expense *i.e.* employee benefit expenses.

- ii. As per **AS 12 'Accounting for Government Grants'**, where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of Rs. 100 lakhs should be credited to capital reserve.

- iii. Rs. 10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, Rs. 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

#9.Illustration | May 2021 |

- i. Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2020.

The company debited the said amount to its machinery account in 2020 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

- ii. ABC Ltd. received two acres of land received for set up of plant. It also received Rs.2 lakhs received for purchase of machinery of Rs. 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis. How should ABC Ltd. recognize these government grants in its books of accounts?

Answer

- i. As per the facts of the case, **Hygiene Ltd. had received a grant of Rs. 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions.** In such circumstances, **AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable.** The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. **Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper.** However, the accounting

treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

ii. ABC Ltd. should recognize the grants in the following manner:

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of Rs. 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at Rs. 10 lakhs – Rs. 2 lakhs = Rs. 8 lakhs and depreciation will be charged on it as follows:

Rs. 8 lakhs / 5 years = Rs. 1.60 lakhs per year.

Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Rs. 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 40,000 [Rs. 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

#10. Illustration | Nov 2021 |

D Ltd. acquired a machine on 01-04-2017 for Rs. 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

Particulars	Rs.
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	<u>12,00,000</u>
	8,00,000
Less: Grant received	<u>(16,00,000)</u>
Balance	<u>(8,00,000)</u>

You are required to explain how should the company deal with this asset in its accounts for 2020-21?

Answer

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants. Accordingly, out of the Rs. 16,00,000 that has been received, Rs. 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance Rs. 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of Rs. 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and Rs. 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2020-21 or 2021-22 as the depreciable amount is now Nil.

#11. Illustration | May 2022 |

A fixed asset is purchased for Rs. 30 lakhs. Government grant received towards it is Rs. 12 lakhs. Residual Value is Rs. 6 lakhs and useful life is 4 years. The company charges depreciation based on Straight-Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of Rs. 7.5 lakhs due to non-compliance with certain conditions. You are required to give necessary journal entries for second year.

Answer

Journal Entries

Year	Particulars		Rs. in lakhs (Dr.)	Rs. in lakhs (Cr.)
2nd	Fixed Asset Account To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	Dr.	7.5	7.5
	Depreciation Account (W.N.) To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	Dr.	5.5	5.5
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)	Dr.	5.5	5.5

Working Note:

Depreciation for Year 2

	Rs. in lakhs
Cost of the Asset	30
Less: Government grant received	(12)
	18

18-6	<u>3</u>
Less: Depreciation for the first year [4]	15
Add: Government grant refundable	<u>7.5</u>
	<u>22.5</u>
22.5-6	5.5
Depreciation for the second year [3]	

1FIN by IndigoLearn

AS -16 Borrowing Costs

ILLUSTRATIONS

#1.Illustration | May 2024, 7 Marks |

On 1st April, 2023, Green Limited started the construction of an Office Building (qualified asset). The land under the building is regarded as a separate asset and is not a part of qualifying asset.

For the purpose of construction of building, the company raised a specific loan of Rs. 14 lakhs from a Bank at an interest rate of 12% per annum. An interest income of Rs. 15,000 was earned on this loan while it was held in anticipation of payments.

The company's other outstanding loans on 1st April, 2023 were as follows:

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

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

Payment date	Amount in Rs.
1 st April, 2023	4,00,000
1 st August, 2023	10,00,000
1 st December, 2023	25,00,000
31 st January, 2024	5,00,000

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

You are required to:

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

Answer:

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

Date of incurrence of expenditure	Amount spent	Financed through	Calculation	Rs.
1 st April 2023	4,00,000	Specific borrowing	4,00,000 x 12% x 10/12	40,000
1 st August 2023	10,00,000	Specific borrowing	10,00,000 x 12% x 10/12	1,00,000

1 st December 2023	25,00,000	General borrowing	25,00,000 x 10.8% x 2/12	45,000
31 st January 2024	5,00,000	General borrowing	5,00,000 x 10.8% x 0/12	Nil
Less: interest income on borrowing				1,85,000 (15,000)
Total amount borrowing cost to be capitalized				1,70,000

(ii) Journal Entry

Date	Particulars	Rs.	Rs.
31.1.2024	Building account Dr.	45,70,000	
	To Bank account		44,00,000
	To Interest payable (borrowing cost)		1,70,000
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)		

Note: In the above journal entry, it is assumed that interest amount will be paid at the year end. Hence, entry for interest payable has been passed on 31.1.2024.

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

Date	Particulars	Rs.	Rs.
31.1.2024	Building account Dr.	45,70,000	
	To Bank account		45,70,000
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)		

(iii) Depreciation on building for the year ending 31.3.2024

Cost of building 45,70,000

Life of building = 20 years

Depreciation = $(45,70,000/20) \times 2/12 = 38,083.33$

(iv) Carrying Value of Building on 31st March 2024:

Carrying Value = Cost of Building - Accumulated Depreciation

= 45,70,000 - 38,083.33

= 45,31,917

Working Notes:

1. Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (Rs.)	Rate of interest		Amount of interest (Rs.)
20,00,000	15%	=	3,00,000
<u>30,00,000</u>	8%	=	<u>2,40,000</u>
<u>50,00,000</u>			<u>5,40,000</u>
Weighted average rate of interest (5,40,000 / 50,00,000 X 100)		=	10.8%*

2. Total expenses to be capitalized for building

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

#2.Illustration | Nov 2023, 5 Marks |

Glen Ltd. began construction of a new building on 1st January, 2022. On 1st April, 2022, following two loans were obtained to fund the construction cost:

- Loan of Rs. 60,00,000 from Data Bank Ltd. was taken at interest rate of 8% per annum. This loan was fully utilized for construction of the new building.
- Loan of Rs. 20,00,000 from Satya Bank Ltd. Out of this, loan amount of Rs. 6,00,000 was utilized for working capital purpose. Total interest of Rs. 1,92,000 were paid to Satya Bank Ltd. for the financial year 2022-23.

Construction of the new building was completed on 31st January, 2023 and was ready for its intended use on the same date.

None of the loan was repaid during the year. The building is a qualifying asset for the purpose of AS-16.

Out of loan from Data Bank Ltd., surplus funds were temporarily invested for the short period of time. This temporary investment earned interest of Rs. 30,000.

You are required to calculate the amount of interest (a) to be capitalized, (b) to be charged to profit and loss account from the total interest incurred as borrowing cost during the year 2022-23 (as per AS-16).

Answer:

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The standard also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset

should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost on Loan of data bank to be capitalized:

$$= \text{Rs.}(60,00,000 \times 8\%) \times 10/12 - \text{Rs.}30,000$$

$$= \text{Rs.}4,00,000 - \text{Rs.} 30,000$$

$$= \text{Rs.}3,70,000$$

Loan	Particulars	Nature of assets	(a) Interest to be Capitalized (Rs.)	(b) Interest to be charged to Profit & Loss Account (Rs.)
Databank	Construction of factory building	Qualifying Asset	3,70,000	(4,80,000 - 4,00,000) 80,000
Satya Bank	Construction of factory building	Qualifying Asset	$(1,92,000 \times 14/20) \times 10/12 = 1,12,000$	$(1,92,000 \times 14/20) \times 2/12 = 22,400$
Satya Bank	Working Capital	Not a Qualifying Asset	NIL	$(1,92,000 \times 6/20) = \text{Rs.}57,600$
	Total		<u>Rs.4,82,000</u>	<u>Rs.1,60,000</u>

Note: Loan from Satya bank is considered to be specific borrowings.

#3.Illustration | May 2019, 5 Marks |

First Ltd. began construction of a new factory building on 1st April, 2017. It obtained Rs.2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (Rs.)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (Rs.)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS 16, you are required to:

- Calculate the amount of interest to be capitalized.
- Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

Answer

i. Computation of average accumulated expenses

Particulars	Amt Rs.
3,00,000 × 12 / 12 =	3,00,000
2,40,000 × 10 / 12 =	2,00,000
4,00,000 × 8 / 12 =	2,66,667
3,60,000 × 3 / 12 =	90,000
	<u>8,56,667</u>

ii. Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (Rs.)
4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	14%	= <u>42,000</u>
		<u>1,38,000</u>
Weighted average rate of interest		= 11.5%
1,38,000 * 100		
<u>12,00,000</u>		

Amount of interest to be capitalized

Particulars	Amt (Rs.)
Interest on average accumulated expenses:	
Specific borrowings (Rs. 2,00,000 × 8%) =	16,000
Non-specific borrowings (Rs. 6,56,667 × 11.5%) =	75,517
Amount of interest to be capitalised =	<u>91,517</u>

iii. Total expenses to be capitalised for building

Particulars	Amt (Rs.)
Cost of building Rs. (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517

iv. Journal Entry

Date	Particulars		Dr. (Rs)	Cr. (Rs)
31.3.2018	Building A/c	Dr	13,91,517	
	To Building WIP A/c			13,00,000
	To Borrowing costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

#4.Illustration | Nov 2020, 5 Marks |

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for Rs.320 lakhs to be utilized as under:

Particulars	Rs (in lakhs)
Construction for factory shed	240
Purchase of Machinery	30
Working capital	24
Purchase of Vehicles	12
Advance for tools/cranes etc.	8
Purchase of technical know how	6

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was Rs.40 lakhs.

In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets.

Answer

As per **AS 16 "Borrowing Costs"**

- **A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.**
- **Other investments and those inventories** that are **routinely manufactured or otherwise produced in large quantities on a repetitive basis** over a **short period** of time, are **not qualifying assets**.
- **Assets that are ready for their intended use or sale** when **acquired** also are **not qualifying assets**.
- **Borrowing costs** that are **directly attributable to the acquisition, construction or production of a qualifying asset** should be **capitalized as part of the cost of that asset**.

- **Other borrowing costs** should be **recognized as an expense** in the **period** in which they are incurred.

Construction of factory shed amounting **Rs.240 lakhs is qualifying asset** in the given case. The **interest** for this amount during the year will be added to the **cost of factory shed**. **All others** (purchase of machinery, vehicles and technical know-how, working capital, advance for tools/cranes) are **non-qualifying assets and related borrowing cost** will be charged to **Profit and Loss statement**.

Qualifying Asset as per AS 16 (construction of a shed) = Rs.240 lakhs

Borrowing cost to be capitalized = 40 lakhs x 240/320 = Rs.30 lakhs

Interest to be debited to Profit or Loss account: (40 - 30) = Rs.10 lakhs.

Note: Assumed that construction of factory shed completed on 31st March, 2020

AS 16 : Borrowing Costs

RTP ILLUSTRATIONS

#1.Illustration | Sep 2025 |

Is it permissible to capitalise borrowing costs incurred on assets which are necessary for the construction of qualifying assets? A company is in the process of constructing a large manufacturing plant in a backward area. As a part of this project it has also purchased a residential building, which is to be used for housing the workers engaged in the construction of the plant. The purchase cost of the building is met by raising a long term loan. The company intends to dispose off the building once the construction of the manufacturing plant is complete. If the manufacturing plant meets the definition of a qualifying asset, would the borrowing costs incurred on funds borrowed to purchase the residential building be eligible for capitalisation?

Answer:

As per para 3 of AS 16 "Borrowing Costs" a qualifying asset as "an asset that necessarily takes a substantial period of time to get ready for its intended use or sale". Further, para 5 of the AS explains that "Assets that are ready for their intended use or sale when acquired also are not qualifying assets".

In the given case, prima facie, it may appear that the residential building is ready for use when acquired, and thus, borrowing costs incurred on purchase of residential building should not be capitalised. However, since in the present case provision of housing facilities is necessary for the construction of the plant, the borrowing costs incurred are, in substance, directly attributable to the construction of the manufacturing plant. Accordingly, the company should capitalise, as a part of the cost of the manufacturing plant, borrowing costs incurred on funds borrowed to acquire the residential building upto the period the manufacturing plant is ready for its intended use.

#2.Illustration | May 2025 |

U Limited has obtained a term loan of Rs. 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 2023. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 2024. An expenditure of Rs. 510 lacs was incurred on installation of Plant and Machinery, Rs. 54 lacs has been advanced to suppliers for additional assets which were also received and installed before 30th April, 2024 (additional asset has taken substantial period of time in its installation) and the balance loan of Rs. 56 lacs has been used for working capital purposes.

The company has paid total interest of Rs. 68.20 lacs during financial year 2023-2024 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts.

Answer:

Borrowing Cost: As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

Qualifying Asset: A qualifying asset is an asset that necessarily takes a substantial period of time (ordinarily, a period of twelve months unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case) to get ready for its intended use or sale.

When construction of asset completed on 30th April, 2024

The treatment for total borrowing cost of Rs. 68.20 lakhs will be as follows:

Purpose	Nature	Interest to be capitalised <i>Rs. in lakhs</i>	Interest to be charged to profit and loss account <i>Rs. in lakhs</i>
Modernisation and renovation of plant and machinery	Qualifying asset	$[68.20 \times (510/620)] = 56.10$	
Advance to suppliers for additional assets	Assumed as Qualifying asset (Refer Note)	$[68.20 \times (54/620)] = 5.94$	
Working Capital	Not a qualifying asset		$[68.20 \times (56/620)] = 6.16$
		<u>62.04</u>	<u>6.16</u>

#3.Illustration | Jan 2025 |

How will interest be capitalized when qualifying assets are funded by borrowings in the nature of bonds that are issued at a discount?

X Ltd. issued in year 1, a 3 year 10% p.a. (interest paid annually) bond with a face value of Rs. 1,00,000 at a price of Rs. 90,000 to finance a qualifying asset which is ready for intended use at the end of year 2. Compute the amount of borrowings costs to be capitalized if the company uses for amortization of discount straight line basis

Answer:

As per AS 16, "Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds". Further, as per para 4 (b) of the standard, "amortization of discounts or premiums relating to borrowings" as a component of borrowing costs. Thus, the borrowing costs comprise the periodic interest payable on the bonds in question and the amount of discount amortised during the period.

Paragraph 6 of the Statement, inter-alia, states that "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".

Further, paragraph 19 states that "Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". Thus, only that portion of the amortised discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Straight line basis

Years	Interest	Amortisation of discount	Total borrowing costs
Year 1	10,000	3,333	13,333
Year 2	10,000	3,333	13,333
Year 3	10,000	3,334	13,334

In the above case, the amount of borrowing costs capitalized would be Rs. 13,333 in Year 1 and Year 2. The borrowing costs of Rs. 13,334 incurred in Year 3 would be expensed since the asset is ready for its intended use at the end of Year 2.

#4.Illustration | Sep 2024 |

Loyal Ltd. has undertaken a project for expansion of capacity as per the following details:

	Plan (Rs.)	Actual (Rs.)
October, 2023	5,00,000	4,00,000
November, 2023	6,50,000	7,95,000
December, 2023	20,00,000	-
January, 2024	2,00,000	50,000
February, 2024	9,00,000	2,00,000
March, 2024	10,00,000	12,00,000

The company pays to its bank interest at a rate of 15% p.a., which is debited on a monthly basis. During the half year, company had Rs. 20 lakh overdraft up to 31st December, surplus cash in January and again overdraft of Rs. 14 lakh from 1.2.2024 and Rs. 30 lakh from 1.3.2024. The company had a strike during December and hence could not continue the work during said period. However, the substantial administrative work related to the project was continued. Onsite work was again commenced on 1st January and all the work were completed on 31st March. Assume that expenditure was incurred on 1st day of each month. Calculate interest to be capitalized giving reason wherever necessary. Assume overdraft will be less, if there is no capital expenditure.

Answer:

Loyal Ltd.

Month	Actual Expenditure (Rs.)	Interest on outstanding amount @ 15% p.a.	Interest capitalized (Rs.)	Outstanding amount	Cumulative amount (Rs.)
	1		2	3	
October, 2023	4,00,000	$4,00,000 \times 15\% \times 1/12$	5,000	4,05,000	4,05,000
November, 2023	7,95,000	$(4,05,000 + 7,95,000) \times 15\% \times 1/12$	15,000	$(4,05,000 + 7,95,000 + 15,000)$	12,15,000
December, 2023	-	$(12,15,000) \times 15\% \times 1/12$	15,188	$12,15,000 + 15,188$	12,30,188
January, 2024	50,000		-	$12,30,188 + 50,000$	12,80,188
February, 2024	2,00,000	$14,00,000 \times 15\% \times 1/12$	17,500	$12,80,188 + 2,00,000 + 17,500$	14,97,688
March, 2024	<u>12,00,000</u>	$(14,97,688 +$	<u>33,721</u>	$14,97,688 +$	27,31,409

	26,45,000	12,00,000)*15 %*1/12	86,409	12,00,000 + 33,721	

Note:

1. As per para 18 of AS 16, 'Borrowing Cost', capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Therefore, the interest for that period i.e. for the month of December has also been capitalized.
2. During January, the company did not incur any interest as there was surplus cash in January. Therefore, no amount should be capitalized during January as per para 14(b) of AS 16.
3. During February, actual overdraft (borrowings) was Rs. 14 lakh only. Hence, interest of Rs. 17,500 on Rs. 14,00,000 has been calculated even though actual expenditure on project exceed Rs. 14 lakh.

#5.Illustration | May 2018 |

In May, 2016, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2017 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2017 amounted to Rs. 25 lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? **Explain** the treatment in line with the provisions of AS 16.

Answer

AS 16 'Borrowing Costs' clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2017) i.e. Rs. 18 lakhs alone can be capitalized. It cannot be extended to Rs. 25 lakhs.

#6.Illustration | Nov 2018 |

A company incorporated in June 2017, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

Answer

As per para 3.2 to **AS 16 'Borrowing Costs'**, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, Explanation to the above para states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on

the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be **implied** that there is a **rebuttable presumption that a 12 months period constitutes substantial period of time.** Under present circumstances where **construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete.** However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensure that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

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

#7.Illustration | May 2019 |

Zen Bridge Construction Limited obtained a loan of Rs. 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	Rs. 50 crores
(ii)	Purchase of Equipment and Machineries	Rs. 6 crores
(iii)	Working Capital	Rs. 4 crores
(iv)	Purchase of Vehicles	Rs. 1 crore
(v)	Advances for tools/cranes etc.	Rs. 1 crore
(vi)	Purchase of Technical Know how	Rs. 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2018	Rs. 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

Answer

According to **AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.** As per the standard, **borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset.** Other borrowing costs should be recognized as an expense in the period in which

they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

	Qualifying Asset	Interest to be capitalized Rs. in crores	Interest to be charged to Profit & Loss	

			A/c Rs. in crores	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No		0.05	1.6/64 x 2
Total		1.25	0.35	

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

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

#8.Illustration | Nov 2019, Nov 2021 |

In May, 2018, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2019 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2019 amounted to Rs. 25 lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

Answer

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2019) i.e. Rs. 18 lakhs alone can be capitalized. It cannot be extended to Rs. 25 lakhs.

#9.Illustration | May 2020 |

Govind Ltd. issued 12% secured debentures of Rs. 100 Lakhs on 01.04.2018, to be utilized as under:

Particulars	Amount (Rs. in lakhs)
Construction of factory building	40
Purchase of Machinery	35

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was Rs. 12,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of Rs. 3,00,000.

You are required to show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

Answer

According to **AS 16 "Borrowing Costs"**, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= Rs. 12,00,000 – Rs. 3,00,000

= Rs. 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be capitalized (Rs.)	Interest to be charged to Profit & Loss Account (Rs.)
i	Construction Of factory building	Qualifying Asset	$9,00,000 \times 40/100$ = Rs. 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	$9,00,000 \times 35/100$ = Rs. 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	$9,00,000 \times 25/100$ = Rs. 2,25,000
	Total		<u>Rs. 3,60,000</u>	<u>Rs. 5,40,000</u>

#10. Illustration | Nov 2020 |

- a) Vital Limited borrowed an amount of Rs.150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized

Rs. 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund out of Rs.150 crores, an income of Rs. 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

b) When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

Answer

a) **Para 10 of AS 16 'Borrowing Costs'** states **that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.** The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for

Actual interest for 2019-20 (10% of Rs. 150 crores)	Rs. 15.00 crores
Less: Income on temporary investment from specific borrowings	Rs. 13.50 crores

the financial year 2019-20 should be calculated as follows:

b) **Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.** An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. **When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.**

#11. Illustration | May 2021 |

Shan Builders Limited has borrowed a sum of US \$ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was Rs. 56 per US \$ and the rate as on 31st March, 2020 Rs. 62 per US \$. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards.

Answer

Interest for the period 2019-20

= US \$ 10 lakhs × 4% × Rs. 62 per US \$ = Rs. 24.80 lakhs

Increase in the liability towards the principal amount

= US \$ 10 lakhs × Rs. (62 - 56) = Rs. 60 lakhs

Interest that would have resulted if the loan was taken in Indian currency

= US \$ 10 lakhs × Rs. 56 × 10.5% = Rs. 58.80 lakhs

Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 58.80 lakhs - Rs. 24.80 lakhs = Rs. 34 lakhs.

Therefore, out of Rs. 60 lakhs increase in the liability towards principal amount, only

Rs. 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 58.80 lakhs being the aggregate of interest of Rs. 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 34 lakhs. Hence, Rs. 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining Rs. 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

#12. Illustration | May 2022 |

An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?

Answer

As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

#13. Illustration | Nov 2022 |

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:
(Rs. in lakhs)

	Phase I	Phase II	Phase III	Phase IV
	Rs.	Rs.	Rs.	Rs.

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

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

Answer

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

Accounting treatment:

1. For Phase I and Phase II

Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of 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.

2. 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.

AS – 26 Intangible Assets
Past Exams and RTP Questions Compiler

#1. Question | RTP Jan 2025 |

During 2023-2024, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	Amount (Rs.)
Completion of detailed programme and design (Phase 1)	25,000
Coding and Testing for establishing technical feasibility (Phase 2)	20,000
Other coding costs (Phase 3)	42,000
Testing costs (Phase 4)	12,000
Product masters for training materials (Phase 5)	13,000
Duplication of computer software and training materials, from product masters (2,000 units) (Phase 6)	40,000
Packing the product (1,000 units) (Phase 7)	11,000

After completion of phase 2, it was established that the computer software is technically feasible for the market. What amount should be capitalized as software costs in the books of the company, on the Balance Sheet date?

Answer:

As per para 44 of AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed programme design or working model. In this case, Rs. 45,000 would be recorded as an expense (Rs. 25,000 for completion of detailed program design and Rs. 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (Rs. 42,000 + Rs. 12,000 + Rs. 13,000) Rs. 67,000. Duplication of computer software and training materials, from product masters and packing the products are the cost incurred after development phase. Hence, the same shall be expensed off during the year it is incurred.

#2. Question | September 2024 Exam, 4 marks

In the following cases, record Journal Entries for amortization in the books of Huge Ltd. for the year ended 31st March, 2024 with reference to AS-26:

- (i) The company had acquired Patent Rights for Rs. 340 lakhs on 01.04.2022. The estimated product life is 4 years. Amortization was decided in the ratio of estimated future cash flows which are as under:
- 1st Year Rs. 140 Lakhs
2nd Year Rs. 350 Lakhs
3rd Year Rs. 280 Lakhs
4th Year Rs. 420 Lakhs

- (ii) The company had developed know-how by incurring expenditure of Rs. 80 lakhs. The know-how has been used by the company since 01.04.2018. Its useful life is 8 years from the year of commencement of its use. The company has not amortised the asset until 31.03.2024.

Answer:

Journal Entry for the year ended on 31st March 2024

			Rs. in lakhs	Rs. in lakhs
31.3.24	Amortization A/c (340 × 350/ 1,190)	Dr.	100	
	To Patent Rights A/c			100
	P&L A/c	Dr.	100	
	To Amortization A/c			100

Working note

Huge Limited amortised Rs. 340 lakhs during next 4 years on the basis of net cash flows arising of the product. The amortisation for second year will be worked out as under:

Rs. 340 x 350 /1,190 (140+350+280+420) = Rs. 100 lakhs

Particulars		Rs. in lakhs	Rs. in lakhs
Prior period item	Dr.	50	
Amortization A/c	Dr.	10	
To Know-how A/c			60
[Being amortization of 6 years (out of which amortization of 5 years charged as prior period item i.e. 80 x 6 /8 = 60 lakhs)]			
Profit and Loss A/c	Dr.	60	
To Amortization A/c			10
To Prior Period Item			50
(Being amount transferred to Profit and Loss account)			

#3. Question | December 2021 Exam, November 2020, 5 marks |

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹42 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

- (1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019?

- (2) What is the carrying amount of the intangible asset as on 31st March, 2019?
- (3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020?
- (4) What is the carrying amount of the intangible asset as on 31st March, 2020?

Answer

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019

42 lakhs is recognized as an expense because the recognition criteria were not met until 1st November, 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2019

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

	(₹ in lacs)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and loss account	46

(iv) Carrying value of intangible asset as on 31.03.2020

	(₹ in lacs)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

#4. Question | January 2021 Exam, 5 marks |

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as Rs. 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

- (i) Import Duty 10%
- (ii) Additional Import Duty 5%
- (iii) Entry Tax 2% (Recoverable later from tax department).
- (iv) Installation expenses ₹1,50,000.

Professional fees for clearance from customs ₹50,000. Compute the cost of software to be Capitalized as per relevant AS.

Answer

Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)

	<u>£1,46,250</u>
Cost in ₹ (UK £1,46,250 x ₹100)	146,25,000
Add: Import duty on cost @ 10% (₹)	<u>14,62,500</u>
	160,87,500
Add: Additional import duty @ 5% (₹)	<u>8,04,375</u>
	<u>168,91,875</u>
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	<u>50,000</u>
Cost of the software to be capitalized (₹)	<u>170,91,875</u>

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

#5. Question | November 2020 Exam, 5 marks | RTP May 2020

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

Answer

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1.	300	.25	150
2.	300	.25	150
3.	150	.25	150
4.	150	.10	60
5.	150	.10	60
6.	75	.05	30
		1.00	600

In the first three years, the patent cost will be **amortized in the ratio of estimated future cash flows** i.e. (300: 300: 300: 150: 150). The unamortized amount of the patent after third year will be ₹150 lakh (600-450) which will be **amortized in the ratio of revised estimated future cash flows** (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

#6. Question | November 2019 Exam, 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.

Answer

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

- (i) In the given case, the legal expenses to defend the patent of a product amounting ₹23,00,000 should **not be capitalized** and be charged to Profit and Loss Statement.
- (ii) The company is required to **expense the entire amount** of ₹7,00,000 in the Profit and Loss account for the year ended 31st March, 2019 because no benefit will arise in the future.
- (iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements **should not be recognized as part of the cost** of an intangible asset at a later date. Thus the company **cannot capitalize** the amount of ₹25,00,000 and it should be recognized as expense
- (iv) Expenditure of 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.

#7. Question | May 2018 Exam, 5 marks | RTP May 2018

A company acquired a patent at a cost of ₹160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹50 lakhs, ₹30 lakhs, ₹60 lakhs, ₹70 lakhs and ₹40 lakhs. Find out the amortization cost of the patent for each of the years.

Answer

Company amortized ₹16,00,000 per annum for the first two years. Hence, Amortization for the first two years $(₹16,00,000 \times 2) = ₹32,00,000$. Remaining carrying cost after two years $= ₹1,60,00,000 - ₹32,00,000 = ₹1,28,00,000$ Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost ₹128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹)
1.	-	0.1	16,00,000
2.	-	0.1	16,00,000
3.	50,00,000	0.2	25,60,000
4.	30,00,000	0.12	15,36,000
5.	60,00,000	0.24	30,72,000
6.	70,00,000	0.28	35,84,000
7.	40,00,000	0.16	20,48,000
Total	250,00,000	1.000	160,00,000

#8. Question | RTP May 2023 |

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

- (1) ₹23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.
- (2) During the year 2021-22, a company spent ₹7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.
- (3) A company spent ₹25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹25,00,000 by disclosing it as a prior period item.
- (4) A company with a turnover of ₹200 crores and an annual advertising budget of ₹50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹50,00,000 incurred on extensive special initial advertisement campaign for the new product.

Answer

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

- (i) In the given case, the legal expenses to defend the patent of a product amounting ₹23,00,000 **should not be capitalized and be charged to Profit and Loss Statement.**
- (ii) The company is **required to expense the entire amount** of ₹7,00,000 in the Profit and Loss account for the year ended 31st March, 2022 because no benefit will arise in the future.
- (iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements **should not be recognized as part of the cost of an intangible asset** at a later date. Thus

the company cannot capitalize the amount of ₹25,00,000 and it should be recognized as expense.

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

#9. Question | RTP November 2022, November 2019, May 2018 |

K Ltd. launched a project for producing product X in October, 2021. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2022. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard.

Answer

As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the standard. Thus, the **manager cannot defer the expenditure write off** to future years in the given case.

Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has **to be written off in the current year** ending 31st March, 2022.

#10. Question | RTP May 2022 |

PQR Ltd. has acquired a Brand from another company for Rs. 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.

Answer

AS 26 'Intangible Assets' provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a **rebuttable presumption** that the useful life of an intangible asset will **not exceed 10 years** from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence **no amortization needs to be provided is not correct** as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

#11. Question | RTP November 2021 |

A company is showing an intangible asset at ₹88 lakhs as on 01.04.2021. This asset was acquired for ₹120 lakhs on 01.04.2017 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over

a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard.

Answer

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a **rebuttable presumption** that the useful life of an intangible asset will **not exceed ten years** from the date when the asset is available for use. Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of **15 years is more than the maximum period** of 10 years specified as per AS 26. Accordingly, the company would be **required to restate** the carrying amount of intangible asset as on 01.04.2021 at ₹72 lakhs i.e.

$$₹120 \text{ lakhs less } ₹48 \text{ lakhs } \left(\frac{120 \text{ Lakhs}}{10 \text{ Years}} \times 4 \text{ Years} = 48 \text{ Lakhs} \right)$$

The difference of ₹16 Lakhs (₹88 lakhs – ₹72 lakhs) will be adjusted against the opening balance of **revenue reserve**. The carrying amount of ₹72 lakhs will be amortized over remaining 6 years by amortizing ₹12 lakhs per year.

#12. Question | RTP May 2021 |

Naresh Ltd. had the following transactions during the financial year 2019 -2020:

- (i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was ₹5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.
- (ii) Naresh Ltd. had taken a franchise on July 2019 to operate a restaurant from Sankalp Ltd. for ₹1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹60,000 during the financial year 2019-2020.
- (iii) On 20th August, 2019, Naresh Ltd, incurred costs of ₹2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years. Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2020.

Answer

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31 st March 2020

Assets	Note No.	₹
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

1.	Intangible assets		₹
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	<u>2,10,000</u>	8,11,200

Working Notes:

(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	<u>(5,16,000)</u>
	Goodwill	5,64,000
	Less: Amortization as per AS 14 ie. over 5 years (as per SLM)	<u>(1,12,800)</u>
	Balance to be shown in the balance sheet	<u>4,51,200</u>
(2)	Franchise	1,80,000
	Less: Amortization (over 6 years)	<u>(30,000)</u>
	Balance to be shown in the balance sheet	<u>1,50,000</u>
(3)	Patent	2,40,000
	Less: Amortization (over 8 years as per SLM)	<u>(30,000)</u>
	Balance to be shown in the balance sheet	<u>2,10,000</u>

#13. Question | RTP November 2020 |

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**.

#14. Question | May 2019 |

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by the Company correct?

Answer

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

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is **correct**.

1FIN by IndigoLearn

#1. Question | Jan 2025 Exam, 5 marks |

J Limited availed an equipment on lease from K Limited. The conditions of the lease terms are as under:

- (i) Lease starts from 1st April, 2020 for a period of 4 Years and useful life of the equipment is 6 years. Both the cost and fair value of equipment are Rs. 12,50,000.
- (ii) The equipment reverts back to the lessor on termination of the lease.
- (iii) The unguaranteed residual value is estimated at Rs. 1,20,000 at the end of the financial year 2023-2024.
- (iv) The amount will be paid in 4 equal instalments at the end of each year.
- (v) Consider IRR = 8%.
- (vi) The present value of Rs. 1 at the end of 4th year at 8% of interest is Rs. 0.735.
- (vii) The present value of annuity of Rs. 1 due at the end of 4th year at 8% IRR is Rs. 3.312

State whether this lease is operating lease or Finance lease (by applying two deterministic parameters). Also calculate unearned finance Income.

Answer:

Computation of annual lease payment:

Particulars	Rs.
Cost of equipment	12,50,000.00
Unguaranteed residual value	1,20,000.00
Present value of unguaranteed residual value	
(Rs. 1,20,000 x 0.735)	88,200.00
Present value of lease payments	
(Rs. 12,50,000 - Rs. 88,200)	11,61,800.00
Present value of annuity for four years is 3.312	
Annual lease payment [11,61,800/3.312]	3,50,785.02

Classification of lease:

Parameter 1:

The present value of the lease payment i.e. Rs. 11,61,800 which equals 92.94% of the fair market value i.e. Rs. 12,50,000.

The present value of minimum lease payments substantially covers the fair value of the leased asset.

Parameter 2:

The lease term (i.e. 4 years) covers the major part of the life of asset (i.e. 6 years).

Therefore, it constitutes a finance lease. Computation of Unearned Finance Income:

Particulars	Rs.
Total lease payments (Rs 3,50,785.02 x 4)	14,03,140.08
Add: Unguaranteed residual value	1,20,000.00
Gross investment in the lease	15,23,140.08
Less: Present value of lease payments and residual value i.e.	
Net Investment (Rs. 88,200 + Rs. 11,61,800)	(12,50,000.00)
Unearned finance income	2,73,140.08

#2. Question | May 2024 Exam, 4 marks |

Colour Limited leased a Machine to Red Limited on 1 April, 2021 on the following:

Cost of the machine	Rs. 18,00,000
Lease term	3 Years
Fair market value of the machine Unguaranteed	Rs. 18,00,000
residual value as on 31.3.2024	Rs. 2,00,000
Internal rate of return	12%

Other information:

The expected useful life of the machine is 5 years. The machine will revert to Colour Limited on termination of the lease. The lease payment is to be made at the end of each year in 3 equal parts.

The present value of Rs. 1 due at the end of 3rd year at 12% rate of interest is

Rs. 0.7118. The present value of annuity of at Rs. 1 due at the end of 3rd year at 12% IRR is Rs. 2.4018.

You are required to analyze whether lease constitutes finance lease. Also calculate unearned finance income, if any.

Answer:

Computation of Annual Lease Payment

Particulars	Amount
Cost of Equipment	18,00,000
Unguaranteed Residual Value	2,00,000
Present Value of unguaranteed residual value (Rs. 200,000 x 0.7118)	1,42,360
Present Value of Lease Payments (Rs. 18,00,000 – Rs. 1,42,360)	16,57,640
Present Value of Annuity for three years is 2.4018 Annual Lease Payment (16,57,640 / 2.4018)	6,90,165.71

Classification of Lease:

Parameter 1:

The present value of lease payment i.e. Rs. 16,57,649 which equals 92.09% of the fair market value i.e., Rs. 18,00,000.

The present value of minimum lease payments is substantially covers the fair value of the leased asset

Parameter 2:

The lease term (i.e. 3 years) covers the major part of the life of the asset (i.e. 5 years).

Therefore, it constitutes a finance lease.

Computation of unearned Finance Income:

Particulars	Amount
Total Lease Payments (Rs. 6,90,165 x 3)	Rs. 20,70,495
Add: Unguaranteed residual value	<u>Rs. 2,00,000</u>
	<u>Rs. 22,70,495</u>
Less: Present value of lease payments and residual value i.e. Net investment (1,42,360+16,57,640)	<u>Rs. 18,00,000</u>
Unearned Finance Income	<u>Rs. 4,70,495</u>

#3. Question | May 2022 Exam, 5 marks |

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

Answer

As per AS 19, **lessees** are required to make following disclosures for **operating leases**:

- (a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years;
 - (iii) later than five years;
- (b) the total of future **minimum sublease payments** expected to be received under noncancelable subleases at the balance sheet date;
- (c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;
- (d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;
- (e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:
 - (i) the basis on which **contingent rent payments** are determined;
 - (ii) the existence and terms of **renewal or purchase options** and escalation clauses; and
 - (iii) **restrictions imposed** by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Note: The Level II and Level III non-corporate entities (and SMCs) need not make disclosures required by (a), (b) and (e) above.

#4. Question | December 2021 Exam, 5 marks |

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost of ₹2,25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

- (i) Annual Lease Rent
- (ii) Lease Rent income to be recognized in each operating year and
- (iii) Depreciation for 3 years lease

Answer

(i) Annual lease rent

Total lease rent

= 130% of ₹2,25,000 X Output during lease period/ Total output

= 130% of ₹2,25,000 x (60,000 + 75,000 + 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = ₹1,46,250

Annual lease rent = ₹1,46,250 / 3 = ₹48,750

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

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

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

Year 1 = ₹39,000

Year 2 = ₹48,750 and

Year 3 = ₹58,500

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹2,25,000 should be allocated over useful life 5 years in proportion of output,

i.e. in proportion of 60 : 75 : 90 : 120 : 105

Depreciation for year 1 is ₹30,000, year 2 = 37,500 and year 3 = 45,000.

#5. Question | January 2021, May 2018 Exam, 5 Marks |

X Ltd. sold machinery having WDV of ₹300 lakhs to Y Ltd. for Rs. 400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease. Give your comments in the following situations:

- (i) Sale price of ₹400 lakhs is equal to fair value.
- (ii) Fair value is ₹450 lakhs.
- (iii) Fair value is ₹350 lakhs and the sale price is ₹250 lakhs.
- (iv) Fair value is ₹300 lakhs and sale price is ₹400 lakhs.
- (v) Fair value is ₹250 lakhs and sale price is ₹290 lakhs.

Answer

Following will be the treatment in the given cases:

- (i) When sale price of ₹400 lakhs is equal to fair value, X Ltd. should immediately recognise the profit of ₹100 lakhs (i.e. 400 – 300) in its books.
- (ii) When fair value is ₹450 lakhs then also profit of ₹100 lakhs should be immediately recognised by X Ltd.
- (iii) When fair value of leased machinery is ₹350 lakhs & sales price is ₹250 lakhs, then loss of ₹50 lakhs (300 – 250) to be immediately recognised by X Ltd. in its books provided loss is not compensated by future lease payment.
- (iv) When fair value is ₹300 lakhs & sales price is ₹400 lakhs then, profit of ₹100 lakhs is to be deferred and amortised over the lease period.
- (v) When fair value is ₹250 lakhs & sales price is ₹290 lakhs, then the loss of ₹50 lakhs (300-250) to be immediately recognised by X Ltd. in its books and profit of ₹40 lakhs (290-250) should be amortised/deferred over lease period.

#6. Question | November 2019 Exam, 5 Marks |

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

- (i) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.
- (ii) Lessee has option to purchase the asset at lower than fair value at the end of lease term.
- (iii) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.
- (iv) Present Value (PV) of Minimum Lease Payment (MLP) = "X" Fair value of the asset is "Y" And X = Y.
- (v) 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.

#7. Question | May 2019 Exam, 5 Marks |

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

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

Answer

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

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

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

Present value of minimum lease payments Rs. 11,56,960 is more than fair value at the inception of lease.

i.e. ₹11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹11,50,000 as per AS 19.

#8. Question | RTP Sep 2025

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:

Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Mansi Ltd.)

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 para 48 of 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.

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.

#9. Question | RTP May 2025

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 Sun Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

Answer:

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment• amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 3)	3.36
Present Value of minimum lease payments (Rs. 3 lakhs each year)	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. 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

#10. Question | RTP Jan 2025

Money Limited leased a machine to Hello Limited on the following terms:

		(Rs. in lakh)
(i)	Fair value of the machine	24.00
(ii)	Lease term	5 years
(iii)	Lease rental per annum	4.00
(iv)	Guaranteed residual value	0.8
(v)	Expected residual value	1.5

(vi)	Internal rate of return	15%

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

Ascertain Unearned Finance Income.

Answer:

As per AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

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

$$\begin{aligned}
 \text{Gross investment} &= \text{Minimum lease payments} + \text{Unguaranteed residual value} \\
 &= [\text{Total lease rent} + \text{Guaranteed residual value (GRV)}] + \text{Unguaranteed residual value (URV)} \\
 &= [(Rs. 4,00,000 \times 5 \text{ years}) + Rs. 80,000] + Rs. 70,000 \\
 &= Rs. 21,50,000 \text{ (a)}
 \end{aligned}$$

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

Year	MLP inclusive of URV Rs.	Internal rate of return (Discount factor @ 15%)	Present Value Rs.
1	4,00,000	0.8696	3,47,840
2	4,00,000	0.7561	3,02,440
3	4,00,000	0.6575	2,63,000
4	4,00,000	0.5718	2,28,720
5	4,00,000	0.4972	1,98,880
	<u>80,000 (GRV)</u>	0.4972	<u>39,776</u>
	20,80,000		13,80,656 (i)
	<u>70,000 (URV)</u>	0.4972	<u>34,804 (ii)</u>
	<u>21,50,000</u>	(i)+ (ii)	<u>13,45,852(b)</u>

Unearned Finance Income (a) - (b) = Rs. 21,50,000 – Rs. 13,45,852 = Rs. 8,04,148.

#11. Question | RTP May 2023 | RTP May 2018

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

Answer

Computation of annual lease payment to the lessor

Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% ($\text{₹}1,33,500 \times 0.751$)	1,00,258.50
Fair value to be recovered from lease payments ($\text{₹}16,99,999.5 - \text{₹}1,00,258.5$)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = $\text{₹}15,99,741 / 2.486$	6,43,500.00

Computation of Unearned Finance Income

Total lease payments ($\text{₹}6,43,500 \times 3$)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) ($\text{₹}1,00,258.5 + \text{₹}15,99,741$)	(16,99,999.50)
Unearned finance income	3,64,000.50

#12. Question | RTP May 2021 |

- (a) Classify the following into either operating or finance lease:
- If Present value (PV) of Minimum lease payment (MLP) = "X" ; Fair value of the asset is "Y" and $X=Y$.
 - Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;
 - Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.
- (b) Viral Ltd. sold machinery having WDV of Rs. 40 lakhs to Saral Ltd. for Rs. 50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –
- Fair value is ₹45 lakhs and sale price is ₹38 lakhs.
 - Fair value is ₹40 lakhs and sale price is ₹50 lakhs.
 - Fair value is ₹46 lakhs and sale price is ₹50 lakhs

Answer

- (a)
- The lease is a **finance lease** if $X = Y$, or if X substantially equals Y.
 - The lease will be classified as a **finance lease**, since a **substantial portion** of the life of the asset is covered by the lease term.
 - (iii) Since the asset is procured **only for the use of lessee**, it is a finance lease.
- (b) As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:
- Situation 1:** Sale price = Fair Value Profit or loss should be recognized immediately.
- Situation 2:** Sale Price < Fair Value
Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.
- Situation 3:** Sale Price > Fair Value
The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Following will be the treatment in the situations given in the question:

- (i) When fair value of leased machinery is ₹45 lakhs & sales price is ₹38 lakhs, then loss of ₹2 lakhs (40 – 38) to be immediately recognized by Viral Ltd. in its books provided loss is not compensated by future lease payment.
- (ii) When fair value is ₹40 lakhs & sales price is ₹50 lakhs then, profit of ₹10 lakhs is to be deferred and amortized over the lease period When fair value is ₹46 lakhs & sales price is ₹50 lakhs, profit of ₹6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of ₹4 lakhs (50-46) is to be amortized/deferred over lease period.

#13. Question | RTP May 2022, November 2020, November 2019 |

Sooraj 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 Sooraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

Answer

As per AS 19 'leases', a lease will be classified as **finance lease** if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 3)	3.36
Present Value of minimum lease payments (₹3 lakhs each year)	₹10.08 lakhs

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, **lease term should be for the major part of the economic life** of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an **operating lease**. Lease payments under an operating lease should be **recognized as an expense** in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

#14. Question | RTP May 2020, November 2019, November 2018 |

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being Rs. 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays Rs. 3,50,000. The lessee has guaranteed a residual value of Rs. 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be Rs. 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

Answer

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the stand point of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is ₹10,00,000 and the net present value of minimum lease payments is ₹10,07,020 (Refer working Note). As the present value of the machine is more than

the fair value of the machine, the machine and the corresponding liability will be recorded at value of ₹10,00,000.

Calculation of finance charges for each year

Year	Finance charge (₹)	Payment	Reduction in outstanding liability (₹)	Outstanding liability (₹)
1st year beginning	-	-	-	10,00,000
End of 1st year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2nd year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3rd year	94,336	3,50,000	2,55,664	3,33,936
End of 4th year	53,430	3,50,000	2,96,570	37,366

Working Note:

Present value of minimum lease payments

	₹
Annual lease rental x PV factor (3,50,000 x (0.8621 + 0.7432 + 0.6407 + 0.5523))	9,79,405
Present value of guaranteed residual value ₹50,000 x (0.5523)	27,615
	10,07,020

#15. Question | RTP May 2019|

Aksat International Limited has given a machinery on lease for 36 months, and its useful life is 60 months. Cost & fair market value of the machinery is Rs. 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is Rs. 50,000.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

Answer

Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year = ₹50,000 x 0.7513 = ₹37,565
 Present value of lease payments = ₹5,00,000 - ₹37,565 = ₹4,62,435 The percentage of present value of lease payments to fair value of the equipment is (₹4,62,435 / ₹5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹4,62,435 / 2.4868 = ₹1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value
 = (₹1,85,956 x 3) + ₹50,000
 = ₹5,57,868 + ₹50,000 = ₹6,07,868

Unearned finance income

= Gross investment - Present value of minimum lease payments and unguaranteed residual value.

$$= ₹6,07,868 - ₹5,00,000 = ₹1,07,868$$

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#1. Question | Jan 2025 Exam, 7 marks |

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

Invoice less than 1 year : 2.5% provision

Invoice more than 1 year : 4.5% provision

The Company has raised Invoices as under:

Invoice Date	Rs.
20 th February, 2021	42,000
17 th July, 2022	25,000
27 th January, 2022	47,000
1 st March, 2023	1,10,000
24 th August, 2023	34,000
20 th March, 2024	75,000

You are required to:

- Calculate the provision to be made for warranty under AS 29 as at 31st March, 2023 and 31st March, 2024:
- Also compute the amount to be debited to Profit and Loss Account for the year ended 31st March, 2024.

Answer:

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

As at 31st March 2023 = Rs. 25,000 x 2.5% + Rs. 47,000 x 2.5% + Rs. 1,10,000 x 4.5%
= Rs. 625 + Rs. 1,175 + Rs. 4,950 = Rs. 6,750

As at 31st March 2024 = Rs. 1,10,000 x 2.5% + Rs. 34,000 x 4.5% + Rs. 75,000 x 4.5%
= Rs. 2,750 + Rs. 1,530 + Rs. 3,375 = Rs. 7,655

Amount debited to Statement of Profit and Loss for year ended 31st March 2024

	Rs.
Balance of provision required as on 31.03.2024	7,655
Less: Opening Balance as on 1.4.2023	(6,750)
Amount debited to Statement of Profit and loss	<u>905</u>

Note: No provision will be made on 31st March 2024 in respect of sales amounting Rs. 42,000, 25,000 and 47,000 made on as the warranty period

#2. Question | November 2022 Exam, 5 marks |

At the end of the financial year ending on 31st March, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Particulars	Probability	Loss (₹)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000

Remaining five cases (Win)	50%	-
Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29.

Answer

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

- 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:

$$\begin{aligned}
 \text{Expected loss in next ten cases} &= 40\% \text{ of ₹ 12,00,000} + 10\% \text{ of ₹ 20,00,000} \\
 &= ₹ 4,80,000 + ₹ 2,00,000 \\
 &= ₹ 6,80,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Expected loss in remaining five cases} &= 30\% \text{ of ₹ 10,00,000} + 20\% \text{ of ₹ 21,00,000} \\
 &= ₹ 3,00,000 + ₹ 4,20,000 \\
 &= ₹ 7,20,000
 \end{aligned}$$

To disclose contingent liability on the basis of maximum loss will be **highly unrealistic**. Therefore, the better approach will be to disclose the overall expected loss of ₹ 1,04,00,000 (₹ 6,80,000 X 10 + ₹ 7,20,000 X 5) as contingent liability.

#3. Question | May 2022 Exam, 5 marks |

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalisation of the accounts for the year ended 31st March, 2022 and needs your advice on the following issues in line with the provisions of AS-29:

- On 1st April, 2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March, 2022, the company does not provide any provision for replacement of lining of the furnace.
- A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalization of the case. There are 70% chances that the penalty may not be levied.

Answer

- A provision should be recognized only when an enterprise has a **present obligation** arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore **no provision is recognized as per AS 29**. The cost of replacement of lining of furnace is not recognized as a provision **because it is a future obligation**. Even a legal requirement does not require the company to make a provision for the cost of replacement because there is no present obligation. Even

the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

- II. As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 70% chances that the penalty may not be levied. Accordingly, Alloy Fabrication Ltd. **should not make the provision for penalty**. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

However, a **provision should be made for remaining 40%** fees of the lawyer amounting ₹2,00,000 in the financial statements of financial year 2021-2022

#4. Question | November 2020 Exam, 5 marks |

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

- (i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.
- (ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.

Answer

- (i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement **is probable**. Thus, a provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is **no obligation to rectify the damage** that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, **no provision is required for the cost of extraction** of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.
- (ii) As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff. The expenditures of training the staff related to the future conduct of the business and are **not liabilities for restructuring at the balance sheet date**. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence **no provision is required**.

#5. Question | November 2019 Exam, 5 marks | RTP May 2023

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

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
11th Feb, 2017	60,000

25th Dec, 2017	40,000
04 th Oct, 2018	1,35,000

Calculate the provision to be made for warranty under AS -29 as at 31st March , 2018 and 31st March 2019 Also compute amount to be debited to P & L account for the year ended 31st March 2019.

Answer

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

As at 31st March, 2018 = ₹60,000 x .02 + ₹40,000 x .03

= ₹1,200 + ₹1,200 = ₹2,400

As at 31st March, 2019 = ₹40,000 x .02 + ₹1,35,000 x .03

= 800 + ₹4,050 = ₹ 4,850

Amount debited to Profit and Loss Account for year ended 31st March, 2019

Invoice Date	Amount (₹)
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 1.4.2018	(2,400)
Amount debited to profit and loss account	2,450

Note: **No provision will be made** on 31st March, 2019 in respect of sales amounting ₹60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

#6. Question | RTP Jan 2025 |

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2023 and needs your expert advice on the following issues:

- (i) The company has its plants at 3 different locations. It has to shut down one of its plants due to internal reasons. The said plant site is under a rental agreement till 31.3.2024. The rent per month is Rs. 80,000. If the company cancels the agreement, it has to pay a penal amount equal to six month's rent. The company also has an option to sub-let the site at a rent of Rs. 45,000 per month.
- (iii) A case has been filed against the company in the consumer court and a notice for levy of a penalty of Rs. 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of Rs. 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.
- (iv) The company had committed to supply a consignment worth Rs. 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% of the value is to be paid. While the consignment was in transit, one of the trucks carrying goods worth Rs. 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed for the compensation.

Give your answers based on relevant Accounting standard.

Answer:

- (i) As per AS 29, an 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract is the lower of net cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

In the given case, Saharsh Ltd. is required to pay:

In case of cancellation of agreement:
= Rs. 80,000 x 6 months = Rs. 4,80,000

In case of continuance of agreement (in case of sub-let):

Net of rent paid over rent collected from sub-tenant (Rs. 80,000 -45,000) x 12 = Rs. 4,20,000.

Lower of the above is to be provided for i.e. Rs. 4,20,000 is to be provided for.

- (ii) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not. Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2023-2024.

- (iii)
- | | |
|---|----------------------|
| Loss due to accident | Rs. 30,00,000 |
| Insurance claim receivable by company | <u>Rs. 27,00,000</u> |
| = Rs. 30,00,000 x 90% = | |
| Loss to be recognised in the books for 2023-2024 | <u>Rs. 3,00,000</u> |
| Insurance claim receivable to be recorded in the books | Rs. 27,00,000 |
| Compensation claim by dealer against company to be provided for in the books = Rs. 30,00,000 x 15%= | Rs. 4,50,000* |

*Note: Alternatively, the compensation @ 15% can be computed on the whole contract amount of Rs. 1 crore. In such a situation, the compensation should be Rs. 15,00,000 (1 crore x 15%).

#7. Question | RTP Jan 2025 |

During the year, QA Ltd. delivered manufactured products to customer

K. The products were faulty and on 1st October, 2023 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2023, the Company commenced legal action against F claiming damages in respect of the supply of defective raw materials.

QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.

On 1st October, 2023, QA Ltd. has estimated that the damages it would have to pay K would be Rs. 5 crore. This estimate was revised to Rs. 5.2 crore as on 31st March, 2024 and Rs. 5.25 crore as at 15th May, 2024. This case was eventually settled on 1st June, 2022, when the Company paid damages of Rs. 5.3 crore to K.

On 1st December, 2023, QA Ltd. had estimated that it would receive damages of Rs. 3.5 crore from F. This estimate was revised to Rs. 3.6 crore as at 31st March, 2024 and Rs. 3.7 crore as on 15th May, 2024. This case was eventually settled on 1st June, 2022 when F paid Rs. 3.75 crore to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2024, provided Rs. 3.6 crore as the financial statements were approved by the Board of Directors on 26th April, 2024.

- (i) Whether the Company is required to make provision for the claim from customer K as per applicable AS? If yes, please give the rationale for the same.
- (ii) If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2024?

- (v) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable AS?

Answer:

- (i) Yes, QA Ltd. is required to make provision for the claim from customer K as per AS 29 since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of Rs. 5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31st March, 2024.
- (ii) Statement of Profit and Loss A/c Dr. Rs. 5.2 crore
To Current Liability A/c Rs. 5.2 crore
- (iii) As per para 30 of AS 29, QA Ltd. shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized.

#8. Question | RTP November 2022, May 2022 |

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

- (i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of ₹10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.
- (ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ₹3,00,000 being the cost of litigation. No entries/provisions have been made in the books.
- (iii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ₹10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

Answer

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

- (i) In this case, **there is no present obligation** arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, **no provision can be recognized** in the instant case.
- (ii) On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case and also a **reliable estimate of the outflow** can be made as ₹3,00,000, there is a present obligation. Hence, **provision should be recognised** for ₹3,00,000 for the amount which may be required to settle the obligation.
- (iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is **no obligation** because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence,

no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

#9. Question | RTP Sep 2024 |

A company incorporated under Section 8 of the Companies Act, 2013, have main objective to promote the trade by organizing trade fairs / exhibitions. When company was organizing the trade fair and exhibitions it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1. 5% contingency charges are treated as income and matching provision for the same is also being made in accounts.
2. A suitable disclosure to this effect is also made in the notes forming part of accounts.

Required:

- (i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS 29.
- (ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet.

Answer:

(i) Para 14 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets" states that a provision should be recognised when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

From the above, it is clear that in the contingencies considered by the company, neither a present obligation exists as a result of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognised for such contingencies under the facts and circumstances of the case.

(ii) "Provision" is the amount retained by the way of providing for any known liability. Since the contingencies stipulated by the company are not known at the balance sheet date, the provision in this regard cannot be created. Therefore, the provision so created by the company shall be treated as a 'Reserve'.

#10. Question | RTP November 2021 |

- (a) A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on

this account cannot be estimated. The accounting treatment and disclosure was made by the company in its financial statements as:

- (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and
- (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

- (b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29?

Answer

- (a) As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when:
 - i. An enterprise has a present obligation as a result of a past event and
 - ii. It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
 - iii. A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

From the above, it is clear that for the contingencies considered by the company, **neither a present obligation exists** because of past event, **nor a reliable estimate can be made** of the amount of the obligation. Accordingly, a **provision cannot be recognized** for such contingencies under the facts and circumstances of the case.

- (b) As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be **no obligation to remedy the consequences**. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company **has to provide for such clean-up cost** in the year in which the law is **virtually certain to be enacted**.

#11. Question | RTP May 2021, November 2019, May 2018 |

- (a) The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.
You are required to examine in line with the provisions of AS 29.
- (b) Explain whether provision is required in the following situations in line with AS 29:
 - (i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;
 - (ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.
 - (iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

Answer

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

It is apparent from the Question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is **not correct**.

(b)

- (i) There is a present obligation that **probably requires an outflow** of resources and a reliable estimate can be made of the amount of obligation – **Provision is recognized**. Disclosures are required for the provision.
- (ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.
- (iii) There is a possible obligation or a present obligation where the likelihood of an **outflow of resources is remote** – **No provision** is recognised. No disclosure is required.

#12. Question | RTP November 2020 |

- (a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.
- (b) Alpha Ltd. has entered into a sale contract of ₹7 crores with Gamma Ltd. during 2018-19 financial year. The profit on this transaction is ₹1 crore. The delivery of goods to take place during the first month of 2019-20 financial year. In case of failure of Alpha Ltd. To deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2018-19 financial year. As on balance sheet date (31.3.2019), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement of provision for contingency in the financial statements for the year ended 31st March, 2019, in line with provisions of AS 29?

Answer

- (a) **A Contingent liability** is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
A present obligation that arises from past events but is not recognized because:
 - (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) A reliable estimate of the amount of the obligation cannot be made.An enterprise should not recognize a contingent **liability but should be disclosed**. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.
Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is **virtually certain**, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.
- (b) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. **should provide for the contingency** amounting ₹2 crores as per AS 29.

#13. Question | RTP May 2020 |

With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

- (i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.
- (ii) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31st Dec. 2019, it goes into liquidation. (Balance Sheet date 31-3-19).

Answer

- (i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is **no obligation** to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is **probable**. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, **no provision is required** for the cost of extraction of oil at balance sheet date. **Ten per cent** of costs that arise through the extraction of oil are **recognized as a liability** when the oil is extracted.
- (ii) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which **gives rise to an obligation**. No outflow of benefits is probable at 31 March 2019. Thus **no provision is recognized**. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote. During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, **provision is recognized** for the best estimate of the obligation.

#14. Question | RTP May 2019, November 2018 |

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

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

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

Answer

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

- (a) an enterprise has a present obligation as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be **no outflow of the resources**. Hence, **no provision is required**. The company will **disclose** the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

AS – 15 EMPLOYEE BENEFITS

ILLUSTRATIONS

#1.Illustration | Jan 2025, Exam, 4 Marks |

What is the difference between Defined Contribution Plan and Defined Benefit Plan? From the following information calculate the amount of defined benefit liability /asset:

Particulars	Rs. in lakhs
Present Value of Defined Benefit Obligation as on 31-3-2024	36.0
Fair Value of Plan asset	38.5
Past service cost not yet recognized	7.5
Present value of available future refund from the plan	6.0

Answer:

Difference between Defined Contribution Plan and Defined Benefit Plan:

S No.	Defined Contribution Plan	Defined Benefit Plan
1	Fixed Contributions are paid by the employer into a separate fund and will have no obligation to pay further contributions.	Detailed actuarial calculation is performed to determine the charge.
2	The employer has no obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits and the employee has to bear the investment and actuarial risk.	The employer ensures that sufficient funds are available to meet the promised benefits regardless of fund performance and the actuarial and investment risk fall on the employer.

Computation of defined benefit liability /Asset:

Particulars	Rs. in lakhs
Present value of the defined benefit obligation as on 31.3.2024	36.00
Less: Past service cost not yet recognized	(7.50)
	28.50
Less: The fair value of plan assets	(38.50)
Defined benefit Asset	10.00

In case where fair value of plan assets is high, it may so happen that the net amount under defined benefit liability turns negative (giving rise to net assets).

As per AS 15 the enterprise, in such a situation, should measure the resulting asset at the lower of:

- (i) the amount so determined, i.e. Rs. 10 lakh; and
- (ii) the present value of available future refunds from the plan i.e. Rs. 6 lakh.

Therefore, defined benefit asset will be recognised at Rs. 6 lakhs.

#2.Illustration | September 2024, Exam, 5Marks |

Pendora Ltd. has given the following details in respect of employee benefit pension plan:

Particulars	Amount Rs.
The fair value of plan assets as on 01-04-2023	5,00,000
The benefits paid out on 30-11-2023	63,000
Inward contributions received on 30-09-2023	1,42,000
The fair value of plan assets as on 31-03-2024	7,50,000

On 01.04.2023, the company made following estimates, based on its market studies and prevailing prices :

Particulars	%
Interest and dividend income (after tax) payable by fund	10.50
Realised gains on plan assets (after tax)	2.00
Fund administrative costs	-2.00
Expected rate of annual return (Interest is compounded annually)	10.50

You are required to find the expected and actual returns on plan assets as on 31.03.2024 as per AS 15.

Answer:

Computation of Expected and Actual Returns on Plan Assets

	Rs.
Return on Rs. 5,00,000 held for 12 months at 10.50%	52,500
Return on Rs. 1,42,000 for 6 months at 10.50%	7,455
Loss of interest on benefits paid for 4 months on Rs. 63,000 for 4 months @ 10.50%	(2,205)
Expected return on plan assets for 2023-2024	57,750
Fair value of plan assets as on 31 st March 2024	7,50,000
Less: Fair value of plan assets as on 1 April, 2023	5,00,000
Contributions received on 30.9.2023	1,42,000
	(6,42,000)
	1,08,000
Add: Benefits paid on 30 th Nov 2023	63,000
Actual return on plan assets	1,71,000

#3.Illustration | May 2024, RTP |

Hello Limited belongs to the manufacturing industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 12 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 4 lakhs instead of Rs. 10 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

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, a surplus amount of Rs. 12 lakhs is required to be credited to the profit and loss statement of the current year.

AS – 9 Revenue Recognition

Past Exams and RTP Questions Compiler

#1. Question | November 2022 Exam, 5 marks |

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

- (i) Delivery is delayed at buyer's request but buyer takes title and accepts billing.
- (ii) Instalment Sales.
- (iii) Trade discounts and volume rebates.
- (iv) Insurance agency commission for rendering services.
- (v) Advertising commission.

Answer

- (i) **Delivery is delayed at buyer's request and buyer takes title and accepts billing** : Revenue should be **recognized notwithstanding that physical delivery** has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.
- (ii) **Instalment sales**: When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the **date of sale**. The **interest element should be recognized as revenue**, proportionately to the unpaid balance due to the seller.
- (iii) **Trade discounts and volume rebates**: Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be **deducted in determining revenue**.
- (iv) **Insurance agency commissions for rendering services**: Insurance agency commissions should be **recognized on the effective commencement or renewal** dates of the related policies.
- (v) **Advertising commission**: Revenue should be **recognized when the service is completed**. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

#2. Question | December 2021 Exam, 5 marks |

Given the following information of Rainbow Ltd.

- (i) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.
 - (ii) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurbishing of their showroom being underway, on their request, goods were delivered on 10th April.
 - (iii) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to repurchase the same goods on 14th April.
 - (iv) Dew Ltd, used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 as interest and royalties respectively from Dew Ltd. during the year 2020 -21.
 - (v) On 25th December, goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year-end on 31st March.
- In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.

Answer

- (i) As per AS 9 "Revenue Recognition", in case of **goods sold on approval basis**, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period **for rejecting the goods had expired**.
- (ii) The sale is complete but delivery has been postponed at buyer's request. The entity should **recognize the entire sale** of ₹ 2,40,000 for the year ended 31st March.

- (iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence **no revenue to be recognized** in the given case.
- (iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The **royalty should be recognized on accrual basis** in accordance with the terms of relevant agreement.
- (v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue **should not be recognized until the goods are sold** to a third party.

#3. Question | July 2021 Exam, 5 Marks |

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March. **(Includes concepts from AS 29-Provisions, Contingent Liabilities & Contingent Assets)**

Answer

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	<u>11.52</u>	<u>2.304</u>
Total				<u>22.68</u>	<u>4.536</u>

Revenue to be recognized Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- Seller of goods has transferred to the buyer the **property in the goods** for a price or all **significant risks and rewards of ownership** have been transferred to the buyer and the **seller retains no effective control** of the goods transferred to a degree usually associated with ownership; and
- No significant uncertainty** exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back,

if not completely satisfied, it may be appropriate to recognize the sale **but to make a suitable provision** for returns based on **previous experiences**.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, **total revenue to be recognized for ₹400 lacs** for the year.

Working Note:

Calculation of Profit % on sales

Time frame of Return from date of purchase	(₹ in lacs)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80
Profit mark up on sales $(80/400) \times 100 = 20\%$	

#4. Question | November 2019 Exam, 5 Marks |

Indicate in each case whether revenue can be recognized and when it will be recognized as per As -9.

- Trade discount and volume rebate received.
- Whether goods are sold to distributor or others for resale. (3) Whether seller concurrently agrees to repurchase the same goods at a later date.
- Insurance agency commission for rendering services.
- On 11-3-2019 cloths worth Rs. 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019.

Answer

- Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be **deducted in determining revenue**.
- When goods are sold to distributor or others, revenue from such sales can generally be recognized if **significant risks of ownership** have passed; however, in some situations the buyer may in substance be an **agent** and in such cases the sale should be **treated as a consignment sale**.
- For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in **substance a financing agreement**, the resulting cash inflow is not revenue as defined and should **not be recognized as revenue**.
- Insurance agency commissions should be recognized on the effective **commencement or renewal** dates of the related policies.
- On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and **all risk and reward** on ownership has been transferred to the buyers. Revenue should be recognized for year ended 31st March, 2019 **notwithstanding that physical delivery** has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

#5. Question | May 2019 Exam, 5 Marks | RTP November 2018, November 2020, RTP May 20

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

- Goods ₹50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018. On 13-01-2018 goods of ₹1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.
- ₹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:

- (i) the seller of goods has transferred to the buyer the property in the goods for a price or all **significant risks and rewards** of ownership have been transferred to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and
- (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i): The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should **recognize the entire sale** of ₹50,000 for the year ended 31st March, 2018.

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

Case (iii) : In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹1,00,000 as the time **period for rejecting the goods had expired**. Thus total revenue amounting ₹2,50,000 (50,000 + 1,00,000 + 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.

#6. Question | RTP Sep 2025 |

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year 2024-25:

- (i) On 31st December, 2024 shoes worth Rs. 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March, 2025.
- (ii) On 10th January, 2025, Tonk Tanner supplied shoes worth Rs. 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April 2025.
- (iii) On 21st March, 2025 shoes worth Rs. 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April, 2025.

You are required to advise the accountant of Tonk Tanners, when amount is to be recognised as revenue in 2024 -25 in above cases in the context of AS 9.

Answer:

(i) Shoes sent to Mohan Shoes (consignee) for consignment sale

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2024-25, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for Rs. 3,20,000 x 75% = Rs. 2,40,000.

(ii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2024-25. Hence, sale of Rs. 4,50,000 to Shani Shoes should not be recognized as revenue.

(iii) Delivery is delayed at buyer's request

On 21st March, 2025, if Shoe Shine takes title and accepts billing for the goods then it is implied that the sale is complete and all the risk and rewards of ownership has been transferred to the buyer. In case no significant uncertainty exists regarding the amount

of consideration for sale, revenue shall be recognized in the year 2024-25 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

#7. Question | RTP May 2025 |

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

- (i) Goods of Rs. 50,000 were sold on 18-03-2024 but at the request of the buyer these were delivered on 15-04-2024.
- (ii) On 13-01-2024 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 31-03-2024.
- (iii) Rs. 1,00,000 worth of goods were sold on approval basis on 01-12-2023. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2024 and no approval or disapproval received for the remaining goods till 31-03-2024.

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, 2024 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:

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

Case (i): The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should recognize the entire sale of Rs. 50,000 for the year ended 31st March, 2024.

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

Case (iii): In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting Rs. 1,00,000 as the time period for rejecting the goods had expired.

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, 2024 in the books of B.S. Ltd.

#8. Question | RTP Jan 2025 |

Mithya Ltd. entered into agreement with Satya Ltd. for sale of goods costing Rs. 8 lakh at a profit of 20% on cost. The sale transaction took place on 1st February, 2024. On the same day, Satya Ltd. entered into another agreement with Mithya Ltd. to resell the same goods at Rs. 10.80 lakh on 1st August, 2024. State the treatment of this transaction in the financial statements of Mithya Ltd. as on 31.03.2024. The pre-determined re-selling price covers the holding cost of Satya Ltd. Give the Journal Entries as on 31.03.2024 in the books of Mithya Ltd.

Answer:

In the given case, Mithya Ltd. concurrently agreed to repurchase the same goods from Satya Ltd. on 1st February, 2024. Also the re-selling price is pre-determined and covers purchasing and holding costs of Satya Ltd. Hence, the transaction between Mithya Ltd. and Satya Ltd. on 1st February, 2024 should be accounted for as financing rather than sale. The resulting cash flow of Rs. 9.60 lakh received by Mithya Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of Mithya Ltd.

			Rs. in lakh	
1.2.2024	Bank Account	Dr.	9.60	
	To Advance from Satya Ltd [□] . (Being advance received from Satya Ltd. amounting [Rs. 8 lakh + 20% of Rs. 8 lakh = 9.60 lakh] under sale and re-purchase agreement)			9.60
31.3.2024	Financing Charges Account To Satya Ltd. (Financing charges for 2 months [(10.80 - 9.60) x 2/6])	Dr.	0.40	0.40
31.3.2024	Profit and Loss Account To Financing Charges Account (Being amount of finance charges transferred to P&L Account)	Dr.	0.40	0.40

#9. Question | RTP Sep 2024 |

When will the revenue be recognized in the case of inter divisional transfers?

Answer:

The Accounting Standard Board of ICAI has come up with an announcement in the earlier years wherein it clarified that the inter-divisional transfers/sales are not revenue as per AS 9 "Revenue Recognition". According to it, in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Therefore, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. Hence, no revenue is recognized in the case of inter-divisional transfers.

#10. Question | RTP May 2023 |

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree?

Answer

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with **reasonable certainty** is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc., revenue recognition is **postponed to the extent of uncertainty involved**. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is **no uncertainty as to ultimate collection**, revenue is recognised at the **time of sale or rendering of service** even though payments are made by instalments.

Thus, PQR Ltd. cannot recognise the interest amount **unless the company actually receives it**. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable **only on receipt basis**.

#11. Question | RTP November 2022 |

When revenue will be recognized in the following situation:

- (i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.
- (ii) Where seller concurrently agrees to repurchase the same goods at a later date.
- (iii) Where goods are sold to distributors, dealers or others for resale.
- (iv) Commissions on service rendered as agent on insurance business.

Answer

- (i) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be **recognised until goods are delivered**. However, when **experience indicates** that most such sales have been consummated, revenue may be recognised when a **significant deposit is received**.
- (ii) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a **financing agreement**. In such a situation, the resulting cash inflow **should not be recognised as revenue**.
- (iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if **significant risks** of ownership have passed. However, in some situations the buyer may in substance be an **agent** and in such cases the sale should be treated as a **consignment sale**.
- (iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the **service is completed**. Insurance agency commissions should be recognised on the effective **commencement or renewal** dates of the related policies.

#12. Question | RTP May 2022 |

An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

Answer

AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when **uncertainties exist** regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be **recognized in the financial year of accrual**. Therefore, the **contention of the Chief Financial Officer is not** in accordance with AS 9.

#13. Question | RTP November 2021 |

- (a) How will you recognize revenue in the following cases:
 - 1. Installation Fees;
 - 2. Advertising and insurance agency commissions;
 - 3. Subscriptions for publications.
- (b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9.

Answer

- (a) **Installation Fees:** In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the **equipment is installed and accepted by the customer**.

Advertising and insurance agency commissions: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the **effective commencement or renewal dates of the related policies**.

Subscription for publications: Revenue received or billed should be deferred and recognized **either on a straight-line basis over time** or, where the items delivered vary in value from period to period, revenue should be **based on the sales value** of the item delivered in relation to the total sales value of all items covered by the subscription

- (b) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When **uncertainties exist** regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be **recognized on sales**. On the other hand, in Apparels Industry, the dealers have **a right to return** the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company **should not recognize the revenue** to the extent of 25% of its sales. The company may **disclose suitable revenue recognition policy** in its financial statements separately for both Jewellery and Apparels business.

#14.Question | RTP May 2021 |

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March,2020:

- (i) On 31st December, 2019 shoes worth Rs. 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March,2020.
- (ii) On 10th January, 2020, Tonk Tanner supplied shoes worth Rs. 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.
- (iii) On 21st March, 2020 shoes worth Rs. 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April, 2020.

Answer

- (i) Shoes sent to Mohan Shoes (consignee) for consignment sale. In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer. In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the **risk and reward** is considered to vest with Tonk Tanners only till the time the sale is made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2019- 2020, the sale will be recognized for the amount of **goods sold by Mohan Shoes to the third party** i.e. for Rs. $3,20,000 \times 75\% = ₹2,40,000$.
- (ii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2019-2020. Hence, sale of ₹4,50,000 to Shani Shoes **should not be recognized** as revenue.
- (iii) Delivery is delayed at buyer's request On 21st March, 2020, if Shoe Shine takes title and accepts billing for the goods then it is implied that the sale is complete and all the risk and rewards of ownership has been transferred to the buyer. In case **no significant uncertainty** exists regarding the amount of consideration for sale, revenue shall be recognized in the year 2019-2020 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

#15.Question | RTP November 2019 |

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include ₹15 lakhs in the sales for 2018-2019. Advise.

Answer

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. If the company is able to assess the ultimate collection with **reasonable certainty**, then additional revenue arising out of the **said price revision may be recognized in 2018-2019 vide para 10 of AS 9.**

#16.Question | RTP May 2019|

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth ₹15,00,000 ready for dispatch. Raj Ltd. accounted ₹15,00,000 as sales and transferred the balance to Advance received against Sales account. Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9.

Answer

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

- (i) the seller of goods has transferred to the buyer the property in the goods for a price or all **significant risks and rewards of ownership** have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
- (ii) **no significant uncertainty exists** regarding the amount of the consideration that will be derived from the sale of the goods. In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. **should recognize the entire sale** of ₹30,00,000 (₹5,00,000 x 6) and no part of the same is to be treated as Advance Received against Sales.

#17.Question | RTP May 2018|

A manufacturing company has the following stages of production and sale in manufacturing fine paper rolls:

Date	Activity	Cost to Date (₹)	Net Realizable Value (₹)
15.1.16	Raw Material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and calculate how much would be net profit for year ending 31.3.16 on this product as per AS 9.

Answer

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- (i) the seller of goods has transferred to the buyer the property in the goods for a price or all **significant risks and rewards** of ownership have been transferred to the buyer and the **seller retains no effective control of the goods** transferred to a degree usually associated with ownership; and
- (ii) **no significant uncertainty exists** regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

- (i) The sale value **is fixed and determinable.**
- (ii) **Property** of the goods is transferred to the customer.

Both these **conditions are satisfied** only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit ₹1,50,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2016

1FIN by IndigoLearn

AS – 7 Construction Contracts

Past Exams and RTP Questions Compiler

#1. Question | May 2024, 7 marks |

Constructions Limited is engaged in the business of constructing Flyovers and Railway over bridges. It obtained a contract from Railway Authorities to construct a railway over bridge for Rs. 400 crores. The construction of the railway over bridge is expected to be completed in 4 years.

At the outset of the contract, it was estimated that the total costs to be incurred will be Rs. 370 crores but by the end of year 1, this estimate stands revised to Rs. 375 crores.

During year 3, the Construction Limited has requested for a variation in the contract which is approved by Railway Authorities and accordingly the total contract value will increase by Rs. 10 crores and costs will increase by Rs. 7 crores.

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

Year 1 Rs. 98.8 crores

Year 2 Rs. 202.4 crores

Year 3 Rs. 310 crores (including unused material of 3 crores)

Year 4 Rs. 382 crores

You are required to:

- (1) Calculate stage of completion of contract for each year
- (2) Profit to be recognised for each year.

Answer:

Stage of completion = Costs incurred to date / Total estimated costs

Year 1: 98.8 crore / 375 crore = 26.35%

Year 2: 202.4 crore / 375 crore = 53.97%

Year 3: (310 crore – 3 crore) / (375+7) crore = 80.37%

Year 4: 382 crore / 382 crore = 100%

Profit to be recognized each year has been calculated as follows:

	Year 1	Year 2	Year 3	Year 4
Contract Revenue (1)	105.40 crore	110.48 crore	113.64 crore	80.48 crore
	(400 crore x 26.35%)	(400 crore x 53.97% - 105.40 crore)	(410 crore x 80.37% - 105.40 crore - 110.48 crore)	(410 crore x 100% - 105.40 crore - 110.48 crore - 113.64 crore)
Contract Cost (2)	98.8 crore	103.60 crore	104.60 crore	75 crore
		202.40 - 98.80 crore)	(307 crore - 98.8 crore - 103.60 crore)	(382 crore - 98.8 crore - 103.6 crore - 104.6 crore)
Contract Profit (1) – (2)	6.60 crore	6.88 crore	9.04 crore	5.48 crore

#2. Question | May 2022, 5 marks |

Grace Ltd., a firm of contractors provided the following information in respect of a contract for the year ended on 31st March, 2022:

Particulars	(₹ in '000)
Fixed Price Contract with an escalation clause Work Certified	35,000
Work not Certified (includes ₹ 26,25,000 for materials issued, out of which material lying unused at the end of the period is ₹ 1,40,000)	17,500
Estimated further cost to completion	3,815
Progress Payment Received Payment to be Received	17,325
Escalation in cost is by 8% and accordingly the contract price is increased by 8%	14,000

From the above information, you are required to:

- Compute the contract revenue to be recognized.
- Calculate Profit /Loss for the year ended 31st March, 2022 and additional provision for loss to be made, if any, for the year ended 31st March, 2022.

Answer

Calculation of total estimated cost of construction

	₹ in thousands
Cost of Contract incurred till date	
- Work certified	17,500
- Work not certified (3,815 thousand – 140 thousand)	3,675
	21,175
Add: Estimated future cost	17,325
Total estimated cost of construction	38,500
Contract Price (35,000 thousand x 1.08)	37,800

Stage of completion

Percentage of completion till date to total estimated cost of construction = [Cost of work completed till date / total estimated cost of the contract] x 100 = [₹ 21,175 thousand / ₹ 38,500 thousand] x 100 = 55%

Revenue to be recognized for the year ended 31st March, 2022

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = ₹ 37,800 thousand x 55% = ₹ 20,790 thousand

Loss to be recognized for the year ended 31st March, 2022

Loss for the year ended 31st March, 2022 = Cost incurred till date – Revenue to be recognized for the year ended 31st March, 2022 = ₹ 21,175 thousand – ₹ 20,790 thousand = ₹ 385 thousand

Provision for loss to be made at the end of 31st March, 2022

#3. Question | June 2021, 5 marks |

Mr. Rakshit gives the following information relating to items forming part of inventory as on 31st

The following data is provided for M/s. Raj Construction Co.

- Contract Price - ₹ 85 lakhs
- Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused at the end of the period.
- Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)
- Specific Contract Costs - ₹ 5 Lakhs
- Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to sub-contractors - ₹ 4 Lakhs
- Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

Answer

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost
= ₹ 45,00,000/₹ 80,00,000
= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

#4. Question | November 2020, 5 marks |

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed. In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000. In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000. In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed. Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

Answer

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

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

Year 2	₹
Actual expenditure	4,75,000
Future expenditure	4,00,000
Expenditure Incurred in Year 1	8,60,000
Total Expenditure	17,35,000

% of work completed = $\frac{4,75,000 + 8,60,000}{17,35,000} \times 100 = 76.95\%$ (Rounded off)

Revenue to be recognized (cumulative) = 20,00,000 x 76.95%
= 15,39,000

Less: revenue recognized in Year 1 = (9,24,800)

Revenue to be recognized in Year 1 = ₹6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. $20,00,000 - 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000$. Note: Calendar year has been considered as accounting year

#5. Question | November 2019, 5 marks | RTP May 23

- I. AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹50 Lakh ₹60 Lakh and ₹75 Lakh respectively. Agreement also lays down the completion time for each unit. Comment, with reference to AS- 7, whether AP Ltd., should treat it as a single contract or three separate contracts.
- II. On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹45 lakhs. On 31st March, 2018, the company found that it had already spent ₹32.50 lakhs on the construction. Additional cost of completion is estimated at ₹15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provisions of AS- 7?

Answer

- I. As per AS 7 'Construction Contracts', when a **contract covers a number of assets**, the construction of each asset should be **treated as a separate** construction contract when:
 - (a) **separate proposals** have been submitted for each asset;
 - (b) each asset has been subject to **separate negotiation** and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
 - (c) the **costs and revenues** of each asset can be identified.

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

II.

	₹in lakhs
Cost of construction incurred till date	32.50
Add: Estimated future cost	<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 recognized as revenue for the year ended 31st March, 2018 per AS 7

(Revised) = Contract price x percentage of completion

$$= ₹45 \text{ lakh} \times 68.28\% = ₹30.73 \text{ lakhs.}$$

	₹in lakhs
Total cost of construction Less: Total contract price	47.60
Total foreseeable loss to be recognized as expense	<u>(45.00)</u>
	<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.

#6. Question | May 2018, 5 marks |

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

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

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

- I. Profit/Loss for the year ended 31st March, 2018.
- II. Contract work in progress as at end of financial year 2017-18.
- III. Revenue to be recognized out of the total contract value.
- IV. Amount due from/to customers as at the year end.

Answer

I.

Loss for the year ended, 31st March, 2018	₹in lakhs
Amount of foreseeable loss	
Total cost of construction (6,250 + 1,250 + 8,750)	16,250
Less: Total contract price	(12,000)
Total foreseeable loss to be recognised as expense	4,250

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Loss for the year ended, 31st March, 2018 amounting ₹4,250 will be recognized

II.

Contract work-in-progress as on 31.3.18	₹in lakhs
Contract work-in-progress i.e. cost incurred to date are ₹7,500 lakhs:	
- Work certified	6,250
- Work not certified	1,250
	7,500

III. Proportion of total contract value recognized as revenue

Cost incurred till 31.3.18 is 46.15% ($7,500/16,250 \times 100$) of total costs of construction. Proportion of total contract value recognised as revenue: 46.15% of ₹12,000 lakhs = ₹5,538 lakhs

IV. Amount due from/to customers at year end

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

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

= [3,250 – 7,000] ₹ in lakhs Amount due to customers = ₹3,750 lakhs.

#7. Question | RTP Sep 2025 |

A company took a construction contract for Rs. 100 lakhs in January, 2024. It was found that 80% of the contract was completed at a cost of Rs. 92 lakhs on the closing date i.e. on 31.3.2025. The company estimates further expenditure of Rs. 23 lakhs for completing the contract. The expected loss would be Rs.15 lakhs. Can the company recognise the loss in the financial statements prepared for the year ended 31.3.2025?

Answer:

As per paragraphs 31 and 35 of AS 7 on Construction Contracts, an expected loss on the construction contract should be recognized as an expense immediately irrespective of (i) whether or not the work has commenced on the contract; or (ii) the stage of completion of the contract; or (iii) the amount of profits expected to arise in other contracts.

Hence, the company must recognize the loss immediately.

#8. Question | RTP May 2025 |

- (i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. 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.

- (ii) On 1st December, 2023, GR Construction Co. Ltd. undertook a contract to construct a building for Rs. 45 lakhs. On 31st March, 2024, 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, 2024 as per provisions of AS-7?

Answer:

- (i) As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:
- separate proposals have been submitted for each asset;
 - each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
 - the costs and revenues of each asset can be identified.

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

(ii)

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

Percentage of completion till date to total estimated cost of construction

$$= (32.50/47.60) \times 100 = 68.28\%$$

Proportion of total contract value recognised as revenue for the year ended 31st March, 2024 per AS 7 (Revised)

$$= \text{Contract price} \times \text{percentage of completion}$$

$$= \text{Rs. 45 lakh} \times 68.28\% = \text{Rs. 30.73 lakhs.}$$

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

According to 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.

#9. Question | RTP Jan 2025 |

Rose Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2024 and is likely to be completed by the next financial year. The contract is for a fixed price of Rs. 12 crore with an escalation clause. You are given the following information for the year ended 31.03.2024:

Cost incurred upto 31.03.2024	Rs. 4 crore
Cost estimated to complete the contract	Rs. 6 crore

Escalation in cost was by 5%. Hence, the contract price is also increased by 5%.

You are required to ascertain the stage of completion and compute the amount of revenue and profit to be recognized for the year as per AS 7.

Answer:

	Rs. in crore

Cost of construction of bridge incurred up to 31.3.2024	4.00
Add: Estimated future cost	<u>6.00</u>
Total estimated cost of construction	<u>10.00</u>
Contract Price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction
 $= (4/10) \times 100 = 40\%$

Revenue and Profit to be recognized for the year ended 31st March, 2024 as per AS 7:

Proportion of total contract value recognized as revenue
 $= \text{Contract price} \times \text{percentage of completion}$
 $= \text{Rs. } 12.60 \text{ crore} \times 40\% = \text{Rs. } 5.04 \text{ crore}$
 Profit for the year ended 31st March, 2024 = Rs. 5.04 crore – Rs. 4 crore
 $= 1.04 \text{ crore.}$

#10. Question | RTP November 2022, November 2019 |

On 1st December, 2020, "Sampath" Construction Limited undertook a contract to construct a building for Rs. 108 lakhs. On 31st March, 2021 the company found that it had already spent Rs. 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was Rs. 36.01 lakhs. You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2021 based on AS 7 "Accounting for Construction Contracts."

Answer

Calculation of foreseeable loss for the year ended 31st March, 2021 (as per AS 7 "Construction Contracts")

	₹ in lakhs
Cost incurred till 31st March, 2021	83.99
Prudent estimate of additional cost for completion	36.01
Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Ltd. for the year ended 31st March, 2021.

#11. Question | RTP Sep 2024 |

Mehta Ltd. has undertaken bridge construction contract wherein, bridge will be constructed in 3 years. The details of the contracts are as follows:

- I. Initial contract revenue Rs. 900 crore
- II. Initial contract cost Rs. 800 crore

	Years		
	I	II	III
	Rs. in crore	Rs. in crore	Rs. in crore
Estimated contract cost	805		820
Increase in contract revenue	-	20	
Estimated additional increase cost	-	15	
Contract cost incurred upto	161	584	

At the end of year II, cost incurred includes Rs. 10 crore, for material stored at the sites to be used in year III to complete the project.

State the amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in these three years.

Answer:

Statement showing analysis of the contract details

(Rs. in crore)				
		<i>Year I</i>	<i>Year II</i>	<i>Year III</i>
(a)	Initial revenue agreed	900	900	900
(b)	Increase in contract revenue	-	20	20
(c)	Total Contract Value	900	920	920
(d)	Contract cost incurred upto the date of reporting	161	574	820
			(excluding Rs. 10* crore of material stored)	
(e)	Estimated cost to complete	644	246	-
(f)	Total estimated contract	805	820(805+15)	820
(g)	Stage of Completion	20%	70%	100%
	[(d/f) x 100]	(161/805 x 100)	(574/820 x 100)	(820/820 x 100)

* Note: 10 crore, for material stored at the sites to be used in its 1st year. i.e. in IInd year it is already included so it will be deducted in II year only.

Statement showing amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in three years

(Rs. in crore)

	<i>Upto reporting date</i>	<i>Recognised in the prior year</i>	<i>Recognized in the current year</i>
Year I			
Revenue (900 x 20/100)	180	-	180
Expenses	<u>161</u>	<u>-</u>	<u>161</u>
Profit	<u>19</u>	<u>-</u>	<u>19</u>
Year II			
Revenue (920 x 70/100)	644	180	464
Expenses (820 x 70/100)	<u>574</u>	<u>161</u>	<u>413</u>
Profit	<u>70</u>	<u>19</u>	<u>51</u>
Year III			
Revenue	920	644	276
Expenses	<u>820</u>	<u>574</u>	<u>246</u>
Profit	<u>100</u>	<u>70</u>	<u>30</u>

#12.Question | RTP May 2022 |

B Ltd. undertook a construction contract for ₹50 crores in April, 2020. The cost of construction was initially estimated at ₹35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.

Answer

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an **expense immediately**. Therefore, the foreseeable loss of ₹3 crores (Rs. 53 crores less ₹50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. The amount of loss is determined irrespective of:

- i. Whether or not work has commenced on the contract;
- ii. Stage of completion of contract activity; or
- iii. The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

#13.Question | RTP November 2021 |

- (a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.
- (b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional ₹2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss.

Answer

- (a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
 - i. total **contract revenue** can be measured reliably;
 - ii. it is probable that the **economic benefits** associated with the contract will flow to the enterprise;
 - iii. both the contract **costs** to complete the contract and the **stage of contract** completion at the reporting date can be measured reliably; and
 - iv. the contract **costs attributable** to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.
- (b) According to AS 7 (Revised) 'Construction Contracts', **incentive payments** are additional amounts payable to the contractor if specified performance standards **are met or exceeded**. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when:
 - i. the contract is **sufficiently advanced** that it is probable that the specified performance standards will be met or exceeded;
 - ii. the amount of the incentive payment can be **measured reliably**. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should **not recognize** any revenue of this contract.

#14.Question | RTP May 2021 |

Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract. As per the terms of the contract, Sky Limited will receive an additional ₹50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The Accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

Answer

According to AS 7 'Construction Contracts', **incentive payments** are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when both the conditions are met:

- the contract is **sufficiently advanced** that it is probable that the specified performance standards will be met or exceeded; and
- the amount of the incentive payment can be **measured reliably**. In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing ₹50 lakhs as revenue **is not correct**.

#15. Question | RTP November 2020, November 2018, May 2018 |

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2019 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹12 crore with an escalation clause. You are given the following information for the year ended 31.03.2019:

	₹ in Crore
Cost of construction of bridge incurred upto 31.3.2019	4.00
Add: Estimated future cost	6.00

Escalation in cost was by 5%. Hence, the contract price is also increased by 5%. You are required to ascertain the stage of completion and compute the amount of revenue and profit to be recognized for the year as per AS 7.

Answer

	₹ in Crore
Cost of construction of bridge incurred upto 31.3.2019	4.00
Add: Estimated future cost	<u>6.00</u>
Total estimated cost of construction	<u>10.00</u>
Contract price (12 crore x 1.05)	12.60 crore

Stage of completion

Percentage of completion till date to total estimated cost of construction

$$= (4/10) \times 100 = 40\%$$

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

= ₹12.60 crore x 40% = Rs. 5.04 crore Profit for the year ended 31st March, 2019 =

= ₹5.04 crore – ₹4 crore = ₹1.04 crore

#16. Question | RTP May 2020 |

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

	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 lacs for standard materials stored at the site to be used in year 3 to

complete the work. **Excludes Rs. 100 lacs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer. Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be

recognized in the Statement of Profit and Loss as per AS -7 (revised).

Answer

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

(Amount in ₹ Lakhs)			
	Up to the reporting date	Recognized in previous years	Recognized in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses (8,050 x 26%)	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (8,200 x 74%)	<u>6,068</u>	<u>2,093</u>	<u>3,975</u>
Profit	740	247	493
Year 3			
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	1,000	740	260
Working Note:			
	Year 1	Year 2	Year 3
Revenue after considering variations	9,000	9,200	9,200
Less: Estimated profit for whole contract	950	1,000	1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168 -100)	8,200 8,100+100)
Degree of completion (B/A)	26%	74%	100%

#17. Question | RTP November 2019|

GTI Ltd. negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹102 lacs, ₹150 lacs, ₹130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region. Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

Answer

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

- separate proposals have been submitted for each asset; (separate negotiation and the contractor and customer have been
- each asset has been subject to able to accept or reject that part of the contract relating to each asset;
- the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a **separate proposal** to different Zonal Offices,

which can be **separately negotiated**, and **costs and revenues** thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one single agreement for contracts. Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be **applied separately** and net income will be determined for each asset as per AS 7.

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AS – 13 Accounting for Investment ILLUSTRATIONS

#1.Illustration | Sep 2025 , 7 Marks |

Ms. Neha had 20,000 Equity shares in Nexus Ltd. at a book value of Rs. 2,40,000 on 01.04.2024. Face value of shares is Rs. 10 per share.

The Directors of Nexus Ltd. announced a bonus of equity shares in the ratio of one share for every 5 shares held on 30/04/2024.

On 31/07/2024 the company made a right issue in the ratio of three shares for every 4 shares held, on payment of Rs. 14 per share. The due date for payment was 31/08/2024. Ms. Neha opted to subscribe 50% of the right shares and sold the remaining of her entitlement to Ms. Rewa for a consideration of Rs. 3 per share.

On 08/10/2024, Ms. Neha received dividend from Nexus Ltd. @ 15% for the year ended 31/03/2024.

On 01/11/2024, Neha sold 11500 shares at a premium of Rs. 16 per share.

You are required to prepare Investment A/c as per AS -13 in the books of Ms. Neha for the year ended 31/03/2025 assuming that the shares are being valued at average cost.

Answer:

Alternative -1

Considering the Examinee has calculated Average Cost directly for shares sold and for Closing Balance of Shares:

Investment Account in Books of Ms. Neha (Scrip: Equity Shares in Nexus Ltd.)

		No.	Amount			No.	Amount
			Rs.				Rs.
1.4.2024	To Bal b/d	20,000	2,40,000	1.11.2024	By Bank	11,500	2,99,000
30.4.2024	To Bonus	4,000	—		(Sale of shares)		
31.8.2024	To Bank (Rights Shares)	9,000	1,26,000	31.3.2025	By Bal. c/d	21,500	2,38,455
1.11.2024	To P&L A/c (Profit on sale of shares)		1,71,455				
		33,000	5,37,455			33,000	5,37,455

Working Notes:

- (1) Bonus Shares = $(20,000) / 5 = 4,000$ shares
- (2) Right Shares = $(20,000 + 4,000) / 4 \times 3 = 18,000$ shares
- (3) Rights shares sold = $18,000 \times 50\% = 9,000$ shares
- (4) Dividend received = $20,000 \times 10 \times 15\% = \text{Rs. } 30,000$ will be taken to P&L statement
- (5) Average Cost of shares sold:
Average Cost = $(2,40,000 + 1,26,000) / 33,000 \times 11,500 = \text{Rs. } 1,27,545$
- (6) Profit on sale of 11,500 shares
= Sales proceeds – Average cost Sales proceeds = $\text{Rs. } 2,99,000$
Profit = $\text{Rs. } 2,99,000 - \text{Rs. } 1,27,545 = \text{Rs. } 1,71,455$.
- (7) Cost of shares on 31.3.2025
 $(2,40,000 + 1,26,000) / 33,000 \times 21,500 = 2,38,455$
- (8) Sale of rights amounting Rs. 27,000 ($\text{Rs. } 3 \times 9,000$ shares) will not be shown in investment A/c but will directly be taken to P & L statement.

#2.Illustration | Sep 2024 , 4 Marks |

On 01.04.2023, Mr. Day has 25,000 shares of Squares Ltd. at a book value of Rs. 25 per share (nominal value of Rs. 10 each). Further information is as under:

- (i) On 31st July 2023, the Directors of Squares Ltd. issued one equity bonus share for every five shares held by the shareholders.
- (ii) On 30th September 2023, the Directors of Squares Ltd. announced a right issue which entitled the holders to subscribe three shares for every two shares at Rs. 20 per share. Shareholders can transfer their rights in full or in part.

Mr. Day sold 1/4th of entitlement to Dhvani for a consideration of Rs. 5 per share and subscribed the rest on 5th October, 2023.

You are required to prepare Investment A/c in the books of Mr. Day for the year ending 31.03.2024.

Answer:

In the books of Mr. Day Investment Account (Equity shares in Square Ltd.)

Date	Particulars	No. of shares	Amount (Rs.)	Date	Particulars	No. of shares	Amount (Rs.)
1.4.23	To Balance b/d	25,000	6,25,000	31.3.24	By Balance c/d (Bal. fig.)	63,750	13,00,000
31.7.23	To Bonus issue (W.N.1)	5,000	-				
5.10.23	To Bank A/c (right shares) (W.N.4)	33,750	6,75,000				
		63,750	13,00,000			63,750	13,00,000

Working Notes:

- (1) Bonus shares = $25,000/5 = 5,000$ shares
- (2) Right shares = $(25,000 + 5,000) \times 3/2 = 45,000$ shares
- (3) Sale of rights = $45,000 \text{ shares} \times \frac{1}{4} \times \text{Rs. } 5 = 11,250 \times 5 = 56,250$ Shares
Rs. 56,250 to be credited to statement of profit and loss
- (4) Rights subscribed = $45,000 \text{ shares} \times 3 \times \text{Rs. } 20 = \text{Rs. } 6,75,000$

#3.Illustration | Nov 2023 , 5 Marks |

Z Ltd. decides to increase its existing share capital by making right issue to its existing shareholders.

The company is offering 2 new shares for every 5 existing shares held by the shareholders. The market value of shares is Rs. 420 per share.

Company is offering each share at Rs. 245 per share.

Calculate the value of right and the ex-right market price of a share.

Answer:

Ex-right value of the shares = $(\text{Cum-right value of the existing shares} + \text{Rights shares} \times \text{Issue Price}) / (\text{Existing Number of shares} + \text{No. of right shares})$

= $(\text{Rs. } 420 \times 5 \text{ Shares} + \text{Rs. } 245 \times 2 \text{ Share}) / (5 + 2) \text{ Shares}$

= $\text{Rs. } 2,590 / 7 \text{ shares} = \text{Rs. } 370 \text{ per share.}$

Value of right = Cum-right value of the share – Ex-right value of the share

= Rs.420 – Rs.370 = Rs.50 per share

Note: In the question, the market value of share is given at Rs. 420 per share. It has been considered that this value is cum right.

#4.Illustration | May 2019, 5 Marks |

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decide and state the amount of transfer, based on the following information:

- i. A portion of long term investments purchased on 1st March, 2017 are to be re- classified as current investments. The original cost of these investments was Rs.14 lakhs but had been written down by Rs.2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was 11 lakhs.
- ii. Another portion of long term investments purchased on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was Rs.7 lakhs but had been written down to Rs.5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was Rs. 4.5 lakhs.
- iii. A portion of current investments purchased on 15th March, 2018 for Rs.7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was Rs.6 lakhs and fair value on 15th June 2018 was Rs.8.5 lakhs,
- iv. Another portion of current investments purchased on 7th December, 2017 for Rs.4 lakhs are to be re-classified as long term investments. The market value of these investments was:

On 31st March, 2018 Rs.3.5 lakhs

On 15th June, 2018 Rs.3.8 lakhs

Answer

As per **AS 13 (Revised) "Accounting for Investments"**, where **long-term investments are reclassified as current investments, transfers** are made at the **lower of cost and carrying amount at the date of transfer**; and where **investments are reclassified from current to long term, transfers** are made at **lower of cost and fair value on the date of transfer**.

Accordingly, the re-classification will be done on the following basis:

- (i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs.12 lakhs in the books.
- (ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs.5 lakhs in the books.
- (iii) In this case, reclassification of current investment into long-term investments will be made at Rs.7 lakhs as cost is less than its fair value of Rs.8.5 lakhs on the date of transfer.
- (iv) In this case, market value (considered as fair value) is Rs.3.8 lakhs on the date of transfer which is lower than the cost of Rs.4 lakhs. The reclassification of current investment into long-term investments will be made at Rs.3.8 lakhs.

#5.Illustration | Nov 2019, 5 Marks |

A Limited invested in the shares of XYZ Ltd. on 1st December, 2019 at a cost of Rs.50,000. Out of these shares, Rs.25,000 shares were purchased with an intention to hold for 6 months and Rs.25,000 shares were purchased with an intention to hold as long-term Investment.

A Limited also earlier purchased Gold of Rs.1,00,000 and Silver of Rs.30,00,000 on 1st April, 2019. Market value as on 31st March, 2020 of above investments are as follows:

Shares Rs.47,500 (Decline in the value of shares is temporary.)

Gold Rs.1,80,000

Silver Rs.30,55,000

How above investments will be shown in the books of accounts of M/s A Limited for the year ended 31st March, 2020 as per the provisions of AS 13 (Revised)?

Answer

As per **AS 13 (Revised) "Accounting for Investments"**, for **investment in shares** -

- **If the investment is purchased with an intention to hold for short-term period** (less than one year), then it will be classified as **current investment and to be carried at lower of cost and fair value**.

In the given case Rs.25,000 shares held as current investment will be carried in the books at Rs.23,750 (47,500/2).

- **If equity shares are acquired with an intention to hold for long term period** (more than one year), then should be considered as **long-term investment to be shown at cost in the Balance Sheet of the company**. However, provision for diminution should be made to recognize a decline, if other than temporary, in the value of the investments.

Hence, Rs.25,000 shares held as long-term investment will be carried in the books at Rs. 25,000.

- **Gold and silver** are generally **purchased with an intention to hold them for long term period** (more than one year) until and unless given otherwise.

Hence, **the investment in Gold and Silver (purchased on 1st March, 2019) should continue to be shown at cost** (since there is no 'other than temporary' diminution) as on 31st March, 2020. **Thus Gold at Rs.1,00,000 and Silver at Rs.30,00,000 respectively will be shown in the books.**

#6.Illustration | Jan 2021, 5 Marks |

Kunal Securities Ltd. wants to reclassify its investments in accordance with AS-13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

- Long term investment in Company A, costing Rs.10.5 lakhs is to be re-classified as current investment. The company had reduced the value of these investments to Rs.9 lakhs to recognize a permanent decline in value. The fair value on the date of reclassification is Rs.9.3 lakhs.
- Long term investment in Company B, costing Rs.14 lakhs is to be re-classified as current investment the fair value on the date of reclassification is Rs.16 lakhs and book value is Rs.14 lakhs.
- Current investment in Company C, costing Rs.12 lakhs is to be re-classified as long term investment as the company wants to retain them. The market value on the date of reclassification is Rs.13.5 lakhs.
- Current investment in Company D, costing Rs.18 lakhs is to be re-classified as long term investment. The market value on the date of reclassification is Rs.16.5 lakhs.

Answer

As per **AS 13 (Revised) "Accounting for Investments"**, where **long-term investments** are reclassified as **current investments, transfers are made at the lower of cost and carrying**

amount at the date of transfer, and where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

- i. In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs.9 lakhs in the books.
- ii. The carrying / book value of the long-term investment is same as cost i.e., Rs.14 lakhs. Hence this long-term investment will be reclassified as current investment at book value of Rs.14 lakhs only.
- iii. In this case, reclassification of current investment into long-term investments will be made at Rs.12 lakhs as cost are less than its market value of Rs.13.5 lakhs.
- iv. Market value of the investment is Rs.16.5 lakhs, which is lower than its cost i.e., Rs.18 lakhs. Therefore, the transfer to long term investments should be done in the books at the market value i.e., Rs.16.5 lakhs.

#7.Illustration | Dec 2021, 5 Marks |

Mr. Mohan has invested some money in various Mutual funds. Following information in this regard is given:

Mutual Funds	Date of purchase	Purchase cost (Rs.)	Brokerage Cost (Rs.)	Stamp duty (Rs.)	Market value as on 31.03.2021 (Rs.)
A	01.05.2017	50,000	200	20	48,225
B	05.08.2020	25,000	150	25	24,220
C	01.01.2021	75,000	300	75	78,190
D	07.05.2020	70,000	275	50	65,880

You are required to:

Classify his investment in accordance with AS-13 (revised) value of Investment in mutual fund as on 31.03.2021

Answer

As per **AS 13 "Accounting for Investments"**, a **current investment** is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value.

A **long-term investment** is an investment other than a current investment. Long term investments are usually carried at cost. If there is a decline, other than temporary, in the value of a long-term investment; the carrying amount is reduced to recognize the decline.

Mutual Funds	Classification	Cost (Rs.)	Market value (Rs.)	Carrying value (Rs.)
A	Long-term Investment	50,220	48,225*	50,220
B	Current Investment	25,175	24,220	24,220
C	Current Investment	75,375	78,190	75,375
D	Current Investment	70,325	65,880	65,880
Total				2,15,695

Note: *The reduction in value of Mutual fund A is considered to be temporary. If reduction in Market value is assumed as other than temporary in nature, then the carrying value of Rs.48,225 will be considered.

#8.Illustration | May 2019, 1 Mark |

State Whether TRUE or FALSE with reason.

"As per the provisions of AS-13, a current investment is an investment, that by its nature, is readily realizable and is intended to be held for not more than six months from the date on which such investment is made."

Answer

False: A current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

AS 13 : Accounting for Investments RTP ILLUSTRATIONS

#1.Illustration | Sep 2025 |

On 1st April 2024, Kesar held 75,000 equity shares of Beta Ltd., recorded at a book value of Rs.15 per share (with a nominal value of Rs. 10 each). The following transactions took place during the year:

1. On 20th June 2024, Kesar purchased 15,000 additional shares of Beta Ltd. at Rs. 16 per share.
2. On 1st August 2024, Beta Ltd. declared a bonus issue of one share for every six shares held.
3. On 31st October 2024, the company announced a rights issue, offering three shares for every seven held at a price of Rs. 15 per share. Shareholders were allowed to fully or partially renounce their rights.

Kesar sold one-third of his rights entitlement to Megha at Rs. 2 per share and subscribed to the remaining rights on 5th November 2024.

You are required to prepare the Investment Account in the books of Kesar for the year ending 31st March 2025.

Answer:

In the books of Kesar

Investment Account (Equity shares in Beta Ltd.)

Date	Particulars	No. of shares	Amount (Rs.)	Date	Particulars	No. of shares	Amount (Rs.)
1.4.24	To	75,000	11,25,000	31.3.25	By Balance	1,35,000	18,15,000
20.6.24	Balanc e b/d To Bank A/c	15,000	2,40,000		c/d (Bal. fig.)		
1.8.24	To Bonus issue (W.N.1)	15,000	-				
5.11.24	To Bank A/c (right shares) (W.N.4)	30,000	4,50,000				
		1,35,000	18,15,000			1,35,000	18,15,000

Working Notes:

(1) Bonus shares = $(75,000 + 15,000)/6 = 15,000$ shares

(2) Right shares = $((75,000 + 15,000 + 15,000)/7) \times 3 = 45,000$ shares

(3) Sale of rights = $(45,000 \text{ shares} \times 1/3) \times 2 = \text{Rs. } 30,000$ to be credited to statement of profit and loss

(4) Rights subscribed = $45,000 \text{ shares} \times 2/3 \times \text{Rs. } 15 = \text{Rs. } 4,50,000$

#2.Illustration | May 2025 |

Mr. Harsh provides the following details relating to his holding in 10% debentures (face value of Rs. 100 each) of Exe Ltd. held as current assets:

1.4.2023	Opening balance - 12,500 debentures, cost Rs. 12,25,000
1.6.2023	Purchased 9,000 debentures @ Rs. 98 each ex-interest
1.11.2023	Purchased 12,000 debentures @ Rs. 115 each cum interest
31.1.2024	Sold 13,500 debentures @ Rs. 110 each cum-interest
31.3.2024	Market value of debentures @ Rs. 115 each

Due dates of interest are 30th June and 31st December.

Brokerage at 1% is to be paid for each transaction. Mr. Harsh closes his books on 31.3.2024. Show investment account as it would appear in his books assuming FIFO method is followed.

Answer:

Investment Account of Mr. Harsh for the year ending on 31-3-2024

(Scrip: 10% Debentures of Exe Limited)

(Interest Payable on 30th June and 31st December)

Date	Particulars	Nominal Value Rs.	Interest Rs.	Cost Rs.	Date	Particulars	Nominal Value Rs.	Interest Rs.	Cost Rs.
1.4.23	To Balance b/d	12,50,000	31,250	12,25,000	30.6.23	By Bank 21,500 x 100 x 10% x 1/2	-	1,07,500	-
1.6.23	To Bank (ex-Interest) (W.N.1)	9,00,000	37,500	8,90,820	31.12.24	By Bank 33,500 x 100 x 10% x 1/2		1,67,500	
1.11.23	To Bank (cum-Interest) (W.N.2)	12,00,000	40,000	13,53,800	31.1.24	By Bank (W.N.3)	13,50,000	11,250	14,58,900
31.1.24	To Profit & Loss A/c (W.N.3)			1,34,920	31.3.24	By Balance c/d (W.N.4)	20,00,000	50,000	21,45,640
31.3.24	To Profit & Loss A/c (Bal. fig.)		2,27,500						
		33,50,000	3,36,250	36,04,540			33,50,000	3,36,250	36,04,540

Working Notes:

1. Purchase of debentures on 1.6.23

Interest element = $9,000 \times 100 \times 10\% \times 5/12 = \text{Rs. } 37,500$

Investment element = $(9,000 \times 98) + [1\% (9,000 \times 98)] = \text{Rs. } 8,90,820$

2. Purchase of debentures on 1.11.2023

Interest element = $12,000 \times 100 \times 10\% \times 4/12 = \text{Rs. } 40,000$

Investment element = $12,000 \times 115 \times 101\% \text{ less } 40,000 = \text{Rs. } 13,53,800$

3. Profit on sale of debentures as on 31.1.24

	Rs.
Sales price of debentures (13,500 x Rs. 110)	14,85,000

Less: Brokerage @ 1%	<u>(14,850)</u>
	14,70,150
Less: Interest (1,35,000/ 12)	<u>(11,250)</u>
	14,58,900
Less: Cost of Debentures [(12,25,000 + (890820 X 1,00,000/9,00,000))]	<u>(13,23,980)</u>
Profit on sale	1,34,920

4. Valuation of closing balance as on 31.3.2024

Market value of 20,000 Debentures at Rs. 115 = Rs. 23,00,000 Cost of

8,000 Debentures = 8,90,820/ 9,000 X 8,000 = 7,91,840

12,000 Debentures = 13,53,800

Total 21,45,640

Value at the end is Rs. 21,45,640, i.e., which is less than market value of Rs. 23,00,000.

#3.Illustration | Sep 2024 |

A company is engaged in the business of refining, transportation and marketing of petroleum products. During the financial year ended 31st March, 2024, the company acquired controlling interest from Government of India in another public sector undertaking @ Rs. 1,551 per share as against the book value of Rs. 192.58 per share and market value of Rs. 876 per share as on 18th February, 2024.

Thus, the strategic premium of Rs. 675 per share has been paid considering various tangible and intangible factors.

The above investment in the shares of the acquired company has been considered as long term strategic investment and, therefore, has been accounted for at cost, i.e. at Rs. 1,551 per share in the financial statements. No provision for diminution in value has been made in the books of account. As per the requirement of Schedule III to the Companies Act, 2013, the aggregate market value of the quoted shares has been properly reflected in the financial statements.

On 28th March, 2024, the acquired shares were quoted at Rs. 880 per share on BSE and the current market price as on 18th July was around Rs. 300.

Considering the tangible and intangible benefits the Management is of the view that there is no permanent diminution in the value of the strategic investment in the acquired company, as the same has been considered as a long-term investment. Therefore, there is no need for provision for diminution in the value of the shares of the acquired company.

Required:

- Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13.
- If any provision for diminution in the value is to be made, whether such provision should be charged to the profit and loss account or whether same can be considered as deferred expenditure and amortised over a period of 5 years. Whether it is open for the company to charge off such diminution in the value in the books of account instead of creating provision.
- Whether the premium paid for strategic benefits for investment described in facts of the case, can be accounted for separately in the books of account keeping in view that AS 13 specifies that long term investments should be recorded at cost and there is no specific provision in the standard in respect of accounting for premium paid for strategic benefits.

Answer:

- The accounting treatment 'at cost' under the head 'Long Term Investment' in the separate financial statements of the company without providing for any diminution in value is correct

and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment.

- (ii) The provision for diminution in the value of investment should be a charge to the profit and loss statement. As per the requirements of AS 13, the diminution in the value of investment can neither be accounted for as deferred revenue expenditure nor it can be written off in the statement of profit and loss.
- (iii) The long-term investments should be carried at cost as per the requirements of AS 13. The amount paid over and above the market price should be treated as cost and cannot be accounted for separately.

#4.Illustration | May 2018 |

Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2012 at a cost of Rs. 3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in January, 2017 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than Rs. 45,000.

You are required to **explain** how you will deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.17 with reference to AS 13?

Answer

As per **AS 13, "Accounting for Investments"** Investments classified as long term investments should be carried in the financial statements at cost. However, **provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.** The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

On this basis, the facts of the case given in the question clearly suggest that the **provision for diminution** should be made to **reduce the carrying amount of shares to Rs. 45,000** in the **financial statements for the year ended 31st March, 2017 and charge the difference of loss of Rs. 2,55,000 to profit and loss account.**

#5.Illustration | Nov 2018 |

M/s Active Builders Ltd. invested in the shares of another company (with an intention to hold the shares for short term period) on 31st October, 2016 at a cost of Rs. 4,50,000. It also earlier purchased Gold of Rs. 5,00,000 and Silver of Rs. 2,25,000 on 31st March, 2014.

Market values as on 31st March, 2017 of the above investments are as follows: Shares Rs. 3,75,000; Gold Rs. 7,50,000 and Silver Rs. 4,35,000

You are required explain how will the above investments be shown in the books of account of M/s Active Builders Ltd. for the year ending 31st March, 2017 as per the provisions of AS 13?

Answer

As per **AS 13 'Accounting for Investments'**, if the shares are purchased with an intention to hold for short-term period then investment will be shown at the realizable value. In the given case, shares purchased on 31st October, 2016, **will be valued at Rs. 3,75,000 as on 31st March, 2017.**

Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in gold and silver (purchased on 31st March, 2014) shall continue to be shown **at cost as on 31st March, 2017 i.e., Rs. 5,00,000 and Rs. 2,25,000 respectively, though their realizable values have been increased.**

Thus the shares, **gold and silver will be shown at Rs. 3,75,000, Rs. 5,00,000 and Rs. 2,25,000 respectively and hence, total investment will be valued at Rs. 11,00,000** in the books of account of M/s Active Builders for the year ending 31 st March, 2017 as per provisions of AS 13.

#6.Illustration | May 2019 |

Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for Rs. 5 lakhs, which the company want to reclassify as long term investment on 31.3.2018. The market value of these investments as on date of Balance Sheet was Rs. 2.5 lakhs. How will you deal with this as on 31.3.18 with reference to AS-13?

Answer

As per **AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost or fair value at the date of transfer.**

In the given case, the market value of the investment (X Ltd. shares) is Rs. 2.50 lakhs, which is lower than its cost i.e. Rs. 5 lakhs. Therefore, the transfer to long term investments should be made at cost of Rs. 2.50 lakhs. The loss of Rs. 2.50 lakhs should be charged to profit and loss account.

#7.Illustration | Nov 2019, Nov 2021 |

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?

Answer

As per **AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it.** For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, **though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.**

#8.Illustration | May 2020 |

Omega Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13. State the values, at which the investments have to be reclassified in the following cases:

- (i) Long term investments in Company A, costing Rs. 8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to Rs. 6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is Rs. 6.8 lakhs.
- (ii) Current investment in Company C, costing Rs. 10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is Rs. 12 lakhs.
- (iii) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these investments was Rs. 18 lakhs but had been written down to Rs. 12 lakhs to recognize permanent decline as per AS 13.

Answer

As per **AS 13 'Accounting for Investments'**, where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer. Accordingly, the re-classification will be done on the following basis:

- (i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs. 6.5 lakhs in the books.
- (ii) In this case, reclassification of current investment into long-term investments will be made at Rs. 10 lakhs as cost is less than its market value of Rs. 12 lakhs.
- (iii) In this case, the book value of the investment is Rs. 12 lakhs, which is lower than its cost i.e. Rs. 18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at Rs. 12 lakhs.

#9.Illustration | Nov 2020 |

A Ltd. on 1-1-2020 had made an investment of Rs. 600 lakhs in the equity shares of B Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2020 became Rs. 200 lakhs as B Ltd. lost a case of copyright. How will you recognize the reduction in the value of the investment in the financial statements for the year ended on 31 -3-2020 as per AS 13 considering this downfall in the value of shares as non- temporary?

Answer

A limited invested Rs. 600 lakhs in the equity shares of B Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs. 300 lakhs and remaining as temporary (current) investment i.e. Rs. 300 lakhs. Irrespective of the fact that investment has been held by A Limited only for 3 months (from 1.1.2020 to 31.3.2020), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long-term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2020 became Rs. 200 lakhs i.e. Rs. 100 lakhs in respect of current investment and Rs. 100 lakhs in respect of long-term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, **the carrying value of investment held as temporary investment should be shown at realizable value i.e. at Rs. 100 lakhs. The reduction of Rs. 200 lakhs in the carrying value of current investment will be charged in the profit and loss account.**

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long-term investment, the carrying amount is reduced to recognize the decline.

Here, **B Limited has lost a case of copyright which drastically reduced the realizable value of its shares to one third which is quite a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run.** Accordingly, it will be appropriate to reduce the carrying amount of long-term investment by Rs. 200 lakhs and show the investments at Rs. 100 lakhs as the downfall in the value of shares is not temporary. The reduction of Rs. 200 lakhs in the carrying value of long-term investment will be charged to the profit and loss account.

#10. Illustration | May 2021 |

Paridhi Electronics Ltd. invested in the shares of Dhansukh Ltd. on 1st May 2020 at a cost of Rs. 10,00,000. Three fourth of these investments were current investments and the remaining investments were intended to be held for more than a year. The published accounts of Dhansukh Ltd. received in January, 2021 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than 7,50,000. The reduction in value is apparent to be non-temporary.

You are required to explain how you will deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.21 with reference to AS 13?

Answer

As per **AS 13, "Accounting for Investments"**, carrying amount for current investments is the **lower of cost and fair value. But long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.** The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

Paridhi Ltd. made three fourth of Rs. 10,00,000 i.e. Rs. 7,50,000 as current investment and remaining Rs. 2,50,000 as long term. The facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares for both categories of shares to bring them to market value. Hence the carrying value of investments will be shown at amount of Rs. 7,50,000 in the financial statements for the year ended 31st March, 2021 and charge the difference of loss of Rs. 2,50,000 to profit and loss account.

#11. Illustration | May 2022 |

JVR Limited has made investment of Rs. 97.84 Crores in Equity Shares of QSR Limited in 2016-17. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to re-assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investment for the year ended 31st March, 2021. Discuss whether

the connection of JVR Limited to bring down the carrying Amount of investment in QSR Limited is in accordance with Accounting Standards.

Answer

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments. A current Investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss. A long - term investment is an investment other than a current investment. **The investments referred in the question can be classified as long-term investments and 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. The contention of the company to bring down the value of investment may be correct if the decline in value is permanent in nature and the reduction in carrying amount may be charged to the statement of profit and loss. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

#12. Illustration | Nov 2022 |

Mother Mart Ltd., wants to re-classify its investment in accordance with AS 13. Decide the treatment to be given in each of the following cases assuming that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller:

- (i) A portion of current investments purchased for Rs. 25 lakhs to be reclassified as long-term investments, as the company has decided to retain them. The market value as on the date of balance sheet was Rs. 30 lakhs. The fair value of the investments on the date of transfer is same as the market value on the balance sheet date
- (ii) Another portion of current investments purchased for Rs. 20 lakhs has to be re- classified as long-term investments. The Fair value of these investments as on the date of the balance sheet was Rs. 12.5 lakhs.
- (iii) One portion of long-term investments, no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was Rs. 15 lakhs, but had been written down to Rs. 11 lakhs to recognize permanent decline as per AS 13.

Answer

As per **AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.** When long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

- (i) In the first case, the market value of the investments is Rs. 30 lakhs, which is higher than its cost i.e. Rs. 25 lakhs. Therefore, the transfer to long term investments should be made at cost i.e. Rs. 25 lakhs
- (ii) In the second case, the market value of the investment is Rs. 12.5 lakhs, which is lower than its cost i.e. Rs. 20 lakhs. Therefore, the transfer to long term investments should be made in the

books at the market value i.e. Rs. 12.5 lakhs. The loss of Rs. 7.50 lakhs (20-12.5) should be charged to Profit and Loss statement.

- (iii) In the third case, the book value of the investments is Rs. 11 lakhs, which is lower than its cost, i.e. Rs. 15 lakhs. As the transfer should be at carrying amount, hence this re-classified current investment should be carried at Rs. 11 lakhs.

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AS – 11 The Effects of Changes in Foreign Exchange Rates ILLUSTRATIONS

#1.Illustration | Nov 2023 , 5 Marks |

Karna Ltd., an Indian Company, has the following foreign currency transactions during the financial year 2022-23:

- (i) On 1st July, 2022, imported goods from Try Ltd., a German based company, amounting to Rs. 30,96,000.
- (ii) On 1st October, 2022, imported plant and machinery from Lucy Ltd., a German based company, for € 18,500. The amount was paid on the date of import itself. (Ignore depreciation).
- (iii) On 1st December, 2022, exported good on credit to Cream Ltd., a German based company, amounting to Rs. 50,40,000.

All the above transactions were recorded in the books of account at the prevailing exchange rate on the date of the transactions. Ignore taxes and duty on the above transactions.

Payment due from Cream Ltd. and payment due to Try Ltd. is outstanding as on 31st March, 2023.

Rate of exchange between reporting currency (Rs.) and foreign currency (€) on different dates are as under:

On 1st July, 2022 1 € = Rs. 86

On 1st October, 2022 1 € = Rs. 88

On 1st December, 2022 1 € = Rs. 84

On 31st March, 2023 1 € = Rs. 90 You are required, as per AS-11:

- (i) To show value at which above items will appear in Balance sheet as on 31st March, 2023;
- (ii) To calculate the amount of gain/loss on each of above transactions on account of exchange differences, if any.

Answer:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", Foreign currency monetary items should be reported using the closing rate. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

- (i) Items given in the question will appear in the Balance Sheet at the following values:
Trade Payables $(30,96,000/86 = 36,000 \text{ German Currency}) \times \text{Rs. } 90 = \text{Rs. } 32,40,000$
Plant and Machinery $18,500 \text{ German Currency} \times \text{Rs. } 88 = \text{Rs. } 16,28,000$
Trade Receivables $(50,40,000/84 = 60,000 \text{ German Currency}) \times \text{Rs. } 90 = \text{Rs. } 54,00,000$
- (ii) Amount of gain / loss on each transaction on account of exchange difference: Exchange loss on Transaction of import of goods from Try Ltd. = Rs. (1,44,000) $[36,000 \text{ German Currency} \times \text{Rs. } 4 \text{ (i.e. } 90-86)]$

Exchange gain on Transaction of export of goods to Cream Ltd = Rs. 3,60,000 [60,000 German Currency X Rs. 6 (i.e. 90-84)]

#2.Illustration | May 2018, 5 Marks|

ABC Ltd. borrowed US \$ 5,00,000 on 01/07/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2017	1 US\$ =	Rs.68.50
31/03/2017	1 US \$ =	Rs.69.50
31/07/2017	1 US \$ =	Rs.70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

Answer

Journal Entries in the Books of ABC Ltd.

Date	Particulars	Amt Rs. (Dr.)	Amt Rs.(Cr.)
Jan. 01, 2017	Bank Account (5,00,000 x 68.50) Dr. To Foreign Loan Account	342,50,000	342,50,000
Mar. 31, 2017	Foreign Exchange Difference Account Dr. To Foreign Loan Account [5,00,000 x (69.50-68.50)]	5,00,000	5,00,000
Jul. 31, 2017	Foreign Exchange Difference Account [5,00,000 x (70-69.5)] Dr. Foreign Loan Account Dr. To Bank Account	2,50,000 347,50,000	350,00,000

#3.Illustration | Nov 2018, 5 Marks|

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.

Answer

As per **AS 11 "The Effects of Changes in Foreign Exchange Rates"**, an enterprise may enter into a **forward exchange contract to establish the amount of the reporting currency required**, the **premium or discount arising at the inception of such a forward exchange contract** should be **amortized as expenses or income over the life of the contract**.

Forward Rate	Rs.62.50
Less: Spot Rate	(Rs.60.75)

Premium on Contract Rs. 1.75

Contract Amount **US\$ 5,00,000**
Total Loss (5,00,000 x 1.75) **Rs. 8,75,000**

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 $(8,75,000/5) \times 3 = \text{Rs.}5,25,000$. Rest Rs.3,50,000 will be recognized in the following year 2018-19.

#4.Illustration | Nov 2018, 5 Marks |

- i. ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to Rs.30,00,000. It was recorded at US \$1 = Rs.60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US \$1 = Rs.62.00.
- ii. Trade receivable includes amount receivable from Preksha Ltd., Rs.10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$1 = Rs.59.00. The exchange rate on balance sheet date (31.03.2018) was US \$1 = Rs.62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

Answer

Amount of Exchange difference and its Accounting Treatment

	Long term Loan	Foreign Currency Rate	Amt Rs.
(i)	Initial recognition US \$50,000 (30,00,000/60) Rate on Balance sheet date Exchange Difference Loss US \$ 50,000 x (62 – 60) Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by Rs.1,00,000	1 US \$ = Rs.60 1 US \$ = Rs.62	30,00,000 1,00,000
(ii)	Trade receivables Initial recognition US\$16,949.152 (10,00,000/59) Rate on Balance sheet date Exchange Difference Gain US \$ 16,949.152* x (62-59) Treatment: Credit Profit and Loss A/c by 50,847.456* And Debit Trade Receivables	1 US \$ = Rs.59 1 US \$ = Rs.62	10,00,000 50,847.456*

Thus, Exchange Difference on Long term loan amounting Rs.1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account

(FCMITDA) but exchange difference on trade receivables amounting Rs.50,847.456 is required to be transferred to Profit and Loss A/c.

#5.Illustration | Nov 2019, 5 Marks |

Karan Enterprises having its Head Office in Mangalore, Karnataka has a branch in Greenville, USA. Following is the trial balance of Branch as at 31 -3-2019:

Particulars	Amount (\$) Dr.	Amount (\$) Cr.
Fixed assets	8,000	
Opening inventory	800	
Cash	700	
Goods received from Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account		4,300
	28,350	28,350

- (i) Fixed assets were purchased on 1st April, 2015.
- (ii) Depreciation at 10% p.a. is to be charged on fixed assets on straight line method.
- (iii) Closing inventory at branch is \$ 700 as on 31-3-2019.
- (iv) Goods received from Head Office (HO) were recorded at Rs.1,85,500 in HO books.
- (v) Remittances to HO were recorded at Rs.1,62,000 in HO books.
- (vi) HO account is recorded in HO books at Rs.2,84,500.
- (vii) Exchange rates of US Dollar at different dates can be taken as :

1-4-2015 Rs.63

1-4-2018 Rs.65

31-3-2019 Rs.67

Prepare the trial balance after been converted into Indian rupees in accordance with AS-11.

Answer

Trial Balance of Foreign Branch (converted into Indian Rupees) as on March 31, 2019

Particulars	\$ (Dr.)	\$ (Cr.)	Conversion Basis	Rate	Rs. (Dr.)	Rs.(Cr.)
Fixed Assets	8,000		Transaction Date	63	5,04,000	
			Rate			
Opening Inventory	800		Opening Rate	65	52,000	
Goods Received	2,800		Actuals		1,85,500	
from HO						
Sales		24,050	Average Rate	66		15,87,300

Purchases	11,800		Average Rate	66	7,78,800	
Expenses	1,800		Average Rate	66	1,18,800	
Cash	700		Closing Rate	67	46,900	
Remittance to HO	2,450		Actuals		1,62,000	
HO Account		4,300	Actuals			2,84,500
Exchange Rate Difference			Balancing Figure		23,800	
	28,350	28,350			18,71,800	18,71,800
Closing Stock	700		Closing Rate	67	46,900	
Depreciation	800		Fixed Asset Rate	63	50,400	

#6.Illustration | Jan 2021, 5 Marks |

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020

- Debtors include amount due from Mr. S Rs.9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$1 = Rs.72.00
US \$ 1=Rs.73.50 on 31st March,2020 US \$ 1= Rs.72.50 on 1st April,2019.
- Long term loan taken on 1st April, 2019 from a U.S. company amounting to Rs.75,00,000. Rs.5,00,000 was repaid on 31st December, 2019, recorded at US \$ 1 = Rs.70.50. interest has been paid as and when debited by the US company.
US \$1= Rs.73.50 on 31st March,2020
US \$1=1Rs. 72.50 on 1st April, 2019.

Answer

As per **AS 11 "The Effects of Changes in Foreign Exchange Rates"**, exchange differences arising on the **settlement of monetary items or on reporting an enterprise's monetary items at rates different** from those at which they were **initially recorded during the period, or reported in previous financial statements**, should be recognized as **income or as expenses in the period in which they arise**.

However, at the option of an entity, **exchange differences** arising on **reporting of long - term foreign currency monetary items at rates different** from those at which **they were initially recorded during the period, or reported in previous financial statements**, in so far as they **relate to the acquisition of a non-depreciable capital asset** can be accumulated in a **"Foreign Currency Monetary Item Translation Difference Account"** in the enterprise's financial statements and amortized over the balance period of such **long-term asset/ liability, by recognition as income or expense in each of such periods**.

Particulars	Foreign Currency Rate	Amt Rs.
Debtors		
Initial recognition US \$12,500 (9,00,000/72)	1 US \$ = Rs.72	9,00,000
Rate on Balance sheet date	1 US \$ =Rs.73.50	
Exchange Difference Gain		18,750
US \$12,500 X (73.50- 72)		

Treatment: Credit Profit and Loss A/c by Rs.18,750			
Long term Loan			
Initial recognition		1 US \$ = Rs.72.50	75,00,000
US \$1,03,448.28 (75,00,000/72.50)			
Repayment – US\$ 7,092.2 (5,00,000/70.5)		1 US \$ = Rs. 70.5	
Balance Loan = \$1,03,448.28 – 7,092.2 = 96,356.08		1 US \$ = Rs.73.50	
Rate on Balance sheet date			
Exchange Difference Loss after adjustment of exchange gain on repayment of Rs.5,00,000			
US \$ 96356.08 * 73.5	70,82,171.88		67,987.48
Less: (7500000-500000)	70,00,000		
Balance	82171.88		
Less: profit (5,00,000/70.5) X 2	14184.40		
Net Loss	67987.48		
Treatment:			
Credit Loan A/c and Debit FCMITD A/C or Profit and Loss A/c by Rs.67,987.48			

Thus, Exchange Difference on Long term loan amounting Rs.67,987.48 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting Rs.18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of Rs.5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of Rs.9 lakhs has not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2020

#7.Illustration | Dec 2021, 5 Marks |

- PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd. a U.S. company, amounting to Rs.40,88,952. The transaction was recorded at US \$1 = Rs.72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US \$1 = Rs.73.60.
- Trade receivables of PP Ltd. include amount receivable from Preksha Ltd., Rs.20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$1 = Rs.73.40. The exchange rate on balance sheet date (31.03.2021) is US \$1 = Rs.73.60. Exchange rate on 1st April, 2020 is US \$1 = Rs.74.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of PP Ltd.

Answer

Long term Finance

Particulars	Foreign Currency Rate	Amt Rs.
Initial recognition US \$ 56,791 (40,88,952/72)	1 US \$ = Rs.72	40,88,952
Rate on Balance sheet date	1 US \$ = Rs.73.60	
Exchange Difference Loss [US \$ 56,791 x (73.60 – 72)]		90,866 (rounded off)

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long - term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a “Foreign Currency Monetary Item Translation Difference Account” in the enterprise’s financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit and Loss A/c by Rs.90,866 and Credit Loan A/c

AS 11: The Effects of Changes in Foreign Exchange Rates RTP ILLUSTRATIONS

#1.Illustration | May 2025 |

Legal Ltd. is engaged in the manufacturing of rubber. For its plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2023, it borrowed US \$1 million from International Funding Agency, USA when exchange rate was 1 \$ = Rs. 63. The funds were used for acquiring machineries, on the same date, to be used in three different plants. The useful life of the machineries is 10 years and their residual value is Rs. 30,00,000.

Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalized even though the company had an option to capitalize it as per notified AS 11.

Now for this new purchase of machinery, Legal Ltd, is interested to avail the option of capitalizing the same to the cost of asset. Exchange rate on 31st March, 2024 is 1 US \$ = Rs. 62. Assume that on 31st March, 2024, Legal Ltd. is not having any old long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2023.

Comment whether Legal Ltd. can capitalize the exchange difference to the cost of asset on 31st March, 2024. If yes, then calculate the depreciation amount on machineries as on 31st March, 2024.

Answer:

As per paragraph 46A of AS 11, ‘The Effects of Changes in Foreign Exchange Rates’, in respect of accounting periods commencing on or after 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 or not (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to

the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

Accordingly, though Legal Ltd. had not earlier exercised the option, yet it can avail the option to capitalize the exchange difference to the cost of machinery by virtue of para 46A of AS 11. Further, since Legal Ltd. has no earlier long term foreign currency borrowings, it is not required to apply capitalization option to earlier borrowing also.

Exchange difference to be capitalized and depreciation amount

Cost of the asset in \$		1 million
Exchange rate on 1 st April, 2023		Rs. 63 = 1\$
Cost of the asset in Rs.	(1 million x Rs. 63)	63 million
Less: Exchange differences as on 31 st March, 2024 (63-62) x \$ 1 million	(Gain)	(1 million)
		62 million
Less: Depreciation for 2023-2024	(62 million - 3 million)/ 10 years	(5.90 million)
		56.10 million

#2.Illustration | Jan 2025 |

Bansal Company Ltd. imported raw material worth US Dollars 12,000 on 15th January, 2024 when the exchange rate was Rs. 68 per US Dollar. The payment for the transaction was made on 5th May, 2024 when exchange rate was Rs. 64 per US Dollar. At the year end, 31st March, 2024, the rate of exchange was Rs. 65 per US Dollar. The accountant of the company passed entry on 31st March, 2024 adjusting the cost of raw material consumed for the difference between Rs. 64 and Rs. 68 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

Answer:

As per AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 15th January, 2024, the raw material purchased and its creditors will be recorded at US dollar 12,000 × Rs. 68 = Rs. 8,16,000.

Also, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. Rs. 65 per US dollar (USD 12,000 × Rs. 65 = Rs. 7,80,000) at 31st March, 2024, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of Rs. 3 (65 – 68) per US dollar i.e. Rs. 36,000 (USD 12,000 × Rs. 3) will be shown as an exchange gain in the profit and loss account for the year ended 31st March, 2024 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of Rs. 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between Rs. 65 and Rs. 64 per US dollar i.e. Rs. 12,000.

Hence, the accounting treatment adopted by the Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

#3.Illustration | Sep 2024 |

Alfa Ltd. purchased an item of property, plant and equipment for US\$ 50 lakh on 01.04.2023 and the same was fully financed by the foreign currency loan [i.e. US \$] repayment in five equal instalments annually. (Exchange rate at the time of purchase was 1 US \$ = Rs. 60). As on 31.03.2024 the first instalment was paid when 1 US \$ fetched Rs.62.00. The entire loss on exchange was included in cost of goods sold. Alfa Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for

exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss and its treatment and depreciation.

Answer:

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Alfa Ltd. has exercised the option and it is long term foreign currency monetary item.

Thus, the entire exchange loss due to variation of Rs. 20 lakh on 31.03.2023 on payment of US \$ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in Rs.) = (50 lakh \$ x Rs. 60) = Rs. 3,000 lakh

Exchange loss on outstanding loan on 31.03.2024 = Rs. 40 lakh US \$ x (62.00-60.00) = Rs. 80 lakh.

So, Rs. 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to Rs. 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by Rs. 100 lakh.

Total depreciation to be provided for the year 2023 - 2024 = 20% of (Rs. 3,000 lakh + 100 lakh) = Rs. 620 lakh.

#4.Illustration | May 2018 |

Power Track Ltd. purchased a plant for US\$ 50,000 on 31st October, 2016 payable after 6 months. The company entered into a forward contract for 6 months @ Rs. 64.25 per Dollar. On 31st October, 2016, the exchange rate was Rs. 61.50 per Dollar.

You are required to **calculate the amount of the profit or loss on forward contract** to be recognized in the books of the company for the year ended 31st March, 2017.

Answer

Calculation of profit or loss to be recognized in the books of Power Track Limited

	Rs.
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 × Rs. 2.75)	Rs.1,37,500
Contract period	6 months
Loss for the period 1 st November, 2016 to 31 st March, 2017 i.e. 5 months falling in the year 2016-2017	5 months
Hence, Loss for 5 months will be Rs. 1,37,500 * 5/6=	Rs. 1,14,583

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Thus, the loss amounting to Rs. 1,14,583 for the period is to be recognized in the year ended 31st March, 2017.

#5.Illustration | Nov 2018 |

(i) Classify the following items as monetary or non-monetary item:

Share Capital , Trade Receivables , Investment in Equity shares , Fixed Assets.

(ii)

Particulars	Exchange Rate per \$
Goods purchased on 1.1.2017 for US \$ 15,000	Rs. 75
Exchange rate on 31.3.2017	Rs. 74
Date of actual payment 7.7.2017	Rs. 73

You are required to ascertain the loss/gain for financial years 2016-17 and 2017- 18, also give their treatment as per AS 11.

Answer

(i)

Share capital - Non-monetary

Trade receivables – Monetary

Investment in equity shares - Non-monetary

Fixed assets - Non-monetary

(ii) As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'**, all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2017 and corresponding creditor would be recorded at **Rs. 11,25,000 (i.e. \$15,000 × Rs. 75)**

According to the standard, **at the balance sheet date all monetary transactions should be reported using the closing rate.** Thus, creditors of US \$15,000 on 31.3.2017 will be reported at **Rs. 11,10,000 (i.e. \$15,000 × Rs. 74)** and exchange profit of **Rs. 15,000 (i.e. 11,25,000 – 11,10,000)** should be credited to **Profit and Loss account in the year 2016-17.**

On 7.7.2017, creditors of \$15,000 is paid at the rate of Rs. 73. As per AS 11, **exchange difference on settlement** of the account should also be transferred to **Profit and Loss account.** Therefore, **Rs. 15,000 (i.e. 11,10,000 – 10,95,000)** will be credited to **Profit and Loss account in the year 2017-18.**

#6.Illustration | May 2019 |

Rau Ltd. purchased a plant for US\$ 1,00,000 on 01st February 2016, payable after three months. Company entered into a forward contract for three months @ Rs. 49.15 per dollar. Exchange rate per dollar on 01st Feb. was Rs. 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

Answer

Forward Rate	Rs. 49.15
Less: Spot Rate	(Rs. 48.85)
Premium on Contract	Rs. 0.30
Contract Amount	US\$ 1,00,000
Total Loss (1,00,000 x 0.30)	Rs. 30,000

Contract period 3 months

Two falling the year 2016-17; therefore loss to be recognised $(30,000/3) \times 2 = \text{Rs. } 20,000$. Rest Rs. 10,000 will be recognised in the following year.

#7.Illustration | 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.

Answer

- i. As per **AS 11 "The Effects of Changes in Foreign Exchange Rates"**, exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Accordingly, exchange difference on trade receivables amounting Rs. 23,076

{Rs. 5,23,076 (US \$ 8547[□] x Rs. 61.20) less Rs. 5,00,000} should be charged to profit & Loss account.

- ii. Calculation of profit or loss to be recognized in the books of Power Track Limited

	Rs.
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 × Rs. 2.75)	Rs.1,37,500
Contract period	6 months
Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019	5 months
Hence, Loss for 5 months will be Rs. 1,37,500 * 5/6 =	Rs. 1,14,583
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Thus, the loss amounting to Rs. 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

#8.Illustration | May 2020 |

- i. AXE Limited purchased fixed assets costing \$ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ 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.

- ii. Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. You are required to comment in line with AS 11.

Answer

- i. **As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.**

Forward Rate Rs. 62.50

Less: Spot Rate (Rs. 60.75)

Premium on Contract Rs. 1.75

Contract Amount US\$ 5,00,000

Total Loss (5,00,000 x 1.75) Rs. 8,75,000

Contract period 5 months

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 $(8,75,000/5) \times 3 =$ Rs. 5,25,000.

Rest Rs. 3,50,000 will be recognized in the following year 2018-19.

- ii. Financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). **The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange 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.**

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

#9.Illustration | Nov 2020 |

(a) Classify the following items as monetary or non-monetary item:

Share Capital, Trade Receivables, Investment in Equity shares, Fixed Assets.

(b)

	Exchange Rate per \$
Goods purchased on 1.1.2019 for US \$ 15,000	Rs. 75
Exchange rate on 31.3.2019	Rs. 74
Date of actual payment 7.7.2019	Rs. 73

You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11.

Answer

(a) Share capital - Non-monetary

Trade receivables - Monetary

Investment in equity shares - Non-monetary

Fixed assets - Non-monetary

(b) As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'**, all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2019 and corresponding creditors would be recorded at Rs. 11,25,000 (i.e. \$15,000 × Rs. 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US \$15,000 on 31.3.2019 will be reported at Rs. 11,10,000 (i.e. \$15,000 × Rs. 74) and exchange profit of Rs. 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2018-19.

On 7.7.2019, creditors of \$15,000 is paid at the rate of Rs. 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, Rs. 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2019-20.

#10. Illustration | May 2021 |

a) Classify the following items into Monetary and Non-monetary:

(i) Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment

b) Trade payables of CAT Ltd. include amount payable to JBB Ltd., Rs. 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US \$1 = Rs. 80.00. The exchange rate on balance sheet date (31.03.2020) was US \$1 = Rs. 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd.

Answer

a) Share capital - Non-monetary;

Trade Payables – Monetary

Cash balance – Monetary;

Property, plant and equipment - Non-monetary

b) **Amount of Exchange difference and its Accounting Treatment**

	Foreign Currency Rate	Rs.
Trade payables		
Initial recognition US \$ 12,500 (Rs.10,00,000/80)	1 US \$ = Rs. 80	10,00,000
Rate on Balance sheet date	1 US \$ = Rs. 85	
Exchange Difference loss US \$ 12,500 x Rs. (85-80)		62,500
Treatment:		
Debit Profit and Loss A/c by Rs. 62,500 and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting Rs. 62,500 is required to be transferred to Profit and Loss.

#11. Illustration | Nov 2021 |

Kumar Ltd. borrowed US \$ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US\$) on different dates are as under:

31-12-2020	1 US \$ = Rs. 44.00

31-03-2021	1 US \$ = Rs. 44.50
30-06-2021	1 US \$ = Rs. 44.75

- i. Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.
- ii. if borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US \$ = Rs. 44.20 then what entry should be passed?

Answer

- i. As per **AS 11 'The Effect of Changes in Foreign Exchange Rates'**, a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Moreover, at each balance sheet date, foreign currency monetary items should be reported using the closing rate. Accordingly, on 31.12.2020 borrowings will be recorded at Rs. 1,32,00,000 (i.e., Rs. 3,00,000 × Rs. 44.00). On 31.3.2021 borrowings (monetary items) will be recorded at Rs. 1,33,50,000 (i.e. \$ 3,00,000 × Rs. 44.50).

Journal of Kumar Ltd.

Date	Particular	Dr. (Rs.)	Cr. (Rs.)
31-12-2020	Bank A/c Dr. To Foreign Loan Account	1,32,00,000	1,32,00,000
31-03-2021	Foreign Exchange Difference Account A/c Dr. To Foreign Loan Account	1,50,000	1,50,000
30-06-2021	Foreign Loan Account A/c Dr. Foreign Exchange Difference Account A/c Dr. To Bank A/c	1,33,50,000 75,000	1,34,25,000

- ii. In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

Date	Particular	Dr. (Rs.)	Cr. (Rs.)
28-02-2021	Foreign Loan Account A/c Dr. Foreign Exchange Difference Account A/c Dr. To Bank A/c	1,32,00,000 60,000	1,32,60,000

Working Notes:

- (i) The exchange difference of Rs. 1,50,000 is arising because the transaction has been reported at different rate (Rs. 44.50 = 1 US \$) from the rate initially recorded (i.e., Rs. 44 = 1 US \$) from the rate initially recorded (i.e., Rs. 44 = 1 US \$)

- (ii) The exchange difference of Rs. 75,000 is arising because the transaction has been settled at an exchange rate (Rs. 44.75 = 1 US\$) different from the rate at which reported in the last financial statements (Rs. 44.50 = 1 US\$).
- (iii) The exchange difference of Rs. 60,000 is arising because the transaction has been settled at a different rate (i.e., Rs. 44.20 = 1 US \$) than the rate at which initially recorded (1 US \$ = Rs. 44.00)

#12. Illustration | May 2022 |

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2022, when the exchange rate was Rs. 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2022 when the exchange rate was Rs. 47 per US Dollar. However, on 31st March, 2022, the rate of exchange was Rs. 48 per US Dollar. The company passed an entry on 31st March, 2022 adjusting the cost of raw materials consumed for the difference between Rs. 47 and Rs. 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

Answer

As per **AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates'**, **monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account.** Trade payables is a monetary item, hence should be valued at the closing rate i.e, Rs. 48 at 31st March, 2022 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs. 5 (Rs. 48-Rs. 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2022 and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of Rs. 1 per US dollar, i.e., the difference between Rs. 48 and Rs. 47 per US dollar. **Hence, the accounting treatment adopted by the company is incorrect.**

#1. Question | September 2024 Exam, 5 marks |

Delta Ltd. is working on different projects those are likely to be completed within 3 years period. It recognizes revenue from these contracts on Percentage of Completion Method for Financial Statements for the years ending 2021, 2022 and 2023 for Rs. 34 Lakhs, Rs. 50 Lakhs and Rs. 65 Lakhs respectively.

However, for Income Tax purpose, it has adopted the Completed Contract Method under which it has recognized revenue of Rs. 30 Lakhs, Rs. 52 Lakhs and Rs. 67 Lakhs for the years ending 2021, 2022 and 2023 respectively. Income Tax rate is 30%.

Compute the amount of Deferred Tax Asset / Liability and Total Tax Expenses for the years ending 31st March 2021, 2022 and 2023.

Answer:

Calculation of Deferred Tax Asset/Liability in Delta Limited

Year	Accounting Income	Taxable Income	Timing Difference	Timing Difference (balance)	Deferred Tax	Deferred Tax Liability (balance)
2021	34,00,000	30,00,000	4,00,000	4,00,000	1,20,000	1,20,000
2022	50,00,000	52,00,000	(2,00,000)	2,00,000	(60,000)	60,000
2023	65,00,000	67,00,000	(2,00,000)	NIL	(60,000)	NIL
	1,49,00,000	1,49,00,000				

Calculation of total tax

Year	Deferred Tax	Current tax expense	Total tax
2021	1,20,000	9,00,000 (30,00,000 x 30%)	10,20,000
2022	(60,000)	15,60,000 (52,00,000 x 30%)	15,00,000
2023	(60,000)	20,10,000 (67,00,000 x 30%)	19,50,000

Note: It is assumed that the revenue and the taxable profit is the same.

#2. Question | November 2023 Exam, 5 marks |

The following particulars are stated in the Balance Sheet of Siddhi Limited as on 31st March, 2022:

Particulars	(Rs. In lakhs)
Deferred Tax Liabilities (Cr.)	2.50
Deferred Tax Assets (Dr.)	1.35

The following transactions were reported during the year 2022 -23:

	Rs. in lakhs
(i) Depreciation as per accounting records	15.00
(ii) Depreciation as per income tax records	20.00
(iii) Interest paid to NBFC accounted in books on accrual basis but paid on 30.06.2023	6.00

(iv) Items disallowed for tax purposes in 2021-22 but allowed in 2022-23	1.05
(v) Donation to Private Trust	40.00
(vi) Tax rate	15%
(vii) There were no additions to fixed assets during the year.	

You are required to calculate the Deferred Tax Asset and Deferred Tax Liability as on 31-03-2023 as per AS-22.

Answer:

Balances of Deferred tax assets and Deferred tax liability as on 31 st March, 2023

	Rs. (in lakhs)
Deferred tax liability (Cr.) (2.5 + .75)	3.25
Deferred tax asset (Dr.) (1.35 - .158*)	1.192

Working Note:

Impact of various items in terms of deferred tax liability / deferred tax asset

S. No.	Transactions	Nature of difference	Effect	Amount (Rs.)
(i), (ii)	Difference in depreciation	Responding timing difference	Creation of DTL	$(20 - 15) \times 15\% = .75$
(iii)	Interest to financial institutions	No timing difference	Not applicable	Not applicable
(iv)	Disallowances, as per IT Act, of earlier years	Timing difference	Reversal of DTA	Rs. 1.05 lakh $\times$ 15% = Rs. .158* lakh
(v)	Donation to private trusts	Permanent difference	Not applicable	Not applicable

Alternatively, may be rounded off as Rs. .157 lakh or 0.1575.

#3. Question | November 2022 Exam, 5 marks |

The following information is furnished in respect of Mohit Limited for the year ending 31st March, 2022.

Depreciation as per accounting records ₹ 56,000 Depreciation for income tax records ₹ 38,000

The above depreciation does not include depreciation on new addition.

A new machinery purchased on 1st April, 2021 costing ₹ 24,000 on which 100% depreciation is allowed in the 1st Year for income tax purpose, whereas straight line method of depreciation is considered appropriate for accounting purpose with a life estimation of 4 years.

The company has made a profit of ₹ 1,28,000 before depreciation and taxes.

Donation to private trust during the year is ₹ 15,000 (not allowed under Income tax laws.)

Corporate tax is 40%.

Answer

Statement of profit and Loss for the year ended 31st March, 2022 (An Extract)

	(₹)
Profit before taxes and depreciation	1,28,000
Less: Depreciation (56,000+ 6,000)	62,000
Profit before tax	66,000
Less: Current tax (W.N)	(32,400)
Deferred Tax	Nil

Profit after tax	33,600

Working Note:

Computation of taxable income

	(₹)
Profit before taxes and depreciation	1,28,000
Less: Depreciation (38,000+ 24,000)	(62,000)
	66,000
Add: Donation*	15,000
	81,000
Current tax (40%)	32,400

Note: The profit of ₹ 1,28,000 given in the question is before depreciation and taxes. It has been considered that this amount is after making adjustment of donation amounting ₹ 15,000.

Impact of various items in terms of deferred tax liability/deferred tax asset

Transactions	Nature of difference	Effect	Amount
(i) Difference in depreciation (old machinery)	Timing difference	Reversal of DTL	$(56,000 - 38,000) \times 40\% = (+) ₹ 7,200$
(ii) Depreciation on new machinery	Timing difference	Creation of DTL	$₹ 18,000$ $(24,000 - 6,000) \times 40\% = (-) ₹ 7,200$
(iii) Donation to private trusts	Permanent difference	Not applicable	--
Net Effect of Deferred Tax			NIL

#4. Question | July 2021 Exam, 5 marks |

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ in Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020 -2021:

- 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 section 35(D) of the Income Tax Act, 1961 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 was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.

Tax Rate to be taken at 40%. You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021.

Answer

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs X 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs X 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs X 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less	Originating timing difference	Increase in DTL	70 lakhs X 40% = 28 lakhs

#5. Question | January 2021, 5 Marks | RTP May 20

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31 -3-2019:

Particulars	(₹ in Lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00
The following transactions were reported during the year 2019-20 :	
Depreciation as per accounting records	160.00
Depreciation as per income tax records	140.00
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	20.00
Donation to Private Trust	20.00
Tax rate	30%

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22.

Answer

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

- (1) **Difference in Depreciation-** Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in

comparison to later years. It is timing difference for which **reversal of Deferred tax liability** is required. Reversal of DTL = ₹ (160 – 140) Lakhs X 30% = ₹6 Lakhs

- (2) **Disallowances, as per IT Act of earlier years**- Due to disallowance tax payable for the earlier years was higher on this account. It is **responding timing difference** which required Reversal of Deferred tax assets. Reversal of Deferred tax assets = ₹20 Lakhs X 30% = ₹ 6 Lakhs
- (3) Donations to private trusts is **not an allowable expenditure** under IT Act. It is permanent difference. Hence, no reversal of tax is required.

#6. Question | November 2020, November 2019 Exam, 5 Marks | RTP November 2019

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

Particulars	(₹)
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year.

Answer

Tax as per accounting profit $15,00,000 \times 20\% = ₹ 3,00,000$

Tax as per Income-tax Profit $2,50,000 \times 20\% = ₹ 50,000$

Tax expense = Current Tax + Deferred Tax

₹ 3,00,000 = ₹ 50,000 + Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

#7. Question | May 2019 Exam, 5 Marks |

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

Answer

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income may be different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as **Permanent Difference**. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income, known as **Timing Difference**.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and **do not reverse subsequently**. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are **capable of reversal** in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

#8. Question | May 2018 Exam, 5 Marks | November 2020 RTP

Rohit Ltd. has provided the following information

Particulars	(₹)
Depreciation as per accounting records	2,50,000
Depreciation as per tax records	5,50,000
Unamortised preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax assets/liability should be recognized as transition adjustment when the tax rate is 50%?

Answer

Transactions	Amount	Timing difference	Deferred tax	Amount @ 50%
	₹			₹
Excess depreciation as per tax records (₹ 5,50,000 – ₹ 2,50,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred tax asset	(20,000)
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹1,30,000 should be recognized as transition adjustment.

#9. Question | RTP Jan 2025 |

ABC Ltd. prepares its accounts annually on 31st March. On 1st April, 2022, it purchases a machine at a cost of Rs. 1,50,000. The machine has a useful life of three years and an expected scrap value of zero. Although it is eligible for a 100% first year depreciation allowance for tax purposes, the straight line method is considered appropriate for accounting purposes. ABC Ltd. has profits before depreciation and taxes of Rs. 2,00,000 each year and corporate tax rate is 40 percent each year. The purchase of machine at a cost of Rs. 1,50,000 in 2022 gives rise to a tax saving of Rs. 60,000. The corporate tax rate has been assumed to be same in each of the three years. Calculate deferred tax and pass necessary journal entries.

What will be the amount of deferred tax, if the substantively enacted tax rates for 2022, 2023 and 2024 are 40%, 35% and 38% respectively.

Answer:

If the cost of 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:

Statement of Profit and Loss
(for the three years ending 31st March, 2022, 2023, 2024)

		(Rs. in thousand)		
		2022	2023	2024
	Profit before depreciation and taxes	200	200	200
Less:	Depreciation for accounting purposes	<u>50</u>	<u>50</u>	<u>50</u>
	Profit before taxes	<u>150</u>	<u>150</u>	<u>150</u>
Less:	Tax expense			
	Current tax:			
	0.40 x (200 -150)	20		
	0.40 x 200		80	80
	Deferred tax:			
	Tax effect of timing differences originating during the year leading to DTL			
	0.40 (150-50)	40		

	Tax effect of timing differences reversing during the year			
	0.40 (0-50)	<u>-</u>	<u>(20)</u>	<u>(20)</u>
	Tax expense	<u>60</u>	<u>60</u>	<u>60</u>
	Profit after tax	<u>90</u>	<u>90</u>	<u>90</u>
	Net timing differences	<u>100</u>	<u>50</u>	<u>0</u>
	Deferred tax liability balance	<u>40</u>	<u>20</u>	<u>0</u>

In 2022, the amount of depreciation allowed for tax purposes exceeds the amount of depreciation charged for accounting purpose by Rs. 1,00,000 and, therefore, taxable income is lower than the accounting income. This gives rise to a deferred tax liability of Rs. 40,000. In 2023 and 2024 accounting income is lower than taxable income because the amount of depreciation charged for accounting purposes exceeds the amount of depreciation allowed for tax purposes by Rs. 50,000 each year. Accordingly, deferred tax liability is reduced by Rs. 20,000 each in both the years. As may be seen, tax expense is based on the accounting income of each period.

In 2022, the profit and loss account is debited and deferred tax liability account is credited with the amount of tax on the originating timing difference of Rs. 1,00,000 while in each of the following two years, deferred tax liability account is debited and profit and loss account is credited with the amount of tax on the reversing timing difference of Rs. 50,000.

The following journal entries will be passed:

Year 2022			
Profit and Loss A/c	Dr.	20,000	
To Current tax A/c (Being the amount of taxes payable for the year 2022 provided for)			20,000
Profit and Loss A/c	Dr.	40,000	
To Deferred tax liability A/c (Being the deferred tax liability created for originating timing difference of Rs. 1,00,000)			40,000
Year 2023			
Profit and Loss A/c	Dr.	80,000	
To Current tax A/c (Being the amount of taxes payable for the year 2023 provided for)			80,000
Deferred tax liability A/c	Dr.	20,000	
To Profit and Loss A/c (Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)			20,000
Year 2024			
Profit and Loss A/c	Dr.	80,000	
To Current tax A/c (Being the amount of taxes payable for the year 2024 provided for)			80,000
Deferred tax liability A/c	Dr.	20,000	
To Profit and Loss A/c			20,000

(Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)			

Presentation:

In the year 2022, the balance of deferred tax account i.e. Rs. 40,000 would be shown separately from the current tax payable for the year in terms of paragraph 30 of AS 22. In the year 2023, the balance of deferred tax liability account would be Rs. 20,000 and be shown separately from the current tax payable for the year as in year 2022. In year 2024, the balance of deferred tax liability account would be nil.

If the rate of tax changes, it would be necessary for the enterprises 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

The amount of deferred tax liability would be computed as follows:

The deferred tax liability carried forward each year would appear in the balance sheet as under:

31st March, 2022	= 0.40 (1,00,000)	= Rs. 40,000
31st March, 2023	= 0.35 (50,000)	= Rs. 17,500
31st March, 2024	= 0.38 (Zero)	= Rs. Zero

Accordingly, the amount debited (credited) to the profit and loss account (with corresponding credit or debit to deferred tax liability) for each year would be as under:

31st March, 2022 Debit	= Rs. 40,000
31st March, 2023 (Credit)	= Rs. (22,500)
31st March, 2024 (Credit)	= Rs. (17,500)

#10. Question | RTP November 2022|

Define followings as per AS 22:

- (i) Accounting income (loss)
- (ii) Taxable income (tax loss)
- (iii) Tax expense (tax saving)

Answer

Accounting income (loss) is the net profit or loss for a period, as reported in the statement

of profit and loss, before deducting income-tax expense or adding income tax saving.

of profit and loss, before deducting income-tax expense or adding income tax saving.

Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

#11. Question | RTP May 2022|

The following transactions were reported by PQR Ltd. during the year 2020-2021:

Particulars	(₹ in Lakhs)
Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	20.00
Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00
Tax Rate	30%

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

Answer

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	Analysis	Nature of difference	Effect	Amount
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	₹20 lakh X 30% = ₹6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

#12. Question | RTP November 2021 |

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22?

Answer

Yes. It can offset deferred tax assets and deferred tax liabilities. As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

- the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and
- the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

#13. Question | RTP May 2021 |

- The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:
 - Depreciation as per books : ₹2,80,000
Depreciation for tax purpose: ₹1,90,000
The above depreciation does not include depreciation on new additions.
 - A new machinery purchased on 1.4.18 costing ₹1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.
 - The company has made a profit of ₹6,40,000 before depreciation and taxes.
 - Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

- What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22?

Answer

- Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)**

Particulars		(₹ in Lakhs)

Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000)
Profit before taxes Less (A)		3,30,000
Less: Tax expense (B)		
Current tax (W.N.1) (3,30,000 x 40%) Deferred tax (W.N.2)	1,32,000	<u>(1,32,000)</u>
Profit after tax (A – B)	NIL	<u>1,98,000</u>

Working Notes:

1. Computation of taxable income

Particulars	(₹)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	<u>(3,10,000)</u>
Taxable income	<u>3,30,000</u>
Tax on taxable income @ 40%	<u>1,32,000</u>

2. Impact of various items in terms of deferred tax liability / deferred tax asset

Transactions	Analysis	Nature of difference	Effect	Amount
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 1,90,000) x 40% = (36,000)
Depreciation on new machinery	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000
Net Impact				NIL

- (b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance **should be disclosed** in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed **under a separate heading** in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the **evidence supporting the recognition** of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

#14.Question | RTP May 2019|

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advice to the company.

Answer

The Company **should provide for deferred tax liability** on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

#15.Question | RTP November 2018|

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is Rs. 1,000 lakhs and Rs. 2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by Rs. 50 lakhs. Assuming tax rate of 40%, you are required to compute the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

Answer

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, **should not be recognized** to the extent deduction from the total income of an enterprise is **allowed during the tax holiday period** as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but **reverse** after the tax holiday period should be **recognized** in the year in which the **timing differences originate**. However, recognition of deferred tax assets should be subject to the consideration of **prudence**. For this purpose, the timing differences which originate first should be considered to reverse first. Out of ₹1,000 lakhs depreciation, timing difference amounting ₹400 lakhs (₹50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for ₹600 lakhs (₹1,000 lakhs – ₹400 lakhs), deferred tax liability will be recognized for ₹240 lakhs (40% of ₹600 lakhs) in first year. In the second year, the entire amount of timing difference of ₹2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting ₹800 lakhs (40% of ₹2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹1,040 lakhs (240 lakhs + 800 lakhs).

AS – 4 Contingencies & Events occurring after the Balance Sheet Date

Past Exams and RTP Questions Compiler

#1. Question | Dec 2021, 5 marks |

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

1. Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
2. On 05.03.2021, ₹53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.
3. One building got damaged due to occurrence of fire on 23.05.2021. Loss was estimated to be ₹81,00,000

Answer

1. If dividends are declared after the balance sheet date but **before the financial statements are approved**, the dividends are **not recognized as a liability at the balance sheet date** because no obligation exists at that time **unless a statute requires otherwise**. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statements for financial year ended 31st March, 2021 and declaration of dividend is **non-adjusting event**.
2. As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring after the balance sheet date **may require adjustment** to the reported values of assets, liabilities, expenses or incomes if **such events relate to conditions** existing at the balance sheet date. In the given case, fraud of the accounting period is **detected after the balance sheet date** but before approval of the financial statements, it is necessary to **recognize the loss**. Thus loss amounting ₹53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is **adjusting event**.
3. AS 4 states that adjustments to assets and liabilities are **not appropriate** for **events occurring after the balance sheet date**, if such **events do not relate to conditions existing at the balance sheet date**. The damage of one building due to fire **did not exist on the balance sheet date** i.e. 31.3.2021. Therefore, loss occurred due to fire is **not to be recognized** in the financial year 2020-2021 **as it is non-adjusting event**.
However, according to the standard, unusual changes **affecting the existence or substratum** of the enterprise **after** the balance sheet date **may indicate** a need to consider the use of **fundamental accounting assumption of going concern** in the preparation of the financial statements. As per the information given in the question, the fire has caused **major destruction**; therefore, **fundamental accounting assumption of going concern would have to be evaluated**. Considering that the **going concern assumption is still valid**, the fact of fire together with an estimated loss of ₹81 lakhs **should be disclosed in the report** of the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

#2. Question | July 21, May 19, 5 marks |

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

- (a) A suit against the Company's Advertisement was filed by a party on 5th April, 2021, claiming damages of ₹5 lakhs.
- (b) Company sends a proposal to sell an immovable property for ₹45 lakhs in March 2021. The book value of the property is ₹30 lakhs as on yearend date. However, the Deed was registered on 15th April, 2021.
- (c) The terms and conditions for acquisition of business of another company have been decided by the end of March 2021, but the financial resources were arranged in April 2021. The amount invested was ₹50 lakhs.
- (d) Theft of cash amounting to ₹4 lakhs was done by the Cashier in the month of March 2021 but was detected on the next day after the Financial Statements have been approved by the Directors.
- (e) A, major fire has damaged the assets in a factory on 5th April, 2018. However, the assets are fully

insured.

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

Answer

- (a) Suit filed against the company is a **contingent liability** but it was **not existing as on date of balance sheet date** as the suit was filed on 5th April after the balance sheet date. **As per AS 4, 'Contingencies'** is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by **future events which may or may not occur**. However, it may be **disclosed with the nature of contingency**, being a contingent liability. This event does not pertain to conditions on the balance sheet date. Hence, it will have **no effect** on financial statement and will be a **non-adjusting event**.
- (b) In this case, **no adjustment to assets and liabilities is required** as the event does **not affect** the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2021. There was **just a proposal** before 31st March, 2021 and hence **sale cannot be shown** in the financial statements for the year ended 31st March, 2021. Sale of immovable property is an event occurring after the balance sheet date is a **non-adjusting event**.
- (c) In the given case, terms and conditions for **acquisition of business** were finalized **before the balance sheet date** and carried out before the closure of the books of accounts but transaction for **payment of financial resources** was effected in April, 2021. Hence, it is an **adjusting event** and necessary adjustment to assets and liabilities for **acquisition of business is necessary** in the financial statements for the year ended 31st March 2021.
- (d) Only those events which **occur between the balance sheet date and the date on which the financial statements are approved**, may indicate the **need for adjustments to assets and liabilities** as at the balance sheet date or may require **disclosure**. In the given case, as the **theft of cash was detected after approval** of financial statements, **no adjustment** is required. Hence it is non-adjusting event.
- (e) The **condition** of fire occurrence was **not existing** on the balance sheet date. Only the disclosure regarding **event of fire** and **loss being completely insured** may be given in the report of approving authority.

#3. Illustration | May 2019, 1 Mark |

As per the provisions of AS-4, a contingency is a condition or situation, the ultimate outcome of which (gain or loss) will be known or determined only on the occurrence of one or more uncertain future events **[True or False]**

Answer

False: A **contingency** is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the **occurrence, or non-occurrence**, of one or more uncertain future events.

#4. Illustration | Nov 2018, 5 Marks |

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again. State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised).

Answer

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an **adjusting event even if it does not reflect** any condition existing on the balance sheet date, **if the event** is such as to indicate that **the fundamental accounting assumption of going concern is no longer appropriate**.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. **The loss by fire** is of such a magnitude that it is not reasonable to expect the

Dee Ltd. to start operations again, i.e., the **going concern assumption is not valid**. Since the fire occurred after 31/03/18, **the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event** the entire accounts need to be prepared on a **liquidation basis with adequate disclosures** by the company by way of **note in its financial statements** in the following manner: "Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on **liquidation basis**."

#5. Illustration | RTP May 2025]

Smart Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March, 2024 are to be approved by the approving authority on 30th June 2024. During the first quarter of 2024-2025, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

- (i) Smart Ltd. has an inventory of 50 stitching machines costing at Rs. 5,500 per machine as on 31st March, 2024. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2024, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of Rs. 4,000 per machine.
- (ii) A fire has broken out in the company's godown on 15th April, 2024. The company has estimated a loss of Rs. 25 lakhs of which 75% is recoverable from the Insurance company.
- (iii) The company has entered into a sale agreement on 30th March, 2024 to sell a property for a consideration of Rs. 7,50,000 which is being carried in the books at Rs. 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2024 when conveyance and possession get completed.
- (iv) The company has received, during the year 2022-2023, a government grant of Rs. 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15th June, 2024 due to violation of some of the conditions of grant during the year 2023-2024.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2024.

Answer:

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30th June 2024. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31st March 2024:

- (i) Since on 31st March 2024, Smart Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2024 will be considered as an adjusting event. Hence, Smart Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to Rs. 4,000 per machine. Total value of inventory in the books will be 50 machines x Rs. 4,000 = Rs. 2,00,000.
- (ii) A fire took place after the balance sheet date i.e. during 2024-2025 financial year. Hence, corresponding financials of 2023-2024 financial year should not be adjusted for loss

occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.

- (iii) Since the transfer of risk and reward and sale was complete in the month of May, 2024 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2023-2024. However, a disclosure for the same should be given by the entity.
- (iv) Since the notice has been received after 31 March but before 30 June 2024 (approval date), the said grant shall be adjusted in the financial statements for financial year 2023-2024 because the violation of the conditions took place in the financial year 2023-2024 and the company must be aware of it.

#6. Illustration | RTP Sep 24]

For five companies whose financial year ended on 31st March, 2023, the financial statements were approved by their approving authority on 15th June, 2023.

During 2023-2024, the following material events took place:

- a. A Ltd. sold a major property which was included in the balance sheet at Rs. 1,00,000 and for which contracts had been exchanged on 15th March, 2023. The sale was completed on 15th May, 2023 at a price of Rs. 2,50,000.
- b. On 30th April, 2023, a 100% subsidiary of B Ltd. declared a dividend of Rs. 3,00,000 in respect of its own shares for the year ended on 31st March, 2023.
- c. On 31st May, 2023, the mail order activities of C Ltd. (a retail trading group) were shut down with closure costs amounting to Rs.2.5 million.
- d. On 1st July, 2023 the discovery of sand under D Ltd.'s major civil engineering contract site causes the cost of the contract to increase by 25% for which there would be no corresponding recovery from the customer.
- e. A fire, on 2nd April, 2023, completely destroyed a manufacturing plant of E Ltd. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company.

You are required to state with reasons, how each of the above items numbered (a) to (e) should be dealt with in the financial statement of the various companies for the year ended 31st March, 2023.

Answer:

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

(a)	A Ltd.	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended on 31.3.2023 and the profit on sale of property Rs. 1,50,000 would be treated as an extraordinary item.
(b)	B Ltd.	The declaration of dividend on 30 th April, 2023 of Rs. 3,00,000 would be treated as a non-adjusting event in the financial statements of 2022-2023. This is because, the dividend has been declared after the balance sheet date and no conditions existed on the balance sheet date for such declaration of dividend. Further as per AS 9, right to receive dividend is established when it is declared and not before that.
(c)	C Ltd.	A closure not anticipated at the year-end would be treated as a non-adjusting event. Memorandum disclosure would be required for closure of mail order activities since non disclosure would affect user's understanding of the financial statements.

(d)	D Ltd.	The event took place after the financial statements were approved by the approving authority and is thus outside the purview of AS 4. However, in view of its significance of the transaction, the directors may consider publishing a separate financial statement/additional statement for the attention of the members in general meeting.
(e)	E Ltd.	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

#7. Illustration | RTP November 22]

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

Answer

Accounting Treatment of Contingent Gains **Contingent gains** are **not recognised** in financial statements since their recognition may result in the **recognition of revenue which may never be realised. However**, when the realisation of a gain is **virtually certain**, then such gain is **not a contingency** and accounting for the **gain is appropriate**.

#8. Illustration | RTP May 2022 |

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

- Tee Ltd. has an inventory of 50 stitching machines costing at ₹5,500 per machine as on 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of ₹4,000 per machine.
- A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of ₹25 lakhs of which 75% is recoverable from the Insurance company.
- A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹20 lakhs

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

Answer

Events occurring after the balance sheet date are those significant events, **both favorable and unfavorable**, that occur between the balance sheet date and the date on which the financial statements are approved by the **Board of Directors** in the case of a **company**, and, by the **corresponding approving authority** in the case of any **other entity. Assets and liabilities** should be **adjusted** for events occurring after the balance sheet date that provide **additional evidence** to assist the estimation of amounts relating to **conditions existing** at the balance sheet date or that indicate that the **fundamental accounting assumption of going concern is not appropriate**. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

- Since on 31 March 2020, Tee Ltd. was expecting a **heavy decline in the demand** of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an **adjusting event**. Hence, Tee Ltd. **needs to adjust the amounts recognized** in its financial statements w.r.t. net

realizable value at the end of the reporting period. Accordingly, inventory should be written down to ₹4,000 per machine. Total value of inventory in the books will be 50 machines x ₹4,000 = ₹2,00,000.

- (ii) A **fire took place** after the balance sheet date i.e. during 2020-2021 financial year. Hence, the financial statements for the year 2019-2020 **should not be adjusted for loss** occurred due to fire. However, in this circumstance, **the going concern assumption will be evaluated**. In case the going concern **assumption is considered to be appropriate** even after the occurrence of fire, **no disclosure of the same is required** in the financial statements.
- (iii) The **contingency is restricted to conditions existing** at the **balance sheet date**. However, in the given case, **suit was filed against the company's advertisement** by a party on **10th April** for amount of ₹20 lakhs. Therefore, it **does not fit into the definition of a contingency** and hence is a **non-adjusting event**.

#9. Illustration | RTP November 2021 |

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

- a. A major property was sold (it was included in the balance sheet at ₹25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹26,50,000.
- b. On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹10 million would be fully covered by the insurance company.
- c. A claim for damage amounting to ₹8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020

Answer

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

- (a) The sale of property should be treated as an **adjusting event** since **contracts** had been exchanged **prior to the year-end**. The effect of the **sale should be reflected** in the financial statements ended on 31.3.2020 and the **profit on sale of property ₹1,50,000** would be **considered**.
- (b) The event is a **non-adjusting event** since it occurred **after the year-end** and does **not relate to the conditions existing at the year-end**. However, it is necessary to consider the **validity of the going concern assumption** having regard to the **extent of insurance cover**. Also, since it is said that the **loss would be fully recovered** by the insurance company, the **fact should be disclosed** by way of a **note to the financial statements**.
- (c) On the basis of **evidence provided**, the claim against the company **will not succeed**. Thus, ₹8 million **should not be provided** in the account, **but should be disclosed** by means of a **contingent liability** with full **details of the facts**. **Provision should be made** for legal fee **expected to be incurred** to the extent that they are **not expected to be recovered**.

#10. Illustration | RTP May 2021 |

A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 2019-2020. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements were approved on 31st May, 2020. Shall company account for such tax in the year 2019-2020 or shall it account for in the year 2020-2021?

Answer

To decide whether, the event is **adjusting or not adjusting** two **conditions** need to be satisfied,

- (a) There has to be **evidence**
- (b) The event must have been related to period ending on **reporting date**. Here both the conditions are satisfied. Court order is a **conclusive evidence** which has been received **before approval of the financial statements** since the liability is related to earlier year. The event will be considered as an **adjusting event** and accordingly the amount will be **adjusted in accounts** of 2019-2020.

#11. Illustration | RTP Nov 2020 |

A fire, on 2nd April, 2020, completely destroyed a manufacturing plant of Omega Ltd. whose financial year ended on 31st March, 2020, the financial statements were approved by their approving authority on 15th June, 2020. It was expected that the loss of Rs. 10 million would be fully covered by the insurance company. How will you disclose it in the financial statements of Omega Ltd. for the year ended 31st March, 2020.

Answer

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

#12. Illustration | RTP May 2020, May 2018 |

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet date in case of a company which follows April to March as its financial year.

- (i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.
- (ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹20 lakhs.

Answer

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

However, adjustments to assets and liabilities **are not appropriate** for events occurring after the balance sheet date, if such events **do not relate to conditions existing at the balance sheet date**. "**Contingencies**" used in the Standard is restricted to **conditions or situations** at the balance sheet date, the financial effect of which is to be determined by **future events which may or may not occur**.

- (i) **Fire** has occurred after the balance sheet date and also the **loss is totally insured**. Therefore, the **event becomes immaterial** and the event is **non-adjusting** in nature.
- (ii) The **contingency** is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a **party on 10th April** for amount of ₹20 lakhs. Therefore, it does **not fit into the definition of a contingency** and hence is a **non-adjusting event**.

#13. Illustration | RTP November 2019 |

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 ₹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

Para 8.3 of 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**. 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 year 2018-2019.

However, according to **para 8.6 of the standard**, unusual changes affecting the **existence or substratum of the enterprise** after the balance sheet date may indicate a need to consider the use of **fundamental accounting assumption of going concern** in the preparation of the financial statements. As per the

information given in the question, the **earthquake has caused major destruction**; therefore, fundamental accounting assumption of **going concern is called upon**.

Hence, **the fact of earthquake** together with an **estimated loss** of ₹25 lakhs **should be disclosed** in the Report of the Directors for the financial year 2018-2019.

#14. Illustration | RTP May 2019 |

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of ₹2 per equity share (on 2 crore fully paid up equity shares of ₹10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Answer

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the **events which take place after the balance sheet date**, are sometimes **reflected** in the financial statements because of **statutory requirements or because of their special nature**.

However, **dividends declared** after the balance sheet date but before approval of financial statements are **not recognized** as a liability at the balance sheet date **because no statutory obligation** exists at that time. Hence **such dividends are disclosed in the notes** to financial statements.

No, **provision for proposed dividends is not required to be made**. Such proposed dividends are to be **disclosed in the notes** to financial statements. Accordingly, the dividend of ₹4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 **shall not be accounted for in the books** for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and **will be paid after approval** in the Annual General Meeting of the members / shareholders.

#15. Illustration | RTP Nov 2018 |

While preparing its final accounts for the year ended 31st March, 2017, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2017 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2017 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2017? You are required to advise the company in line with AS 4

Answer

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

A **debtor** for ₹20,00,000 suffered **heavy loss due to earthquake** in the last week of February, 2017 which was **not covered by insurance**. This information with its implications was already known to the company. The **fact that he became bankrupt** in April, 2017 (after the balance sheet date) is only an **additional information** related to the **condition existing** on the balance sheet date.

Accordingly, **full provision for bad debts** amounting ₹20,00,000 should be made, to cover the **loss arising due to the insolvency of a debtor**, in the final accounts for the year ended 31st March 2017. Since the company has **already made 5% provision** of its total debtors, **additional provision** amounting ₹19,00,000 **shall be made** (20,00,000 x 95%) for the year ended 31st March, 2017.

AS – 5 Net Profit or Loss for the period, Prior period items & Changes in Accounting policies

Past Exams and RTP Questions Compiler

#1. Question | Nov 2023 Exam, 5 marks |

The accountant of Beryl Limited has asked you to identify the following items as – Change in Accounting Policies / Change in Accounting Estimates / Extraordinary Items / Prior period items / Ordinary Activity:

- (i) Non-provision for salary already due in earlier year.
- (ii) Attachment of the property of the enterprise.
- (iii) Introduction of new pension scheme for employees.
- (iv) Change in Reserve for obsolete inventory.
- (v) Settlement of litigation case.
- (vi) Actual Bad debts exceeds the provision.
- (vii) Legislative changes having long term retrospective application.
- (viii) Capitalisation of working capital loan interest.
- (ix) Change from Cost Model to Revaluation Model for measurement of carrying amount of PPE.
- (x) Government sanctioned grant in current year for expenses incurred in previous accounting year.

Answer:

- (i) Prior Period item
- (ii) Attachment of property of enterprise is an extraordinary item.
- (iii) Introduction of new pension scheme for employees is not a change in accounting policy. It is an ordinary activity.
- (iv) Change in provision for obsolete inventory is a change in accounting estimate.
- (v) Litigation settlement is an ordinary activity but requires separate disclosure
- (vi) Change in estimate
- (vii) Ordinary activity requiring separate disclosure
- (viii) Error
- (ix) Change in Accounting policy.
- (x) Ordinary activity requiring separate disclosure or extra ordinary item.

#2. Question | November 2022 Exam, 5 marks | RTP May 2022, November 19, November 18 |

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

- i. Provision for doubtful debts was created @3% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 4%.
- ii. During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.
- iii. Till 31st March, 2020 the furniture was depreciated on straight line basis over a period of 5 years. From the Financial year 2020-2021, the useful life of furniture has been changed to 3 years.
- iv. Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.
- v. During the year ended 31st March 2021, there was change in cost formula in measuring the cost of inventories.

Answer

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

- ii. As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous transaction, will **neither be treated as change in an accounting policy nor change in accounting estimate**.
- iii. Change in useful life of furniture from 5 years to 3 years is **a change in accounting estimate** and is not a change in accounting policy.
- iv. Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is **neither a change in accounting policy nor a change in accounting estimate**.
- v. Change in cost formula used in measurement of cost of inventories is a **change in accounting policy**.

#3. Question | May 2022 Exam, 5 marks |

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

Discuss with reference to applicable Accounting Standards.

Answer

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

It is given that revision of wages took place in April, 2022 with **retrospective effect** from 1st January, 2022. Therefore, wages payable for the period from 1.01.2022 to 31.3.2022

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

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

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

#4. Illustration | Jan 2021 Exam, 5 Marks | RTP May 23

State whether the following items are examples of change in Accounting Policy / Change in Accounting Estimates / Extraordinary items / Prior period items / Ordinary Activity :

- i. Actual bad debts turning out to be more than provisions.
- ii. Change from Cost model to Revaluation model for measurement of carrying amount of PPE.
- iii. Government grant receivable as compensation for expenses incurred in previous accounting period.

- iv. Treating operating lease as finance lease.
- v. Capitalization of borrowing cost on working capital.
- vi. Legislative changes having long term retrospective application.
- vii. Change in the method of depreciation from straight line to WDV.
- viii. Government grant becoming refundable.
- ix. Applying 10% depreciation instead of 15% on furniture.
- x. Change in useful life of fixed assets

Answer

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
i.	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
ii.	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
iii.	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
iv.	Treating operating lease as finance lease.	Prior- period Items
v.	Capitalization of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
vi.	Legislative changes having long term retrospective application	Ordinary Activity
vii.	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
viii.	Government grant becoming refundable	Extra -ordinary Items
ix.	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
x.	Change in useful life of fixed assets	Change in Accounting Estimates

#5. Illustration | May 2019 Exam, 1 Mark |

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period. **[True or False]**

Answer

False: The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

#6. Illustration | May 2018 Exam, 5 Marks | RTP May 2019

PQR Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

- (a) Goods worth ₹5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ₹3,50,000

against the claim. Explain the treatment of such receipt in final account for the year ended 31st March, 2018.

- (b) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra ordinary item or prior period item?

Answer

- (a) As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses, which arise, in the current period as a result of **error or omissions** in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be **separately disclosed** in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived. In the given instance, **it is clearly a case of error/omission** in preparation of financial statements for the year 2015-16. Hence, claim received in the financial year 2017- 18 is a prior period item and should be **separately disclosed** in the statement of Profit and Loss.
- (b) In the given case, a limited company created 2.5% **provision for doubtful debts** for the year 2017-2018. Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS 5, the revision in rate of provision for doubtful debts will be **considered as change in estimate and is neither a prior period item nor an extraordinary item**

#7. Illustration | RTP Sep 2025 |

- (a) When can an item qualify to be a prior period item as per AS 5?
- (b) The company finds that the stock sheets of 31.3.2024 did not include two pages containing details of inventory worth Rs. 20 lakhs. State, how will you deal with this matter in the accounts of A Ltd., for the year ended 31st March, 2025 with reference to AS 5.

Answer:

- a. According to para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', prior period items refers to those income or expenses, which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period e.g., arrears payable to workers in current period as a result of revision of wages with retrospective effect.
- b. As per para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', omission of two pages containing details of inventory worth Rs.20 lakhs in 31.3.2024 is a prior period item. As per para 19 of the standard, prior period items are normally included in the determination of net profit or loss for the current period. Accordingly, Rs.20 lakhs must be added to opening stock of 1.4.2024. 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.

#8. Illustration | RTP May 2025 |

The Accountant of Heera Ltd. 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, 2024. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

- (i) 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.

- (ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.
- (iii) During the year ended 31st March, 2024, there was change in cost formula in measuring the cost of inventories.

Answer:

- (i) 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.
- (ii) 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.
- (iii) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

#9. Illustration | RTP November 2022, May 2018 |

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets. Do you agree with the treatment and disclosure? If not, state your views.

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" **Extraordinary items** should be **disclosed** in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each **extraordinary item** should be **separately disclosed** in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. In the given case the selling of land to tide over liquidation problems as well as fire in the factory **does not constitute ordinary activities** of the Company. These items are distinct from the **ordinary activities** of the business. Both the events are **material in nature** and expected **not to recur frequently or regularly**. Thus, these are **Extraordinary Items**. Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is **not correct**. The profit on sale of land, and loss due to fire should be **disclosed separately** in the statement of profit and loss.

#10. Illustration | RTP Jan 2025 |

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write it back to the Profit and Loss account as a prior period item.

Is the company's proposed accounting treatment correct? Discuss.

Answer:

5. The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The balance amount left in the provision created earlier is not as a result of error in the past. So it will not be considered as prior period item. Such write back of provision is not an ordinary feature of the business, it shall be considered as an extra-ordinary item.

As per paragraph 8 of AS 5, extraordinary items should be disclosed in the Statement of Profit and Loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the Statement of Profit and Loss in a manner that its impact

on current profit or loss can be perceived. Hence, the amount so written-back (if material) should be disclosed as an extraordinary item as per AS 5 rather than as prior period items.

#11. Illustration | RTP Sep 2024 |

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

- I. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.
- II. Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.

Answer:

As per para 31 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

- (i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.
- (ii) Similarly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

#12. Illustration | RTP April 2022 |

A company created a provision of ₹7,50,000 for staff welfare while preparing the financial statements for the year 2021-22. On 31st March 2022, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to 10,00,000. The accounts were approved by Board of Directors on 15th April, 2022. You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2022 in line with the provisions of AS 5?

Answer

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹2,50,000 is **neither a prior period item nor an extraordinary item**. It is a **change in estimate**, which has been occurred in the year 2021-22. As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes **extraordinary items** and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the **same classification** in the statement of profit and loss, as was used previously, for the **estimate**.

#13. Illustration | RTP November 2021, May 2020 |

- (a) There was a major theft of stores valued at ₹10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021
- (b) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹20,000 per month. Earlier there was no such scheme of pension in the organization. Explain whether this will constitute a change in accounting policy or not as per AS 5.

Answer

- (a) Due to major theft of stores in the preceding year (2019-2020) which was **detected only during the current financial year** (2020-2021), there was **overstatement of closing inventory** of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The **adjustments are required** to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both **opening inventory** of the current year and **profit brought forward** from the previous year should be **separately disclosed** in the statement of profit and loss together with their nature and amount in a manner that their **impact on**

the current profit or loss can be perceived. **Alternatively**, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the **notes to the accounts** for the current year i.e, year ended 31st March, 2021.

- (b) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the **adoption of an accounting policy** for events or transactions that **differ in substance** from previously occurring events or transactions, **will not be considered as a change in accounting policy**. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which **did not occur previously**. Hence, it will **not be treated as a change in an accounting policy**.

#14. Illustration | RTP May 2021 |

XYZ Ltd. is in the process of finalizing its account for the year ended 31st March, 2020. The company seeks your advice on the following: The company's tax assessment for assessment year 2017-18 has been completed on 14th February, 2020 with a demand of ₹5.40 crore. The company paid the entire due under protest without prejudice to its right of appeal. The company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of ₹3.70 crore. (May '21)

Answer

Since the company is not appealing against the addition of Rs. 1.70 crore (₹5.40 crore less ₹3.70 crore), therefore, the **same should be provided/ expensed off in its accounts** for the year ended on 31st March, 2020. However, the amount paid under protest can be kept under the heading 'Long-term Loans & Advances / Short-term Loans and Advances' as the case may be along with **disclosure as contingent liability** of ₹3.70 crore.

AS – 17 Segment Reporting

Past Exams and RTP Questions Compiler

#1. Question | Nov 2023 Exam, 5 marks |

Garnet Limited has 4 operating segments. The total revenue (internal and external) and assets are set out as below:

Segment	Inter Segment Sales	External Sales	Total Assets
Fan	3,200	10,900	23,700
Light	200	1,400	13,200
Lamp	0	1,500	4,200
Printer	1,100	200	3,400
TOTAL	4,500	14,000	44,500

How many reportable segments does Garnet Limited have as per the Revenue and Assets criteria given in AS 17? State Reasons for your answer.

Answer:

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

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

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until at least 75% of total enterprise revenue is included in reportable segments. This is not applicable in the given case. In the given case 75% of External Revenue is Rs. 10,500 Lakhs ($\text{Rs. } 14,000 \times 75\%$) and the total External Revenue from Reportable segments is Rs. 12,300 Lakhs. So, no need to add Reportable segments.

On the basis of turnover criteria segment Fan is reportable segment as its sales are more than 1,850 lakhs (10% of Rs. 18,500 lakhs). Moreover, total external revenue attributable to reportable segment is also more than 75% of the total enterprise revenue.

On the basis of asset criteria, Fan and Light are reportable segments as their assets are more than 4,450 lakhs (10% of Rs. 44,500 lakhs).

#2. Question | May 2022 Exam, 5 marks |

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March, 2022 has been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	Profit (Loss) ₹ in lakhs
A	225
B	25
C	(175)
D	(20)
E	(105)

Answer

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

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

- The combined result of all segments in profit; i.e. ₹ 250 Lakhs or
- The combined result of all segments in loss; i.e. ₹ 300 Lakhs Whichever is greater in **absolute amount** i.e. ₹ 300 Lakhs.

Operating Segment	Absolute amount of Profit or Loss (₹ In lakhs)	Reportable Segment: Yes or No
A	225	Yes
B	25	No
C	175	Yes
D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments **A, C and E are reportable** segments (since their results in absolute amount is 10% or more of ₹ 300 lakhs i.e. 30 lakhs).

#3. Question | January 2021, 5 marks | RTP May 2023

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

Particulars	P	Q	R	S	T	Total
Segment assets	80	30	20	20	10	160
Segment results	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'. **(Similar to November 20 & November 19 Exams but different figures)**

Answer

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

- Its revenue from sales to external customers and from other transactions with other segments is **10% or more of the total revenue**- external and internal of all segments; or
- Its segment result whether profit or loss is 10% or more of:
 - The combined result of all segments in profit; or
 - The combined result of all segments in loss, whichever is greater in **absolute amount**; or
- Its segment assets are **10% or more of the total assets of all segments**. Accordingly,
 - On the basis of revenue from sales criteria, **segment P is a reportable segment**.
 - On the basis of the result criteria, segments **P & T are reportable segments** (since their results in absolute amount is 10% or more of ₹200 Lakhs).
 - 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**.

#4. Question | November 2020 Exam, 5 Marks |

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions: (₹ in Lacs)

Particulars	A	B	C	D	Total
Segment assets	100	300	200	400	1,000
Segment results	45	(70)	80	(10)	45
Segment Revenue	39	51	48	12	150

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17. **(Similar to January 2021 & November 19 but different figures)**

Answer

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

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

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

- The combined result of all segments in profit; or
- The combined result of all segments in loss, whichever is greater in absolute amount; or Its segment assets are 10% or more of the total assets of all segments

On the basis of revenue criteria, segments A, B, C and D - all are reportable segments.

On the basis of the result criteria, segments A, B and C are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs).

On the basis of asset criteria, **all segments except D are reportable segments.**

Since all the segments are covered in at least one of the above criteria, **all segments have to be reported** upon in accordance with Accounting Standard (AS) 17.

#5. Question | November 2019 Exam, 5 Marks |

Mac Ltd. gives the following data regarding to its six segments:

Particulars	A	B	C	D	E	F	Total
Segment assets	80	160	60	40	40	20	400
Segment results	100	(380)	20	20	(20)	60	(200)
Segment Revenue	600	1,240	160	120	160	120	2,400

The accountant contends that segments 'A' and 'B' alone are reportable segments. Is he justified in his view? Discuss in the context of AS-17 'Segment Reporting'. **(Similar to November 2020 & January 2021 but different figures)**

Answer

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

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

Or

Its segment result whether profit or loss is 10% or more of combined result of all segments in profit; or combined result of all segments in loss, whichever is greater in absolute amount;

or

Its segment assets are 10% or more of the total assets of all segments. If the total external revenue attributable to reportable segments constitutes **less than 75% of total enterprise revenue, additional segments** should be identified as reportable segments **even if they do not meet the 10% thresholds** until at least 75% of total enterprise revenue is included in reportable segments. On the basis of turnover criteria segments A and B are reportable segments.

On the basis of the result criteria, segments A, B and F are reportable segments (since their results in absolute amount is 10% or more of ₹ 400 lakhs).

On the basis of asset criteria, all segments except F are reportable segments. Since all the segments are covered in at least one of the above criteria **all segments have to be reported** upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of accountant is wrong.

#6. Question | May 2018 Exam, 5 Marks |

M/s Nathan Limited has three segments namely P, Q and R. The assets of the company are ₹15 crores.

Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in

the assets of each segment are P - ₹1 crore, Q - ₹0.90 crores and R - ₹0.80 crores. The accountant contends all these three segments are reportable segments. Comment.

Answer

According to AS 17 "Segment Reporting", segment Assets **do not include income tax assets**. Therefore, the revised total assets are 12.3 crores [₹15 – (₹1 + 0.9 + 0.8). Details of Segment wise assets Segment P holds total assets of ₹3 crores (₹4 crores – ₹1 crores); Segment Q holds ₹5.1 crores (₹6 crores – ₹0.9 crores); Segment R holds ₹4.2 crores (₹5 crores – ₹0.8 crores). Thus, all the three segments hold more than 10% of the total assets, **all segments are reportable** segments. Hence, the contention of the Accountant that all three segments are reportable segments is **correct**.

#7. Question | RTP Sep 2025 |

The Chief Accountant of Cotton Garments Limited gives the following data regarding its five segments:

Particulars	A	B	C	D	E	Total
Segment Assets	40	15	10	10	5	80
Results	(95)	5	5	(5)	15	(75)
Segment Revenue	310	40	30	40	30	450

The Chief Accountant is of the opinion that segment "A" alone should be reported. Is he justified in his view? Examine his opinion in the light of provisions of AS 17 'Segment Reporting'.

Answer:

As per para 27 of 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

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

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

Accordingly,

(a) On the basis of revenue from sales criteria, segment A is a reportable segment.

(b) On the basis of the result criteria, segments A & E are reportable segments (since their results in absolute amount is 10% or more of Rs. 100 crore).

(c) On the basis of asset criteria, all segments except E are reportable segments.

Since all the segments are covered in atleast 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 'A' is reportable is wrong.

#8. Question | RTP Jan 2025 |

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:

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment

transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if followed consistently.

#9. Question | RTP Sep 2024 |

Whether interest expense relating to overdrafts and other operating liabilities identified to a particular segment should be included in the segment expense or not?

Answer:

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

#10. Question | RTP November 2022, May 2021, November 20, November 19, May 18 |

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

Answer

AS 17 'Segment Reporting' requires that **inter-segment transfers** should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing intersegment transfers and any **change therein should be disclosed** in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and **applied consistently**. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is **correct** if, followed consistently.

#11. Question | RTP May 2022 |

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban. Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.

Answer

AS 17 explains that, "a single geographical segment **does not include** operations in economic environments with **significantly differing risks and returns**. A geographical segment may be a single country, a group of two or more countries, or a region within a country". Accordingly, to identify geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns **irrespective of the fact whether they are within the same country**.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement...". Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, **judgement is required** to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment. Company A, in making judgment for identifying geographical segments, should also consider the **relevance, reliability and comparability** over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

#12.Question | RTP November 2021 |

- (a) Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.
- (b) Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain.

Answer

- (a) As per AS 17, "A business segment is a **distinguishable component** of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to **risks and returns that are different** from those of other business segments. Factors that should be considered in determining whether products or services are related include:
- (i) the nature of the **products of services**;
 - (ii) the nature of the **productions processes**;
 - (iii) the type of class of **customers** for the products or services;
 - (iv) the methods use **to distribute** the products or provide the services; and
 - (v) if applicable, the nature of the **regulatory environment**, for example, banking, insurance, or public utilities."

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors. In the present case, the Company should consider whether the chemicals with different applications, have similar risks and returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

- (b) As per AS 17, "Changes in accounting policies adopted for segment reporting that have a **material effect** on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable." It also states that "some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a **significant impact on the segment information** reported but will not change aggregate financial information reported for the enterprise. To enable **users to understand and impact** of such changes, this Statement requires the disclosure of the nature of change and the financial effect of the change, if reasonably determinable".
- In view of the above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting. Accordingly, if the change **has a material financial effect** on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, **should be disclosed**.

#13.Question | RTP November 2018|

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	

Answer

Calculation of segment result

Segments	A	B	C	Total
	₹	₹	₹	₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		<u>25,000</u>	<u>1,00,000</u>	<u>1,25,000</u>
Total segment revenue as per AS 17 (A)	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	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	
Total segment expenses as per AS 17 (B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A-B)	2,44,000	1,79,000	69,000	4,92,000

AS – 18 RELATED PARTY DISCLOSURES

ILLUSTRATIONS

#1.Illustration | Jan 2025, Exam , 4 Marks |

The following information is provided for the year ended 31st March, 2024:

- (i) AX Limited holds 70% shares of BX Limited
- (ii) BX Limited holds 30% shares of CX Limited
- (iii) DX Limited holds 40% shares of in CX Limited
- (iv) DX Limited holds 49% shares in EX Limited

You are required to:

- (i) Identify the related parties for the reporting entities – AX Limited, CX Limited and EX Limited.
- (ii) If DX Limited would have sold its investment in EX Limited on 1st October, 2023, but goods were continued to be supplied by DX Limited to EX Limited throughout the year, will this scenario change your answer with respect to any of the reporting entity mentioned in point (i)?

Give reasons for your answer as per AS 18.

Answer:

Reporting entity	Related party
AX Limited	BX Limited (AX Limited controls BX Limited directly as holding company) CX Limited (AX Limited has significant influence in CX Limited indirectly through BX Limited)
CX Limited	AX Limited (AX Limited has significant influence in CX Limited indirectly through BX Limited) BX Limited (BX Limited has significant influence in CX Limited) DX Limited (DX Limited holds 40% shares, means substantial interest of more than or equal to 20%, hence significant influence exists in this case)
EX Limited	DX Limited (DX Limited holds 49% shares, means substantial interest of more than or equal to 20%, hence significant influence exists in this case)

- (ii) No, DX would still be a related party of EX Limited EX Limited will report DX Limited as a related party as per AS 18. However, the transaction for the period in which the related party relationship exists will only be disclosed.

#2.Illustration | Sep 2025, RTP |

X Ltd. sold goods to its associate company for the 1st quarter ending 30.6.2024. After that, the related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

Answer:

As per para 23 of AS 18 on 'Related Party Disclosures', transactions of X Ltd., with its associate company for the first quarter ending 30.6.2024 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not to be disclosed as related party transaction

#3.Illustration | May 2025, RTP |

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited”?

Answer:

Mr. A will not be considered as a related party of SP Hotels Limited in view of paragraph 3(c) of AS 18 which states, “individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual”. In the given case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

#4.Illustration | Jan 2025, RTP |

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

A Limited has a corporate communications department, which centralises the public relations function for the whole group of A Limited and its subsidiaries. No charges are, however, levied by A Limited on its subsidiaries and accordingly, these transactions are not given accounting recognition. Would these constitute related party transactions requiring disclosure under AS 18 in the standalone financial statements of A Limited?

Answer:

These transactions would require disclosure under AS 18 in the standalone financial statements of A Limited. As per paragraph 10 of AS 18, a related party transaction is “a transfer of resources or obligations between related parties, regardless of whether or not a price is charged”. In the given situation, there is a transfer of resources from A Limited to its subsidiaries, though no price is charged for the same. Hence, it will constitute as related party transaction and will require disclosure in the financial statements of A Ltd.

#5.Illustration | May 2024, RTP |

- (i) A Ltd. enters into an agreement with Mr. Bhola for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by Mr. Bhola, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Bhola does not have any voting power in A Limited.
- (ii) Shri Manoj a relative of key management personnel received remuneration of ` 3,50,000 for his services in the company for the period from 1st April, 2022 to 30th June, 2022. On 1st July, 2022, he left the service.
You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 2023 for the purposes of AS 18 'Related Party Disclosures'.

Answer:

- (i) Mr. Bhola will not be considered as a related party of A Ltd. in view of provisions of AS 18 "Related Party Disclosures" which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties".

In the given case, in the absence of share ownership, Mr. Bhola would not be considered to exercise significant influence on A Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr Bhola does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

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

Hence, Shri Manoj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2023 as he received remuneration for his services in the company for the period from 1st April, 2022 to 30th June, 2022.

AS – 20 Earnings Per Share

Past Exams and RTP Questions Compiler

#1. Question | Jan 2024 Exam, 5 marks |

XYZ Limited has provided you the following information as on 31st March, 2024:

Particulars	Amount
Net profit (After Tax)	Rs. 31,20,000
No. of shares outstanding as on 31-3-2024 of Rs. 10 each	8,00,000
Average fair value of one equity share during the year 2023-24	Rs. 25
Weighted average no. of shares under option during the year 2023-24	80,000
Exercise price for shares under option during the year 2023-24	Rs. 20
12% Debentures of Rs. 100 each	Rs. 30,00,000
(Each debenture is convertible into 4 equity shares)	
Tax rate	30%

The company issued one equity share as bonus for every 5 equity shares outstanding as on 1st October, 2023. It further issued 2,00,000 equity shares of Rs. 10 each as on 1st January, 2024. The Financial Year of the company ends on 31st March each year.

You are required to calculate Basic and Diluted earnings per share as on 31st March, 2024 (round off your answer to 2 decimal places).

Answer:

(a) Computation of Basic Earnings per Share

	Earnings Rs.	No. of Shares	EPS Rs.
Earnings per share for the year 2023- 2024	31,20,000	6,50,000 (W.N 2)	4.80

Computation of Dilutive Earnings per Share			
	Earnings Rs.	Shares	EPS Rs.
Net profit for the year	31,20,000		
Weighted average number of shares (W.N. 2) outstanding during year on 31.3.2024 (i)		6,50,000	
Number of shares under option		80,000	
Number of shares that would have been issued at fair value: $(80,000 \times 20.00)/25.00$		(64,000)	
No. of incremental shares issued for no consideration (ii)		16,000	
Diluted earnings per share after options	31,20,000	6,66,000 (i + ii)	4.68
12% Convertible Debentures (W.N. 3)	2,52,000	1,20,000	-
Diluted earnings	<u>33,72,000</u>	<u>7,86,000</u>	4.29

Working notes:**1. Computation of shares issued on bonus**

No. of shares outstanding as on 31 st March 2024	8,00,000
Less: Shares issued on 1 st Jan 2024	<u>(2,00,000)</u>
Outstanding shares as on 31 st December 2023	<u>6,00,000</u>
Bonus shares (6,00,000 x 1/(1+5))	1,00,000
Outstanding shares before bonus issue as on 1 st April 2023 (6,00,000x5/6)	5,00,000

2. Weighted Average number of Equity shares

	Shares	Months	Weighted average
Opening balance as on 1.4.2023	5,00,000 (W.N.1)	12/12	5,00,000
Bonus	1,00,000	12/12	1,00,000
Further issue of shares on 1.1.2024	2,00,000	3/12	<u>50,000</u>
			<u>6,50,000</u>

3. 12% Convertible Debentures

Increase in net profit {Rs. 30,00,000 x 0.12 x (1 - 0.30)}	Rs. 2,52,000
No. of incremental shares {30,000 x 4}	1,20,000

#2. Question | November 2023 Exam, 5 marks |

On 1 April 2023, ABC Limited has given the following information:

	Rs.
50,000 equity shares of Rs. 100 each (Rs. 80 paid up by all shareholders)	40,00,000
2,00,000 8% Preference shares of Rs. 10 each	20,00,000
10,000, 12% Debentures of Rs. 100 each (Each debenture is convertible into 3 equity shares of Rs. 100 each)	10,00,000

On 1st July 2023, the remaining Rs. 20 was called up and paid by all the shareholders except one shareholder holding 10,000 equity shares. During the year 2023-24 the company had a profit after tax of Rs. 3,44,000.

Tax rate is 30%.

You are required to compute Basic and Diluted EPS.

Answer:

(a) Basic Earnings per share (EPS) =

Net profit attributable to equity shareholders

Weighted average number of equity shares outstanding during the year

= 1,84,000 / 46,000 shares = Rs. 4 per share

Diluted earnings per share

Net profit for the current year	Rs. 3,44,000

No. of equity shares outstanding	50,000
Basic earnings per share	Rs. 4
No. of 12% convertible debentures of Rs. 100 each Each debenture is convertible into 3 equity shares	10,000
Interest expense for the current year	Rs. 1,20,000
Tax relating to interest expense (30%)	Rs. 36,000
Adjusted net profit for the current year	Rs. (1,84,000 + 1,20,000 - 36,000) = Rs. 2,68,000
No. of equity shares resulting from conversion of debentures	30,000
No. of equity shares used to compute diluted earnings per share	46,000 + 30,000 = 76,000
Diluted earnings per share	2,68,000 / 76,000 = Rs. 3.53

Working Note:

1. Net profit attributable to equity share holders = Net profit less preference dividends

Total earnings – preference shares dividend

Rs. 3,44,000 – Rs. (8% x 20,00,000)

Rs. 3,44,000 - Rs. 1,60,000

= Rs. 1,84,000

2. Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
	Rs.	Rs.	Rs.
01.04.2023	50,000	80	50,000 x 80/100 x 3/12 = 10,000
01.07.2023	40,000	100	40,000 x 9/12 = 30,000
01.07.2023	10,000	80	10,000 x 80/100 x 9/12 = 6,000
Total weighted average equity shares			46,000

#3. Question | November 2023 Exam, 5 marks |

Sapphire Limited earned Net profit of Rs. 39,00,000 and Rs. 59,40,000 for the years 2021-22 & 2022-23 respectively.

The following information were given for 2022-2023:

- The company declared Rights issue of two new shares for each five outstanding shares.

- (ii) 4,00,000 shares were outstanding prior to Rights issue.
- (iii) Rights issue price was Rs. 27.50 and the last date to exercise rights was 1st July, 2022.
- (iv) Fair value of one equity share immediately prior to exercise of rights on 1 st July, 2022 was Rs. 143.

You are required to Compute Basic Earnings Per Share as per AS-20:

- (i) For the year 2021-22, and
- (ii) For the year 2022-23

Answer:

Computation of Basic Earnings Per Share

	Year 2021-22 Rs.	Year 2022-23 Rs.
EPS for the year 2021-22 as originally reported		
Net profit of the year attributable to equity shareholders		
Weighted average number of equity shares outstanding during the year		
= (Rs. 39,00,000 / 4,00,000 shares)	9.75	
EPS for the year 2021-22 restated for rights issue		
= [Rs. 39,00,000 / (4,00,000 shares × 1.3*)]	7.5	
EPS for the year 2022-23 including effects of rights issue		
Rs. 59,40,000		
$\frac{(4,00,000 \times 1.3 \times 3/12) + (5,60,000 \times 9/12)}{5,50,000}$		
Rs. 59,40,000		
5,50,000		10.8 (approx..)

Working Notes:

- 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

$$\frac{(143 \times 4,00,000 \text{ shares}) + (27.5 \times 1,60,000 \text{ shares})}{4,00,000 \text{ shares} + 1,60,000 \text{ shares}} = 6,16,00,000 / 5,60,000 \text{ shares} = 110$$
- Computation of adjustment factor
 Fair value per share prior to exercise of rights = 143/110 = 1.3(approx..)
 Theoretical ex-rights value per share

#4. Question | November 2022 Exam, 5 marks |

The following information is provided to you:

Net profit for the year 2022: ₹ 72,00,000 Weighted average number of equity shares outstanding during the year 2022: 30,00,000 shares

Average Fair value of one equity share during the year 2022: ₹25.00

Weighted average number of shares under option during the year 2022: 6,00,000 shares

Exercise price for shares under option during the year 2022: ₹ 20.00

You are required to compute Basic and Diluted Earnings Per Share as per AS 20.

Answer

Computation of Basic earnings per share

	Earnings (₹)	Shares (₹)	Earnings/Share (₹)

Net profit for the year 2022 during year 2022	72,00,000		
Weighted average no. of shares		30,00,000	
Basic earnings per share			2.40

Computation of Diluted earnings per share

	Earnings (₹)	Shares (₹)	Earnings/ Share (₹)
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Number of shares under option		6,00,000	
Number of shares that would have been issued at fair value (6,00,000 x 20.00)/25.00		(4,80,000)	
Diluted earnings per share	72,00,000	31,20,000	2.31 (rounded-off)

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

To the extent that partly paid shares are **not entitled to participate in dividends** during the reporting period they are considered the **equivalent of options**.

#5. Question | May 2022 Exam, 5 marks |

NAT, a listed entity, as on 1st April, 2021 had the following capital structure:

	Shares (₹)
10,00,000 Equity Shares having face value of ₹ 1 each	10,00,000
10,00,000 8% Preference Shares having face value of ₹ 10 each	1,00,00,000

During the year 2021-2022, the company had profit after tax of ₹ 90,00,000

On 1st January, 2022, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December, 2021.

On 1st January, 2022, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.

NAT's shares were trading at ₹ 8.05 per share on 31st March, 2022.

Further it has been provided that the basic earnings per share for the year ended 31st March, 2021 was previously reported at ₹ 62.30.

You are required to:

Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March, 2022 including the comparative figure, in accordance with AS-20 Earnings Per Share.

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?

Answer

- Calculation of Basic Earnings per share for the year ended 31st March, 2022 including the comparative figure:
Earnings for the year ended 31st March, 2021 = EPS x Number of shares outstanding during 2020-2021

- (a) **Adjusted Earnings per share** after taking into consideration bonus issue

Adjusted Basic EPS = Earnings for the year 2020-2021 / Total outstanding shares + Bonus issue

= ₹ 6,23,00,000 / (10,00,000 + 5,00,000)

= ₹ 6,23,00,000 / 15,00,000

= ₹ 41.53 per share

- (b) **Basic EPS** for the year 2021-2022

Basic EPS =

Total Earnings — Preference Shares Dividend

Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 2022

$$\frac{(\text{₹ } 90,00,000 - \text{₹ } (1,00,00,000 \times 8\%))}{(10,00,000 + 5,00,000 + (2,00,000 \times 3/12))}$$

= ₹ 82,00,000 / 15,50,000 shares = ₹ 5.29 per shares.

- 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 2021, 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.

#6. Question | December 2021, 5 Marks |

"At the time calculating diluted earnings per share, effect is given to all dilutive potential

equity shares that are outstanding during the period". Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

(i)	Net profit after tax for the year	₹ 64,12,500
(ii)	No. of equity shares outstanding	15,00,000
(iii)	No. of 9% convertible debentures of ₹ 100 issued on 1st July, 2020	75,000
(iv)	Each debenture is convertible into 8 Equity Shares	
(v)	Tax relating to interest expenses	35%

Answer

In calculating diluted earnings per share, effect is given to all **dilutive potential equity shares** that were outstanding during the period." As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding* during the period should be **adjusted for the effects** of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share. Basic EPS for the year 2020-21 = 64,12,500/15,00,000 = ₹ 4.275 or ₹ 4.28

Computation of diluted earnings per share for year 2020-21

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity Shares}}$$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹ 67,41,562

No. of equity shares resulting from conversion of debentures: 6,00,000 Shares (75,000 × 8)

Weighted average no. of equity shares used to compute diluted EPS:

$$(15,00,000 \times 12/12 + 6,00,000 \times 9/12)$$

= 19,50,000 Shares

Diluted earnings per share: (67,41,562/19,50,000) = ₹ 3.46

Working Note:

Interest expense for 9 months = $75,00,000 \times 9\% \times 9/12 = ₹ 5,06,250$

Tax expense 35 % on interest is ₹1,77,188 ($5,06,250 \times 35\%$)

*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.

#7. Question | November 2019 Exam, 5 Marks | RTP May 2023

Following information is supplied by K Ltd.

Right issue price - ₹98

Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹102

Net Profit to equity shareholders:

2017-2018 - ₹50,00,000

2018-2019 - ₹75,00,000

You are required to calculate the basic earnings per share as per AS - 20 Earning per Share.

Answer

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

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

Theoretical ex-rights fair value per share = ₹ 100.86

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

Computation of earnings per share:

EPS for the year 2017-18 as originally reported: $₹50,00,000 / 2,50,000 \text{ shares} = ₹20$

EPS for the year 2017-18 restated for rights issue: $= ₹50,00,000 / (2,50,000 \text{ shares} \times 1.01) = ₹19.80$

* $[(2,50,000 \times 1.01 \times 3/12) + (3,50,000 \times 9/12)] = 63,125 + 2,62,500 = 3,25,625 \text{ shares}$

Note: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

#8. Question | November 2018 Exam, 5 Marks |

From the following information given by Sampark Ltd., Calculate Basis EPS and Diluted EPS as per AS 20:

	₹ 64,12,500
Net Profit for the current year	2,50,00,000
No. of Equity Shares Outstanding	50,00,000
No. of 12% convertible debentures of ₹ 100 each Each debenture is convertible into 8 Equity Shares	50,000
Interest expense for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000

$$\text{Basic EPS} = \frac{\text{Net Profit for the current year}}{\text{No. of Equity Shares}} = \frac{₹2,50,000}{50,00,000}$$

Basic EPS = ₹5

Calculation of Diluted Earning Per Share

$$\text{Diluted EPS} = \frac{\text{Adjusted Net Profit for the current year}}{\text{Weighted average no. of Equity Shares}}$$

Adjusted net profit for the current year	₹
Net profit for the current year	2,50,00,000
Add: Interest expenses for the current year	6,00,000
Less: Tax saving relating to Tax Expenses	(1,80,000)
	<u>2,54,20,000</u>

No. of equity shares resulting from conversion of debentures: 4,00,000 Shares

Weighted average no. of equity shares used to compute diluted EPS:

$$(50,00,000 + 4,00,000) = 54,00,000 \text{ Equity Shares}$$

Diluted earnings per share: $(2,54,20,000 / 54,00,000) = ₹4.71$ (Approx.)

#9. Question | May 2018 Exam, 5 Marks |

As at 1st April, 2016 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2016 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2017 was ₹21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totaling to ₹3,40,000. Compute Basic EPS for the year ended 31st March, 2017 as per Accounting Standard 20 "Earnings Per Share".

Answer

$$\begin{aligned} \text{Basic Earnings per share (EPS)} &= \frac{\text{Net Profit for the current year}}{\text{Weighted average no. of Equity Shares outstanding during the year}} \\ &= \frac{21,96,000}{4,57,500 \text{ shares (as per working note)}} = ₹4.80 \text{ per share} \end{aligned}$$

Working Note:

Calculation of weighted average number of equity shares As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares (₹)	Amount paid per share (₹)	Weighted average no. of equity shares (₹)
1.4.2016	6,00,000	5	$6,00,000 \times 5/10 \times 5/12 = 1,25,000$
1.9.2016	5,40,000	10	$5,40,000 \times 7/12 = 3,15,000$
1.9.2016	60,000	5	$60,000 \times 5/10 \times 7/12 = 17,500$
Total weighted average equity shares			4,57,500

#10. Question | RTP Sep 2024 |

The following information relates to XYZ Limited for the year ended 31st March, 2024:

Net Profit for the year after tax: Rs. 37,50,000

Number of Equity Shares of Rs. 10 each outstanding: Rs. 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of Rs. 100 each	50,000

Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

Answer:

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year

Rs. 37,50,000 / 5,00,000 = Rs. 7.50 per share

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

	Rs.
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of Rs. 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share = 40,30,000 / 5,55,000 = Rs. 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

#11. Question | RTP Sep 2024 |

XYZ Limited has a wholly owned subsidiary BC Limited. The Group prepares consolidated Financial Statements for the year ended 31st March, 2024. XYZ Limited (in its separate financial statements) has incurred a loss of Rs. 2 crore during the year, while the consolidated profit for the group during the year is Rs. 40 lakh.

XYZ Limited has 5,00,000 shares outstanding as at 31st March, 2024. Further, it has granted options to issue equity shares as at that date. In respect of such options, 1,00,000 shares are considered to be the shares issued for no consideration. There are no changes in income or expenses that are expected from the issue of equity shares on exercise of these options.

Calculate Basic and Diluted EPS for XYZ Limited for separate financial statements and for the Group.

Answer:

Computation of earnings per share

Particulars	Consolidated financial statements	Standalone financial statements of XYZ Limited
Basic earnings/(loss) per share	Rs. 8 [40,00,000/5,00,000]	(Rs. 40) [2,00,00,000/5,00,000]
Diluted earnings/ (loss) per share	Rs. 6.66 [40,00,000/6,00,000]	(Rs. 40) [2,00,00,000/5,00,000]

As per paragraph 39 of AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

In the above case, if the exercise of options was considered for separate financial statements of XYZ Limited, the diluted loss per share would have reduced to Rs. 33.33 [2,00,00,000/6,00,000]. As this is antidilutive, the options would not be treated as potentially dilutive equity shares. Accordingly, in the separate financial statements of XYZ Limited, the Diluted EPS would be same as Basic EPS.

#12. Question | RTP Sep 2024 |

The following information is available in respect of High-end Ltd. for the accounting year 2022-2023 and 2023-2024:

Net profit for		Rs.
Year	2022-2023	22,00,000
Year	2023-2024	30,00,000

Number of shares outstanding prior to right issue 10,00,000 shares.

Right issue: One new share for each five shares outstanding i.e. 2,00,000 shares.

: Right issue price Rs. 25

: Last date to exercise right 31st July, 2023.

Fair value of one equity share immediately prior to exercise of rights on 31.07.2023 is Rs. 32.

You are required to compute, as per AS 20:

- Basic earnings per share for the year 2022-2023.
- Restated basic earnings per share for the year 2022-2023 for right issue.
- Basic earnings per share for the year 2023-2024.

Answer:

Computation of basic earnings per share

	2022-2023 (Rs.)	2023-2024 (Rs.)
EPS for the year 2022-2023 as originally reported		
= Net profit for the year attributable to equity shareholders / weighted average number of equity shares outstanding during the year		
= Rs. 22,00,000 / 10,00,000 shares	2.20	
EPS for the year 2022-2023 restated for the right issue = Rs. 22,00,000 / (10,00,000 x 1.04)	2.12	
EPS for the year 2023-2024 (including effect of right issue)		
= Rs. 30,00,000 / {(10,00,000 x 1.04 x 4/12) + (12,00,000 x 8/12)}		2.62

Working Notes:

- Computation of theoretical ex-rights fair value per share = (fair value of all outstanding shares immediately prior to exercise of rights + Total value received from exercise of rights) / (number of shares outstanding prior to exercise + number of shares issued on the exercise)
= (Rs. 32 x 10,00,000 + Rs. 25 x 2,00,000) / (10,00,000 + 2,00,000)
= Rs. 30.83
- Computation of adjustment factor

- = Fair value per share prior to exercise of rights / Theoretical ex- right value per share
- = Rs. 32/Rs. 30.83
- = 1.04 (approx.)

#13.Question | RTP November 2022, November 19|

The following information relates to XYZ Limited for the year ended 31st March, 2022:

Net Profit for the year after tax: ₹37,50,000

Number of Equity Shares of ₹10 each outstanding: ₹5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

Answer

Computation of basic earnings per share

Net profit for the current year / Weighted average number of equity shares outstanding during the year

$$= ₹37,50,000 / 5,00,000 = ₹7.50 \text{ per share}$$

Computation of diluted earnings per share = $\frac{\text{Adjusted Net Profit for the current year}}{\text{Weighted average no.of Equity Shares}}$

Adjusted net profit for the current year	₹
Net profit for the current year	37,50,000
Add: Interest expenses for the current year	4,00,000
Less: Tax saving relating to Tax Expenses	(1,20,000)
	<u>40,30,000</u>

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

$$= 40,30,000 / 5,55,000 = ₹7.26 \text{ per share}$$

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

#14.Question | RTP May 2022|

- (i) Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

- (ii) X Limited, as at March 31, 2021, has income from continuing ordinary operations of ₹2,40,000, a loss from discontinuing operations of ₹3,60,000 and accordingly a net loss of ₹1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

Answer

- (i) The current method of calculating Diluted EPS adopted by AB limited **is not in accordance with AS 20**. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.
AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares". Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.
- (ii) As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations". As income from continuing ordinary operations, ₹2,40,000 would be considered and not ₹(1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, **200 potential equity shares** would be dilutive potential equity shares since their inclusion would **decrease the net profit** per share from continuing ordinary operations from ₹240 to ₹200. Thus the basic E.P.S would be ₹(120) and diluted E.P.S. would be ₹(100).

#15. Question | RTP November 2021 |

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20?

Answer

The appropriation made to such a **mandatory reserve** created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period". With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still **attributable to equity shareholders**. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is **not correct**.

#16. Question | RTP May 2021 |

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date, weight is to be considered:

- (i) Equity Shares issued in exchange of cash,
- (ii) Equity Shares issued as a result of conversion of a debt instrument,
- (iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,
- (iv) Equity Shares issued for rendering of services to the enterprise,
- (v) Equity Shares issued in lieu of interest and/or principal of an other financial instrument,
Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Answer

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given situations:

- (i) Date of Cash receivable
- (ii) Date of conversion
- (iii) Date on which settlement becomes effective
- (iv) When the services are rendered
- (v) Date when interest ceases to accrue
- (vi) Date on which the acquisition is recognized.

#17.Question | RTP November 2020, November 2018|

A-One Limited supplied the following information. You are required to compute the earnings per share as per AS 20:

Net profit attributable to equity shareholders

Year 2017-18: ₹1,00,00,000

Year 2018-19: ₹1,50,00,000

Number of shares outstanding prior to Right Issue = 50,00,000 shares

Right Issue: One new share for each four outstanding shares ₹12,50,000 shares

Right Issue Price - ₹96

Last date of exercising rights - 30-06-2018

Fair value of one equity share immediately prior to exercise of rights on 30-06-2018 was ₹101.

Answer

Computation of earnings per share

	2017-18	2018-19
EPS for the year 2017-18 as originally reported: (₹1,00,00,000 / 50,00,000 shares)	2.00	
EPS for the year 2017-18 restated for rights issue: ₹1,00,00,000 / (50,00,000 shares × 1.01)*	1.98	
EPS for the year 2018-19 including effects of rights issue ₹1,50,00,000 $\frac{₹1,50,00,000}{(50,00,000 \times 1.01 \times \frac{3}{12}) + (62,50,000 \times \frac{9}{12})}$		2.52

*Computation of earnings per share in case of Rights Issue requires computation of adjustment factor which is given as working note.

Working Notes:

Computation of theoretical ex-rights fair value per share

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

$$\frac{101 \times 50,00,000 \text{ shares} + 96 \times 12,50,000 \text{ Shares}}{50,00,000 \text{ Shares} + 12,50,000 \text{ Shares}}$$

$$= ₹62,50,00,000 / 62,50,000 = ₹100$$

Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{₹101}{₹100} = ₹1.01$$

#18.Question | RTP May 2019|

Question 6 “While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period.” Explain this statement in the light of relevant AS. Also calculate the diluted EPS from the following information:

Net Profit for the current year (After Tax): ₹1,00,00,000

No. of Equity shares outstanding: 10,00,000

No. of 10% Fully Convertible Debentures of Rs. 100 each :1,00,000

(Each Debenture is compulsorily & fully convertible into 10 equity shares issued at the mid of the year)

Debenture interest expense for the current year: ₹5,00,000

Assume applicable Income Tax rate @ 30%

Answer

As per AS 20 ‘Earnings per Share’, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, “in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period.”

Computation of diluted earnings per share = $\frac{\text{Adjusted Net Profit for the current year}}{\text{Weighted average no. of Equity Shares}}$

Adjusted net profit for the current year	₹
Net profit for the current year	1,00,00,000
Add: Interest expenses for the current year	5,00,000
Less: Tax saving relating to Tax Expenses	(1,50,000)
	<u>1,03,50,000</u>

Number of equity shares resulting from conversion of debentures

$$\frac{1,00,000 \times 100}{10} = 10,00,000 \text{ Equity shares}$$

Weighted average number of equity shares used to compute diluted earnings per share

$$= [(10,00,000 \times 12) + (10,00,000 \times 6)] / 12 = 15,00,000 \text{ equity shares}$$

$$\text{Diluted earnings per share} = ₹1,03,50,000 / 15,00,000 \text{ shares} = ₹6.90 \text{ per share}$$

AS – 24 Discontinuing Operations

Past Exams and RTP Questions Compiler

#1. Question | July 2021 Exam, 5 marks | RTP November 2021

Analyse the disclosure and presentation requirements of AS 24 for Discontinuing Operations (any five).

Answer:

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s).
- The business or geographical segment(s) in which it is reported as per AS 17 .
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable.
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

#2. Question | July 2021 Exam, 5 marks | RTP November 2021

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:

- If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.
- 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?
- Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

Answer

- As per AS 24, a discontinuing operation is a component of an enterprise:
 - that the enterprise, pursuant to a single plan, is:
 - 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
 - disposing of **piecemeal**, such as by selling off the component's assets and settling its liabilities individually; or
 - terminating through abandonment; and
 - that represents a separate major line of business or geographical area of operations; and
 - 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:
 - Gradual or evolutionary phasing out of a **product line or class of service**;
 - Shifting** of some production or marketing activities for a particular line of business from one location to another; and

- c) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.
- (ii). No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.
Hence, **AS 24 will not be applicable** and it cannot be considered as Discontinuing operations.
- (iii). Yes, phased and time bound program resolved in the board **clearly indicates the closure of the passenger car segment** in a definite time frame and will constitute a clear roadmap.
Hence, this action will attract compliance of AS 24 and it will be **considered as Discontinuing Operations** as per AS-24.

#3. Question | November 2018 Exam, 5 marks |

What are the initial disclosure requirements of AS 24 for discontinuing operations?

Answer

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure **event occurs**:

- A. A description of the discontinuing operation(s)
- B. The business or geographical segment(s) in which it is reported as per AS 17
- C. The date and **nature** of the initial disclosure event.
- D. The **date or period** in which the discontinuance is expected to be completed if known or determinable.
- E. The **carrying amounts**, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.
- F. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.
- G. The amount of **pre-tax profit or loss** from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.
- H. The amounts of **net cash flows** attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

#4. Question | RTP Jan 2025 |

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

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

Answer:

- (i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:
 - a) a description of the discontinuing operation(s);
 - b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;
 - c) the date and nature of the initial disclosure event;
 - d) the date or period in which the discontinuance is expected to be completed if known or determinable;
 - e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
 - f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
 - g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

- h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.
- (ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:
 - i. Gradual or evolutionary phasing out of a product line or class of service;
 - ii. Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
 - iii. Shifting of some production or marketing activities for a particular line of business from one location to another; and
 - iv. Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

#5. Question | RTP Sep 2024 |

Arzoo Ltd. is in the business of manufacture of Passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the Passenger car segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner.

- (i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.
- (ii) If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS 24?
- (iii) Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner?

Answer:

Mere gradual phasing out is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operations'.

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

- 1. Gradual or evolutionary phasing out of a product line or class of service;
- 2. Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- 3. Shifting of some production or marketing activities for a particular line of business from one location to another; and
- 4. Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above the answers are:

- (i) No, 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. Above all, the new segment i.e. commercial vehicle production line in a new factory has not started.
- (ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, closure road map and new segment starting roadmap are missing. Hence, AS 24 will not be applicable.
- (iii) Yes, phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap. Hence, this action will attract compliance of AS 24.

#6. Question | RTP May 2023 |

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

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

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

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

Answer

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

- (i). that the enterprise, pursuant to a single plan, is:
 - (1) disposing of **substantially in its entirety**,
 - (2) disposing of **piecemeal**, or
 - (3) terminating through **abandonment**; and
- (ii). that represents a **separate major line of business or geographical area** of operations; and
- (iii). that can be **distinguished operationally** and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is **not a discontinued operation**. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

- (i) the enterprise has entered into a binding sale agreement for **substantially** all of the assets attributable to the discontinuing operation; or
- (ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

#7. Question | RTP November 2022 |

What are the disclosure requirement in interim financial reports as per AS 24 for discontinuing operations?

Answer

Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

- (a) Any **significant activities** or events since the **end of the most recent annual reporting** period relating to a discontinuing operation and
- (b) Any **significant changes** in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

#8. Question | RTP May 2022, May 2020 |

- (i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?
- (ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances. (RTP Nov 18 also)

Answer

- (i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:
 - I. a description of the discontinuing operation(s);
 - II. the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;
 - III. the date and nature of the initial disclosure event;
 - IV. the date or period in which the discontinuance is expected to be completed if known or determinable;
 - V. the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
 - VI. the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
 - VII. the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and
 - VIII. the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.
- (ii) Para 3 of AS 24 "Discontinuing Operations" explains the **criteria for determination of discontinuing operations**. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:
 - (a) Gradual or evolutionary phasing out of a product line or class of service;
 - (b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
 - (c) Shifting of some production or marketing activities for a particular line of business from one location to another; and
 - (d) Closing of a facility to achieve productivity improvements or other cost savings. An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

#9. Question | RTP May 2021 |

Arzoo Ltd. is in the business of manufacture of passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment to the commercial vehicles segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan, it has planned that it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

Answer

Mere gradual phasing out is **not considered as discontinuing operation** as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

- (1) Gradual or evolutionary phasing out of a product line or class of service;
- (2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- (3) Shifting of some production or marketing activities for a particular line of business from one location to another; and
- (4) Closing of a facility to achieve productivity improvements or other cost savings.
- (5) In view of the above, mere gradual phasing out in itself cannot be considered as discontinuing operation. The companies' strategic plan also has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

AS-23 Accounting for Associates for CFS

Past Exams and RTP Questions Compiler

#1. Question | RTP Jan 2025 |

A Ltd. invested Rs. 1,00,000 to acquire 10% stake (Investment I) in B Ltd. and later invested Rs. 3,00,000 to acquire additional 20% (Investment II). The net asset value of the B Ltd. at the respective investment dates was Rs. 7,50,000 and Rs. 12,50,000 respectively. Determine whether B Ltd. is an associate of A Ltd. Also, calculate goodwill arising on the acquisition of the associate.

Answer:

As per para 3 of AS 23 an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. In this case, A Ltd. has invested 30 % in B Ltd. so B Ltd. is to be considered as an associate of A Ltd.

The goodwill arising on the acquisition of the associate will be computed as follows:

		Rs.
Investment I		1,00,000
Share of net assets	(10 percent of Rs. 7,50,000)	<u>(75,000)</u>
Goodwill (A)		<u>25,000</u>
Investment II		3,00,000
Share of net assets	(20 percent of Rs. 12,50,000)	<u>(2,50,000)</u>
Goodwill (B)		<u>50,000</u>
Total goodwill (A + B)		<u>75,000</u>

#2. Question | RTP Sep 2024 |

Hill Ltd. has a share capital of 50,000 shares @ Rs. 100 per share. Sun Ltd. acquired 15% shares in Hill Ltd. on 1.4.2024. It also acquired all the 5,000, 12% convertible debentures of Rs. 100 each of Hill Ltd. These debentures will be converted at par into equity shares of Hill Ltd. after 3 years. State whether, as per AS 23, Hill Ltd. is an Associate of Sun Ltd. or not with reasons?

Answer:

As per para 3 of AS 23 'Accounting for Investments in Associates in Consolidated Financial Statements', an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Standard further explains in para 4 that as regards share ownership, if an investor holds, directly or indirectly through subsidiary (ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary (ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

Further as per an explanation to para 4 of the standard, for the purpose of classification of associate, the potential equity shares of the investee held by the investor will not be taken into account for determining the voting power of the investor. In other words, the voting power should be determined on the basis of the current outstanding securities with voting rights.

As per the information given in the question, Sun Ltd. presently holds indirectly 22.7% shares (with and without voting rights) (Refer W.N.) in Hill Ltd. However, the current outstanding securities with voting rights in Hill Ltd. is only 15% and the remaining holding is on account of potential equity shares. Since potential equity shares

do not have voting rights they will not be taken into consideration while determining the significant influence of Sun Ltd. on Hill Ltd. Hence, Hill Ltd. is not an associate of Sun Ltd.

Working Note:

Calculation of percentage of holding of shares after conversion

Current holding is 15% i.e. 7,500 shares of Rs. 100 each 7,50,000

Potential equity shares i.e. 5,000 shares of Rs. 100 each 5,00,000

12,50,000

Total share capital of Hill Ltd. after conversion of debentures into equity shares will be = Rs. 50,00,000 + Rs. 5,00,000 = Rs. 55,00,000

Percentage of holding = $\text{Rs. } (12,50,000 / 55,00,000) \times 100 = 22.7\%$ approx.

#1. Question | RTP Jan 2025 |

XY Limited reported a Profit Before Tax (PBT) of Rs. 18 lakhs for the third quarter ending 31st December 2024. Following observations are noted;

- (i) Dividend income of Rs. 8 lakhs received during the quarter has been recognized to the extent of Rs. 2 lakh only.
- (ii) Sales promotion expenses Rs. 15 lakhs incurred in the third quarter, 70% has been deferred to the fourth quarter as the sales in the last quarter is high.
- (iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of Rs. 4 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only Rs. 1 lakhs.
- (iv) Rs. 3 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.
- (v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of Rs. 5 lakhs. Out of this loss Rs. 2 lakhs relates to previous quarters.
- (vi) Sale of investment in the first quarter resulted in a gain of Rs. 30 lakhs. The company had apportioned this equally to the four quarters.

Calculate the result of the third quarter as per AS 25 and also comment on the company's view on each observation.

Answer:

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise's financial year.

Comments on observations:

- a. Dividend income received during 3rd quarter should be recognised in the 3rd quarter only.
- b. Sales promotion expenses cannot be deferred on the basis that fourth quarter has more sales. This expense should be recognized in 3rd quarter only.
- c. 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.
- d. Extra ordinary gain of Rs. 3 lakhs should be wholly recognized in 3rd quarter only.
- e. Loss of Rs. 2 lakhs belong to previous quarters and not 3rd quarter, so it should not be deducted from the profit of 3rd quarter.
- f. Gain on sale of investment is in the nature of occasional gain, so it cannot be deferred and hence the amount of Rs. 7.5 lakhs considered as income of 1st quarter, will be reversed from the profit of the 3rd quarter.

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

Statement showing Adjusted Profit Before Tax for the third quarter

	(Rs.)
Profit before tax (as reported)	18,00,000
Add: Dividend income Rs. (8,00,000 - 2,00,000)	6,00,000
Excess depreciation charged in the 3rd quarter, due to change in the method	-
Extra ordinary gain Rs. (3,00,000-1,50,000)	1,50,000
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively Rs. (5,00,000-3,00,000)	<u>2,00,000</u>
	27,50,000
Less: Sales promotion expenses (70% of Rs. 15 lakhs)	(10,50,000)
Gain on sale of investment (occasional gain should not be deferred)	<u>(7,50,000)</u>
Adjusted Profit before tax for the third quarter	<u>9,50,000</u>

#1. Question | RTP Sep 2024 |

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 recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised 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.

Whether it will be a cash-generating unit as per AS 28?

Answer:

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

Preparation of financial statements – Statement of Profit and Loss, Balance Sheet and Cash Flow Statement

ILLUSTRATIONS

#1.Illustration | May 2025, 14 Marks |

Following particulars are furnished by Bela Ltd for the year ended 31st March 2025.

Particulars	Debit Rs.	CreditRs.
Equity Share Capital (Face Value 100)		6,00,000
8% Preference Share Capital (Face Value 100)		3,00,000
Factory Building	6,20,000	
Plant & Machinery	4,98,000	
Furniture & Fittings	1,52,000	
General Reserve		88,000
Term Loan from Public Financial Corp.		3,40,000
Inventory		
Raw Material	1,35,000	
Finished Goods	66,000	
Provision for taxation		12,000
Dividend Payable		10,000
Preliminary Expenses	21,000	
Profit & Loss A/c		99,000
Cash in hand	16,000	
Cash at Bank	39,000	
Trade Receivables	2,38,000	
Unsecured Loan		85,000
Trade Payables		2,45,000
Outstanding Expenses		6,000
	<u>17,85,000</u>	<u>17,85,000</u>

Other Information:

- The cost of assets was:
 Factory Building Rs. 6,94,000
 Plant & Machinery Rs. 5,35,000
 Furniture & Fittings Rs. 1,76,000h
- The Equity Capital on 01/04/2024 stood at 5,000 shares fully paid up and 1,000 sharesRs. 70 paid up. The directors made final call of Rs. 30 per share on 01/10/2024. A shareholder could not pay the call on 75 shares and his shares were forfeited. They were reissued @ Rs. 70 per share as fully paid.
- Profit on reissue of forfeited equity shares was included in profit and loss account.
- Bills discounted but not yet matured Rs. 15,000
- The balance of Term Loan from Public Finance Corporation includes Rs. 8,000 for interest accrued but not due. The loan is secured against hypothecation of Plant and Machinery.
- The directors declared a dividend of 5% on Equity shares on 10/04/2025.

You are required to prepare the Balance sheet as at 31st March, 2025 as required under Part-1 of the schedule III of the Companies Act.

Workings should form part of the answer.

Answer:

Balance Sheet of Bela Ltd. as at 31st March, 2025

Particulars	Note No	Rs.
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	9,00,000
b Reserves and Surplus	2	1,66,000
2 Non-current liabilities		
a Long-term borrowings	3	4,17,000
3 Current liabilities		
a Trade Payables	4	2,45,000
b Other current liabilities	5	24,000
c Short-term provisions	6	<u>12,000</u>
Total		<u>17,64,000</u>
ASSETS		
1 Non-current assets		
a PPE	7	12,70,000
2 Current assets		
a Inventories	8	2,01,000
b Trade receivables	9	2,38,000
c Cash and cash equivalents	10	<u>55,000</u>
Total		<u>17,64,000</u>

Notes to accounts

		Rs.
1 Share Capital		
Equity share capital		
Issued, Subscribed and paid up 6,000 Equity Shares of Rs.100 each	(A)	6,00,000
Preference share capital		
Issued, subscribed and paid up 3,000 8% Preference shares of Rs. 100 each	(B)	<u>3,00,000</u>
	Total (A + B)	<u>9,00,000</u>
2 Reserves and Surplus		
Capital reserve (W.N.)		3,000
General reserve		88,000
Add: Profit and Loss Account	99,000	
Less: Preliminary expenses	(21,000)	
Less: profit on reissue (75x 40)	<u>(3,000)</u>	<u>75,000</u>

		Total	<u>1,66,000</u>
3	Long-term borrowings		
	Secured- Term Loans		
	Loan from Public Financial Corporation (3,40,000 – 8,000)		3,32,000
	(Secured by hypothecation of Plant and Machinery)		
	Unsecured loan		<u>85,000</u>
		Total	<u>4,17,000</u>
4	Trade Payables		2,45,000
5	Other current liabilities		
	Interest accrued but not due on loans (PFC)		8,000
	Dividend Payable		10,000
	Outstanding expenses		<u>6,000</u>
		Total	<u>24,000</u>
6	Short-term provisions		
	Provision for taxation		12,000
7	PPE		
	Factory Buildings	6,94,000	
	Less: Depreciation	<u>(74,000)</u>	6,20,000
	Plant & Machinery	5,35,000	
	Less: Depreciation	<u>(37,000)</u>	4,98,000
	Furniture & Fittings	1,76,000	
	Less: Depreciation	<u>(24,000)</u>	<u>1,52,000</u>
	Total		<u>12,70,000</u>
8	Inventories		
	Raw Material		1,35,000
	Finished goods		<u>66,000</u>
		Total	<u>2,01,000</u>
9	Trade receivables		2,38,000
10	Cash and cash equivalents		
	Cash at bank		39,000
	Cash in hand		<u>16,000</u>
		Total	55,000

Working Note:

Calculation of Capital Reserve on reissue of forfeited equity shares: Balance in forfeiture Account = Rs. 5,250

Discount on reissue of shares = Rs. 2,250

Amount to be transferred to capital reserve = Rs. 5,250 - Rs. 2,250 = Rs. 3,000

Note:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2025. Such dividends will be disclosed in notes only.

2. There is a Contingent Liability for bills discounted but not yet matured amounting to Rs. 15,000

#2.Illustration | May 2025, 4 Marks |

Due to inadequacy of profits during the year ended 31st March, 2025, DAY Ltd proposes to declare 9% dividend out of General reserves.

From the following particulars, ascertain the amount that can be utilized from the General reserves according to the Companies (Declaration of dividend) rules, 2014.

	Rs.
9,50,000, Equity Shares of Rs. 10 each fully paid up	95,00,000
General reserves as on 1 st April, 2024	18,50,000
Revaluation Reserve as on 1 st April, 2024	4,25,000
Net profit for the year ended 31 st March, 2025	3,75,000
Average rate of dividend during the last 3 years has been	12.5%

Answer:

Amount that can be drawn from reserves for 9% dividend	
9% dividend on Rs. 95,00,000	Rs. 8,55,000
Profits available	
Current year profit	(3,75,000)
Amount which can be utilised from reserves	<u>4,80,000</u>

Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 2014:

Condition I

Since 9% is lower than the average rate of dividend (12.5%), 9% dividend can be declared.

Thus, this condition is satisfied.

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.

Rs. 11,35,000 [10% of (95,00,000+18,50,000)].

Thus, this condition too is satisfied.

Condition III

The balance of reserves after drawl Rs. 13,70,000 (Rs. 18,50,000 - Rs. 4,80,000) should not fall below 15.

% of its paid up capital i.e. Rs. 14,25,000 (15% of Rs. 95,00,000]

Thus, this condition is not satisfied, the company cannot withdraw Rs. 4,80,000 from accumulated reserves.

Conclusion:

Since condition-III is not satisfied, the Day Ltd cannot declare dividend @ 9%. However, all three conditions to be satisfied, Day Ltd. can MAXIMUM utilize Rs. 4,25,000 and pay dividend to that extent.

#3.Illustration | Jan 2025, 14 Marks |

Sustain Limited is incurring losses due to adverse market conditions. It decided to reorganize is capital structure. The summarized Balance Sheet of the company as on 31st March, 2024 is as follows:

Particulars	Notes	Rs.

Equity and Liabilities		
1. Shareholders' Fund	1	10,00,000
(a) Share Capital	2	(2,50,000)
(b) Reserves and Surplus		
2. Non-current liabilities		
Long term borrowing	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 provision (Provision for Income Tax)		<u>1,00,000</u>
Total		<u>15,40,000</u>
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		<u>2,30,000</u>
Total		<u>15,40,000</u>

Notes to accounts:

	Rs.
1. Share Capital	
Equity share capital:	
50,000 Equity shares of Rs. 10 each fully paid up	5,00,000
25,000 Equity shares of Rs. 10 each, Rs. 8 paid up	2,00,000
Preference share capital:	
30,000 8% Cumulative Preference shares of Rs. 10 each (Preference dividend has been in arrears for 3 years)	<u>3,00,000</u>
	<u>10,00,000</u>
2. Reserves and Surplus	
Profit and Loss account (debit balance)	<u>(2,50,000)</u>
3. Long-term borrowings	
Secured:	
10% Debentures of Rs. 100 each	<u>4,50,000</u>
	<u>4,50,000</u>
4. Property, Plant and Equipment	
Freehold property	1,00,000
Plant and machinery	<u>7,50,000</u>
	<u>8,50,000</u>
5. Intangible assets	

<i>Goodwill</i>	<u>60,000</u>
	<u>60,000</u>
6. Non-current investments	
<i>Non-trade investments at cost</i>	<u>2,80,000</u>
	<u>2,80,000</u>

Subsequent to approval by court and all interested parties, the following scheme of reconstruction were agreed:-

- 1) Uncalled capital is to be called up in full and such shares and other fully paid -up equity shares to be reduced to Rs. 5 per share.
- 2) The preference shareholders will accept a reduction of Rs. 2.5 per share, in exchange the rate of dividend is to be increased to 9%.
- 3) Preference shareholders will forgo their claim of dividend for one year and one equity share of Rs. 5 each is to be issued for the remaining arrears of dividend.
- 4) Mr. X holds 10% debentures for Rs. 2,50,000. He is also a creditor for Rs. 50,000. He agreed to cancel 50% of his total debt, including interest on debentures, pay Rs. 20,000 to the company and to receive new 12% debentures for the balance amount.
- 5) The remaining claim of the debenture holders, including outstanding interest to be reduced to 60%. In consideration of the reduction, the debenture holders are to receive new 9% preference shares at new face value.
- 6) The taxation liability is to be settled at Rs. 1,20,000.
- 7) Market value of Non-current Investments is Rs. 2,50,000. Investments to be brought to their market value.
- 8) Inventory equal to Rs. 1,00,000 at 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 for such amount which is sufficient to pay off bank overdraft and other outstanding liabilities and maintain its cash/bank balance at Rs. 85,000.
- 12) The amount available by the scheme shall be utilized in writing of Goodwill, debit balance of profit and loss a/c and balance of inventory.

You are required to:

- a) Show the journal entries, necessary to record the above transaction in the company's books and
- b) Prepare a note to show revised Share capital structure of the company after completion of the scheme.

Answer:

Journal Entries in books of Sustain Limited

			Rs.	Rs.
1.	Bank Account	Dr.	50,000	
	To Equity Share Capital Account			50,000
	(Balance of Rs. 2 per share on 25,000 equity shares called up)			
2.	Equity Share Capital (Rs. 10) Account		7,50,000	
	To Equity Share Capital (Rs. 5) Account			3,75,000
	To Capital Reduction Account			3,75,000

	(Reduction of equity shares of Rs. 10 each to shares of Rs. 5 each as per reconstruction scheme)			
3.	8 % Cumulative Preference Share Capital (Rs. 10) A/c Dr.	3,00,000		
	To 9% Cumulative Preference Share Capital (Rs. 7.5) A/c			2,25,000
	To Capital Reduction A/c			75,000
	(Being Preference shares of Rs. 10 each reduced by Rs. 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 (Rs. 5) A/c			48,000
	(Being Equity Shares of Rs. 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	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	20,000		
	To 9% Cumulative Preference Share capital A/c			1,32,000

	To Capital Reduction A/c (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)			88,000
10	Provision for Tax A/c Capital Reduction A/c To Bank A/c (Being payment of tax liability in full settlement)	Dr.	1,00,000 20,000	1,20,000
11	Trade payables A/c (1,30,000-50,000) Capital reduction A/c	Dr.	80,000 20,000	
12	To Inventory A/c [Being settlement of creditors by giving inventory]			1,00,000
12	Capital reduction A/c To Investment A/c To Provision for bad debt A/c (2,30,000 x 2%) To Plant & Machinery (7,50,000x 20%) (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)	Dr.	1,84,600	30,000 4,600 1,50,000
13	Bank A/c To 12% debentures A/c (New 12 % debentures issued to pay off bank overdraft and maintain cash balance)	Dr.	2,00,000	2,00,000
14.	Bank Overdraft To Bank A/c (Bank overdraft paid)	Dr.	65,000	65,000
15.	Capital reduction A/c To Goodwill A/c To Profit and loss A/c To Inventory To Capital reserve A/c [Being goodwill and profit and loss account (Dr. bal.), balance inventory; and balance of capital reduction account transferred to capital reserve]	Dr.	4,27,900	60,000 2,50,000 20,000 97,900

Notes to accounts

	Rs.
1. Share Capital	
Equity share capital	
Issued, subscribed and paid up	
84,600 equity shares of Rs. 5 each each (75,000+9,600)	4,23,000
47,600, 9 % Cumulative Preference Shares of Rs. 7.50 each (30,000+17,600)	3,57,000
Total	7,80,000

Working note

1. Calculation of the number of equity shares issued for 2 years arrear of preference share dividend

$$3,00,000 \times 8\% \times 2 = 48,000$$

$$\text{Equity share of Rs. 5 per share issued} = 48,000 / 5 = 9,600 \text{ shares}$$

2. Cash & bank Account

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 (bal. fig.)	2,00,000	By Balance C/d	85,000
	<u>2,70,000</u>		<u>2,70,000</u>

3. The new face value of preference share is $10 - 2.5 = \text{Rs. } 7.5$

Calculation of Number of 9% Preference shares issued in consideration of reduction:

$$1,32,000 / 7.5 = 17,600$$

#4.Illustration | September 2024, 14 Marks |

The following is the Trial Balance of Shivam Ltd as on 31st March, 2024 :

Particulars	Dr. (Rs.000)	Particulars	Cr. (Rs.000)
Land at Cost	148	Equity Share of Rs. 10 each	200
Plant & Machinery at Cost	520	10% Debenture of Rs. 100 each	135
Debtors	65	General Reserve	90
Closing Stock	58	Profit & Loss Ale	48
Bank	14	Security Premium	27
Adjusted Purchases	226	Sales	473
Factory Expenses	40	Creditors	35
Administration Expenses	22	Provision for Depreciation	116
Selling Expenses	20	Suspense A/c	3
Debenture Interest	14		
Total	1,127	Total	1,127

Additional Information:

- On 31st March, the Company issued Bonus Shares to the Shareholders on 1 : 2 basis (one equity share issued as bonus for every 2 equity shares held). No entry relating to this has yet been made.

- The Authorized Share Capital of the Company is 35,000 Equity Shares of Rs. 10 each.
- The Company, on the advice of an independent valuer, revalued the Land at Rs. 2,45,000.
- The Directors declared a Dividend of 10% on 5th April, 2024 and also transferred profit @ 10% to General Reserve.
- Suspense Account of Rs. 3,000 represents cash received for the Sale of some Machinery on the 1st day of the financial year 2023-24. Cost of this Machinery was Rs. 10,000 and Accumulated Depreciation thereon being Rs. 8,000.
- Depreciation is to be provided on Plant & Machinery at 10% on Cost.
- Provision for Income tax is required @ 30%.

You are required to prepare Shivam Ltd.'s Profit and Loss A/c for the year ended 31st March, 2024 and Balance Sheet as at that date as per the provisions of the Companies Act, 2013 after considering the above information. Ignore previous year figures.

Answer:

Shivam Limited
Balance Sheet as at 31st March 2024

Particulars		Note No.	Rs. (in 000)
I. Equity and Liabilities			
1. Shareholders' funds			
(a) Share capital	1		300.00
(b) Reserves and Surplus	2		232.70
2. Non-Current liabilities			
(a) Long term borrowings	3		135.00
3. Current liabilities			
(a) Trade Payables			35.00
(b) Short-Term Provisions			<u>30.30</u>
Total			<u>733.00</u>
II. Assets			
1. Non-current assets			
(a) Property, Plant and Equipment and Intangible assets	4		596.00
(i) Property, Plant and Equipment			
2. Current assets			
(a) Inventories			58.00
(b) Trade receivables			65.00
(c) Cash and cash equivalents			<u>14.00</u>
Total			<u>733.00</u>

Shivam Limited

Statement of Profit and Loss for the year ended 31st March 2024

	Particulars	Notes	Rs. (in '000)
I.	Revenue from operations		473.00
II.	Other Income	5	<u>1.00</u>
III.	Total Income		<u>474.00</u>
IV.	Expenses:		
	Purchases		226.00
	Finance costs		<u>14.00</u>

	Depreciation and Amortisation expenses (10% of 510*)		51.00
	Other expenses	6	<u>82.00</u>
V.	Total Expenses		<u>373.00</u>
	Profit before Tax (III-IV)		<u>101.00</u>
	Tax Expense:		
	Current tax		<u>(30.30)</u>
	Profit for the period (after tax)		<u>70.70</u>

Notes to accounts

				Rs. (in 000)
1.	Share Capital			
	Equity share capital			
	<u>Authorised</u>			<u>350.00</u>
	35,000 shares of Rs. 10 each			
	<u>Issued, subscribed & paid-up</u>			
	20,000 shares of Rs. 10 each fully paid up	200.00		
	Add: 10,000 Bonus Shares issued during the year	<u>100.00</u>		300.00
2.	Reserves and Surplus			
	Securities Premium Account	27.00		
	Opening Balance	<u>27.00</u>		
	Less: Utilised for bonus issue			0.00
	Revaluation reserve (2,45,000 – 1,48,000)			97.00
	General Reserve 90			
	Less: Utilized for bonus issue (73)	17.00		
	Add: Transfer from Profit & loss @ 10%	<u>7.07</u>		24.07
	Profit & loss Balance			
	Opening balance	48.00		
	Profit for the period	70.70		
	Appropriations			
	Transfer to General Reserve @ 10%	<u>(7.07)</u>		<u>111.63</u>
				<u>232.70</u>
3.	Long term borrowing			
	10% Debentures			135.00
4	Property, Plant and Equipment			
	Land			
	Opening balance		148.00	
	Add: Revaluation adjustment		<u>97.00</u>	
	Closing balance			245.00
	Plant and Machinery			
	Opening balance		520.00	
	Less: Disposed off		<u>(10.00)</u>	
			510.00	

	Less: Depreciation (1,16,000-8,000+51,000)	(159.00)	
	Closing balance		351.00
	Total		596.00
5	Other Income		
	Profit on sale of machinery:		
	Sale value of machinery	3.00	
	Less: Book value of machinery (10,000-8,000)	(2.00)	1.00
6	Other expenses:		
	Factory expenses	40.00	
	Selling expenses	20.00	
	Administrative expenses	22.00	82.00

The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March 2024. Such dividends will be disclosed in notes only.

Working note:

Bonus Shares Issue:

- Bonus shares are issued in a 1:2 ratio, so for every 2 equity shares, 1 bonus share is issued.
- Equity Share Capital = Rs. 2,00,000 / Rs. 10 = 20,000 shares.
- Bonus Shares = 20,000 / 2 = 10,000 shares × Rs. 10 = Rs. 1,00,000.

Alternatively, since, the amount of interest on 10% 1,35,000 Debentures comes to Rs 13,500 while the Debenture Interest in the trial balance is listed as Rs. 14,000, the difference of Rs. 500 (Rs.13,500 - Rs.14,000) may be treated as an advance payment.

#5.Illustration | May 2024, 4 Marks |

Following information are available in respect of Z Limited as on 31 st March, 2024

1. Equity shares of Rs. 100 each Rs. 500 lakhs
2. General Reserve Rs. 100 lakhs
3. Loss for the year ending 31st March, 2024 Rs. 5 lakhs

Due to absence of profits during the year 2023-24, the management recommends to declare dividend of 10% on equity share capital out of general reserve.

The rates of equity dividend for the last 5 years immediately preceding the year 2023-24 are as follows:

2022-23	2021-22	2020-21	2019-20	2018-19
12%	14%	10%	10%	7%

As an accountant of the company, you are required to suggest whether the recommendation of the management is justified? If, you do not agree, then suggest the rate of dividend.

Answer:

In case of declaration of dividend out of free reserves, there are 3 conditions:

- (1) Dividend Rate < Average Rate of last 3 years
 $10\% < 12\% [(12+14+10)/3]$
 Condition is Satisfied
- (2) Dividend Distributed < 10% of PUSC + Reserve and Surplus
 $50,00,000 < 59,50,000 [(5,00,00,000 + 1,00,00,000 - 5,00,000) \times 10\%]$

Condition is Satisfied

- (3) Reserves after dividend > 15% of PUSC 45,00,000 not > 75,00,000

$(5,00,00,000 \times 15\%)$

Condition is Not Satisfied

- (4) The closing balance of reserves after payment of dividend and set off of loss = Rs. 75,00,000
Therefore, can be utilized = 20,00,000 (1,00,00,000 – 5,00,000 – 75,00,000) Thus, rate of dividend = $(20,00,000/5,00,00,000) = 4\%$

Alternatively

To judge the recommendation of management, the satisfaction of all three conditions is to be checked:

- (1) Condition I

The proposed dividend of 10% is less than the average rate of dividend being 12% (i.e.) $(12+14+10)/5 = 12\%$.

Hence, this condition is satisfied.

- (2) Condition II

Amount to be withdrawn.

10% dividend on Equity share capital	50,00,000
+ Loss of Current year	<u>5,00,000</u>
Amount to be drawn from General Reserve	<u>55,00,000</u>

Maximum amount that can be withdrawn should not exceed 10% of paid-up share capital + free reserves.

= 10% of [Rs. 500 lakhs + Rs. 100 lakhs] = Rs. 60,00,000

As the amount to be withdrawn is within the maximum limit, hence, this condition is also satisfied.

- (3) Condition III

Balance of reserves after withdrawal (100-55) Rs. 45,00,000 15% of paid-up capital Rs. 75,00,000

As the balance of reserves should not be less than 15% of its paid-up share capital, but here the balance of reserves after withdrawal is less than 15% of paid-up share capital, hence this condition is not satisfied, hence, 10% dividend cannot be declared.

Maximum withdrawal of Reserve if condition II is satisfied.

Opening balance of Reserves in the beginning = Rs. 1,00,00,000 of the year

- Closing balance of reserves being 15% of = Rs. 75,00,000 paid-up capital

Reserves available = Rs. 25,00,000

Maximum permissible Divisible Profits

Permissible withdrawal as above = Rs. 25,00,000

Less: Current Year's Loss = Rs. 5,00,000

Maximum permissible Divisible profit = Rs. 20,00,000

Actual permissible rate of Dividend =

$(Rs. 20,00,000 / Rs. 5,00,00,000) \times 100 = 4\%$

Therefore, the recommendation of management is not justified and a dividend only up to a rate of 4% can be declared.

#6.Illustration | Nov 2023, 20 Marks |

The following is the Trial Balance of Falgun Ltd., as on 31st March, 2023:

Particulars	Debit Amt. in (Rs.)	Credit Amt. in (Rs.)
Equity Share Capital (Fully paid-up shares of Rs. 100 each)		10,00,000

10% Preference Share Capital of Face Value Rs. 100 each		4,00,000
General Reserve		2,85,000
2,000 10% Debentures of Rs. 100 each		2,00,000
Securities Premium Account		50,000
Land (at Cost)	7,00,000	
Plant and Machinery	14,70,000	
Furniture	4,00,000	
Provision for Depreciation - Plant and Machinery		3,00,000
Provision for Depreciation - Furniture		1,90,000
Trade Receivables	3,10,000	
Trade Payables		72,000
Cash-in-Hand	1,34,000	
Cash-at-Bank	3,05,000	
Bank Over Drafts from Nationalized bank (Long Term)		2,00,000
(Secured by Hypothecation of Stocks)		
6% Secured Loan from State Finance Corporation (repayable after 3 years) (Secured by Hypothecation of Plant and Machinery)		4,50,000
Unclaimed Dividend		23,000
Loan from Director (Short Term)		1,00,000
Adjusted Purchases	2,25,000	
Closing Stock	1,12,000	
Sales		8,46,000
Carriage Inward	17,200	
Miscellaneous Expenses	10,200	
Selling and Distribution Expenses	46,600	
Depreciation	1,80,000	
Salaries	72,000	
Director's Fees	40,000	
Travelling Expenses (include Rs. 50,000/- for foreign tour)	1,30,000	
Profit and Loss Account		40,000
Office Expenses	28,000	
Rent Received		24,000
Total	41,80,000	41,80,000

Additional Information:

- (i) Authorized Capital - divided into -
 - a) 20,000 equity shares of Rs. 100 each.
 - b) 10,000 10% preference shares of Rs. 100 each
- (ii) Equity shares include, 2,500 equity shares issued for consideration other than cash.
- (iii) The company has land professionally valued and decides to include it in the Balance sheet at its valuation of Rs. 8,50,000.
- (iv) It is proposed to capitalize part of the undistributed profits by making bonus issue to the shareholders by allocating one equity share of Rs. 100 each for every 5 shares held.
- (v) Trade Receivables of Rs. 46,000 are due for more than six months. There is no doubtful amount.
- (vi) Depreciation expenses include depreciation of Rs. 1,10,000 on Plant and Machinery and that of Rs. 70,000 on Furniture.

- (vii) Cash-at-Bank include Rs. 55,000 with Desire Bank Ltd., which is not scheduled Bank.
- (viii) Miscellaneous expenses included Rs. 5,000 being audit fees paid to auditors.
- (ix) Bill Receivables for Rs. 35,000 maturing on 31st July, 2023 has been discounted.
- (x) Balance of secured loan from State Finance Corporation is inclusive of Rs. 36,000 for interest accrued but not due.
- (xi) Directors declared final dividend @ 8% on 6th April, 2023, transferring any amount that may be required from General Reserve. Ignore Taxation.
- (xii) Interest on debenture for the year is outstanding as on 31st March, 2023. You are required to prepare Balance Sheet as on 31st March, 2023 and Statement of Profit and Loss with Notes to Accounts for the year ending 31st March, 2023 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures. (Ignore taxation).
(All workings should form part of the answer)

Answer:

Statement of Profit and Loss of Falgun Ltd. for the year ended 31st March, 2023

	Particulars	Notes	Rs.
I.	Revenue from operations		8,46,000
II.	Other income (Rent income)		24,000
III.	Total Income (I + II)		8,70,000
IV.	Expenses:		
	Cost of materials consumed / Cost of purchases	9	2,42,200
	Changes in inventories of finished goods, work-in-progress and Inventory-in-Trade		-
	Employee benefits expense	10	72,000
	Finance costs (Interest on debentures)	11	20,000
	Depreciation and amortization expenses	12	1,80,000
	Other expenses	13	2,54,800
	Total expenses		7,69,000
V.	Profit (Loss) for the period (III - IV)		1,01,000

Balance Sheet of Falgun Ltd. as at 31st March, 2023

Particulars	Note No	Rs.
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	14,00,000
b Reserves and Surplus	2	6,26,000
2 Non-current liabilities		
a Long-term borrowings	3	8,14,000
3 Current liabilities		
a Short term borrowings	4	1,00,000
b Trade Payables		72,000
c Other current liabilities	5	79,000
d Short term provisions		
Total		30,91,000
ASSETS		

1	Non-current assets		
a	Property, plant and equipment	6	22,30,000
2	Current assets		
a	Inventories		1,12,000
b	Trade receivables	7	3,10,000
c	Cash and bank equivalents	8	4,39,000
d	Short term loans & advances		
	Total		30,91,000

Note: There is a Contingent Liability for bills discounted but not yet matured amounting Rs. 35,000.

Notes to accounts:

		Rs.
	<i>Share Capital</i>	
1	Authorised capital:	
	10,000, 10% preference shares of Rs. 100	10,00,000
	20,000 Equity shares of Rs. 100 each	20,00,000
		30,00,000
	Issued and subscribed capital:	
	4,000, 10% preference shares of Rs. 100 each fully paid	4,00,000
	10,000 Equity shares of Rs. 100 each, fully paid	<u>10,00,000</u>
	(of the above 2,500* shares have been issued for consideration other than cash)	14,00,000
2	Reserves and Surplus	
	Securities premium	50,000
	Revaluation reserve	1,50,000
	General Reserve	2,85,000
	Surplus (Profit & Loss balance)	
	Opening balance	40,000
	Profit for the year	<u>1,01,000</u>
	Total	<u>6,26,000</u>
3.	Long-term borrowings	
	<u>Debentures</u>	
	2,000 10% Debentures of Rs. 100 each	2,00,000
	<u>Secured: Term Loans</u>	
	6% Loan from State Finance Corporation [repayable after 3years (Rs. 4,50,000 - Rs. 36,000 for interest accrued but not due)] (secured by hypothecation of Plant and machinery)	4,14,000
	<u>Others</u>	
	Bank overdraft from Nationalized bank (secured by hypothecation of stocks)	<u>2,00,000</u>
	Total	8,14,000
4.	Short-term borrowings	
	Loan from Directors	1,00,000
5	Other current liabilities	
	Unclaimed dividend	23,000

	Interest on Debentures	20,000	
	Interest accrued but not due on loans (SFC)	36,000	79,000
6	Property, plant and equipment		
	Land 7,00,000		
	Add: Revaluation Adjustment 1,50,000		8,50,000
	Plant & Machinery	14,70,000	
	Less: Provision for depreciation	(3,00,000)	11,70,000
	Furniture	4,00,000	
	Less: Provision for depreciation	(1,90,000)	2,10,000
	Total		22,30,000
7	Trade receivables		
	Debts outstanding for a period exceeding six months		46,000
	Other Debts		2,64,000
			3,10,000
8	Cash and cash equivalents		
	Cash at bank with Scheduled Banks (3,05,000-55,000)	2,50,000	
	with others	55,000	
	Cash in hand	1,34,000	4,39,000
9	Cost of materials consumed/Cost of purchases		
	Adjusted purchases	2,25,000	
	Carriage inward	17,200	2,42,200
10	Employee benefit expense		
	Salaries		72,000
11	Finance cost		
	Debenture interest		20,000
12	Depreciation and amortization expenses		
	Plant and Machinery 1,10,000		
	Furniture 70,000		
			1,80,000
13	Other expenses		
	Misc. expenses (10,200-5,000)	5,200	
	Audit fee	5,000	
	Selling & Distribution expenses	46,600	
	Director's fee	40,000	
	Travelling expenses (including foreign tour)	1,30,000	
	Office expenses	28,000	<u>2,54,800</u>

Notes:

1. The final dividend will not be recognized as a liability at the balance sheet date (even if it is declared after reporting date but before approval of the financial statements) as per Accounting Standards. Hence, it has not been recognized in the financial statements for the year ended 31 March, 2023. Such dividends will be disclosed in notes only.

2. Since Bonus issue is in proposal state, no adjustment has been made in the given answer.

#7. Illustration | May 2019, 10 Marks |

The following information was provided by PQR Ltd. for the year ended 31st March, 2019

1. Gross Profit Ratio was 25% for the year, which amounts to Rs.3,75,000.
2. Company sold goods for cash only.
3. Opening inventory was lesser than closing inventory by Rs.25,000.
4. Wages paid during the year Rs.5,55,000.
5. Office expenses paid during the year Rs.35,000.
6. Selling expenses paid during the year Rs.15,000.
7. Dividend paid during the year Rs.40,000 (including dividend distribution tax).
8. Bank Loan repaid during the year Rs.2,05,000 (included interest Rs.5,000)
9. Trade Payables on 31st March, 2018 were Rs.50,000 and on 31st March, 2019 were Rs.35,000.
10. Amount paid to Trade payables during the year Rs.6,10,000
11. Income Tax paid during the year amounts to Rs.55,000 (Provision for taxation as on 31st March, 2019 Rs.30,000)
12. Investments of Rs.8,20,000 sold during the year at a profit of Rs.20,000.
13. Depreciation on furniture amounts to Rs.40,000.
14. Depreciation on other tangible assets amounts to Rs.20,000.
15. Plant and Machinery purchased on 15th November, 2018 for Rs.3,50,000.
16. On 31st March, 2019 Rs.2,00,000, 7% Debentures were issued at face value in an exchange for a plant.
17. Cash and Cash equivalents on 31st March, 2018 Rs.2,25,000.
 - i. Prepare cash flow statement for the year ended 31st March, 2019, using direct method.
 - ii. Calculate cash flow from operating activities, using indirect method.

Answer

i. Cash Flow Statement for the year ended 31st March, 2019 (Using direct method)

Particulars	Rs.	Rs.
Cash flows from Operating Activities		
Cash sales (Rs.3,75,000/25%)		15,00,000
Less: Cash payments for trade payables	(6,10,000)	
Wages Paid	(5,55,000)	
Office and selling expenses Rs.(35,000 + 15,000)	(50,000)	(12,15,000)
Cash generated from operations before taxes		2,85,000
Income tax paid		(55,000)
Net cash generated from operating activities (A)		2,30,000
Cash flows from Investing activities		
Sale of investments Rs.(8,20,000 + 20,000)	8,40,000	
Payments for purchase of Plant & machinery	(3,50,000)	
Net cash used in investing activities (B)		4,90,000
Cash flows from financing activities		
Bank loan repayment (including interest)	(2,05,000)	
	(40,000)	

Particulars	Rs.	Rs.
Dividend paid (including dividend distribution tax)		
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,75,000
Cash and cash equivalents at beginning of the period		2,25,000
Cash and cash equivalents at end of the period		7,00,000

ii. Cash Flow from Operating Activities' by indirect method

Particulars		Rs.
Net Profit for the year before tax and extraordinary items		2,80,000
<i>Add:</i> Non-Cash and Non-Operating Expenses:		65,000
Depreciation	60,000	
Interest Paid	5,000	
<i>Less:</i> Non-Cash and Non-Operating Incomes: Profit on Sale of Investments		(20,000)
Net Profit after Adjustment for Non-Cash Items Less		3,25,000
Decrease in trade payables	(15,000)	
Increase in inventory	(25,000)	(40,000)
Cash generated from operations before taxes		2,85,000

Working Note:

Calculation of net profit earned during the year

Particulars		Rs.
Gross Profit		3,75,000
<i>Less:</i> Office expenses, selling expenses:	50,000	
Depreciation	60,000	
Interest Paid	5,000	(1,15,000)
		2,60,000
<i>Add:</i> Profit on sale of investment		(20,000)
Net profit before taxes		2,80,000

#8. Illustration | Nov 2019, 10 Marks |

From the following particulars furnished by the Prashant Ltd., prepare the Balance Sheet as at 31st March, 2019 as required by Schedule III of the Companies Act, 2013 :

Particulars	Debit (Rs.)	Credit (Rs.)
Equity share capital (face value of Rs.10 each)		15,00,000
Calls-in-arrears	5,000	
Land	5,50,000	
Building	4,85,000	
Plant & machinery	5,60,000	

General reserve		2,70,000
Loan from State Financial Corporation		2,10,000
Inventories	3,15,000	
Provision for taxation		72,000
Trade receivables	2,95,000	
Short-term loans & advances	58,500	
Profit & loss account		1,06,800
Cash in hand	37,300	
Cash at bank	2,85,000	
Unsecured loans		1,65,000
Trade payables		2,67,000
Total	25,90,800	25,90,800

The following additional information is also provided:

- 10,000 equity shares were issued for consideration other than cash.
- Trade receivables of Rs.55,000 are due for more than six months.
- The cost of building and plant & machinery is Rs.5,50,000 and Rs.6,25,000 respectively.
- The loan from State Financial Corporation is secured by hypothecation of plant & machinery. The balance of Rs.2,10,000 in this account is inclusive of Rs.10,000 for interest accrued but not due.
- Balance at Bank included Rs.15,000 with Aakash Bank Ltd., which is not a scheduled bank.

Answer

Prashant Ltd.

Balance Sheet as on 31st March, 2019

Particulars	Notes	Rs.
Equity and Liabilities		
1 Shareholders' funds		
a Share capital	1	14,95,000
b Reserves and Surplus	2	3,76,800
2 Non-current liabilities		
Long-term borrowings	3	3,65,000
3 Current liabilities		
a Trade Payables		2,67,000
b Other current liabilities	4	10,000
c Short-term provisions	5	72,000
Total		25,85,800
Assets		
1 Non-current assets		
Property, Plant and Equipment	6	15,95,000
2 Current assets		
a Inventories		3,15,000
b Trade receivables	7	2,95,000
c Cash and bank balances	8	3,22,300
d Short-term loans and advances		58,500

	Total	25,85,800

Notes to accounts

		Rs.
1. Share Capital		
Equity share capital issued & subscribed & fully paid up 1,50,000 equity shares of Rs.10 each (of the above 10,000 shares have been issued for consideration other than cash)	15,00,00	
Less : Calls in arrears	0 (5,000)	14,95,000
2. Reserves & Surplus		
General Reserve	2,70,000	
Profit & Loss balance	1,06,800	3,76,800
3. Long-term borrowings		
Loan from State Financial Corporation (2,10,000-10,000) (Secured by hypothecation of Plant and Machinery)	2,00,000	
Unsecured Loan	1,65,000	3,65,000
4. Other current liabilities		
Interest accrued but not due on loans (SFC)		10,000
5. Short-term provisions		
Provision for taxation		72,000
6. Property, Plant & Equipment		
Land	5,50,000	
Building	5,50,000	
Less: Depreciation	(65,000)	4,85,000
Plant & Machinery	6,25,000	
Less: Depreciation	(65,000)	5,60,000
		15,95,000
7. Trade receivables		
Outstanding for a period exceeding six months	55,000	
Other amounts	2,40,000	2,95,000
8. Cash and Bank balance		
Cash at bank	2,85,000	
Cash in hand	37,300	3,22,300

#9. Illustration | Nov 2020, 10 Marks |

The following figures have been extracted from the books of Manan Jo Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

1. Net profit before taking into account income tax and income from law suits but after taking into account the following items was Rs.30 lakhs :
 - i. Depreciation on Property, Plant & Equipment Rs.7.50 lakhs.
 - ii. Discount on issue of Debentures written off Rs.45,000.
 - iii. Interest on Debentures paid Rs.5,25,000.
 - iv. Book value of investments Rs. 4.50 lakhs (Sale of Investments for Rs.4,80,000).
 - v. Interest received on investments Rs.90,000.
 - vi. Compensation received Rs.1,35,000 by the company in a suit filed.
2. Income tax paid during the year Rs.15,75,000.
3. 22,500, 10% preference shares of Rs.100 each were redeemed on 02-04-2019 at a premium of 5%.
4. Further the company issued 75,000 equity shares of Rs.10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)
5. Dividend for FY 2018-19 on preference shares were paid at the time of redemption.
6. Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 Rs.7.50 lakhs (including dividend distribution tax) and interim dividend paid Rs.2.50 lakhs for the year 2019-2020.
7. Land was purchased on 02.4.2019 for Rs.3,00,000 for which the company issued 22,000 equity shares of Rs.10 each at a premium of 20% to the land owner and balance in cash as consideration.

Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 01.04.2019	As on 31.3.2020
	Rs.	Rs.
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payables	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

Answer

Manan Ltd.

Cash Flow Statement for the year ended 31st March, 2020

Particulars	Rs.	Rs.
Cash flow from Operating Activities		
Net profit before taxation		30,00,000
Depreciation	7,50,000	
Discount on issue of debentures	45,000	
Interest on debentures paid	5,25,000	
Interest on investments received	(90,000)	
Profit on sale of investments	(30,000)	12,00,000
<i>Operating profit before working capital changes</i>		42,00,000
Adjustments for:		
Increase in inventory	(1,77,000)	
Decrease in trade receivable	7,350	
Increase in trade payables	450	

Increase in outstanding expenses	10,200	(1,59,000)
<i>Cash generated from operations</i>		40,41,000
Income tax paid		(15,75,000)
<i>Cash flow from ordinary items</i>		24,66,000
<i>Cash flow from extraordinary items:</i>		
Compensation received in a suit filed		1,35,000
Net cash flow from operating activities		26,01,000
Cash flow from Investing Activities		
Sale proceeds of investments	4,80,000	
Interest received on investments	90,000	
Purchase of land (3,00,000 less 2,64,000)	(36,000)	
Net cash flow from investing activities		5,34,000
Cash flow from Financing Activities		
Proceeds of issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(23,62,500)	
Preference dividend paid	(2,25,000)	
Interest on debentures paid	(5,25,000)	
Dividend paid (7,50,000 + 2,50,000)	(10,00,000)	
Net cash used in financing activities		(35,12,500)
Net decrease in cash and cash equivalents during the year		(3,77,500)
Add: Cash and cash equivalents as on 31.3.2019		3,94,450
Cash and cash equivalents as on 31.3.2020		16,950

#10. Illustration | Nov 2020, 5 Marks |

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

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

Additional Information:

- Remaining life of Fixed Assets is 6 years with even use. The net realizable value of Fixed Assets as on 31st March, 2020 is Rs.90,000.
- Firm's Sales & Purchases for the year ending 31st March, 2020 amounted to Rs.7,80,000 and Rs.6,25,000 respectively.
- The cost & net realizable value of the stock as on 31st March, 2020 was, Rs.60,000 and Rs.66,000 respectively.
- General expenses (including interest on Loan) for the year 2019-20 were Rs.53,800.
- Deferred expenditure is normally amortized equally over 5 years starting from the Financial year 2018-19 i.e. Rs.6,000 per year.

- vi. Debtors on 31st March, 2020 is Rs.65,000 of which Rs.5,000 is doubtful. Collection of another Rs.10,000 debtors depends on successful re-installation of certain products supplied to the customer.
- vii. Closing Trade payable Rs.48,000, which is likely to be settled at 5% discount.
- viii. There is a prepayment penalty of Rs.4,000 for Bank loan outstanding.
- ix. Cash & Bank balances as on 31st March, 2020 is Rs.1,65,200.

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

Answer

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

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

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

Liabilities and Capital		Rs.	Assets		Rs.
Capital		1,50,000	Fixed assets		90,000
Profit & Loss A/c opening balance	56,000		Debtors		
Profit earned during the year	35,600	91,600	Doubtful debts provision	65,000	50,000
11% Loan		84,000	Closing stock		66,000
Trade payables		45,600	Cash & Bank balance		1,65,200
		3,71,200			3,71,200

#11. Illustration | Jan 2021, 12 Marks |

Following information was extracted from the books of S Ltd. for the year ended 31st March, 2020 :

- Net profit before taking into account income tax and after taking into account the following items was Rs.30 lakhs;
 - Depreciation on Property, Plant & Equipment Rs.7,00,000
 - Discount on issue of debentures written off Rs.45,000.
 - Interest on debentures paid Rs.4,35,000
 - Investment of Book value Rs.3,50,000 sold for Rs.3,75,000.
 - Interest received on Investments Rs.70,000
- Income tax paid during the year Rs.12,80,000
- Company issued 60,000 Equity Shares of Rs.10 each at a premium of 20% on 10th April, 2019.
- 20,000,9% Preference Shares of Rs.100 each were redeemed on 31st March, 2020 at a premium of 5%
- Dividend paid during the year amounted to Rs.11 Lakhs (including dividend distribution tax)

6. A new Plant costing Rs.7 Lakhs was purchased in part exchange of an old plant on 1st January, 2020. The book value of the old plant was Rs.8 Lakhs but the vendor took over the old plant at a value of Rs.6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March, 2020.
7. 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 31.03.2020 was Rs.14,76,000. The inventory on 31.03.2019 was correctly valued at Rs. 13,50,000.
8. Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

	As on 1st April,2019 (Rs.)	As on 31st March,2020 (Rs.)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash & Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method

Answer

S Ltd.

Cash Flow Statement for the year ended 31st March, 2020

Particulars	Rs.	Rs.
Cash flows from operating activities		
Net profit before taxation*		30,00,000
Adjustments for:		
Depreciation on PPE	7,00,000	
Discount on debentures	45,000	
Profit on sale of investments	(25,000)	
Interest income on investments	(70,000)	
Interest on debentures	4,35,000	
Stock adjustment	1,64,000	
{14,76,000 less 16,40,000(14,76,000/90X100)}		
<i>Operating profit before working capital changes</i>		12,49,000
Changes in working capital		42,49,000
(Excluding cash and bank balance):		
Increase in inventory	(2,90,000)	
{16,40,000(14,76,000/90X100) less 13,50,000}		
Decrease in Trade receivables	13,800	
Increase in trade payables	2,600	
Increase in o/s expenses	4,400	(2,69,200)
<i>Cash generated from operations</i>		39,79,800
Income taxes paid		(12,80,000)
Net cash generated from operating activities		26,99,800
Cash flows from investing activities		

Sale of investments	3,75,000	
Interest received	70,000	
Payments for purchase of fixed assets (7,00,00 – 6,00,000)	(1,00,000)	
Net cash generated from investing activities		3,45,000
Cash flows from financing activities		
Redemption of Preference shares	(21,00,000)	
Issue of shares	7,20,000	
Interest paid	(4,35,000)	
Dividend paid	(11,00,000)	
Net cash used in financing activities		(29,15,000)
<i>Net increase in cash</i>		1,29,800
<i>Cash at beginning of the period</i>		2,40,700
Cash at end of the period		3,70,500

#12. Illustration | July 2021, 20 Marks |

The following is the Trial Balance of H Ltd., as on 31st March, 2021:

Particulars	Dr.	Cr.
Equity Capital (Shares of Rs.100 each)		8,05,000
5,000, 6% preference shares of Rs.100 each		5,00,000
9% Debentures		4,00,000
General Reserve		40,00,000
Profit & Loss A/c (of previous year)		72,000
Sales		60,00,000
Trade Payables		10,40,000
Provision for Depreciation on Plant & Machinery		1,72,000
Suspense Account		40,000
Land at cost	24,00,000	
Plant & Machinery at cost	7,70,000	
Trade Receivables	19,60,000	
Inventories (31-03-2020 [□])	9,50,000	
Bank	2,30,900	
Adjusted Purchases	22,32,100	
Factory Expenses	15,00,000	
Administration Expenses	3,00,000	
Selling Expenses	14,00,000	
Debenture Interest	36,000	
Goodwill	12,50,000	
	1,30,29,000	1,30,29,000

Additional Information:

(i) The authorised capital of the company is :

5,000, 6% preference shares of Rs.100 each 5,00,000

10,000, equity shares of Rs.100 each 10,00,000

Issued equity capital as on 1st April 2020 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 2020. 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.

- (ii) On 31st March 2021, the Directors declared a dividend of 5% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.
- (iii) The company on the advice of independent valuer wishes to revalue the land at Rs.36,00,000
- (iv) Suspense account of Rs.40,000 represents amount received for the sale of some of the machinery on 1-4-2020. The cost of the machinery was Rs.1,00,000 and the accumulated depreciation thereon being Rs.30,000.
- (v) Depreciation is to be provided on plant and machinery at 10% on cost.
- (vi) Amortize 1/5th of Goodwill.

You are required to prepare H Limited's Balance Sheet as on 31-3-2021 and Statement of Profit and Loss with notes to accounts for the year ended 31-3-2021 as per Schedule III of the Companies Act, 2013. Ignore previous years' figures & taxation.

Answer

H Ltd Balance Sheet as at 31st March 2021

Particulars	Note No	Amount in Rs.
Equity and Liabilities		
I. Shareholders' Funds		
a. Share Capital	1	13,00,000
b. Reserves and Surplus	2	53,91,900
II. Non-Current Liabilities		
a. Long Term Borrowings	3	4,00,000
III. Current Liabilities		
a. Trade Payables	4	10,40,000
b. Other Current Liabilities	5	70,000
Total		82,01,900

Assets		
I. Non-Current Assets		
a. Property, Plant and Equipment	6	40,61,000
b. Intangible Assets	7	10,00,000
II. Current Assets		
a. Inventories		9,50,000
b. Trade Receivables		19,60,000
c. Cash and Cash equivalents		2,30,900
Total		82,01,900

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No	Amount in Rs.
I. Revenue from operations		60,00,000
Total Revenue		60,00,000

II. Expenses		
Purchases (adjusted)		22,32,100
Finance Costs	8	36,000
Depreciation and Amortization	9	3,17,000
Other Expenses	10	32,30,000
Total Expenses		58,15,100
III. Profit/(Loss) for the period		1,84,900

Notes to Accounts

1 Share Capital		
a. <u>Authorized Capital</u>		
5,000, 6% Preference shares of Rs.100/- each		5,00,000
10,000 Equity Shares of Rs.100/- each		10,00,000
b. <u>Issued & Subscribed Capital</u>		
5,000, 6% Preference shares of Rs.100/- each		5,00,000
8,000, Equity shares of Rs.100/- each		8,00,000
Total		13,00,000
2 Reserves & Surplus		
Capital Reserve (100 X (90-40))		5,000
Revaluation Reserve (36,00,000-24,00,000)		12,00,000
General Reserve		40,00,000
Surplus	1,84,900	
Add: Balance from previous year	72,000	
Less: Dividends declared	(70,000)	
Profit/(Loss) carried forward to Balance Sheet		1,86,900
Total		53,91,900
3 Long-Term Borrowings		
Secured 9% Debentures		4,00,000
4 Trade Payables		10,40,000
5 Other Current Liabilities		
Dividend Payable		
Preference Dividend	30,000	
Equity Dividend	40,000	
Total		70,000
6 Property, Plant and Equipment		
Land		
Opening balance	24,00,000	
	0	
Add: Revaluation Adjustment	12,00,000	
	0	

	Closing Balance	36,00,000	
	Plant and Machinery		
	Opening Balance	7,70,000	
	Less: Disposed off	(1,00,000)	
	Depreciation	(2,09,000)	
	Closing Balance	4,61,000	
	Total		40,61,000
7	Intangible Assets		
	Goodwill	12,50,000	
	Less: Amortized (1/5th)	(2,50,000)	
	Total		10,00,000
8	Finance Costs		
	Debenture Interest		36,000
9	Depreciation and Amortization		
	Plant and Machinery	67,000	
	Goodwill	2,50,000	
	Total		3,17,000
10	Other Expenses		
	Factory Expenses	15,00,000	
	Selling Expenses	14,00,000	
	Administrative Expenses	3,00,000	
	Loss on sale of Plant and Machinery		
	Book Value		
	(1,00,000-30,000)	70,000	
	Less: Sale Value	(40,000)	
	Total	30,000	32,30,000

Note

- The inventories (31.3.20) amounting Rs.9, 50,000 (given in the trial balance of the question) should have been as closing inventory i.e. as on 31.3.21. In the above solution, this inventory has been considered as closing inventory i.e. for 31.3.21. If this is considered as inventory of 31.3.20, the closing inventory (as on 31.3.21) will not be available for the balance sheet as on 31.3.21 and in that case, the balance sheet will not tally without using suspense account amounting Rs.9,50,000.

2. The financial statements given in the above answer include adjustment for dividend declared on 31st March, 2021, strictly, as per the information given in the question. However, practically dividends are declared in the annual general meetings which take place after the reporting date.

Preparation of Financial Statements

RTP ILLUSTRATIONS

#1.Illustration | Sep 2025 |

Following is the trial balance of ABC Limited as on 31.3.2025.

Particulars	Debit	Particulars	Credit
Land at cost	800	Equity capital (shares of ` 10 each)	500
Calls in arrears	5	10% Debentures	300
Cash in hand	2	General reserve	150
Plant & Machinery at cost	824	Profit & Loss A/c (F.Y. 2023-24)	75
Trade receivables	120	Securities premium	40
Inventories (31-3-25)	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	<u>30</u>		
	2455		2455

Additional Information:

- The authorized share capital of the company is 80,000 shares of ` 10 each.
- The company revalued the land at ` 9,60,000.
- Equity capital includes shares of ` 50,000 issued for consideration other than cash.
- Suspense account of ` 10,000 represents cash received from the sale of some of the machinery on 1.4.2024. The cost of the machinery was ` 24,000 and the accumulated depreciation thereon being ` 20,000.
- Depreciation is to be provided on plant and machinery at 10% on cost.
- Balance at bank includes ` 5,000 with Abhay Bank Ltd., which is not a Scheduled Bank.

You are required to prepare ABC Limited's Balance Sheet as on 31.3.2025 and Statement of Profit and Loss with notes to accounts for the year ended 31.3.2025 as per Schedule III. Ignore previous year's figures & taxation.

Answer:

ABC Limited

Balance Sheet as at 31st March 2025

Particulars	Note No.	(` in '000)

A. Equity and Liabilities		
1. Shareholder's funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	971.00
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		<u>30.00</u>
Total		<u>1,796.00</u>
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	4	1,550.00
2. Current Assets		
(a) Inventories		96.00
(b) Trade Receivables		120.00
(c) Cash and Cash equivalents	5	<u>30.00</u>
Total		<u>1,796.00</u>

ABC Limited

Statement of Profit and Loss for the year ended 31st March 2025

Particulars	Note No.	(` in '000)
I. Revenue from Operations		1200.00
II. Other Income	6	<u>6.00</u>
III. Total Revenue		<u>1,206.00</u>
IV. Expenses:		
Purchases Finance Costs		400.00
Depreciation (10% of 800) Other expenses	7	30.00
Total Expenses		80.00
V. Profit / (Loss) for the period (III – IV)	8	<u>150.00</u>
		<u>660.00</u>
		546.00

Notes to Accounts

	Particulars		(` in '000)
1	Share Capital		
	Equity Share Capital		
	Authorised		
	80,000 Shares of ` 10/- each		<u>800</u>
	Issued, Subscribed and Called-up		
	50,000 Shares of ` 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	<u>(5)</u>	495

2	Reserves and Surplus		
	Securities Premium Account		40
	General Reserve		150
	Profit & Loss Balance		
	Opening Balance	75	
	Add: Profit for the period	<u>546</u>	621
	Revaluation Reserve ` (960 – 800)		<u>160</u>
			<u>971</u>
3	Long-Term Borrowings		
	10% Debentures		300
4	PPE		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	<u>160</u>	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	<u>(24)</u>	
		800	
	Less: Depreciation ` (150 – 20 + 80)	<u>(210)</u>	
	Closing Balance		<u>590</u>
	Total		<u>1,550</u>
5	Cash and Cash Equivalents		
	Cash at Bank		
	With scheduled banks	23	
	With others (Abhay Bank Limited)	5	
	Cash in hand	<u>2</u>	30
6	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less: Book value of machinery (24 – 20)	<u>(4)</u>	6
7	Finance Costs		
	Debenture Interest		30
8	Other Expenses:		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	<u>45</u>	150

#2.Illustration | May 2018 |

Kapil Ltd. has authorized capital of Rs. 50 lakhs divided into 5,00,000 equity shares of Rs. 10 each. Their books show the following balances as on 31st March, 2017:

	Rs.		Rs.
Inventory 1.4.2016	6,65,000	Bank Current Account	20,000
Discounts & Rebates allowed	30,000	Cash in hand	8,000
Carriage Inwards	57,500	Interest (bank overdraft)	1,11,000
Patterns	3,75,000	Calls in Arrear @ Rs. 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of Rs. 10 each)	
Purchases	12,32,500	Bank Overdraft	12,67,000
Wages	13,68,000		
Freehold Land	16,25,000	Trade Payables (for goods)	2,40,500
Plant & Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rent (Cr.)	30,000
Trade Receivables	4,00,500	Transfer fees received	6,500
Advertisement	15,000	Profit & Loss A/c (Cr.)	67,000
Commission & Brokerage	67,500	Repairs to Building	56,500
Business Expenses	56,000	Bad debts	25,500

The inventory (valued at cost or market value, which is lower) as on 31st March, 2017 was

Rs. 7,08,000. Outstanding liabilities for wages Rs. 25,000 and business expenses Rs. 36,000. Dividend declared @ 12% on paid-up capital and it was decided to transfer to reserve @ 2.5% of profits.

Charge depreciation on closing written down amount of Plant & Machinery @ 5%, Engineering Tools @ 20%; Patterns @ 10%; and Furniture & Fixtures @10%. Provide 25,000 as doubtful debts after writing off Rs.16,000 as bad debts. Provide for income tax @ 30%. Corporate Dividend Tax Rate @ 17.304 (wherein Base Rate is 15%).

You are required to **prepare Statement of Profit & Loss for the year ended 31st March, 2017 and Balance Sheet as on that date.**

Answer

Kapil Ltd.

Balance Sheet

as at 31st March, 2017

		Particulars	Note No.	(Rs.)
I		Equity and Liabilities		
	(1)	Shareholders' Funds		
	(a)	Share Capital	1	19,90,000
	(b)	Reserves and Surplus	2	59,586
	(2)	Current Liabilities		
	(a)	Trade Payables		2,40,500
	(b)	Other Current Liabilities	3	13,28,000
	(c)	Short-Term Provisions	4	<u>4,07,414</u>
		Total ASSETS		<u>40,25,500</u>
II	(1)	Non-Current Assets		
	(a)	Fixed Assets		
	(i)	Tangible Assets		29,30,000
	(2)	Current Assets	5	
	(a)	Inventories		7,08,000
	(b)	Trade Receivables		3,59,500
	(c)	Cash and Cash Equivalents	6	<u>28,000</u>
		Total	7	<u>40,25,500</u>

Kapil Ltd.

Statement of Profit and Loss for the year ended 31st March, 2017

	Particulars	Note No.	(Rs.)
I	Revenue from Operations		36,17,000
II	Other Income	8	<u>36,500</u>
III	Total Revenue [I + II]		<u>36,53,500</u>
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,08,000]		(43,000)
	Employee Benefits Expenses	9	13,93,000
	Finance Costs	10	1,11,000
	Depreciation and Amortization Expenses		1,20,000

	Other Expenses	11	<u>4,40,000</u>
	Total Expenses		<u>32,53,500</u>
V	Profit before Tax (III-IV)		4,00,000
VI	Tax Expenses @ 30%		<u>(1,20,000)</u>
VII	Profit for the period		<u>2,80,000</u>

Notes to Accounts:

1. Share Capital

Authorized Capital	
5,00,000 Equity Shares of Rs. 10 each	<u>50,00,000</u>
Issued Capital	
2,00,000 Equity Shares of Rs. 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of Rs.10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of Rs.10 each Rs. 8 paid	<u>40,000</u>
(Call unpaid Rs.10,000)	<u>19,90,000</u>

2. Reserves and Surplus

General Reserve		7,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	2,80,000	
Less: Transfer to Reserve @ 2.5%	(7,000)	
Less: Equity Dividend [12% of (20,00,000-10,000)]	(2,38,800)	
Less: Corporate Dividend Tax (Working note)	<u>(48,614)</u>	<u>52,586</u>
		<u>59,586</u>

3. Other Current Liabilities

Bank Overdraft	12,67,000
Outstanding Expenses [25,000+36,000]	<u>61,000</u>
	<u>13,28,000</u>

4. Short-term Provisions

Provision for Tax	1,20,000
Equity Dividend payable	2,38,800
Corporate Dividend Tax	<u>48,614</u>
	<u>4,07,414</u>

5. Tangible Assets

Particulars	Value given (Rs.)	Depreciation rate	Depreciation Charged (Rs.)	Written down value at the end (Rs.)
Land	16,25,000		-	16,25,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Patterns	3,75,000	10%	37,500	3,37,500
Engineering Tools	<u>1,50,000</u>	20%	<u>30,000</u>	<u>1,20,000</u>
	<u>30,50,000</u>		<u>1,20,000</u>	<u>29,30,000</u>

6. Trade Receivables

Trade receivables (4,00,500-16,000)	3,84,500
Less: Provision for doubtful debts	<u>(25,000)</u>
	<u>3,59,500</u>

7. Cash & Cash Equivalent

Cash Balance	8,000
Bank Balance in current A/c	<u>20,000</u>
	<u>28,000</u>

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	<u>30,000</u>
	<u>36,500</u>

9. Employee benefits expenses

Wages	13,68,000
Add: Outstanding wages	<u>25,000</u>
	<u>13,93,000</u>

10. Finance Cost

Interest on overdraft	1,11,000

11. Other Expenses

Carriage Inward	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,000] (Business Expenses)	92,000
Bad Debts [25,500+16,000]	41,500
Provision for Doubtful Debts	25,000
	<u>4,40,000</u>

Working Note

Calculation of grossing-up of dividend:

Particulars	Rs.
Dividend distributed by Company	2,38,800
Add: Increase for the purpose of grossing up of dividend	<u>42,141</u>
$2,38,800 \times [15/(100-15)]$	
Gross dividend	2,80,941
Dividend distribution tax @ 17.304%	48,614

#3.Illustration | May 2018 |

A company provides you the following information:

- (i) Total sales for the year were Rs. 398 crores out of which cash sales amounted to Rs. 262 crores.
- (ii) Receipts from credit customers during the year, aggregated Rs. 134 crores.
- (iii) Purchases for the year amounted to Rs. 220 crores out of which credit purchase was 80%.

Balance in creditors as on

1.4.2016 Rs. 84 crores

31.3.2017 Rs. 92 crores

(iv) Suppliers of other consumables and services were paid Rs. 19 crores in cash.

(v) Employees of the enterprises were paid 20 crores in cash.

- (vi) Fully paid preference shares of the face value of Rs. 32 crores were redeemed. Equity shares of the face value of Rs. 20 crores were allotted as fully paid up at premium of 20%.
- (vii) Debentures of Rs. 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.
- (viii) Rs. 26 crores were paid by way of income tax.
- (ix) A new machinery costing Rs. 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was Rs. 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of Rs. 15 crores. The balance was paid in cash to the vendor.
- (x) Investment costing Rs. 18 crores were sold at a loss of Rs. 2 crores.
- (xi) Dividends amounting Rs. 15 crores (including dividend distribution tax of Rs. 2.7 crores) was also paid.
- (xii) Debenture interest amounting Rs. 2 crores was paid.
- (xiii) On 31st March 2016, Balance with Bank and Cash on hand was Rs. 2 crores.

On the basis of the above information, you are required to **prepare a Cash Flow Statement** for the year ended 31st March, 2017 (Using direct method).

Answer

Cash flow statement (using direct method) for the year ended 31 st March, 2017

	(Rs. in crores)	(Rs. in crores)
Cash flow from operating activities		
Cash sales	262	
Cash collected from credit customers	134	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(251)	
Cash from operations	145	
Less: Income tax paid	(26)	
Net cash generated from operating activities		119
Cash flow from investing activities		
Net Payment for purchase of Machine (25 – 15)	(10)	
Proceeds from sale of investments	16	
Net cash used in investing activities		6
Cash flow from financing activities		
Redemption of Preference shares	(32)	

Proceeds from issue of Equity shares	24	
Debenture interest paid	(2)	
Dividend Paid	(15)	
Net cash used in financing activities		(25)
Net increase in cash and cash equivalents		100
Add: Cash and cash equivalents as on 1.04.2016		<u>2</u>
Cash and cash equivalents as on 31.3.2017		<u>102</u>

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(Rs. in crores)
Opening Balance in creditors Account	84
Add: Purchases (220x .8)	<u>176</u>
Total	260
Less: Closing balance in Creditors Account	<u>92</u>
Cash paid to suppliers of goods	168
Add: Cash purchases (220x .2)	<u>44</u>
Total cash paid for purchases to suppliers (a)	212
Add: Cash paid to suppliers of other consumables and services (b)	19
Add: Payment to employees (c)	<u>20</u>
Total cash paid to suppliers of goods & services and to employees	<u>251</u>
[(a)+ (b) + (c)]	

#4.Illustration | Nov 2018 |

You are required to prepare a Balance Sheet as at 31st March 2018, as per Schedule III of the Companies Act, 2013, from the following information of Mehar Ltd:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Term Loans (Secured)	40,00,000	Investments (Non- current)	9,00,000
Trade payables	45,80,000	Profit for the year	32,00,000
Other advances	14,88,000	Trade receivables	49,00,000
Cash and Bank Balances	38,40,000	Miscellaneous Expenses	2,32,000

Staff Advances	2,20,000	Loan from other parties	8,00,000
Provision for Taxation	10,20,000	Provision for Doubtful Debts	80,000
Securities Premium	19,00,000		
Loose Tools	2,00,000	Stores	16,00,000
General Reserve	62,00,000	Fixed Assets (WDV)	2,26,00,000
Capital Work-in- progress	8,00,000	Finished Goods	30,00,000

Additional Information:-

- Share Capital consist of-
 - 1,20,000 Equity Shares of Rs. 100 each fully paid up.
 - 40,000, 10% Redeemable Preference Shares of Rs. 100 each fully paid up.
- The company declared dividend @ 5% of equity share capital. The dividend distribution tax rate is 17.304%. (15% CDT, surcharge 12%, Education Cess 2% and SHEC @ 1%)
- Depreciate Assets by Rs. 20,00,000.

Answer

Balance Sheet of Mehar Ltd. as at 31st March, 2018

		Note	Rs.
I	EQUITY AND LIABILITIES:		
(1)	(a) Share Capital	1	1,60,00,000
	(b) Reserves and Surplus	2	98,64,424
(2)	Non-current Liabilities		
	Long term Borrowings- Terms Loans (Secured)		40,00,000
(3)	Current Liabilities		
	(a) Trade Payables	-	45,80,000
	(b) Other current liabilities	3	20,03,576
	(c) Short-term Provisions (Provision for taxation)		10,20,000
	Total ASSETS		3,74,68,000
II	Non-current Assets		
(1)	(a) Fixed Assets:		
	(i) Tangible Assets	4	2,06,00,000
	(ii) Capital WIP		8,00,000

(b) Non- current Investments		9,00,000
(2) Current Assets:		
(a) Inventories	5	48,00,000
(b) Trade Receivables	6	48,20,000
(c) Cash and Cash Equivalents		38,40,000
(d) Short-term Loans and Advances	7	<u>17,08,000</u>
Total		3,74,68,000

Notes to accounts

			(Rs.)
1.	Share Capital		
	Authorized, issued, subscribed & called up 1,20,000, Equity Shares of Rs. 100 each	1,20,00,000	
	40,000 10% Redeemable Preference Shares of 100 each	<u>40,00,000</u>	<u>1,60,00,000</u>
2.	Reserves and Surplus		
	Securities Premium Account	19,00,000	
	General reserve	62,00,000	
	Profit & Loss Balance		
	Opening balance		
	Profit for the period 32,00,000		
	Less: Miscellaneous Expenditure written off <u>(2,32,000)</u>		
	29,68,000		
	Less: Appropriations		
	Dividend (10,00,000)		
	Dividend distribution tax <u>(2,03,576)</u>	<u>17,64,424</u>	<u>98,64,424</u>
3.	Other current liabilities		
	Loan from other parties	8,00,000	
	Dividend Distribution tax [W.N]	10,00,000	

	Dividend	<u>2,03,576</u>	20,03,576
4.	Tangible assets		
	Fixed Assets		
	Opening balance	2,26,00,000	
	Less: Depreciation Closing balance	<u>(20,00,000)</u>	
	Inventories		2,06,00,000
5.	Finished Goods Stores	30,00,000	
	Loose Tools	16,00,000	
		<u>2,00,000</u>	
			<u>48,00,000</u>
6.	Trade Receivables		
	Less: Provision for Doubtful Debts Short term loans & Advances Staff Advances	49,00,000	
		<u>(80,000)</u>	
			48,20,000
7.	Other Advances		
		2,20,000	
		<u>14,88,000</u>	
			17,08,000

Working Note:

Calculation of Dividend distribution tax

Grossing-up of dividend:

	Rs.
Dividend distributed by Mehar Ltd.	
Equity shares dividend 6,00,000	
Preference share dividend <u>4,00,000</u>	10,00,000
Add: Increase for the purpose of grossing up of dividend	
10,00,000 x [15 / (100-15)]	<u>1,76,470</u>
Gross dividend	<u>11,76,470</u>

#5.Illustration | Nov 2018 |

PQ Ltd., a non-investment company has been incurring losses for the past few years. The company provides the following information for the current year:

	(Rs. in lakhs)
Paid up equity share capital	180
Paid up preference share capital	30
Reserves (including Revaluation reserve Rs. 15 lakhs)	225
Securities premium	60
Long term loans	60
Deposits repayable after one year	30
Application money pending allotment	1080
Accumulated losses not written off	30
Investments	270

PQ Ltd. has only one whole-time director, Mr. Hello. You are required to calculate the amount of maximum remuneration that can be paid to him as per provisions of Companies Act, 2013, if no special resolution is passed at the general meeting of the company in respect of payment of remuneration for a period not exceeding three years.

Answer**Calculation of effective capital and maximum amount of monthly remuneration**

	(Rs. in lakhs)
Paid up equity share capital	180
Paid up Preference share capital	30
Reserve excluding Revaluation reserve (225-15)	210
Securities premium	60
Long term loans	60
Deposits repayable after one year	30
	570
Less: Accumulated losses not written off	(30)
Investments	(270)
Effective capital for the purpose of managerial remuneration	270

Since PQ Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration, managerial remuneration will be calculated on the basis of effective capital of the company, therefore maximum remuneration payable to the Managing Director should be @ Rs. 60,00,000 per annum*.

*If the effective capital is less than 5 Crore, limit of yearly remuneration payable should not exceed Rs. 60 lakhs as per Companies Act, 2013.

#6.Illustration | Nov 2018 |

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 were summarised as follows:

	2018 (Rs.)	2017 (Rs.)
Equity share capital	1,20,000	1,00,000
Reserves:		
Profit and Loss Account	9,000	8,000
Current Liabilities:		
Trade Payables	8,000	5,000
Income tax payable	3,000	2,000
Declared Dividends	4,000	2,000
	1,44,000	1,17,000
Fixed Assets (at W.D.V) :		
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	25,000	16,000
Long Term Investments	32,000	28,000
Current Assets:		
Inventory	14,000	8,000
Trade Receivables	8,000	6,000
Cash & Bank	12,000	17,000
	1,44,000	1,17,000

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

	Rs.
Profit before tax	8,000
Income Tax	(3,000)

Profit after tax	5,000
Declared Dividends	<u>(4,000)</u>
Retained Profit	1,000

Further Information is available:

1. Depreciation on Building Rs. 1,000.
2. Depreciation on Furniture & Fixtures for the year Rs. 2,000.
3. Depreciation on Cars for the year Rs. 5,000. One car was disposed during the year for Rs. 3,400 whose written down value was Rs. 2,000.
4. Purchase investments for Rs. 6,000.
5. Sold investments for Rs. 10,000, these investments cost Rs. 2,000.

You are required to prepare Cash Flow Statement as per AS-3 (revised) using indirect method.

Answer

Harry Ltd.

Cash Flow Statement

for the year ended 31st March, 2018

	Rs.	Rs.
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation (1,000 + 2,000 + 5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	<u>(1,400)</u>	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	<u>3,000</u>	
Cash generated from operations	1,600	
Income taxes paid	<u>(2,000)</u>	
<i>Net cash generated from operating activities (A)</i>		(400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	(16,000)	

Sale of Investment	10,000	
Purchase of Investment	(6,000)	
Purchase of Furniture & fixtures	(14,000)	
<i>Net cash used in investing activities (B)</i>		(22,600)
Cash flows from financing activities		
Issue of shares for cash	20,000	
Dividends paid*	(2,000)	
<i>Net cash from financing activities(C)</i>		<u>18,000</u>
Net decrease in cash and cash equivalents (A + B + C)		(5,000)
Cash and cash equivalents at beginning of period		<u>17,000</u>
Cash and cash equivalents at end of period		12,000

* Dividend declared for the year ended 31st March, 2017 amounting Rs. 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

Working Notes:

1. Calculation of Income taxes paid

	Rs.
Income tax expense for the year	3,000
Add: Income tax liability at the beginning of the year	2,000
	5,000
Less: Income tax liability at the end of the year	(3,000)
	<u>2,000</u>

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (Rs.)	Car (Rs.)
W.D.V. at 31.3.2018	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	<u>—</u>	<u>2,000</u>
	36,000	32,000
Less: W.D.V. at 31. 3. 2017	(22,000)	(16,000)
Acquisitions during 2016-2018	<u>14,000</u>	<u>16,000</u>

#7.Illustration | May 2019 |

The following balance appeared in the books of Oliva Company Ltd. as on 31-03-2019

Particulars		Rs.	Particulars		Rs.
Inventory 01-04-2018			Sales		17,10,000
Raw Material	30,000		Interest		3,900
Finished goods	<u>46,500</u>	76,500	Profit and Loss A/c		48,000
Purchases		12,15,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans:		
			Short-term Long-term	4,500	
Salaries and wages		40,200	Fixed Deposits (unsecured):	<u>21,000</u>	25,500
			Short -term	1,500	
General Charges			Long - term	<u>3,300</u>	4,800
Interim Dividend paid (inclusive of Dividend Distribution Tax)		16,500	Trade payables		3,27,000
Building		27,000			
Plant and Machinery		1,01,000			
Furniture		70,400			
Motor Vehicles		10,200			
Stores and Spare		40,800			
Parts Consumed		45,000			
Investments:					
Current	4,500				
Non-Current	<u>7,500</u>	12,000			
Trade receivables		2,38,500			
Cash in Bank		<u>2,71,100</u>			
		<u>24,34,200</u>			<u>24,34,200</u>

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 2019 and Company's Balance Sheet as on that date:

1. Inventory on 31st March,2019 Raw material Rs. 25,800 & finished goods Rs. 60,000.
2. Outstanding Expenses: Manufacturing Expenses Rs. 67,500 & Salaries & Wages Rs. 4,500.
3. Interest accrued on Securities Rs. 300.

4. General Charges prepaid Rs. 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 Rs. 1,000.
7. The Taxation provision of 40% on net profit is considered.

Answer

Oliva Company Ltd.

Statement of Profit and loss for the year ended 31.03.2019

(Rs.)

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		4,200
III	Total Revenue (I +II)		<u>17,14,200</u>
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	<u>3,51,510</u>
	Total Expenses		<u>16,65,150</u>
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Olive Company Ltd Balance Sheet for the year ended 31.03.2019

	Particulars		Note	Amount
	Equity and Liabilities			
(1)	(i) Shareholders' funds			
	(a) Share Capital			3,15,000
	(b) Reserves and surplus	1		50,430
(2)	Non-current liabilities			
	(a) Long-term borrowings	2		23,300
(3)	Current Liabilities			
	(a) Short -term borrowings	3		6,000
	(b) Trade payables			3,27,000
	(c) Other current liability	4		73,000
	(d) Short term provision	5		<u>19,620</u>
				<u>8,14,350</u>
	ASSETS			
(1)	Non current assets			
	(a) Property, Plant & equipment			
	(i) Tangible assets	6		2,04,160
	(b) Non-current investments			7,500
(2)	Current assets			
	(a) Current investments			4,500
	(b) Inventories	7		85,800
	(c) Trade receivables			2,38,500
	(d) Cash and cash equivalents			2,71,100
	(e) Short-term loans and advances	8		2,490
	(f) Other current assets	9		<u>300</u>
				<u>8,14,350</u>

Notes to accounts

No	Particulars		Amount	Amount
1.	Reserve & Surplus			
	Profit & Loss Account: Balance b/f		48,000	
	Net Profit for the year		29,430	

	Less: Interim Dividend including DDT		(27,000)	50,430
2.	Long term borrowings			
	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 long term borrowings		<u>1,000</u>	73,000
5.	Short term provisions			
	Provision for Income tax			19,620
6.	Tangible Assets			
	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>	<u>32,640</u>	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)	12,90,000	
	Less: Closing inventory		(25,800)	12,64,200
11.	Changes in inventory of Finished Goods & WIP			
12.	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		46,500	13,500
13.	Employee Benefit expenses			
	Salary & Wages (40,200 + 4,500)			44,700
	Other Expenses:			
	Manufacturing Expenses (2,70,000 + 67,500)		3,37,500	
	General Charges (16,500 – 2,490)		14,010	3,51,510

#8.Illustration | May 2019 |

The following extract of Balance Sheet of X Ltd. (a non-investment company) was obtained:

Balance Sheet (Extract) as on 31st March, 2019

Liabilities	Rs.
<u>Authorized capital:</u>	
15,000, 14% preference shares of Rs. 100	15,00,000
1,50,000 Equity shares of Rs. 100 each	1,50,00,000
	1,65,00,000
<u>Issued and subscribed capital:</u>	
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
Capital reserves (Rs. 1,50,000 is revaluation reserve)	1,95,000
Securities premium	50,000
15% Debentures	65,00,000
Investment in shares, debentures, etc.	75,00,000
Profit and Loss account (debit balance)	15,25,000

You are required to compute Effective Capital as per the provisions of Schedule V to the Companies Act, 2013.

Answer

Computation of Effective Capital

	Rs.
Paid-up share capital-	
15,000, 14% Preference shares	15,00,000
1,20,000 Equity shares	96,00,000
Capital reserves (excluding revaluation reserve)	45,000
Securities premium	50,000
15% Debentures	<u>65,00,000</u>
(A)	<u>1,76,95,000</u>
Investments	75,00,000
Profit and Loss account (Dr. balance)	<u>15,25,000</u>
(B)	<u>90,25,000</u>
Effective capital (A-B)	<u>86,70,000</u>

#9.Illustration | May 2019 |

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2019.

Balance Sheets

	Particulars	Note	31.03.2019 (Rs.)	31.03.2018 (Rs.)
I	EQUITY AND LIABILITIES			
	(1) Shareholder's Funds	1	3,50,000	3,00,000
	(a) Share Capital	2	82,000	38,000
	(b) Reserves and Surplus			
	(2) Non-Current Liabilities		65,000	44,000
	(3) Current Liabilities	3	37,000	27,000
	(a) Trade Payables			
	(b) Other Current Liabilities			
	(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 Assets (Goodwill)		47,000	60,000
Non-Current Investments		35,000	10,000
(2) Current Assets		78,000	85,000
(a) Inventories		1,08,000	75,000
(b) Trade Receivables		<u>32,000</u>	<u>17,000</u>
(c) Cash & Cash Equivalents		<u>5,66,000</u>	<u>4,37,000</u>
Total			

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.

Answer

Cash flow Statement for the year ending 31st March, 2019

	Particulars	Rs.	Rs.
1	Cash Flow from Operating Activities		
A.	Closing balance as per Profit and Loss Account		27,000
	<i>Less:</i> Opening balance as per Profit and Loss Account		(18,000)
	<i>Add:</i> Dividend declared during the year		37,000
	<i>Add:</i> Interim dividend paid during the year		10,000
	<i>Add:</i> Transfer to reserve		10,000
	<i>Add:</i> Provision for Tax		<u>32,000</u>
B.	Net profit before taxation, and extra-ordinary item		98,000
C.	<i>Add:</i> Items to be added		
	Depreciation	18,000	
	Loss on sale of Plant	3,000	
	Goodwill written off	<u>13,000</u>	34,000
D.	<i>Less:</i> Dividend Income		<u>(1,500)</u>
E.	Operating profit before working capital changes [B + C - D]		1,30,500
F.	<i>Add:</i> Decrease in Current Assets and Increase in Current Liabilities		
	Decrease in Inventories	7,000	
	Increase in Trade Payables	<u>21,000</u>	28,000
G.	<i>Less:</i> Increase in Trade Receivables		<u>(33,000)</u>
H.	Cash generated from operations (E+F-G)		1,25,500

I.	Less: Income taxes paid	(28,000)
	Net Cash from (used in) operating activities	<u>97,500</u>
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	<u>2,100</u>
	Net cash used in investing activities	<u>(95,500)</u>
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	<u>(27,000)</u>
	Net cash from financing activities	<u>13,000</u>
IV.	Net increase in cash and cash equivalents (I+II+III)	15,000
V.	Cash and cash equivalents at beginning of period	<u>17,000</u>
VI.	Cash and cash equivalents at end of period (IV+V)	<u>32,000</u>

1. Land and Building Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,00,000	By Bank A/c (Sale)	50,000
To Capital Reserve A/c (Profit on sale/revaluation)	25,000	By Balance c/d	75,000
	1,25,000		1,25,000

2. Plant and Machinery Account

Particulars	Rs.	Particulars	Rs.
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	3,000

		(Loss on sale)	
		By Balance c/d	1,91,000
	2,24,000		2,24,000

3. Investments Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	10,000	By Bank A/c (Div. received)	600
To bank A/c (Purchase)	<u>25,600</u>	By Balance c/d	<u>35,000</u>
	35,600		35,600

#10. Illustration | Nov 2019 |

On 31st March 2019, Gaurav Ltd. provides you the following particulars:

Particulars		Debit Rs.	Credit Rs.
Equity Share Capital (Face value of Rs. 100 each)			12,50,000
Call in Arrears		1,250	
Land & Building		6,87,500	
Plant & Machinery		6,56,250	
Furniture		62,500	
General Reserve			2,62,500
Loan from State Financial Corporation			1,87,500
Stock:			
Raw Materials	62,500		
Finished Goods	<u>2,50,000</u>	3,12,500	
Provision for Taxation			1,60,000
Trade receivables		2,50,000	
Advances		53,375	
Profit & Loss Account			1,08,375
Cash in Hand		37,500	
Cash at Bank		3,08,750	
Unsecured Loan			1,51,250
Trade payables			2,50,000

The following additional information is also provided:

- (i) 2,500 Equity shares were issued for consideration other than cash.
- (ii) Debtors of Rs. 65,000 (included in trade receivables) are due for more than 6 months.
- (iii) The cost of the Assets were:
- Building Rs. 7,50,000,
- Plant & Machinery Rs. 8,75,000
- Furniture Rs. 78,125
- (iv) The balance of Rs. 1,87,500 in the Loan Account with State Finance Corporation is inclusive of Rs. 9,375 for Interest accrued but not due. The loan is secured by hypothecation of Plant & Machinery.
- (v) Balance at Bank includes Rs. 2,500 with Global Bank Ltd., which is not a Scheduled Bank.

You are required to prepare the Balance sheet of Gaurav Ltd. as on 31 st March, 2019 as per Schedule III to the Companies Act, 2013.

Answer

Gaurav Ltd.

Balance Sheet as on 31st March, 2019

Particulars Notes		Rs.
Equity and Liabilities		
1 Shareholders' funds		
Share capital	1	12,48,750
2 Reserves and Surplus	2	3,70,875
Non-current liabilities		
Long-term borrowings	3	3,29,375
Current liabilities		
Trade Payables	4	2,50,000
Other current liabilities	5	9,375
Short-term provisions		1,60,000
Total		23,68,375
Assets		
Non-current assets		
1 PPE	6	4,06,250
Current assets		
2 Inventories	7	3,12,500
Trade receivables		2,50,000
		3,46,250

Cash and cash equivalents	8	53,375
Short-term loans and advances	9	23,68,375
Total		

Notes to accounts

	Rs.
1 Share Capital	
Equity share capital	
Issued & subscribed & called up	
12,500 Equity Shares of Rs. 100 each	
(of the above 2,500 shares have been issued for consideration other than cash)	
	12,50,000
Less: Calls in arrears	(1,250)
	12,48,750
Total	12,48,750
2 Reserves and Surplus	
General Reserve	2,62,500
Surplus (Profit & Loss A/c)	1,08,375
Total	3,70,875
3 Long-term borrowings	
Secured Term Loan	
State Financial Corporation Loan (1,87,500 – 9,375) (Secured by hypothecation of Plant and Machinery)	
Unsecured Loan	1,78,125
Total	1,51,250
4 Other current liabilities	3,29,375
Interest accrued but not due on loans (SFC)	9,375
5 Short-term provisions	
Provision for taxation	1,60,000
6 PPE	
Land and Building	7,50,000

Less: Depreciation	(62,500)	6,87,500
Plant & Machinery	8,75,000	
Less: Depreciation	(2,18,750)	
Furniture & Fittings	78,125	6,56,250
Less: Depreciation	(15,625)	62,500
Total		14,06,250
7 Inventories		
Raw Materials		62,500
Finished goods		2,50,000
Total		3,12,500
8 Trade receivables		
Outstanding for a period exceeding six months		65,000
Other Amounts		1,85,000
Total		2,50,000
9 Cash and cash equivalents		
Cash at bank		
with Scheduled Banks	3,06,250	
with others (Global Bank Ltd.)	2,500	3,08,750
Cash in hand		37,500
Total		3,46,250

#11. Illustration | Nov 2019 |

The following is the Draft Profit & Loss A/c of Harsha Ltd., the year ended 31st March, 20X1:

		Rs.			Rs.
To	Administrative, Selling and distribution expenses	41,12,710	By	Balance b/d	28,61,750
"	Directors fees	6,73,900		Balance from Trading A/c	201,26,825
"	Interest on debentures	1,56,200		Subsidies received from Govt.	13,69,625
"	Managerial remuneration	14,26,750			
"	Depreciation on fixed assets	26,12,715			

"	Provision for Taxation	62,12,500		
"	General Reserve	20,00,000		
"	Investment Revaluation Reserve	62,500		
"	Balance c/d	71,00,925		
		243,58,200		243,58,200

Depreciation on fixed assets as per Schedule II of the Companies Act, 2013 was

Rs. 28,76,725. You are required to calculate the maximum limits of the managerial remuneration as per Companies Act, 2013.

Answer

Calculation of net profit u/s 198 of the Companies Act, 2013

	Rs.	Rs.
Balance from Trading A/c		201,26,825
Add: Subsidies received from Government		<u>13,69,625</u>
		214,96,450
Less: Administrative, selling and distribution expenses	41,12,710	
Director's fees	6,73,900	
Interest on debentures	1,56,200	
Depreciation on fixed assets as per Schedule II Profit u/s 198	<u>28,76,725</u>	<u>(78,19,535)</u>
		136,76,915

Maximum Managerial remuneration under Companies Act, 2013 = 11% of

Rs. 136,76,915 = Rs. 15,04,461.

#12. Illustration | Nov 2019 |

The following figures have been extracted from the books of X Limited for the year ended on 31.3.2019. You are required to prepare a cash flow statement as per AS 3 using indirect method.

- Net profit before taking into account income tax and income from law suits but after taking into account the following items was Rs. 20 lakhs:
 - Depreciation on Property, Plant & Equipment Rs. 5 lakhs.
 - Discount on issue of Debentures written off Rs. 30,000.
 - Interest on Debentures paid Rs. 3,50,000.
 - Book value of investments Rs. 3 lakhs (Sale of Investments for Rs. 3,20,000).
 - Interest received on investments Rs. 60,000.

- (f) Compensation received Rs. 90,000 by the company in a suit filed.
- (ii) Income tax paid during the year Rs. 10,50,000.
- (iii) 15,000, 10% preference shares of Rs. 100 each were redeemed on 31.3.2019 at a premium of 5%. Further the company issued 50,000 equity shares of Rs. 10 each at a premium of 20% on 2.4.2018. Dividend on preference shares were paid at the time of redemption.
- (iv) Dividend paid for the year 2017-2018 Rs. 5 lakhs and interim dividend paid Rs. 3 lakhs for the year 2018-2019.
- (v) Land was purchased on 2 4.2018 for Rs. 2,40,000 for which the company issued 20,000 equity shares of Rs. 10 each at a premium of 20% to the land owner as consideration.
- (vi) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 31.3.2018	As on 31.3.2019
	Rs.	Rs.
Inventory	12,00,000	13,18,000
Trade receivables	2,58,000	2,53,100
Cash in hand	1,96,300	35,300
Trade payables	2,11,000	2,11,300
Outstanding expenses	75,000	81,800

Answer

X Ltd.

Cash Flow Statement

for the year ended 31st March, 2019

	Rs.	Rs.
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items: Adjustments for:		20,00,000
Depreciation on PPE	5,00,000	
Discount on issue of debentures	30,000	
Interest on debentures paid	3,50,000	
Interest on investments received	(60,000)	
Profit on sale of investments	<u>(20,000)</u>	<u>8,00,000</u>

Operating profit before working capital changes		28,00,000
Adjustments for:		
Increase in inventory	(1,18,000)	
Decrease in trade receivable	4,900	
Increase in trade payables	300	
Increase in outstanding expenses	<u>6,800</u>	<u>(1,06,000)</u>
Cash generated from operations		26,94,000
Income tax paid		<u>(10,50,000)</u>
		16,44,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		<u>90,000</u>
Net cash flow from operating activities		17,34,000
Cash flow from Investing Activities		
Sale proceeds of investments	3,20,000	
Interest received on investments	<u>60,000</u>	
Net cash flow from investing activities		3,80,000
Cash flow from Financing Activities		
Proceeds by issue of equity shares at 20% premium	6,00,000	
Redemption of preference shares at 5% premium	(15,75,000)	
Preference dividend paid	(1,50,000)	
Interest on debentures paid	(3,50,000)	
Dividend paid (5,00,000 + 3,00,000)	<u>(8,00,000)</u>	
Net cash used in financing activities		<u>(22,75,000)</u>
Net decrease in cash and cash equivalents during the year		(1,61,000)
Add: Cash and cash equivalents as on 31.3.2018		<u>1,96,300</u>
Cash and cash equivalents as on 31.3.2019		<u>35,300</u>

Note: Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

#13. Illustration | May 2020 |

On 31st March, 2020, Om Ltd. provides to you the following ledger balances after preparing its Profit and Loss Account for the year ended 31st March, 2020:

Credit Balances

	Rs.
Equity shares capital (fully paid shares of Rs. 10 each)	1,05,00,000
General Reserve	21,84,000
Loan from State Finance Corporation (Secured by hypothecation of Plant & Machinery – Repayable within one year Rs. 3,00,000)	15,75,000
Loans: Unsecured (Long term)	12,70,500
Sundry Creditors for goods & expenses (Payable within 6 months)	21,00,000
Profit & Loss Account	10,50,000
Provision for Taxation	12,25,350
	199,04,850

Debit Balances :

	Rs.
Calls in arrear	10,500
Land	21,00,000
Buildings	30,75,000
Plant and Machinery	55,12,500
Furniture & Fixture	5,25,000
Inventories : Finished goods	21,00,000
Raw Materials	5,25,000
Trade Receivables	21,00,000
Advances: Short-term	4,48,350
Cash in hand	3,15,000
Balances with banks	25,93,500
Patents & Trade marks	6,00,000
	199,04,850

The following additional information is also provided in respect of the above balances:

(i) 6,30,000 fully paid equity shares were allotted as consideration for land & buildings.

(ii) Cost of Building Rs. 42,00,000

Cost of Plant & Machinery Rs. 73,50,000

Cost of Furniture & Fixture Rs. 6,56,250

- (iii) Trade receivables for Rs. 5,70,000 are due for more than 6 months.
- (iv) The amount of Balances with Bank includes Rs. 27,000 with a bank which is not a scheduled Bank and the deposits of Rs. 7,50,000 are for a period of 9 months.
- (v) Unsecured loan includes Rs. 3,00,000 from a Bank and Rs. 1,50,000 from related parties.

You are not required to give previous year figures. You are required to prepare the Balance Sheet of the Company as on 31st March, 2020 as required under Schedule III of the Companies Act, 2013.

Answer

Om Ltd.

Balance Sheet as on 31st March, 2020

Particulars	Notes	Figures at the end of current reporting period (Rs.)
Equity and Liabilities		
Shareholders' funds		
a Share capital	1	1,04,89,500
b Reserves and Surplus	2	32,34,000
Non-current liabilities		
a Long-term borrowings	3	25,45,500
Current liabilities		
a Trade Payables		21,00,000
b Other current liabilities	4	3,00,000
c Short-term provisions	5	12,25,350
Total		1,98,94,350
Assets		
1 Non-current assets		
a Property, Plant and Equipment	6	1,12,12,500
b Intangible assets (Patents & Trade Marks)		6,00,000
2 Current assets		
a Inventories	7	26,25,000
b Trade receivables	8	21,00,000
		29,08,500

c	Cash and cash equivalents	9	4,48,350
d	Short-term loans and advances Total		1,98,94,350

Notes to accounts

			Rs.
1	Share Capital		
	Equity share capital		
	Issued, subscribed and called up		
	10,50,000 Equity Shares of Rs. 10 each (Out of the above 6,30,000 shares	1,05,00,000	
	have been issued for consideration other than cash)		
	Less: Calls in arrears	(10,500)	
			1,04,89,500
	2. Reserves and Surplus		
	General Reserve		21,84,000
	Surplus (Profit & Loss A/c)		10,50,000
			32,34,000
	3. Long-term borrowings		
	Secured Term Loans		
	Loan from State Finance Corporation (Rs. 15,75,000 lessRs. 3,00,000)		
	(Secured by hypothecation of Plant		
	and Machinery) Unsecured		
	Bank Loan		12,75,000
	Loan from related parties Others	3,00,000	
	Total	1,50,000	12,70,500
	4. Other current liabilities	8,20,500	
	Loan Instalment repayable within one year		25,45,500
	5. Short-term provisions		
	Provision for taxation		3,00,000
	6. Property, Plant and Equipment		
	Land Buildings		12,25,350
	Less: Depreciation		21,00,000
		42,00,000	

	Plant & Machinery	(11,25,000)	
	Less: Depreciation	73,50,000	30,75,000
	Furniture & Fittings	(18,37,500)	
	Less: Depreciation	6,56,250	55,12,500
	Total	(1,31,250)	
	7. Inventories		5,25,000
	Raw Material		1,12,12,500
	Finished goods		5,25,000
			21,00,000
			<u>26,25,000</u>
8	Trade receivables		
	Debts outstanding for a period exceeding six months		5,70,000
	Other Debts		15,30,000
	Total		21,00,000
9	Cash and cash equivalents		
	Cash at bank with Scheduled Banks including Bank deposits for period of 9 months amounting Rs. 7,50,000	25,66,500	
	with others	<u>27,000</u>	25,93,500
	Cash in hand		3,15,000
	Total		<u>29,08,500</u>

#14. Illustration | May 2020 |

Kartik Ltd. is a non-investment company and has been incurring losses for the past few years. The company provides the following information for the current year:

	(Rs. in lakhs)
Paid up equity share capital	270
Paid up Preference share capital	45
Reserves (including Revaluation reserve Rs. 22.5 lakhs)	337.5
Securities premium	90

Long term loans	90
Deposits repayable after one year	45
Application money pending allotment	1620
Accumulated losses not written off	45
Investments	405

Kartik Ltd. has only one whole-time director, Mr. Kumar. You are required to calculate the amount of maximum remuneration that can be paid to him as per provisions of the Companies Act, 2013, if no special resolution is passed at the general meeting of the company in respect of payment of remuneration.

Answer

Calculation of effective capital and maximum amount of monthly remuneration

	(Rs. in lakhs)
Paid up equity share capital	270
Paid up Preference share capital	45
Reserve excluding Revaluation reserve (337.5- 22.5)	315
Securities premium	90
Long term loans	90
Deposits repayable after one year	45
	855
Less: Accumulated losses not written off	(45)
Investments	(405)
Effective capital for the purpose of managerial remuneration	405

Since Kartik Ltd. is incurring losses and no special resolution has been passed by the company for payment of remuneration. Effective capital of the company is less than 5 crores, maximum remuneration payable to the Managing Director should be @ Rs. 60,00,000 per annum.

Note: Revaluation reserve and application money pending allotment are not included while computing effective capital of Kartik Ltd.

#15. Illustration | May 2020 |

Prepare Cash Flow Statement of Light Ltd. for the year ended 31st March, 2020, in accordance with AS 3 (Revised) from the following Summary Cash Account:

Summary Cash Account

	Rs. in '000	Rs. in '000
Balance as on 01.04.2019		315

Receipts from Customers		24,894
Sale of Investments (Cost Rs. 1,35,000)		153
Issue of Shares		2,700
Sale of Fixed Assets		<u>1,152</u>
		29,214
Payment to Suppliers	18,306	
Purchase of Investments	117	
Purchase of Fixed Assets	2,070	
Wages & Salaries	621	
Selling & Administration Expenses	1,035	
Payment of Income Tax	2,187	
Payment of Dividends	720	
Repayment of Bank Loan	2,250	
Interest paid on Bank Loan	<u>450</u>	<u>(27,756)</u>
Balance as on 31.03.2020		1,458

Answer

Light Ltd.

Cash Flow Statement for the year ended 31st March, 2020

Cash flows from operating activities	(Rs. '000)	(Rs. '000)
Cash receipts from customers	24,894	
Cash payments to suppliers	(18,306)	
Cash paid to employees	(621)	
Other cash payments (for Selling & Administrative expenses)	<u>(1,035)</u>	
Cash generated from operations	4,932	
Income taxes paid	<u>(2,187)</u>	
Net cash from operating activities		2,745
Cash flows from investing activities		
Payments for purchase of fixed asset	(2,070)	
Proceeds from sale of fixed assets	1,152	
Purchase of investments	(117)	

Sale of investments	153	
Net cash used in investing activities		(882)
Cash flows from financing activities		
Proceeds from issuance of share capital	2,700	
Bank loan repaid	(2,250)	
Interest paid on bank loan	(450)	
Dividend paid	(720)	
Net cash used in financing activities		(720)
Net increase in cash and cash equivalents		1,143
Cash and cash equivalents at beginning of period		315
Cash and cash equivalents at end of period		1,458

#16. Illustration | Nov 2020 |

Om Ltd. has authorized capital of Rs. 50 lakhs divided into 5,00,000 equity shares of Rs. 10 each. Their books show the following ledger balances as on 31st March, 2021:

	Rs.		Rs.
Inventory 1.4.2020	6,65,000	Bank Current Account (Dr. balance)	20,000
Discounts & Rebates allowed	30,000	Cash in hand	11,000
Carriage Inwards	57,500		
Purchases	12,32,500	Calls in Arrear @ Rs. 2 per share	10,000
Rate, Taxes and Insurance	55,000	Equity share capital	20,00,000
Furniture & Fixtures	1,50,000	(2,00,000 shares of Rs. 10 each)	
Business Expenses	56,000	Trade Payables	2,40,500
Wages	14,79,000	Sales	36,17,000
Freehold Land	7,30,000	Rent (Cr.)	30,000
Plant & Machinery	7,50,000	Transfer fees received	6,500
Engineering Tools	1,50,000	Profit & Loss A/c (Cr.)	67,000
Trade Receivables	4,00,500	Repairs to Building	56,500
Advertisement Expenses	15,000	Bad debts	25,500
Commission & Brokerage Expenses	67,500		

The inventory (valued at cost or market value, which is lower) as on 31 st March, 2021 was

Rs. 7,05,000. Outstanding liabilities for wages Rs. 25,000 and business expenses Rs. 36,500. It was decided to transfer Rs. 10,000 to reserves.

Charge depreciation on written down values of Plant & Machinery @ 5%, Engineering Tools @ 20% and Furniture & Fixtures @10%. Provide Rs. 25,000 as doubtful debts for trade receivables. Provide for income tax @ 30%. It was decided to transfer Rs. 10,000 to reserves.

You are required to prepare Statement of Profit & Loss for the year ended 31st March, 2021 and Balance Sheet as at that date.

Answer

Balance Sheet of Om Ltd. as at 31st March, 2021

	Particulars	Note No.	(Rs.)
I	Equity and Liabilities		
	(1) Shareholders' Funds		
	(a) Share Capital	1	19,90,000
	(b) Reserves and Surplus	2	3,82,000
	(2) Current Liabilities		
	(a) Trade Payables		2,40,500
	(b) Other Current Liabilities	3	61,500
	(c) Short-Term Provisions	4	<u>1,35,000</u>
	Total		<u>28,09,000</u>
II	ASSETS		
	(1) Non-Current Assets		
	(a) Property, Plant and Equipment	5	16,97,500
	(2) Current Assets		
	(a) Inventories		7,05,000
	(b) Trade Receivables	6	3,75,500
	(c) Cash and Cash Equivalents	7	<u>31,000</u>
	Total		<u>28,09,000</u>

Statement of Profit and Loss of Om Ltd. for the year ended 31st March, 2021

	Particulars	Note No.	(Rs.)
I	Revenue from Operations		36,17,000
II	Other Income	8	<u>36,500</u>

III	Total Revenue [I + II]		<u>36,53,500</u>
IV	Expenses:		
	Cost of purchases		12,32,500
	Changes in Inventories [6,65,000-7,05,000]		(40,000)
	Employee Benefits Expenses	9	15,04,000
	Depreciation and Amortization Expenses		82,500
	Other Expenses	10	<u>4,24,500</u>
	Total Expenses		<u>32,03,500</u>
V	Profit before Tax (III-IV)		4,50,000
VI	Tax Expenses @ 30%		<u>(1,35,000)</u>
VII	Profit for the period		<u><u>3,15,000</u></u>

Notes to Accounts:

1. Share Capital

Authorized Capital	
5,00,000 Equity Shares of Rs. 10 each	<u>50,00,000</u>
Issued Capital	
2,00,000 Equity Shares of Rs. 10 each	20,00,000
Subscribed Capital and fully paid	
1,95,000 Equity Shares of Rs.10 each	19,50,000
Subscribed Capital but not fully paid	
5,000 Equity Shares of Rs.10 each Rs. 8 paid	40,000
(Call unpaid Rs.10,000)	<u>19,90,000</u>

2. Reserves and Surplus

General Reserve		10,000
Surplus i.e. Balance in Statement of Profit & Loss:		
Opening Balance	67,000	
Add: Profit for the period	3,15,000	
Less: Transfer to Reserve	<u>(10,000)</u>	<u>3,72,000</u>
		<u><u>3,82,000</u></u>

3. Other Current Liabilities

Outstanding Expenses [25,000+36,500]	61,500

4. Short-term Provisions

Provision for Tax	1,35,000

5. Property, Plant and Equipment

Particulars	Value given (Rs.)	Depreciation rate	Depreciation Charged (Rs.)	Written down value at the end (Rs.)
Land	7,30,000		-	7,30,000
Plant & Machinery	7,50,000	5%	37,500	7,12,500
Furniture & Fixtures	1,50,000	10%	15,000	1,35,000
Engineering Tools	<u>1,50,000</u>	20%	<u>30,000</u>	<u>1,20,000</u>
	<u>17,80,000</u>		<u>82,500</u>	<u>16,97,500</u>

6. Trade Receivables

Trade receivables	4,00,500
Less: Provision for doubtful debts	<u>(25,000)</u>
	<u>3,75,500</u>

7. Cash & Cash Equivalent

Cash Balance	11,000
Bank Balance in current A/c	<u>20,000</u>
	<u>31,000</u>

8. Other Income

Miscellaneous Income (Transfer fees)	6,500
Rental Income	<u>30,000</u>
	<u>36,500</u>

9. Employee benefits expenses

Wages	14,79,000
Add: Outstanding wages	<u>25,000</u>
	<u>15,04,000</u>

10. Other Expenses

Carriage Inwards	57,500
Discount & Rebates	30,000
Advertisement	15,000
Rate, Taxes and Insurance	55,000
Repairs to Buildings	56,500
Commission & Brokerage	67,500
Miscellaneous Expenses [56,000+36,500] (Business Expenses)	92,500
Bad Debts	25,500
Provision for Doubtful Debts	<u>25,000</u>
	<u>4,24,500</u>

#17. Illustration | Nov 2020 |

XYZ Ltd. is having inadequacy of profits in the year ending 31-03-2021 and it proposes to declare 10% dividend out of General Reserves.

From the following particulars ascertain the amount that can be utilized from general reserves, according to the Companies (Declaration of Dividend out of Reserves) Rules, 2014:

5,00,000 Equity Shares of Rs. 10 each fully paid up	50,00,000
General Reserves	25,00,000
Revaluation Reserves	6,50,000
Net profit for the year	1,42,500

Average rate of dividend during the last five years has been 12%.

Answer

Amount that can be drawn from reserves for (10% dividend on Rs. 50,00,000 i.e.

Rs. 5,00,000)

Profits available

Current year profit Rs. 1,42,500

Amount which can be utilized from reserves (Rs. 5,00,000 – 1,42,500) Rs. 3,57,500 Conditions as per Companies (Declaration of dividend out of Reserves) Rules, 20X1: **Condition I**

Since 10% is lower than the average rate of dividend (12%), 10% dividend can be declared.

Condition II

Maximum amount that can be drawn from the accumulated profits and reserves should not exceed 10% of paid up capital plus free reserves i.e. Rs. 7,50,000 [10% of (50,00,000 + 25,00,000)]

Condition III

The balance of reserves after drawl Rs. 21,42,500 (Rs. 25,00,000 - Rs. 3,57,500) should not fall below 15 % of its paid up capital ie. Rs. 7,50,000 (15% of Rs. 50,00,000]

Since all the three conditions are satisfied, the company can withdraw Rs. 3,57,500 from accumulated reserve (as per Declaration and Payment of Dividend Rules, 2014).

#18. Illustration | Nov 2020 |

Mohit Ltd. provides the following information as on 31st March, 2021:

Liabilities	Rs.
<u>Authorized capital:</u>	
1,00,000, 14% preference shares of Rs.100	1,00,00,000
10,00,000 Equity shares of Rs.100 each	10,00,00,000
	<u>11,00,00,000</u>
<u>Issued and subscribed capital:</u>	
77,500, 14% preference shares of Rs. 100 each fully paid	77,50,000
5,40,000 Equity shares of Rs. 100 each, Rs. 80 paid-up	4,32,00,000
Share suspense account	90,00,000
Reserves and surplus	
Capital reserves (Rs. 5,00,000 is revaluation reserve)	8,77,500
Securities premium	2,25,000
Secured loans:	
15% Debentures	2,92,50,000
Unsecured loans:	
Public deposits	16,65,000
Cash credit loan from SBI (short term)	5,92,500
Current Liabilities:	
Trade Payables	15,52,500
Assets:	
Investment in shares, debentures, etc.	3,50,50,000
Profit and Loss account (Dr. balance)	68,50,000

Share suspense account represents application money received on shares, the allotment of which is not yet made. You are required to compute effective capital as per the provisions of Schedule V if Mohit Ltd is non-investment company. Would your answer differ if Mohit Ltd. is an investment company?

Answer

Computation of effective capital:

	Where Mohit Ltd. is a non-investment company	Where Mohit Ltd. is an investment company
Paid-up share capital —		
77,500, 14% Preference shares	77,50,000	77,50,000
5,40,000 Equity shares	4,32,00,000	4,32,00,000
Capital reserves	3,77,500	3,77,500
Securities premium	2,25,000	2,25,000
15% Debentures	2,92,50,000	2,92,50,000
Public Deposits	<u>16,65,000</u>	<u>16,65,000</u>
(A)	<u>8,24,67,500</u>	<u>8,24,67,500</u>
Investments	3,50,50,000	-
Profit and Loss account (Dr. balance)	<u>68,50,000</u>	<u>68,50,000</u>
(B)	<u>4,19,00,000</u>	<u>68,50,000</u>
Effective capital (A-B)	<u>4,05,67,500</u>	<u>7,56,17,500</u>

#19. Illustration | May 2021 |

The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

Extract of Balance Sheet

	Particulars	Notes	2021 (Rs.'000)	2020 (Rs.'000)
	Equity and Liabilities			
1	Shareholder's funds			
(a)	Share capital	1	500	200
2	Non- current liabilities			
(a)	Long term loan from bank		---	250
3	Current liabilities			
(a)	Trade Payables		1,000	3,047
	Assets			
1	Non-current assets			

2	(a)	Property, Plant and Equipment	230	128
		Current assets		
	(a)	Trade receivables	2,000	4,783
	(b)	Cash & cash equivalents (Cash balance)	212	35

Extract of Statement of Profit and Loss

	Particulars	Notes	2021 (Rs.'000)	2020 (Rs.'000)
I	Expenses:			
	Employee benefits expense		69	25
	Other expenses	2	115	110
II	Tax expense:			
	Current tax (paid during year)		243	140

Notes to accounts

		2021 (Rs.'000)	2020 (Rs.'000)
1	Share Capital		
	Equity Shares of Rs.10 each, fully paid up	500	200
2	Other expenses		
	Overheads	115	110

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore depreciation. Dividend amounting Rs. 80,000 was paid during the year ended 31st March, 2021.

Answer

Supriya Ltd.

Cash Flow Statement for the year ended 31st March, 2021

(Using direct method)

	(Rs. '000)
Cash flows from operating activities	
Cash receipts from customers	2,783
Cash payments to suppliers	(2,047)
Cash paid to employees	(69)
Other cash payments (for overheads)	(115)

Cash generated from operations	552	
Income taxes paid	(243)	
<i>Net cash from operating activities</i>		309
Cash flows from investing activities		
Payments for purchase of Property, Plant and Equipment	(102)	
<i>Net cash used in investing activities</i>		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	
Dividend paid	(80)	
<i>Net cash used in financing activities</i>		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		<u>35</u>
Cash and cash equivalents at end of period		212

#20. Illustration | May 2021 |

Om Ltd. has the Authorised Capital of Rs. 15,00,000 consisting of 6,000 6% Redeemable Preference shares of Rs. 100 each and 90,000 equity Shares of Rs.10 each. The following was the Trial Balance of the Company as on 31st March, 2021:

Particulars	Dr.	Cr.
Investment in shares at cost (non-current investment)	1,50,000	
Purchases	14,71,500	
Selling expenses	2,37,300	
Inventory as at the beginning of the year	4,35,600	
Salaries and wages (included Rs. 30,000 being Director's Remuneration)	1,56,000	
Cash on hand	84,000	
Bills receivable	1,24,500	
Interest on Bank overdraft	29,400	
Interest on debentures upto 30th Sep (1st half year)	11,250	
Trade receivables and trade payables	1,50,300	2,63,550
Freehold property at cost	10,50,000	

Furniture at cost less depreciation of Rs. 45,000	1,05,000	
6% Redeemable Preference share capital		6,00,000
Equity share capital fully paid up		6,00,000
5% mortgage debentures secured on freehold properties		4,50,000
Dividends		12,750
Profit and Loss A/c (opening balance)		85,500
Sales (Net)		20,11,050
Bank overdraft (secured by hypothecation of stocks and receivables)		4,50,000
Technical knowhow fees (cost paid during the year)	4,50,000	
Audit fees	18,000	
Total	44,72,850	44,72,850

Other Information:

1. Closing Stock was valued at Rs. 4,27,500.
2. Purchases include Rs. 15,000 worth of goods and articles distributed among valued customers.
3. Salaries and Wages include Rs. 6,000 being Wages incurred for installation of Electrical Fittings which were recorded under "Furniture".
4. Bills Receivable include Rs. 4,500 being dishonoured bills. 50% of which had been considered irrecoverable.
5. Bills Receivable of Rs. 6,000 maturing after 31st March were discounted.
6. Depreciation on Furniture to be charged at 10% on Written Down Value
7. Interest on Debentures for the half year ending on 31st March was due on that date.
8. Technical Knowhow Fees is to be written off over a period of 10 years.
9. Trade receivables include Rs. 18,000 due for more than six months.

You are required to prepare the Balance Sheet as at 31st March, 2021 and Statement of Profit and Loss for the year ended 31st March, 2021 as per Schedule III to the Companies Act, 2013 after taking into account the above information. Ignore taxation.

Answer

Balance sheet of Om Ltd. as at 31st March, 2021

		Note	(Rs.)
I	Equity and Liabilities		
(1)	Shareholders' funds:		

	(a) Share capital	1	12,00,000
	(b) Reserves and surplus	2	1,14,150
(2)	Non-current liabilities:		
	Long term borrowings	3	4,50,000
(3)	Current liabilities:		
	(a) Short term borrowings	4	4,50,000
	(b) Trade payables		2,63,550
	(c) Other current liabilities	5	<u>11,250</u>
	Total		<u>24,88,950</u>
II	ASSETS		
(1)	Non- Current Assets:		
	(a) Property, plant and equipment	6	11,49,900
	(b) Intangible assets	7	4,05,000
	(c) Non-current investments (Shares at cost)		1,50,000
(2)	Current Assets:		
	(a) Inventories		4,27,500
	(b) Trade receivables	8	2,72,550
	(c) Cash and Cash equivalents – Cash on hand		84,000
	Total		<u>24,88,950</u>

Note: There is a Contingent liability for Bills receivable discounted with Bank Rs. 6000.

Statement of Profit and Loss of Om Ltd. for the year ended 31st March, 2021

	Particulars	Note	Rs.
I	Revenue from Operations		20,11,050
II	Other income (Dividend income)		<u>12,750</u>
III	Total Revenue (I &+ II)		<u>20,23,800</u>
IV	Expenses:		
	(a) Purchases of Inventory (14,71,500 – Advertisement Expenses 15,000)		14,56,500
	(b) Changes in Inventories of finished Goods / Work in progress & inventory (4,35,600 – 4,27,500)		8,100
	(c) Employee Benefits expense	9	1,20,000
	(d) Finance costs	10	51,900

	(e) Depreciation & Amortization Expenses [10% of (1,05,000 + 6,000)]		11,100
	(f) Other Expenses	11	<u>3,47,550</u>
	Total Expenses		<u>19,95,150</u>
V	Profit before exceptional, extraordinary items and tax		28,650
VI	Exceptional items		-
VII	Profit before extra-ordinary items and tax		28,650
VIII	Extraordinary items		-
IX	Profit before tax		28,650

Notes to accounts

			(Rs.)
1. Share Capital			
Authorized capital:			
90,000 Equity Shares of Rs. 10 each.	9,00,000		
6,000 6% Preference shares of Rs. 100 each	<u>6,00,000</u>		
Issued, subscribed & called up:			
60,000, Equity Shares of Rs. 10 each	6,00,000		
6,000 6% Redeemable Preference Shares of 100 each	<u>6,00,000</u>		
			<u>12,00,000</u>
2. Reserves and Surplus			
Balance as on 1st April, 2020	85,500		
Add: Surplus for current year	<u>28,650</u>		
Balance as on 31st March, 2021			<u>1,14,150</u>
3. Long Term Borrowings			
5% Mortgage Debentures (Secured against Freehold Properties)			4,50,000
4. Short Term Borrowings			
Secured Borrowings: Loans Repayable on Demand			4,50,000
Overdraft from Banks (Secured by Hypothecation of Stocks & Receivables)			
5. Other Current liabilities			

	Interest due on Borrowings (5% Debentures)		11,250
6.	Property, plant and equipment		
	Furniture		
	Furniture at Cost Less depreciation Rs. 45,000 (as given in Trial Balance)	1,05,000	
	Add: Depreciation	<u>45,000</u>	
	Cost of Furniture	1,50,000	
	Add: Installation charge of Electrical Fittings wrongly included under the heading Salaries and Wages		
		<u>6,000</u>	
	Total Gross block of Furniture A/c	1,56,000	
	Accumulated Depreciation Account:		
	Opening Balance-given in Trial Balance 45,000		
	Depreciation for the year:		
	On Opening WDV at 10% i.e.		
	(10% x 1,05,000)	10,500	
	On additional purchase during the year		
	at 10% i.e. (10% x 6,000)	<u>600</u>	
	Less: Accumulated Depreciation	<u>56,100</u>	99,900
	Freehold property (at cost)		<u>10,50,000</u>
			<u>11,49,900</u>
7.	Intangible Assets		
	Technical knowhow	4,50,000	
	Less: Written off	<u>45,000</u>	<u>4,05,000</u>
8.	Trade Receivables		
	Sundry Debtors (a) Debt outstanding due more than six months	18,000	
	(b) Other Debts (refer Working Note)	1,34,550	
	Bills Receivable (1,24,500 -4,500)	<u>1,20,000</u>	2,72,550
9.	Employee benefit expenses		
	Salaries & Wages	1,56,000	

	Less: Wages incurred for installation of electrical fittings to be capitalised	6,000	
	Less: Directors' Remuneration shown separately	<u>30,000</u>	
	Balance amount		<u>1,20,000</u>
10.	Finance Costs		
	Interest on bank overdraft	29,400	
	Interest on debentures	<u>22,500</u>	
			51,900
11.	Other Expenses		
	Payment to the auditors	18,000	
	Director's remuneration	30,000	
	Selling expenses	2,37,300	
	Technical knowhow written off (4,50,000/10)	45,000	
	Advertisement (Goods and Articles Distributed)	15,000	
	Bad Debts (4,500 x 50%)	<u>2,250</u>	
			3,47,550

Working Note:

Calculation of Sundry Debtors-Other Debts		
Sundry Debtors as given in Trial Balance	1,50,300	
Add Back: Bills Receivables Dishonoured	<u>4,500</u>	
	1,54,800	
Less: Bad Debts written off – 50% Rs. 4,500	<u>(2,250)</u>	
Adjusted Sundry Debtors	1,52,550	
Less: Debts due for more than 6 months (as per information given)	<u>(18,000)</u>	
Total of other Debtors i.e. Debtors outstanding for less than 6 months	1,34,550	

#21. Illustration | May 2021 |

Star Ltd. gives the following information the year ended 31st March, 2021:

	Rs.
Gross profit	60,38,048
Subsidies received from Govt.	4,10,888

Administrative, Selling and distribution expenses	12,33,813
Directors' fees	2,02,170
Interest on debentures	46,860
Managerial remuneration	4,28,025
Depreciation on Property, plant and equipment (PPE)	7,83,815
Provision for Taxation	18,63,750
Transfer to General Reserve	6,00,000
Transfer to Investment Revaluation Reserve	18,750

Depreciation on PPE as per Schedule II of the Companies Act, 2013 was Rs. 8,63,018

You are required to calculate the maximum amount of the managerial remuneration as allowed as per Companies Act, 2013.

Answer

	Rs.	Rs.
Gross profit		60,38,048
Add: Subsidies received from Government		<u>4,10,888</u>
		64,48,936
Less: Administrative, selling and distribution expenses	12,33,813	
Director's fees	2,02,170	
Interest on debentures	46,860	
Depreciation on PPE as per Schedule II	<u>8,63,018</u>	<u>(23,45,861)</u>
Profit u/s 198		41,03,075

Maximum Managerial remuneration under Companies Act, 2013= 11% of Rs. 41,03,075

= Rs. 4,51,338

#22. Illustration | Nov 2021 |

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2021 (Using direct method):

- (i) Total sales for the year were Rs. 597 crores out of which cash sales amounted to Rs. 393 crores.
- (ii) Receipts from credit customers during the year, totalled Rs. 201 crores.
- (iii) Purchases for the year amounted to Rs. 330 crores out of which credit purchases were 80%.

Balance in creditors as on

1.4.2020 Rs. 126 crores

31.3.2021 Rs. 138 crores

- (iv) Suppliers of other consumables and services were paid Rs. 28.5 crores in cash.
- (v) Employees of the enterprises were paid 30 crores in cash.
- (vi) Fully paid preference shares of the face value of Rs. 48 crores were redeemed. Equity shares of the face value of Rs. 30 crores were allotted as fully paid up at premium of 20%.
- (vii) Debentures of Rs. 30 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.
- (viii) Rs. 39 crores were paid by way of income tax.
- (ix) A new machinery costing Rs. 15 was purchased.
- (x) Investment costing Rs. 27 cores were sold at a loss of Rs. 3 crores.
- (xi) Dividends totalling Rs. 22.5 crores was also paid.
- (xii) Debenture interest amounting Rs. 3 crore was paid.
- (xiii) On 31st March 2020, Balance with Bank and Cash on hand totalled Rs. 3 crores.

Answer

Cash flow statement (using direct method) for the year ended 31st March, 2021

	(Rs. in crores)	(Rs. in crores)
Cash flow from operating activities		
Cash sales	393	
Cash collected from credit customers	201	
Less: Cash paid to suppliers for goods & services and to employees (Refer Working Note)	(376.5)	
Cash from operations	217.5	
Less: Income tax paid	(39)	
Net cash generated from operating activities		178.5
Cash flow from investing activities		
Payment for purchase of Machine	(15)	
Proceeds from sale of investments	24	
Net cash used in investing activities		9
Cash flow from financing activities		
Redemption of Preference shares	(48)	
Proceeds from issue of Equity shares	36	
Debenture interest paid	(3)	
Dividend Paid	(22.5)	

Net cash used in financing activities	(37.5)
Net increase in cash and cash equivalents	150
Add: Cash and cash equivalents as on 1.04.2020	3
Cash and cash equivalents as on 31.3.2021	153

Working Note:

Calculation of cash paid to suppliers of goods and services and to employees

	(Rs. in crores)
Opening Balance in creditors Account	126
Add: Purchases (330x .8)	264
Total	390
Less: Closing balance in Creditors Account	138
Cash paid to suppliers of goods	252
Add: Cash purchases (330x .2)	66
Total cash paid for purchases to suppliers (a)	318
Add: Cash paid to suppliers of other consumables and services (b)	28.5
Add: Payment to employees (c)	30
Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)]	376.5

#23. Illustration | Nov 2021 |

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	51	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 :

- (i) The authorized share capital of the company is 80,000 shares of Rs. 10 each.
- (ii) The company revalued the land at Rs. 9,60,000.
- (iii) Equity share capital includes shares of Rs. 50,000 issued for consideration other than cash.
- (iv) 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.
- (v) Depreciation is to be provided on plant and machinery at 10% on cost.
- (vi) 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.

Answer

Delta Limited

Balance Sheet as at 31st March 2021

Particulars	Note No.	(Rs. in '000)
A. Equity and Liabilities		
1. Shareholders' funds		
(a) Share Capital	1	495.00
(b) Reserves and Surplus	2	807.20
2. Non-Current Liabilities		
(a) Long Term Borrowings	3	300.00
3. Current Liabilities		
(a) Trade Payables		30.00

(b) Short- term provision	4	<u>163.80</u>
Total		<u>1,796.00</u>
B. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment	5	1,550.00
2. Current Assets		
(a) Inventories		96.00
(b) Trade Receivables	6	120.00
(c) Cash and Cash equivalents	7	<u>30.00</u>
Total		<u>1,796.00</u>

Statement of Profit and Loss for the year ended 31st March 2021

Particulars	Note No.	(Rs. in '000)
I. Revenue from Operations		1200.00
II. Other Income	8	<u>6.00</u>
III. Total Income (I +II)		<u>1,206.00</u>
IV. Expenses:		
Purchases (adjusted)		400.00
Finance Costs	9	30.00
Depreciation (10% of 800)		80.00
Other expenses	10	<u>150.00</u>
Total Expenses		<u>660.00</u>
V. Profit / (Loss) for the period before tax (III – IV)		546.00
VI. Tax expenses @30%		<u>163.80</u>
VII Profit for the period		<u>382.20</u>

Notes to Accounts

	Particulars	(Rs. in '000)
1	Share Capital	
	Equity Share Capital	
	Authorised	
	80,000 Shares of Rs. 10/- each	<u>800</u>

	Issued, Subscribed and Called-up		
	50,000 Shares of Rs. 10/- each	500	
	(Out of the above 5,000 shares have been issued for consideration other than cash)		
	Less: Calls in arrears	(5)	495
2	Reserves and Surplus		
	Securities Premium		40.00
	Revaluation Reserve Rs. (960 – 800)		160.00
	General Reserve		150.00
	Surplus i.e. Profit & Loss Account Balance		
	Opening Balance	75.00	
	Add: Profit for the period	<u>382.20</u>	<u>457.20</u>
			<u>807.20</u>
3	Long-Term Borrowings		
	10% Debentures		300
4.	Short – term provision		
	Provision for tax		163.80
5	Property, plant & equipment		
	Land		
	Opening Balance	800	
	Add: Revaluation adjustment	<u>160</u>	
	Closing Balance		960
	Plant and Machinery		
	Opening Balance	824	
	Less: Disposed off	<u>(24)</u>	
		800	
	Less: Depreciation Rs. (150 – 20 + 80)	<u>(210)</u>	
	Closing Balance		<u>590</u>
	Total		<u>1,550</u>
6	Trade receivables		
	Debits outstanding for a period exceeding six months	50	

	Other debts	70	120
7	Cash and Cash Equivalents		
	Cash at Bank With scheduled banks	23	
	With others (ABC Bank Limited)	5	
	Cash in hand	2	30
8	Other Income		
	Profit on sale of machinery		
	Sale value of machinery	10	
	Less: Book value of machinery (24 – 20)	(4)	6
9	Finance Costs		
	Debenture Interest		30
10	Other Expenses:		
	Factory expenses	80	
	Selling expenses	25	
	Administrative expenses	45	150

#24. Illustration | May 2022 |

"Current maturities of long term borrowing are disclosed separately under the head Other current liabilities in the balance sheet of a company." You are required to comment in line with schedule III to the Companies Act 2013.

Answer

Current maturities of loan term borrowing are shown under 'short term borrowings' and not under 'Other current liabilities' as per the amendment to Schedule III vide MCA notification dated 24th March, 2021. Hence the statement given in the question is not valid.

#25. Illustration | May 2022 |

The following is the extract of Balance Sheet of Jupiter Ltd. as at 31st March 2021:

	Rs.
Equity and Liabilities	
Authorized Capital:	
40,000, 14% preference shares of Rs. 100	40,00,000
4,00,000 Equity shares of Rs. 100 each	4,00,00,000
	4,40,00,000
Issued and Subscribed Capital:	

30,000, 14% Preference Shares of Rs.100 each, fully paid up	30,00,000
2,40,000 Equity Shares of Rs.100 each, Rs.80 paid-up	1,92,00,000
Share Suspense Account	40,00,000
Reserve & Surplus:	
Capital reserves (60% is revaluation reserve)	5,00,000
Securities Premium	1,00,000
Secured loans:	
15% Debentures	1,30,00,000
Unsecured loans:	
Public deposits	7,40,000
Cash credit loan from IDBI (short term)	9,30,000
Current Liabilities:	
Trade payables	6,90,000
Assets	
Investment in Shares, debentures, etc.	1,50,00,000
Profit and Loss Account	30,50,000
Preliminary expenses not written off	1,10,000

Share Suspense Account represents application money received on shares, the allotment of which is not yet made.

Jupiter Ltd. has been incurring losses for the last few years. Jupiter Ltd. has only one whole-time director.

You are required to compute effective capital as per provisions of schedule V to the Companies Act, 2013. Would your answer differ if Jupiter Ltd. is an investment company? Also calculate the amount of maximum remuneration that can be paid if no special resolution is passed at the general meeting of the company in respect of payment for a period not exceeding three years.

Answer

Calculation of effective capital

Particulars	Where Jupiter Ltd. is a non-investment Company (Rs.)	Where Jupiter Ltd. is an investment Company (Rs.)
Paid-up share capital		
30,000, 14% Preference Shares	30,00,000	30,00,000

2,40,000 Equity Shares	1,92,00,000	192,00,000
Capital Reserves excluding revaluation reserve	2,00,000	2,00,000
Securities Premium	1,00,000	1,00,000
15% Debentures	1,30,00,000	1,30,00,000
Public Deposits	7,40,000	7,40,000
Total (A)	362,40,000	362,40,000
Investments	1,50,00,000	
Profit and Loss Account (Dr. balance)	30,50,000	30,50,000
Preliminary Expenses not written off	1,10,000	1,10,000
Total (B)	181,60,000	31,60,000
Effective Capital [A - B]	1,80,80,000	3,30,80,000

Effective capital of the company for both the situations is less than 5 crores. Hence maximum remuneration payable to director should be @ Rs. 60,00,000 per annum.

#26. Illustration | May 2022 |

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement for the year ended 31st March, 2021:

	31.03.2021 (Rs.)	31.03.2020 (Rs.)
Share Capital	14,00,000	11,20,000
General Reserve	5,60,000	3,50,000
Profit and Loss Account	1,40,000	84,000
Debentures	2,80,000	-
Provision for taxation	1,40,000	98,000
Trade payables	9,80,000	11,48,000
Plant and Machinery	9,80,000	7,00,000
Land and Building	8,40,000	5,60,000
Investments	1,40,000	-
Trade receivables	7,00,000	9,80,000
Inventories	5,60,000	2,80,000
Cash in hand and at Bank	2,80,000	2,80,000

- i. Depreciation @ 20% was charged on the opening value of Plant and Machinery.

- ii. At the year end, one old machine costing 70,000 (WDV 28,000) was sold for Rs. 49,000. Purchase of machinery was also made at the year end.
- iii. Rs. 70,000 was paid towards Income tax during the year.
- iv. Land & Building is not subject to any depreciation. Expenses on renovation of building amount Rs. 2,80,000 were incurred during the year.

Prepare Cash Flow Statement.

Answer

Omega Ltd.

Cash Flow Statement for the year ended 31st March, 2021

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account	56,000	
Provision for taxation	1,12,000	
Transfer to General Reserve	2,10,000	
Depreciation	1,40,000	
Profit on sale of Plant and Machinery	(21,000)	
Operating Profit before Working Capital changes	4,97,000	
Increase in Inventories	(2,80,000)	
Decrease in Trade receivables	2,80,000	
Decrease in Trade payables	(1,68,000)	
Cash generated from operations	3,29,000	
Income tax paid	(70,000)	
Net Cash from operating activities		2,59,000
Cash Flow from Investing Activities		
Purchase of plant & machinery	(4,48,000)	
Expenses on building	(2,80,000)	
Increase in investments	(1,40,000)	
Sale of old machine	49,000	
Net Cash used in investing activities		(8,19,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	2,80,000	
Proceeds from issue of debentures	2,80,000	
Net cash from financing activities		5,60,000

Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		<u>2,80,000</u>
Cash and Cash equivalents at the end of the year		<u>2,80,000</u>

Working Notes:

Provision for taxation account

	Rs.		Rs.
To Cash (Tax Paid)	70,000	By Balance b/d	98,000
To Balance c/d	1,40,000	By Profit and Loss A/c	1,12,000
		(Balancing figure)	
	<u>2,10,000</u>		<u>2,10,000</u>

Plant and Machinery account

	Rs.		Rs.
To Balance b/d	7,00,000	By Depreciation	1,40,000
To Profit and Loss A/c (profit on sale of machine)	21,000		
To Cash (Balancing figure)	4,48,000	By Cash (sale of machine)	49,000
		By Balance c/d	<u>9,80,000</u>
	<u>11,69,000</u>		<u>11,69,000</u>

#27. Illustration | Nov 2022 |

The following balance appeared in the books of Oliva Ltd. as on 31-03-2022.

Particulars		Rs.	Particulars		Rs.
Inventory 01-04-2021			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	<u>46,500</u>	76,500	Profit and Loss A/c		21,000
Purchases of raw material		12,60,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Secured Loans:		
			Short-term Long-term		
					25,500

				4,500	
				<u>21,000</u>	
Salaries and wages		40,200	Fixed Deposits (unsecured):		
			Short -term	1,500	
General Charges		16,500	Long - term	<u>3,300</u>	4,800
			Trade payables		3,27,000
Building		1,01,000			
Plant and Machinery		70,400			
Furniture		10,200			
Motor Vehicles		40,800			
Investments: Current	4,500				
Non-Current	<u>7,500</u>	12,000			
Trade receivables		2,38,500			
Cash in Bank		<u>2,71,100</u>			
		<u>24,07,200</u>			
					<u>24,07,200</u>

From the above balance and the following information, prepare the company's statement of Profit and Loss for the year ended 31st March, 2022 and company's Balance Sheet as on that date:

1. Inventory on 31st March, 2022- Raw material Rs. 25,800 and finished goods Rs. 60,000.
2. Outstanding Expenses: Manufacturing Expenses Rs. 67,500 & Salaries & Wages Rs. 4,500.
3. Interest accrued on Securities Rs. 300.
4. General Charges prepaid Rs. 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 Rs. 1,000.
7. The Taxation provision of 40% on net profit is considered.

Answer

Oliva Ltd.

Balance Sheet as at 31.03.2022

	Particulars	Note	Amount
(1)	Equity and Liabilities		
(i)	Shareholders' funds		
(a)	Share Capital		3,15,000
(b)	Reserves and surplus	1	50,430
(2)	Non-current liabilities		
(a)	Long-term borrowings	2	23,300
(3)	Current Liabilities		
(a)	Short -term borrowings	3	7,000
(b)	Trade payables		3,27,000
(c)	Other current liability	4	72,000
(d)	Short term provision	5	<u>19,620</u>
			<u>8,14,350</u>
II	ASSETS		
(1)	Non-current assets		
(a)	Property, Plant & equipment	6	2,04,160
(b)	Non-current investments		7,500
(2)	Current assets		
(a)	Current investments		4,500
(b)	Inventories	7	85,800
(c)	Trade receivables		2,38,500
(d)	Cash and cash equivalents		2,71,100
(e)	Short-term loans and advances	8	2,490
(f)	Other current assets	9	<u>300</u>
			<u>8,14,350</u>

Oliva Ltd.

Statement of Profit and loss for the year ended 31.03.2022

(Rs.)

	Particulars	Note	Amount

I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		<u>4,200</u>
III	Total income (I +II)		<u>17,14,200</u>
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods, work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	<u>3,51,510</u>
	Total Expenses		<u>16,65,150</u>
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operations		29,430

Notes to accounts

No.	Particulars		Amount	Amount
1.	Reserve & Surplus			
	Profit & Loss Account: Balance b/f		21,000	
	Net Profit for the year		29,430	50,430
2.	Long term borrowings			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits: Unsecured		<u>3,300</u>	23,300
3.	Short term borrowings			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		1,500	

	Current maturities of long term borrowings		<u>1,000</u>	7,000
4.	Other current liabilities			
	Expenses Payable (67,500 + 4,500)		72,000	72,000
5.	Short term provisions			
	Provision for Income tax			19,620
6.	Property, plant and equipment			
	Building	1,01,000		
	Less: Depreciation @ 2%	<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>	<u>32,640</u>	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			2,490
9.	Other Current Assets			
	Interest accrued			300
10.	Cost of material consumed			
	Opening inventory of raw Material	30,000		
	Add: Purchases	<u>12,60,000</u>	12,90,000	
	Less: Closing inventory		<u>(25,800)</u>	12,64,200
11.	Changes in inventory of Finished Goods & WIP			
	Closing Inventory of Finished Goods		60,000	
	Less: Opening Inventory of Finished Goods		<u>(46,500)</u>	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

#28. Illustration | Nov 2022 |

The following information of X Ltd. (a non-investment company) as on 31st March, 2022 was obtained:

	Rs.
<u>Authorized capital:</u>	
15,000, 14% preference shares of Rs. 100	15,00,000
1,50,000 Equity shares of Rs. 100 each	<u>1,50,00,000</u>
	<u>1,65,00,000</u>
<u>Issued and subscribed capital:</u>	
14,000, 14% preference shares of Rs. 100 each fully paid	14,00,000
1,30,000 Equity shares of Rs. 100 each, Rs. 90 paid-up	1,17,00,000
Capital reserves (Rs. 1,75,000 is revaluation reserve)	2,00,000
Securities premium	50,000
15% Debentures	70,00,000
Investment in shares, debentures, etc.	60,00,000
Profit and Loss account (debit balance)	13,50,000

You are required to compute Effective Capital as per the provisions of Schedule V to the Companies Act, 2013.

Answer

Computation of Effective Capital

	Rs.
Paid-up share capital-	
14,000, 14% Preference shares	14,00,000
1,30,000 Equity shares	1,17,00,000
Capital reserves (excluding revaluation reserve)	25,000
Securities premium	50,000
15% Debentures	<u>70,00,000</u>
(A)	<u>2,01,75,000</u>

Investments	60,00,000
Profit and Loss account (Dr. balance)	<u>13,50,000</u>
(B)	<u>73,50,000</u>
Effective capital (A-B)	<u>1,28,25,000</u>

#29. Illustration | Nov 2022 |

The Balance Sheet of Max Ltd. for the year ending 31st March, 2022 and 31st March, 2021 were summarised as:

Particulars	Note No	2022 Rs.	2021 Rs.
Equity and Liabilities			
Shareholders' funds			
Equity share capital		1,20,000	1,00,000
Reserves	1	9,000	8,000
Current Liabilities			
(i) Trade Payables		8,000	5,000
(ii) Short term provision	2	<u>7,000</u>	<u>4,000</u>
		<u>1,44,000</u>	<u>1,17,000</u>
Non-current assets			
(i) PPE (at W.D.V)	3	78,000	58,000
(ii) Long Term Investments		32,000	28,000
Current Assets			
(i) Inventory		14,000	8,000
(ii) Trade Receivables		8,000	6,000
(iii) Cash & Bank		<u>12,000</u>	<u>17,000</u>
		<u>1,44,000</u>	<u>1,17,000</u>

Notes to accounts

		2022	2021
1	Reserves and Surplus		
	Profit & Loss A/c	9,000	8,000
2	Short term provision		
	provision for Income tax	7,000	4,000

3 PPE		
Building	19,000	20,000
Furniture & Fixture	34,000	22,000
Cars	<u>25,000</u>	<u>16,000</u>
	<u>78,000</u>	<u>58,000</u>

The Profit and Loss statement for the year ended 31st March, 2022 disclosed:

	Rs.
Profit before tax	8,000
Income Tax	<u>(7,000)</u>
Profit after tax	<u>1,000</u>

Further Information is available:

- Depreciation on Building for the year Rs. 1,000
- Depreciation on Furniture & Fixtures for the year Rs. 2,000
- Depreciation on Cars for the year Rs. 5,000. One car was disposed during the year for Rs. 3,400 whose written down value was Rs. 2,000.
- Purchase investments for Rs. 6,000.
- Sold investments for Rs. 10,000, these investments cost Rs. 2,000.

Prepare Cash Flow Statements for the year ended 31st March, 2022 as per AS-3 (revised) using indirect method.

Answer

Max Ltd.

Cash Flow Statement for the year ended 31st March, 2022

	(Rs.)	(Rs.)
Cash flows from operating activities		
Net Profit before taxation	8,000	
Adjustments for:		
Depreciation Rs. (1,000 + 2,000 + 5,000)	8,000	
Profit on sale of Investment	(8,000)	
Profit on sale of car	<u>(1,400)</u>	
Operating profit before working capital changes	6,600	
Increase in Trade receivables	(2,000)	
Increase in inventories	(6,000)	
Increase in Trade payables	<u>3,000</u>	

Cash generated from operations	1,600	
Income taxes paid	<u>(4,000)</u>	
Net cash generated from operating activities (A)		(2,400)
Cash flows from investing activities		
Sale of car	3,400	
Purchase of car	<u>(16,000)</u>	
Sale of Investment	10,000	
Purchase of Investment	<u>(6,000)</u>	
Purchase of Furniture & fixtures	<u>(14,000)</u>	
Net cash used in investing activities (B)		(22,600)
Cash flows from financing activities		
Issue of shares for cash	<u>20,000</u>	
Net cash from financing activities(C)		<u>20,000</u>
Net decrease in cash and cash equivalents (A + B +C)		(5,000)
Cash and cash equivalents at beginning of period		<u>17,000</u>
Cash and cash equivalents at end of period		12,000

Working Notes:

1. Calculation of Income taxes paid

	Rs.
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	<u>4,000</u>
	11,000
Less: Income tax liability at the end of the year	<u>(7,000)</u>
	<u>4,000</u>

2. Calculation of Fixed assets acquisitions

	Furniture & Fixtures (Rs.)	Car (Rs.)
W.D.V. at 31.3.2022	34,000	25,000
Add back: Depreciation for the year	2,000	5,000
Disposals	<u>-</u>	<u>2,000</u>
	36,000	32,000

Less: W.D.V. at 31.3.2021	<u>(22,000)</u>	<u>(16,000)</u>
Acquisitions during 2021-2022	<u>14,000</u>	<u>16,000</u>

1FIN by IndigoLearn

AS – 3 Cash Flow Statement ILLUSTRATIONS

#1.Illustration | May 2025, 7 Marks |

The Balance Sheet of Moon Ltd. as on 31st March 2025 and 2024 were given as:

Particulars	Notes	31 st March, 2025	31 st March, 2025
		Rs.	Rs.
Equity and Liabilities			
1. Shareholder Funds			
(a) Share Capital	1	8,00,000	6,00,000
(b) Reserves and Surplus	2	80,000	50,000
2. Non-Current Liabilities			
(a) Deferred Tax Liability		6,000	-
3. Current liabilities			
(a) Trade payable		40,000	25,000
(b) Short term provisions (Provision for tax)		<u>15,000</u>	<u>10,000</u>
Total		<u>9,41,000</u>	<u>6,85,000</u>
Assets			
1. Non-Current Assets			
(a) Property Plant and Equipment	3	3,95,000	2,90,000
2. Current Assets			
(a) Trade Receivable		20,000	10,000
(b) Inventories		2,50,000	2,00,000
(c) Cash and cash equivalent	4	<u>2,76,000</u>	<u>1,85,000</u>
Total		<u>9,41,000</u>	<u>6,85,000</u>

Notes to Accounts

Notes	Particulars	2025 (Rs.)	2024(Rs.)
1.	Share Capital Equity Shares of Rs. 10 each	8,00,000	6,00,000
2.	Reserve & Surplus Profit and loss Account	80,000	50,000
3.	Property, Plant and Equipment (at WDV)		

	Building	1,00,000	1,00,000
	Furniture and fixtures	<u>2,95,000</u>	<u>1,90,000</u>
	Total	<u>3,95,000</u>	<u>2,90,000</u>
4.	Cash & Cash equivalents	2,76,000	1,85,000

Further information related to Profit and loss A/c for the year ended March, 2025 is as under:

- Profit before tax is Rs. 45,000
- Tax expense during the year Rs. 15,000 (it includes deferred tax liability of Rs. 6,000 created during the year)
- Depreciation charged on furniture and fixture for the year was Rs. 35,000. One old furniture item was sold for Rs. 17,000 and the profit on such disposal amounting to current year Rs. 8,000 was booked in the current year.

Prepare a Cash Flow Statement for the year ended 31st March, 2025.

Answer:

Moon Ltd.

Cash Flow Statement for the year ended 31st March, 2025

	Rs.	Rs.
Cash flows from operating activities		
Net Profit before taxation	45,000	
Adjustments for:		
Depreciation	35,000	
Profit on sale of Furniture & Fixtures	<u>(8,000)</u>	
Operating profit before working capital changes	72,000	
Increase in Trade receivables	(10,000)	
Increase in inventories	(50,000)	
Increase in Trade payables	<u>15,000</u>	
Cash generated from operations	27,000	
Income taxes paid (W.N.1)	(4,000)	
Net cash generated from operating activities		
Cash flows from investing activities		
Sale of Furniture & Fixtures	17,000	
Purchase of Furniture & Fixtures (W.N.2)	<u>(1,49,000)</u>	23,000
<i>Net cash used in investing activities</i>		(1,32,000)
Cash flows from financing activities		
Issue of shares for cash	2,00,000	
Net cash generated from financing activities		<u>2,00,000</u>
Net decrease in cash and cash equivalents		91,000
Cash and cash equivalents at beginning of period (31.3.2024)		<u>1,85,000</u>
Cash and cash equivalents at end of period (31.3.2025)		<u>2,76,000</u>

Working Notes:

	Rs.
1.	
Income taxes paid	
Income tax expense for the year	15,000
<i>Add: Income tax liability at the beginning of the year</i>	<u>10,000</u>
	25,000

	Less: Income tax liability at the end of the year	(15,000)
	Less: DTL	<u>(6,000)</u>
		<u>4,000</u>
2	Property, plant and equipment acquisitions	
	Furniture & Fixtures	Rs.
	W.D.V. at 31.3.2025	2,95,000
	Add back:	
	Depreciation for the year	35,000
	Disposals (17,000 -8,000)	<u>9,000</u>
		3,39,000
	Less: W.D.V. at 31.12.2024	<u>(1,90,000)</u>
	Acquisitions during 2024-2025	<u>1,49,000</u>

#2.Illustration |Jan 2025, 7 Marks |

Given below are the extracts of the Balance Sheet of BGH Limited:

Particulars	31 st March, 2024 (Rs.)	31 st March, 2023 (Rs.)
Share Capital	5,00,000	4,00,000
Profit & Loss Account	1,10,000	60,000
10% Debentures (issued at the end of the year)	1,00,000	-
Bank Loan	2,50,000	2,00,000
Trade Payable	60,000	75,000
Dividend Payable	-	50,000
Interest Payable on Bank Loan (Current Year)	25,000	20,000
Goodwill	1,20,000	1,50,000
Trade Receivables	65,000	95,000
Inventory	55,000	30,000

You are required to prepare for the year ended 31st March,2024:

Cash Flow from Operating Activities;

Cash Flow from Financing Activities.

Answer:

Cash Flow from Operating Activities for the Year Ended 31 March 2024

Particulars	Rs.
Cash Flow from Operating Activities	
Retained earnings (1,10,000-60,000)	50,000
Adjustments for non-cash items	
Goodwill Amortisation	30,000
Interest expenses	25,000
	<u>1,05,000</u>

Changes in Working Capital	
Decrease in Trade Receivables	30,000
Increase in Inventory	(25,000)
Decrease in Trade Payables	(15,000)
Cash Flow from Operating Activities	95,000

Cash Flow from Financing Activities for the Year Ended 31 March 2024

Increase in Share Capital	1,00,000
Increase in Bank Loan	50,000
Issue of 10% Debentures	1,00,000
Dividend Paid	(50,000)
Interest Paid	(20,000)
Cash Flow from Financing Activities	1,80,000

#3.Illustration | September 2024, 7 Marks |

On the basis of the following data, prepare Cash Flow Statement as per AS-3 for the year ended 31st March, 2024:

- Total Sales for the year were Rs. 380 lakhs out of which Cash Sales amounted to Rs. 262 Lakhs.
- Receipts from credit customers during the year, total Rs. 134 lakhs.
- Total Purchases for the year amounted to Rs. 220 lakhs, out of which 80% were credit purchases.
- Opening balance in creditors Rs. 84 lakhs and Closing balance in creditors Rs. 92 lakhs.
- Suppliers of other consumables and services were paid Rs. 19 lakhs in cash.
- Employees of the enterprise were paid Rs. 20 lakhs in cash.
- Fully-paid preference shares of the face value of Rs. 32 lakhs were redeemed.
- Issued equity shares of the face value of Rs. 20 lakhs at a premium of 20%.
- Debenture of Rs. 20 lakhs at premium of 10% were redeemed by issuing equity shares in lieu of their claims.
- Rs. 26 lakhs were paid by way of Income Tax.
- A new machinery costing Rs. 20 lakhs was purchased in a part exchange of an old machinery. The book value of the old machinery was Rs. 13 lakhs, but the vendor agreed to take over the old machinery at a higher value of Rs. 15 lakhs. The balance due to vendor was paid in cash.
- Dividend Rs. 15 lakhs (including dividend distribution tax) of Rs. 2.7 lakhs was also paid on 30th March, 2024.
- Debenture interest Rs. 3 lakhs was paid.
- During the year Rs. 8 lakhs rent was received from property held as investment.
- Rs. 0.50 lakh interest was earned on the advance payments to suppliers of Goods.
- Cash and cash equivalents on 1st April 2023, Rs. 2 lakhs.

Answer:

Cash flow statement for the year ended 31st March 2024

	(Rs. in lakhs)	(Rs. in lakhs)
Cash flow from operating activities		

Cash sales	262.00	
Cash collected from credit customers	134.00	
Interest received on advance payment to suppliers	0.50	
Less: Cash purchases	(44.00)	
Less: Payment to Creditors (84 + 176 – 92)	(168.00)	
Less: Cash paid to suppliers for consumables & services	(19.00)	
Less: Cash paid to employee	(20.00)	
Cash from operations	145.50	
Less: Income tax paid	(26.00)	
Net cash generated from operating activities		119.50
Cash flow from investing activities		
Payment for purchase of Machine (20-15)	(5.00)	
Proceeds from rent received	8.00	
Net cash used in investing activities		3.00
Cash flow from financing activities		
Redemption of Preference shares	(32.00)	
Proceeds from issue of Equity shares	24.00	
Debenture interest paid	(3.00)	
Dividend Paid	(15.00)	
Net cash used in financing activities		(26.00)
Net increase in cash and cash equivalent		96.50
Add: Cash and cash equivalents as on 1.04.2023		2.00
Cash and cash equivalents as on 31.3.2024		98.50

#4. Illustration | May 2024, 7 Marks |

The following information is provided for Aarambh Limited:

Particulars	31 st March 2023 (Rs.)	31 st March 2024 (Rs.)
Profit and Loss a/c	5,400 (Dr.)	37,800
Provision for Taxation	2,21,400	1,35,000
General Reserve	54,000	81,000
12%	1,18,000	2,91,600
Debentures	1,29,600	1,18,800
Trade Payables	54,000	1,08,000
8% Current Investments	3,99,600	3,99,600
Property, plant and equipment	1,29,600	1,62,000
(Gross) Accumulated Depreciation	81,000	2,61,360
Trade Receivables (Gross)	27,000	54,000
Provision for Doubtful Debts	1,35,000	81,000
Inventories	54,00	30,240
Cash and Cash Equivalents		

Additional information:

- (i) Income tax provided during the year Rs. 1,62,000.

- (ii) New debentures have been issued at the end of current financial year.
 (iii) New investments have been acquired at the end of the current financial year.

You are required to calculate net Cash Flow from Operating Activities.

Answer:

Cash Flow from Operating Activities

	Rs.
Difference between Profit and Loss Account Rs. (37,800 + 5,400)	43,200
Add: Transfer to General Reserve (81,000-54,000)	27,000
Add: Adjustment for Provision for taxation	<u>1,62,000</u>
Profit Before tax	2,32,200
Add: Adjustment for Depreciation (Rs. 1,62,000 – Rs. 1,29,600)	32,400
Add: Adjustment for provision for doubtful debt (Rs. 54,000 –Rs. 27,000)	27,000
Add: Debenture Interest Paid Rs. (1,18,800 × 12%)	14,256
Less: Income from Investments (54,000 × 8%)	<u>(4,320)</u>
Operating Profit before Working Capital changes	3,01,536
Decrease in Inventories Rs. (1,35,000-81,000)	54,000
Increase in Trade receivables Rs. (2,61,360-81,000)	(1,80,360)
Decrease in Trade payables Rs. (1,29,600-1,18,800)	<u>(10,800)</u>
Cash generated from operations	1,64,376
Income tax paid	<u>(2,48,400)</u>
Net Cash generated from Operating Activities	(84,024)

Working Note:

Provision for taxation account

	Rs.		Rs.
To Cash (Paid) (Balancing figure)	2,48,400	By Balance b/d	2,21,400
To Balance c/d	<u>1,35,000</u>	By Profit and Loss A/c	<u>1,62,000</u>
	<u>3,83,400</u>		<u>3,83,400</u>

#5.Illustration | May 2018, 5 Marks |

Classify the following activities as

(i) Operating (ii) Investing (iii) financial and (iv) Cash Equivalents.

- (1) Cash receipts from Trade Receivables
- (2) Marketable Securities
- (3) Purchase of investment
- (4) Proceeds from long term borrowings
- (5) Wages and Salaries paid
- (6) Bank overdraft
- (7) Purchase of Goodwill
- (8) Interim dividend paid on equity shares
- (9) Short term Deposits
- (10) Underwriting commission paid

Answer

i. Operating Activities:

1. Cash receipts from trade receivables
5. Wages and Salaries paid

ii. Investing Activities:

3. Purchase of Investments
7. Purchase of goodwill
9. Short term deposits (assuming more than 3 months)

iii. Financing Activities:

4. proceeds from long term borrowings
6. Bank overdraft
8. Interim dividend paid on equity shares
10. Underwriting commission paid.

iv. Cash Equivalent

2. Marketable securities.
9. Short term deposits (If upto 3 months)

#6.Illustration | Nov 2019, 5 Marks |

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019.

Particulars	Amount (Rs.)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received from associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000
Interest received on investment (TDS of Rs. 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on. 1st December, 2018 which are redeemable within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred Rs. 9,600)	90,000

Answer**Cash Flow Statement from Investing Activities of Subham Creative Limited for the year ended 31-03-2019**

Cash generated from investing activities	Amt (Rs.)	Amt (Rs.)
Interest on loan received	70,000	
Pre-acquisition dividend received on investment made	52,600	
Unsecured loans given to subsidiaries	(5,00,000)	
Interest received on investments (gross value)	82,000	

TDS deducted on interest	(8,200)	
Sale of Plant & Machinery (90,000 – 9,600)	80,400	
Cash used in investing activities (before extra-ordinary item)		(2,23,200)
Extraordinary claim received for loss of machinery		55,000
Net cash used in investing activities (after extra-ordinary item)		(1,68,200)

Note:

- (a) Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
- (b) Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.
- (c) The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

#7.Illustration |July 2021, 5 Marks |

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3(Revised) from the following cash account summary:

Cash summary Account

Inflows	Rs. ('000)	Outflows	Rs. ('000)
Opening Balance	945	Payment to suppliers	54,918
Receipts from Customers	74,682	Purchase of Investments	351
Sale of Investments (Cost Rs. 4,05,000)	459	Property, plant and equipment	6,210
Issue of Shares	8,100	Wages and salaries	1,863
Sale of Property, Plant and equipment	3,456	Payment of Overheads	3,105
		Taxation	6,561
		Dividends	2,160
		Repayment of Bank Overdraft	6,750
		Interest paid on Bank Overdraft	1,350
		Closing Balance	4,374
	87,642		87,642

Answer

Gama Limited Cash Flow Statement For the Year Ended 31st March 2021

Particulars	Amount Rs.(000)	Amount Rs.(000)
Cash flow from Operating Activities:		
Cash receipts from customers	74,682	
Cash payments to suppliers	(54,918)	

Cash payments for wages & salaries	(1,863)	8,235
Cash payments of overheads	(3,105)	
Cash Generated from Operations	14,796	
Payment of Taxation	(6,561)	
Net Cash from Operating Activities		
Cash Flow from Investing Activities:		
Proceeds from sale of investments	459	(2,646)
Proceeds from sale of Property, Plant and Equipment	3,456	
Purchase of Investments	(351)	
Purchase of Property, Plant and Equipment	(6,210)	
Net Cash Used in Investing Activities		
Cash Flow from Financing Activities:		
Proceeds from issue of shares	8,100	(2,160)
Payment of Dividend	(2,160)	
Repayment of Bank Overdraft	(6,750)	
Interest paid on Bank Overdraft	(1,350)	
Net Cash Used in Financing Activities		
Net Increase in Cash & Cash Equivalent		3,429
Cash and Cash Equivalent in the Beginning of the year		945
Cash and Cash Equivalent in the end of the year		4374

#8. Illustration | Dec 2021, 5 Marks |

Following are the extracts from the Balance Sheet of ABC Ltd.

Liabilities	31.3.2020 (Rs.)	31.3.2021 (Rs.)
Equity Share Capital	25,00,000	35,60,000
10% Preference Share Capital	7,00,000	6,00,000
Securities Premium Account	5,00,000	5,50,000
Profit & Loss A/c	20,00,000	28,00,000

Equity Share Capital for the year ended 31st March, 2021 includes Rs.60, 000 of equity shares issued to Grey Ltd. at par for supply of Machinery of Rs.60, 000.

Profit & Loss account on 31st March, 2021 includes Rs.50, 000 of dividend received on Equity shares invested in X Ltd.

Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised)

Answer

The related items given in the question will appear in the Cash Flow Statement of ABC Limited for the year ended 31st March, 2021 as follows:

Particulars	Amt (Rs.)	Amt (Rs.)
Cash flows from operating activities		
Closing Balance as per Profit and Loss Account	28,00,000	
Less: Opening Balance as per Profit and Loss Account	(20,00,000)	
	8,00,000	

Less: Dividend received	(50,000)	750000
Cash flows from investing activities		
Dividend received		50,000
Cash flows from financing activities		
Proceeds from issuance of share capital		
Equity shares issued for cash	10,00,000	
Proceeds from securities premium	<u>50,000</u>	10,50,000
(5,50,000 – 5,00,000)		
Less: Redemption of Preference shares (7,00,000 – 6,00,000)	(1,00,000)	9,50,000

Note:

1. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the cash flow statement.
2. ABC Ltd. has been considered as a non-financial company in the given answer.

8. Illustration | Sep 2025, RTP |

From the following information, prepare cash flow statement of Kiran Ltd. as at 31st March, 2025 by using indirect method:

	2024	2025
Liabilities		
Share capital	12,00,000	12,00,000
Profit & Loss A/c	8,50,000	10,00,000
Long Term Loans	10,00,000	10,60,000
Trade payables	<u>3,50,000</u>	<u>4,00,000</u>
Assets	34,00,000	36,60,000
Fixed Assets	17,00,000	20,00,000
Investment in shares	2,00,000	2,00,000
Inventory	6,80,000	7,00,000
Trade receivables	7,20,000	6,60,000
Cash	60,000	70,000
Bills Receivable	<u>40,000</u>	<u>30,000</u>
	34,00,000	36,60,000

Income Statement for the year ended 31st March, 2025

Sales		40,80,000
Less: Cost of sales		<u>27,20,000</u>
Gross Profit		13,60,000
Less: Operating expenses:		
Administrative expenses	4,60,000	
Depreciation	<u>2,20,000</u>	<u>(6,80,000)</u>
Operating Profit		6,80,000
Add: Non-operating incomes (dividend received)		<u>50,000</u>
		7,30,000
Less: Interest paid		<u>(1,40,000)</u>

Profit before tax		5,90,000
Less: Income-tax		<u>(2,60,000)</u>
Profit after tax		<u>3,30,000</u>

Statement of Retained Earnings

		₹
Opening balance		8,50,000
Add: Profit		<u>3,30,000</u>
		11,80,000
Less: Dividend paid		<u>(1,80,000)</u>
Closing balance		<u>10,00,000</u>

Answer:

Cash flow statement of Kiran Ltd. for the year ended 31st March 2025

		₹	₹
(i)	Cash flows from operating activities		
	Profit before tax	5,90,000	
	Add: Depreciation (Non-cash expenses)	2,20,000	
	Interest (Non-operating expenses)	<u>1,40,000</u>	
		9,50,000	
	Less: Dividend (Non-operating income)	<u>(50,000)</u>	
	Operating Profit	9,00,000	
	Add: Decrease in Bills Receivable	10,000	
	Decrease in Trade receivables	60,000	
	Increase in Trade payables	<u>50,000</u>	
		10,20,000	
	Less: Increase in inventory	<u>(20,000)</u>	
	Cash flow from operations before tax	10,00,000	
	Less: Tax paid	<u>(2,60,000)</u>	
	Cash flow from operating activities		7,40,000
(ii)	Cash flows from investing activities		
	Purchase of fixed assets	(5,20,000)	
	[20,00,000 + 2,20,000 - 17,00,000]		
	Dividend on investments	<u>50,000</u>	
	Cash used in investing activities		(4,70,000)
(iii)	Cash flows from financing activities		
	Long term loan taken	60,000	
	Interest paid	(1,40,000)	
	Dividend paid	<u>(1,80,000)</u>	
	Cash used in financing activities		<u>(2,60,000)</u>
	Net increase in cash during the year		10,000
	Add: Opening cash balance		<u>60,000</u>
	Closing cash balance		<u>70,000</u>

9. Illustration | May 2025, RTP |

From the following data of Vishnu Ltd. prepare cash flow statement from Operating activities using direct method as per AS 3:

	31.03.2024 (Rs.)	31.03.2023 (Rs.)
Current Assets:		
Inventory	1,20,000	1,65,000
Trade receivables	2,05,000	1,88,000
Cash & cash equivalents	35,000	20,500
Current Liabilities:		
Trade payable	1,95,000	2,15,000
Provision for tax	48,000	65,000

Summary of Statement of Profit and Loss	Rs.	Rs.
Sales	85,50,000	
Less: Cost of sales	(56,00,000)	29,50,000
Other Income		
Interest income	20,000	
Fire insurance claim received	1,10,000	1,30,000
		30,80,000
Depreciation	(24,000)	
Administrative and selling expenses	(15,40,000)	
Interest expenses	(36,000)	
Foreign exchange loss	(18,000)	(16,18,000)
Net Profit before tax and extraordinary income		14,62,000
Income Tax		(95,000)
Net Profit		13,67,000

Additional information:

- 1) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.
- 2) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.

Answer:

Cash Flow Statement from operating activities of Vishnu Ltd. for the year ended 31 March 2024 (Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from Trade receivables (W.N. 3)		85,33,000
Less: Cash paid to Suppliers (W.N.2)	55,75,000	
Payment for Administration and Selling expenses	15,40,000	
Payment for Income Tax (W.N.4)	1,12,000	(72,27,000)
		13,06,000

Adjustment for extraordinary items (fire insurance claim)		1,10,000
Net Cash Flow from Operating Activities		14,16,000

Working Notes:

1. Calculation of total purchases

Cost of Sales = Opening stock + Purchases – Closing Stock

Rs. 56,00,000 = Rs. 1,65,000 + Purchases – Rs. 1,20,000

Purchases = Rs. 55,55,000

2. Calculation of cash paid to Suppliers

Trade Payables

		Rs.			Rs.
To	Bank A/c (balancing figure)	55,75,000	By	Balance b/d	2,15,000
To	Balance c/d	<u>1,95,000</u>	By	Purchases (W.N. 1)	<u>55,55,000</u>
		<u>57,70,000</u>			<u>57,70,000</u>

3. Calculation of cash received from Customers

Trade Receivables

		Rs.			Rs.
To	Balance b/d	1,88,000	By	Bank A/c (balancing figure)	85,33,000
To	Sales	<u>85,50,000</u>	By	Balance c/d	<u>2,05,000</u>
		<u>87,38,000</u>			<u>87,38,000</u>

4. Calculation of tax paid during the year in cash

Provision for tax

		Rs.			Rs.
To	Bank A/c (balancing figure)	1,12,000	By	Balance b/d	65,000
To	Balance c/d	<u>48,000</u>	By	Profit and Loss A/c	<u>95,000</u>
		<u>1,60,000</u>			<u>1,60,000</u>

10. Illustration |Jan 2025, RTP |

Classify the following activities as (1) Operating Activities, (2) Investing Activities, (3) Financing Activities (4) Cash Equivalents.

- a) Proceeds from long-term borrowings.
- b) Proceeds from Trade receivables.
- c) Trading Commission received.
- d) Redemption of Preference Shares.
- e) Proceeds from sale of investment
- f) Interim Dividend paid on equity shares.
- g) Interest received on debentures held as investment.
- h) Dividend received on shares held as investments.
- i) Rent received on property held as investment.
- j) Dividend paid on Preference shares.
- k) Marketable Securities

Answer:

Operating Activities: b, c.

Investing Activities: e, g, h, i.
Financing Activities: a, d, f, j.
Cash Equivalents: k

#10. Illustration | May 2020, RTP |

4. Purse Ltd., a non financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

- (i) Loans and Advances given to the following and interest earned on them:
 - (1) to suppliers
 - (2) to employees
 - (3) to its subsidiaries companies
 - (ii) Investment made in subsidiary Wallet Ltd. and dividend received
 - (iii) Dividend paid for the year
 - (iv) Insurance claim received against loss of property, plant and equipment by fire.
- Discuss in the context of AS 3 'Cash Flow Statement'.

Answer:

- (i) Loans and advances given and interest earned
 - 1. to suppliers Cash flows from operating activities
 - 2. to employees Cash flows from operating activities
 - 3. to its subsidiary companies Cash flows from investing activities
- (ii) Investment made in subsidiary company and dividend received
Cash flows from investing activities
- (iii) Dividend paid for the year Cash flows from financing activities
- (iv) Insurance claim received against loss of property, plant and equipment by fire.

#11. Illustration | May 2020, RTP |

Classify the following activities as

- (1) Operating Activities,
 - (2) Investing Activities,
 - (3) Financing Activities
 - (4) Cash Equivalents.
- a. Proceeds from long-term borrowings.
 - b. Proceeds from Trade receivables.
 - c. Trading Commission received.
 - d. Redemption of Preference Shares.
 - e. Proceeds from sale of investment
 - f. Interim Dividend paid on equity shares.
 - g. Interest received on debentures held as investment.
 - h. Dividend received on shares held as investments.
 - i. Rent received on property held as investment.
 - j. Dividend paid on Preference shares.

k. Marketable Securities

Operating Activities:

Proceeds from Trade receivables.

Trading Commission received.

Investing Activities:

Proceeds from sale of investment

Interest received on debentures held as investment.

Dividend received on shares held as investments.

Rent received on property held as investment.

Financing Activities:

Proceeds from long-term borrowings.

Redemption of Preference Shares.

Interim Dividend paid on equity shares.

Dividend paid on Preference shares

Cash Equivalent:

Marketable Securities

Chapter 3 Buy – back of Securities

Past Exams and RTP Questions Compiler

#1. Question |Jan 2025 Exam, 4 marks |

Following information are available in respect of Z Limited as on 31st March, 2024

4,00,000 Equity share capital of Rs. 10 each	Rs. 40,00,000
Capital Reserve	Rs. 20,000
Revenue Reserve	Rs. 50,00,000
Securities Premium	Rs. 6,00,000
Profit and Loss Account	Rs. 19,00,000
Investments	Rs. 40,00,000

The company decides to buy back 20% of its Equity capital @Rs. 15 per share on 1st April, 2024. Buy back is as per provisions of the Companies Act and company passed the necessary resolutions for it. For this purpose, it sold its investments of Rs. 40 lakhs for Rs. 32 lakhs. You are required to pass the necessary journal entries.

Answer:

In the books of Z Limited Journal Entries

	Particulars		(Rs.)	(Rs.)
1)	Bank A/c Profit & Loss A/c To Investments (Being investment sold for the purpose of buy-back of Equity Shares)	Dr. Dr.	32,00,000 8,00,000	40,00,000
2)	Equity share capital A/c Premium payable on buy-back A/c To Equity shares buy-back A/c (Being the amount due on buy-back of equity shares)	Dr. Dr.	8,00,000 4,00,000	12,00,000
3)	Equity shares buy-back A/c To Bank A/c (Being payment made for buy-back of equity shares)	Dr	12,00,000	12,00,000
4)	Securities Premium A/c To Premium payable on buy- back (Being premium payable on buy-back charged from Securities premium)	Dr	4,00,000	4,00,000
5)	Profit & Loss A/c To Capital Redemption Reserve A/c (Being creation of capital redemption reserve to the extent of the equity shares bought back)	Dr	8,00,000	8,00,000

#2. Question |September 2024 Exam, 7 marks |

Aerodots Ltd. has the following capital structure as on 31.03.2024 :

Particulars	Amount(Rs. in thousands)
Equity Share Capital (shares of Rs. 10 each)	600
Reserves:	
General Reserve	540
Securities Premium	200
Profit & Loss	100
Revaluation Reserve	30
Investment Allowance Reserve (Statutory Reserve)	75
Infrastructure Development Reserve	25
Loan Funds	2000

On 1st April, 2024 the company wants to buy back 14,000 equity shares of Rs. 10 each at Rs. 30 per Equity share.

You are required to calculate maximum permissible number of equity shares that can be bought back.

Buy Back of shares is duly authorized by its articles and necessary resolution has been passed by the company.

Answer:

Statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test (W.N.1)	15
Resources Test (W.N.2)	12
Debt Equity Ratio Test (W.N.3)	11
Maximum number of shares that can be bought back[least of the above]	11

Thus, the lowest being 11,000 shares, the company cannot buy back 14,000 shares.

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in thousands)
Number of shares outstanding	60
25% of the shares outstanding	15

2. Resources Test

Particulars	Rs. (in thousands)
Paid up capital	600
Free reserves (540 + 200 + 100)	<u>840</u>
Shareholders' funds	<u>1,440</u>
25% of Shareholders fund	360
Buy-back price per share	Rs. 30
Number of shares that can be bought back	12,000 shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

Particulars	Rs. in thousands
(a) Loan funds	2,000
(b) Minimum equity to be maintained after buy-back in the ratio of 2:1 (Rs.) (a/2)	1,000
(c) Present equity shareholders fund (Rs.)	1,440
(d) Future equity shareholders fund (Rs.) (see W.N.4) (1,440-110)	1,330
(e) Maximum permitted buy-back of Equity (Rs.)[(d) – (b)]	330
(f) Maximum number of shares that can be bought back @ Rs. 30 per share	11,000 shares

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

$$= (1,440 - x) - 1,000 = y$$

$$= 440 - x = y \quad (1)$$

Equation 2: Maximum Permitted Buy-Back X Nominal Value Per Share/Offer Price Per Share
 $y/30 \times 10 = x$

or

$$3x = y \quad (2)$$

by solving the above two equations we get

$$x = \text{Rs. 110 thousands } y = \text{Rs. 330 thousands}$$

Alternatively, Maximum number of shares from debt equity ratio test may be worked out as follows:

$$\text{Buy-back price} + \text{Face value of equity shares} \quad \text{Rs. 30} + \text{Rs. 10} = \text{Rs. 40}$$

Excess of equity fund over the minimum equity to be maintained $1440-1000 = 440$ thousands

$$\text{Number of Shares that can be bought back} = 440/40 \text{ thousands} \\ = 11 \text{ thousands.}$$

#3. Question | November 2023 Exam, 5 marks |

The following is the extract of Balance Sheet of Yellow Limited as on 31.03.2023:

	Rs.
4,00,000 Equity shares of Rs. 10 each	40,00,000
General Reserve	48,00,000
Profit & Loss Account	10,00,000
Securities Premium	18,00,000
Secured Loans	60,00,000
Unsecured Loans	32,00,000
Current Liabilities	28,00,000
	2,36,00,000
Property, Plant and Equipment	90,00,000

Investments	18,00,000
Current Assets	1,28,00,000
	2,36,00,000

The company intends to buy-back 80,000 equity shares of Rs. 10 each at a premium of 150%.

You are required to state whether the company can buy back equity shares.

Answer:

Determination of Buy-back of maximum no. of shares as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	(Shares)
Number of shares outstanding	4,00,000
25% of the shares outstanding	1,00,000

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	
Paid up capital (Rs.)	40,00,000
Free reserves (Rs.) (48,00,000 + 18,00,000 + 10,00,000)	76,00,000
Shareholders' funds (Rs.)	1,16,00,000
25% of Shareholders fund (Rs.)	29,00,000
Buy-back price per share	Rs. 25
Number of shares that can be bought back (shares) Actual	1,16,000
Number of shares for buy-back	80,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back. Debt Equity ratio of the company should not exceed 2:1 after such buy-back. In this case, the debt is Rs. 92,00,000 (60,00,000 + 32,00,000) and equity after such buy back will be Rs. 96,00,000 (1,16,00,000 – 20,00,000). Thus, the debt equity ratio is 0.96:1, which is less than 2:1. Company qualifies all tests for buy-back of shares and came to the conclusion that it can buy 80,000 equity shares @ Rs. 25.

#4. Question | November 2022 Exam, 5 marks |

PG Limited furnishes the following Balance Sheet as at 31st March, 2022:

	Particulars	Notes	₹ (in Lakhs)
1.	Equity and Liabilities		
	Shareholders' funds		
	Share Capital	1	12,000
	Reserves and Surplus	2	8,100
2.	Current liabilities		
	(a) Trade Payables		7,450
	(b) Other Current Liabilities		1,950
	Total		29,500
	Assets		
1.	Non-current assets		
	Property, Plant and Equipment		12,760
	Non-current Investments		740
2.	Current assets		
	Inventories		6,000
	Trade receivables		2,600
	Cash and cash equivalents		7,400

	Total	29,500

Notes to accounts:

	Particulars	₹ (in Lakhs)
1.	Share Capital	
	Authorized, issued and subscribed capital	
	Equity share capital (fully paid up shares of ₹ 10 each)	12,000
2	Reserves and Surplus	
	Securities premium	1,750
	General reserve	2,650
	Capital redemption reserve	2,000
	Profit and Loss	1,700
	Total	8100

On 1st April, 2022, the company announced the buy-back of 25% of its Equity Shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 750 lakhs. On 5th April, 2022, the company achieved the target of buy-back. You are required to pass necessary journal entries for the above transactions.

Answer

In the books of PG Limited

Journal Entries

Date	Particulars	Dr.	Cr.
2022 -Apr 1	Bank A/c Dr.	750	
	To Investment A/c		740
	To P& L A/c (Profit on sale of investment)		10
	(Being investment sold on profit)		
April 5	Equity share capital A/c Dr.	3,000	
	Premium payable on buy-back A/c Dr.	1,500	
	To Equity shares buy-back A/c		4,500
	(Being the amount due to equity shareholders on buy-back)		
	Securities Premium A/c Dr.	1,500	
	To Premium on Buy back A/c		1,500
	(Being the amount of premium charged from securities premium account)		
	Equity shares buy-back A/c Dr.	4,500	
	To Bank A/c		4,500
	(Being the payment made on account of buy-back of 30 Lakh Equity Shares)		
	Profit and Loss A/c Dr.	1,700	
	General reserve A/c Dr.	1,300	
	To Capital redemption reserve A/c		3,000
	(Being amount equal to nominal value of buy-back shares from free reserves transferred to capital redemption reserve account as per the law)		

Note:

1. In the last entry given in the solution, it is possible to adjust transfer to Capital Redemption Reserve Account from different combinations of amounts from Securities Premium, General Reserve and Profit and Loss Account to the extent available.

2. Calculation of amount of Buy Back of Share: ₹12,000/10 X 25% X ₹ 15 = ₹ 4,500 Lakhs

#5. Question | May 2022, 5 Marks |**Quick Ltd. has the following capital structure as on 31st March, 2021:**

		(₹) in Crores	
(1)	Share Capital:		462
	(Equity Shares of ₹ 10 each, fully paid)		
(2)	Reserves and Surplus:		
	General Reserve	336	
	Securities Premium Account	126	
	Profit and Loss Account	126	
	Statutory Reserve	180	
	Capital Redemption Reserve	87	
	Plant Revaluation Reserve	33	888
(3)	Loan Funds:		
	Secured	2,200	
	Unsecured	320	2,520

On the recommendations of the Board of Directors, on 16th September, 2021, the shareholders of the company have approved a proposal to buy-back of equity shares. The prevailing market value of the company's share is ₹ 20 per share and in order to induce the existing shareholders to offer their shares for buy-back, it was decided to offer a price of 50% over market value. The company had sufficient balance in its bank account for the buy-back of shares.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,680 Crores or ₹ 2,100 Crores. Assuming that the entire buy-back is completed by 31st December, 2021, Pass the necessary accounting entries (narrations not required) in the books of the company in each situation (10 Marks)

Answer

Statement determining the maximum number of shares to be bought back Number of shares

Particulars	When loan fund is		
	₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
Shares Outstanding Test (W.N.1)	11.55	11.55	11.55
Resources Test (W.N.2)	8.75	8.75	8.75
Debt Equity Ratio Test (W.N.3)	Nil	5.25	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	5.25	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹ 1,680 crores)

₹ in crores

(a)	Equity share buy-back account	Dr.	157.5	
	To Bank account			157.5
(b)	Equity share capital account (5.25 x ₹ 10)	Dr.	52.5	
	Securities premium account (5.25 x ₹ 20)	Dr.	105	
	To Equity share buy-back account			157.5
©	General reserve account	Dr.	52.5	
	To Capital redemption reserve account			52.5

Working Notes:**1. Shares Outstanding Test**

Particulars	(₹) Shares in Crores
Number of shares outstanding	46.2
25% of the shares outstanding	

2. Resources Test

Particulars	
Paid up capital (₹ in crores)	462
Free reserves (₹ in crores) (336+126+126)	588
Shareholders' funds (₹ in crores)	1,050
25% of Shareholders fund (₹ in crores)	₹ 262.5 crores
Buy-back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	8.75 crores shares

3. Debt Equity Ratio Test

Particulars		When loan fund is		
		₹ 2,520 crores	₹ 1,680 crores	₹ 2,100 crores
(a)	Loan funds (₹ in crores)	2,520	1,680	2,100
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹ in crores)	1,260	840	1,050
(c)	Present equity shareholders fund (₹ in crores)	1,050	1,050	1,050
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	N.A.	997.5 (1,050-52.5)	N.A.
(e)	Maximum permitted buy-back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	Nil	157.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	Nil	5.25 (by simultaneous equation)	Nil

Note:

- Under Situations 1 & 3 the company does not qualify for buy-back of shares as per the provisions of the Companies Act, 2013.
- As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back.

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then

Equation 1: (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity

$$(1,050 - x) - 840 = y$$

Since

$$\text{Equation 2} = \frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \times \text{Nominal Value}$$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \frac{y}{30} \times 10$$

$$\text{Or } 3x = y = (2)$$

by solving the above two equations we get

$$x = ₹ 52.5 \text{ crores } y = ₹ 157.5 \text{ crores}$$

3. Statutory reserves, capital redemption reserve and plant revaluation reserves are not free reserves.
4. For calculation of debt -equity ratio both secured and unsecured loans have been considered.

#6. Question | December 2021 Exams, 10 Marks

Mohan Ltd. furnishes the following summarised Balance Sheet on 31st March 2021. (₹ in Lakhs)

	Amount
Equity and Liabilities:	
Shareholders' fund	
Share Capital	
Equity Shares of ₹10 each fully paid up	780
6% Redeemable Preference shares of ₹50 each fully Paid up	240
Reserves and Surplus	
Capital Reserves	58
General Reserve	625
Securities Premium	52
Profit & Loss	148
Revaluation Reserve	34
Infrastructure Development Reserve	16
Non-current liabilities	
7% Debentures	268
Unsecured Loans	36
Current Liabilities	395
	2,652
Assets:	
Non-current Assets	
Plant and Equipment less depreciation	725
Investment at cost	720
Current Assets	1207
	2652

Other Information:

- (1) The company redeemed preference shares at a premium of 10% on 1st April, 2021.
- (2) It also offered to buy back the maximum permissible number of equity shares of ₹10 each at ₹30 per share on 2nd April 2021.
- (3) The payment for the above was made out of available bank balance, which appeared as a part of the current assets.
- (4) The company had investment in own debentures costing ₹60 lakhs (face value ₹75 lakhs). These debentures were cancelled on 2nd April 2021.
- (5) On 4th April 2021 company issued one fully paid-up equity share of ₹10 each by way of bonus for every five equity shares held by the shareholders.

You are required to:

- a. Calculate maximum possible number of equity shares that can be bought back as per the Companies Act, 2013 and

- b. Record the Journal Entries for the above-mentioned information.

Answer

(a)

- (i) **Statement determining the maximum number of shares to be bought back**
Number of shares (in lakhs)

Particulars	When loan fund is ₹304 lakhs
Shares Outstanding Test (W.N.1)	19.5
Resources Test (W.N.2)	11.175
Debt Equity Ratio Test (W.N.3)	29.725
Maximum number of shares that can be bought back [least of the above]	11.175

Thus, the company can buy 11,17,500 Equity shares at ₹30 each.

Working Notes:

a) Shares Outstanding Test

Particulars	(Shares in lakh)
Number of shares outstanding	78
25% of the shares outstanding	19.5

b) Resources Test

Particulars	
Paid up capital (₹ in lakh)	780
Free reserves (₹ in lakh) (625+52+148-24-240*)	561
Shareholders' funds (₹ in lakh)	1341
25% of Shareholders fund (₹ in lakh)	335.25
Buy-back price per share	30
Number of shares that can be bought back	11.175
*Amount transferred to CRR is excluded from free reserves. Premium on redemption also reduced.	

- c) Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy-Back

	Particulars	₹ In Lakh
(a)	Loan funds (₹)	304
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹) (a/2)	152
(c)	Present equity shareholders fund (₹)	1341
(d)	Future equity shareholders fund (₹) (see W.N.4)	1043.75 (1341-297.25)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	891.75
(f)	Maximum number of shares that can be bought back @ ₹30 per share	29.725
	As per the provisions of the Companies Act, 2013, Company	Qualifies

Alternatively, when current liabilities are considered as part of loan funds, in that case Debt Equity Ratio Test will be done as follows:

	Particulars	₹ In Lakh
(a)	Loan funds (₹)	699
(b)	Minimum equity to be maintained after buy- back in the ratio of 2:1 (₹) (a/2)	349.5
(c)	Present equity shareholders fund (₹)	1341

(d)	Future equity shareholders fund (₹) (see W.N.4)	1093.125 (1341-247.875)
(e)	Maximum permitted buy-back of Equity (₹) [(d) – (b)]	743.625
(f)	Maximum number of shares that can be bought back @ ₹30 per share	24.7875
	As per the provisions of the Companies Act, 2013, Company	Qualifies

d) Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy- back of equity is 'y'
Then

Equation 1: (Present Equity- Transfer to CRR) - Minimum Equity to be maintained = Maximum Permitted Buy-Back

$$= (1341 - x) - 152 = y$$

$$= 1189 - x = y \quad (1)$$

Equation 2: Maximum Permitted Buy-Back x Nominal Value Per Share/Offer Price Per Share

$$y/30 \times 10 = x \text{ or } 3x = y \quad (2)$$

by solving the above two equations we get $x = 247.875$ and $y = 743.625$

(ii) Journal Entries for Buy Back

Date	Particulars		Debit	Credit
2021 1st April	6% Redeemable preference share capital A/c	Dr.	240	
	Premium on redemption of preference shares A/c	Dr.	24	
	To Preference shareholders A/c			264
	(Being preference share capital transferred to shareholders account)			
	Preference shareholders A/c	Dr.	264	
				264
	(Being payment made to shareholders)			
	General Reserve or P&L A/c*		24	
	To Premium on redemption of preference shares A/c			24
	(Being premium on redemption of preference shares adjusted through securities premium)			
2nd April	Equity shares buy-back A/c	Dr.	335.25	
	To Bank A/c			335.25
	(Being 11.175 lakhs equity shares of ₹10 each bought back @ ₹30 per share)			
	Equity share capital A/c	Dr.	111.75	
	Securities Premium A/c	Dr.	52	
	General Reserve or P&L A/c	Dr.	171.50	
	To Equity Shares buy-back A/c			335.25
	(Being cancellation of shares bought back)			
	General reserve A/c	Dr.	351.75	
	To Capital redemption reserve A/c			351.75
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law ie. $240 + 111.75$ lakhs)			
2nd April	7% Debentures A/c	Dr.	75	
	To Investment (own debentures) A/c			60
	To Profit on cancellation of own debentures A/c			15

	(Being cancellation of own debentures costing ₹60 lakhs, face value being ₹75 lakhs and the balance being profit on cancellation of debentures)			
4th April	Capital Redemption Reserve	Dr.	133.65	
	To Bonus Shares A/c			133.65
	(Being issue of one bonus equity share for every five equity shares held)			
	Bonus shares A/c	Dr.	133.65	
	To Equity share capital A/c			133.65
	(Being bonus shares issued)			

Working Note: Bonus Share to be issued = 66.825 (78 - 11.175) lakh shares divided by 5 = 13.365 lakh shares.

Note: *Securities premium has not been utilized for the purpose of premium payable on redemption of preference shares assuming that the company referred in the question is governed by Section 133 of the Companies Act, 2013 and complies with the Accounting Standards prescribed for them. Alternative entry considering otherwise is also possible by utilizing securities premium amount.

#7. Question | July 2021, 15 Marks |

A company provides the following 2 possible Capital Structures as on 31st March, 2021:

Particulars	Situation 1	Situation 2
	₹	₹
Equity Share Capital (Shares of ₹10 each, fully paid up)	30,00,000	30,00,000
Reserves & Surplus:		
General Reserve	12,00,000	12,00,000
Securities Premium	6,00,000	6,00,000
Profit & Loss	2,10,000	2,10,000
Statutory Reserve	4,20,000	4,20,000
Loan Funds	25,00,000	1,20,00,000

The company is planning to offer buy back of Equity Share at a price of ₹30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in both the situations as per Companies Act, 2013 and are also required to pass necessary Journal Entries in the situation where the buyback is possible.

Answer

Statement determining the maximum number of shares to be bought back

Particulars	When loan fund is	
	₹25,00,000	₹1,20,00,000
Shares Outstanding Test (W.N.1)	75,000	75,000
Resources Test (W.N.2)	41,750	41,750
Debt Equity Ratio Test (W.N.3)	94,000	Nil
Maximum number of shares that can be bought back [least of the above]	41,750	Nil

Journal Entries for the Buy-Back (applicable only when loan fund is ₹25,00,000)

	Particulars		Debit	Credit
(a)	Equity shares buy-back account	Dr.	12,52,500	
	To Bank account			12,52,500
	(Being payment for buy-back of 41,750 equity shares of ₹10 each @ ₹30 per share)			
(b)	Equity share capital account (5.25 x ₹ 10)	Dr.	52.5	
	Securities premium account (5.25 x ₹ 20)	Dr.	105	

	To Equity share buy-back account			157.5
©	General reserve account	Dr.	52.5	
	To Capital redemption reserve account			52.5

#8. Question | January 2021, 5 Marks |

The Directors of Umang Ltd. passed a resolution to buyback 5,00,000 of its fully paid equity shares of ₹10 each at ₹15 per share. This buyback is in compliance with the provisions of the Companies Act, 2013.

For this purpose, the company

- Sold its investments of ₹30,00,000 for ₹25,00,000.
 - Issued 20,000, 12% preference shares of ₹100 each at par, the entire amount being payable with application.
 - Used ₹15,00,000 of its Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back.
 - The company has necessary cash balance for the payment to shareholders.
- You are required to pass necessary Journal Entries (including narration) regarding buyback of shares in the books of Umang Ltd.

Answer

Journal Entries in the books of Umang Ltd.

		Dr.	Cr.
1.	Bank A/c	Dr. 25,00,000	
	Profit and Loss A/c	Dr. 5,00,000	
	To Investment A/c		30,00,000
	(Being investment sold for the purpose of buy-back of Equity Shares)		
2.	Bank A/c	Dr. 20,00,000	
	To 12% Pref. Share capital A/c		20,00,000
	(Being 12% Pref. Shares issued for ₹20,00,000)		
3.	Equity share capital A/c	Dr. 50,00,000	
	Premium payable on buy-back	Dr. 25,00,000	
	To Equity shares buy-back A/c		75,00,000
	Equity shareholders A/c		
	(Being the amount due on buy-back of equity shares)		
4.	Equity shares buy-back A/c/ Equity shareholders A/c	Dr. 75,00,000	
	To Bank A/c		75,00,000
	(Being payment made for buy-back of equity shares)		
5.	Securities Premium A/c General	Dr. 15,00,000	
	Reserve A/c	Dr. 10,00,000	
	To Premium payable on buy-back		25,00,000
	(Being premium payable on buy-back charged from Securities premium)		
6.	General Reserve A/c	Dr. 30,00,000	
	To Capital Redemption Reserve A/c		30,00,000
	(Being creation of capital redemption reserve to the extent of the equity shares bought back after deducting fresh pref. shares issued)		

#9. Question | November 2019 Exam, 15 Marks |

X Ltd. furnishes the following summarized Balance Sheet as at 31-03-2018.

Liabilities	₹	₹
Share Capital		
Equity Share Capital of ₹20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹100 each fully paid up	10,00,000	60,00,000
Reserves & Surplus		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	20,00,000	
Dividend Equalization Fund	<u>5,50,000</u>	43,50,000
Non-Current Liabilities		
12% Debenture		12,50,000
Current Liabilities and Provisions		5,50,000
Total		1,21,50,000
Fixed Assets		
Tangible Assets		1,00,75,000
Current Assets		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	<u>15,75,000</u>	<u>20,75,000</u>
Total		<u>1,21,50,000</u>

The shareholders adopted the resolution on the date of the above mentioned Balance Sheet to:

- (1) Buy back 25% of the paid up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹30 per share.
 - (2) To finance the buy back of share company :
 - (a) Issue 3000, 14 % debenture of 100 each at a premium of 20%
 - (b) Issue 2500, 10 % preference share of ₹100 each
 - (3) Sell investment worth ₹1,00,000 for ₹1,50,000.
 - (4) Maintain a balance of ₹2,00,000 in Revenue Reserve.
 - (5) Later the company issue three fully paid up equity share of ₹20 each by way of bonus share for every 15 equity share held by the equity shareholder.
- You are required to pass the necessary journal entries to record the above transactions and prepare Balance Sheet after buy back.

Answer

In the books of X Limited Journal Entries

	Particulars	Dr.	Cr.
1.	Bank A/c Dr.	3,60,000	
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
2.	Bank A/c Dr.	2,50,000	
	To 10% preference share capital A/c		2,50,000
	(Being 10% preference share issued to finance buy back)		
3.	Bank A/c	1,50,000	
	To Investment A/c		1,00,000
	To Profit on sale of investment (Being investment sold on profit)		50,000

4.	Equity share capital A/c (62,500 x ₹20) Dr.	12,50,000	
	Securities premium A/c (62,500 x ₹16) Dr.	10,00,000	
	To Equity shares buy back A/c (62,500 x ₹36)		22,50,000
	(Being the amount due to equity shareholders on buy back)		
5.	Equity shares buy back A/c Dr.	22,50,000	
	To Bank A/c		22,50,000
	(Being the payment made on account of buy back of 62,500 Equity Shares as per the Companies Act)		
6.	Revenue reserve Dr.	3,00,000	
	Securities premium Dr.	2,60,000	
	Profit and Loss A/c Dr.	4,40,000	
	To Capital redemption reserve A/c*		10,00,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law) [12,50,000 less 2,50,000]		
7.	Capital redemption reserve A/c Dr.	7,50,000	
	To Bonus shares A/c (W.N.1)		7,50,000
	(Being the utilization of capital redemption reserve to issue 37,500 bonus shares)		
8.	Bonus shares A/c Dr.	7,50,000	
	To Equity share capital A/c		7,50,000
	(Being issue of 3 bonus equity share for every 15 equity shares held)		

*Alternatively, entry for combination of different amounts (from Revenue reserve, Securities premium and profit and Loss account.) may be passed for transferring the required amount to CRR.

Note: It may be noted that as per the provisions of the Companies Act, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Issue of debentures has been excluded for the purpose of "specified securities" and the entire amount of ₹10,00,000 (after deducting only pref. share capital) has been credited to CRR while solving the question.

#10. Question | May 2019 Exams, 10 Marks |

Following is the summarized Balance Sheet of Super Ltd. as on 31st March, 2018.

Liabilities	₹
Share Capital	
Equity Share Capital of ₹10 each fully paid up	17,00,000
Reserves & Surplus	
Revenue Reserve	23,50,000
Securities Premium	2,50,000
Profit & Loss Account	2,00,000
Infrastructure Development Reserve	1,50,000
Secured Loan	
9% Debentures	22,50,000
Unsecured Loan	8,50,000
Current Maturities of Long term borrowings	15,50,000
	93,00,000
Assets	
Property, Plant & Equipment	

Tangible Assets	58,50,000
Current Assets	34,50,000
	93,00,000

Super Limited wants to buy back 35,000 equity shares of ₹10 each fully paid up on 1st April, 2018 at ₹30 per share. Buy Back of shares is fully authorised by its articles and necessary resolutions have been passed by the company towards this. The payment for buy back of shares will be made by the company out of sufficient bank balance available as part of the Current Assets.

Comment with calculations, whether the Buy Back of shares by the company is within the provisions of the Companies Act, 2013.

Answer

Determination of maximum no. of shares that can be bought back as per the Companies Act, 2013

1. Shares Outstanding Test

Particulars	(Shares)
Number of shares outstanding	1,70,000
25% of the shares outstanding	42,500

2. Resources Test: Maximum permitted limit 25% of Equity paid up capital + Free Reserves

Particulars	₹
Paid up capital (₹)	17,00,000
Free reserves (₹) (23,50,000 + 2,50,000 + 2,00,000)	28,00,000
Shareholders' funds (₹)	45,00,000
25% of Shareholders fund (₹)	11,25,000
Buy back price per share	₹30
Number of shares that can be bought back (shares)	37,500
Actual Number of shares proposed for buy back	35,000

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Shareholder's Funds post Buy Back

Particulars	₹
(a) Loan funds (₹) (22,50,000+8,50,000+15,50,000)	46,50,000
(b) Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2)	23,25,000
© Present equity/shareholders fund (₹)	45,00,000
(d) Future equity/shareholders fund (₹) (see W.N.) (45,00,000 – 5,43,750)	39,56,250*
(e) Maximum permitted buy back of Equity (₹) [(d) – (b)]	16,31,250
(f) Maximum number of shares that can be bought back @ ₹30 per share	54,375 shares
(g) Actual Buy Back Proposed	35,000 Shares

Summary statement determining the maximum number of shares to be bought back

Particulars	Number of shares
Shares Outstanding Test	42,500
Resources Test	37,500
Debt Equity Ratio Test	54,375
Maximum number of shares that can be bought back [least of the above]	37,500

Company qualifies all tests for buy-back of shares and it can buy back maximum 37,500 shares on 1st April, 2018.

However, company wants to buy-back only 35,000 equity shares @ ₹30. Therefore, buyback of 35,000 shares, as desired by the company is within the provisions of the Companies Act, 2013.

Working Note:

Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Then $(45,00,000 - x) - 23,25,000 = y$ (1)

$= \left(\frac{y}{30} \times 10 \right) = x$ Or $3x = y$ (2)

by solving the above equation, we get

$x = ₹5,43,750$

$y = ₹16,31,250$

#11. Question | May 2019 Exams, 10 Marks|

Alpha Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2017:

	₹ In lakhs	₹ In lakhs
Equity & Liabilities		
Shareholders' Funds		
Equity share capital (fully paid up shares of ₹10 each)		2,400
Reserves and Surplus		
Securities Premium	350	
General Reserve	530	
Capital Redemption Reserve	400	
Profit & Loss Account	<u>340</u>	1,620
Non-current Liabilities		
12% Debentures	1,500	
Current Liabilities		
Trade Payables	1,490	
Other Current Liabilities	<u>390</u>	<u>1,880</u>
Total		<u>7,400</u>
Assets		
Non-current Assets		
Property, Plant & Equipment		4,052
Current Assets		
Current Investments	148	
Inventories	1,200	
Trade Receivables	520	
Cash and Bank	<u>1,480</u>	<u>3,348</u>
Total		<u>7,400</u>

- On 1st April, 2017, the company announced buy-back of 25% of its equity shares@ ₹15 per share. For this purpose, it sold all its investment for ₹150 lakhs.
- On 10th April, 2017 the company achieved the target of buy-back.
- On 30th April, 2017, the company issued one fully paid up equity share of ₹10 each by way of bonus for every four equity shares held by the equity shareholders by capitalization of Capital Redemption Reserve.

You are required to pass necessary journal entries and prepare the Balance Sheet of Alpha Ltd. after bonus issue.

Answer
In the books of Alpha Limited

Journal Entries

Date	Particulars		Dr.	Cr.
2017			(₹ in lakhs)	
April 1	Bank A/c	Dr.	150	
	To Investment A/c			148
	To Profit on sale of investment			2
	(Being investment sold on profit)			
April 10	Equity share capital A/c	Dr.	600	
	Securities premium A/c	Dr.	300	
	To Equity shares buy back A/c			900
	(Being the amount due to equity shareholders on buy back)			
	Equity shares buy back A/c	Dr.	900	
	To Bank A/c			900
	(Being the payment made on account of buy back of 60 Lakh Equity Shares)			
April 10	General reserve A/c	Dr.	530	
	Profit and Loss A/c	Dr.	70	
	To Capital redemption reserve (CRR) A/c			600
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law)			
April 30	Capital redemption reserve A/c	Dr.	450	
	To Bonus shares A/c (W.N.1)			450
	(Being the utilization of capital redemption reserve to issue bonus shares)			
	Profit on sale of Investment	Dr.	2	
	To Profit and Loss A/c			2

Note: For transferring amount equal to nominal value of buy back shares from free reserves to capital redemption reserve account, the amount of ₹340 lakhs from P & L A/c and the balance from general reserve may also be utilized. The combination of different set of amounts (from General Reserve and Profit and Loss Account) aggregating ₹600 lakhs may also be considered for the purpose of transfer to CRR.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount (₹ in Lakhs)
<u>Equity & Liabilities</u>		
(1) Shareholder's Funds		
(a) Share Capital	1	2,250
(b) Reserves and Surplus	2	872
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		1,500
(3) Current Liabilities		
(a) Trade payables		1,490
(b) Other current liabilities		390
Total		6,502
<u>Assets</u>		
(1) Non-current assets		

(a) Fixed assets		
(i) Tangible assets		4,052
(2) Current assets		
(a) Current investments		
(b) Inventory		1,200
(c) Trade receivables		520
(d) Cash and cash equivalents (W.N. 2)		730
Total		6,502

Notes to Accounts

Date	Particulars	Dr.	Cr.
2017		(₹ in lakhs)	
April 1	Bank A/c	Dr. 150	
	To Investment A/c		148
	To Profit on sale of investment		2
	(Profit on sale transfer to Profit and Loss A/c)		

Note: For transferring amount equal to nominal value of buy back shares from free reserves to capital redemption reserve account, the amount of ₹340 lakhs from P & L A/c and the balance from general reserve may also be utilized. The combination of different set of amounts (from General Reserve and Profit and Loss Account) aggregating ₹600 lakhs may also be considered for the purpose of transfer to CRR.

Balance Sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount (₹ in Lakhs)
<u>Equity & Liabilities</u>		
(1) Shareholder's Funds		
(c) Share Capital	1	2,250
(d) Reserves and Surplus	2	872
(3) Non-Current Liabilities		
(b) Long-term borrowings - 12% Debentures		1,500
(4) Current Liabilities		
(c) Trade payables		1,490
(d) Other current liabilities		390
Total		6,502
<u>Assets</u>		
(3) Non-current assets		
(b) Fixed assets		
(i) Tangible assets		4,052
(4) Current assets		
(e) Current investments		
(f) Inventory		1,200
(g) Trade receivables		520
(h) Cash and cash equivalents (W.N. 2)		730
Total		6,502

Notes to Accounts

Particulars		(₹ in Lakhs)
1. Share Capital		
Equity share capital (225 lakh fully paid up shares of ₹10 each)		2,250

2. Reserves and Surplus			
General Reserve	530		
Less: Transfer to CRR	(530)		
Capital Redemption Reserve	400		
Add: Transfer due to buy-back of shares from P/L	70		
Add: Transfer due to buy-back of shares from Gen. res.	530		
Less: Utilisation for issue of bonus shares	(450)	550	
Securities premium	350		
Less: Adjustment for premium paid on buy back	(300)	50	
Profit & Loss A/c	340		
Add: Profit on sale of investment	2		
Less: Transfer to CRR	(70)	272	872

Working Notes:

- Amount of equity share capital** = 2,400 - 600 (buyback) + 450 (Bonus shares) = 2,250
- Cash at bank after issue of bonus shares**

	₹ in lakhs
Cash balance as on 1st April, 2017	1480
Add: Sale of investments	150
	1630
Less: Payment for buy back of shares	(900)
	730

#12. Question | RTP Sep 2024 Exams |

Purpose Ltd. resolves to buy back 4 lakhs of its fully paid equity shares of Rs. 10 each at Rs. 22 per share. This buyback is in compliance with the provisions of the Companies Act and does not exceed 25% of Company's paid up capital in the financial year. For the purpose, it issues 1 lakh 11 % preference shares of Rs. 10 each at par, the entire amount being payable with applications. The company uses Rs. 16 lakhs of its balance in Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back. Give necessary journal entries to record the above transactions.

Answer:

Journal Entries in the books of Purpose Ltd.

			Rs.	Rs.
1.	Bank A/c	Dr.	10,00,000	
	To 11% Preference share application & allotment A/c			10,00,000
2.	(Being receipt of application money on preference shares)			
	11% Preference share application & allotment A/c	Dr.	10,00,000	
	To 11% Preference share capital A/c			10,00,000
3.	(Being allotment of 1 lakh preference shares)			
	General reserve A/c	Dr.	30,00,000	
	To Capital redemption reserve A/c			30,00,000

4.	(Being creation of capital redemption reserve for buy back of shares)	Dr.	40,00,000	
	Equity share capital A/c	Dr.	48,00,000	
	Premium payable on buyback A/c			88,00,000
	To Equity shareholders/Equity shares buy back A/c			
5.	(Amount payable to equity shareholder on buy back)	Dr.	88,00,000	
	Equity shareholders/ Equity shares buy back A/c			88,00,000
	To Bank A/c			
6.	(Being payment made for buy back of shares)	Dr.	16,00,000	
	Securities Premium A/c			
	General reserve A/c		32,00,000	
	To Premium payable on buyback A/c			48,00,000
	(Being premium on buyback charged from securities premium and general reserve)			

Working Notes:

1. Calculation of amount used from General Reserve Account

	Rs.
Amount paid for buy back of shares (4,00,000 shares x Rs. 22)	88,00,000
Less: Proceeds from issue of Preference Shares (1,00,000 shares x Rs. 10)	(10,00,000)
Less: Utilization of Securities Premium Account	<u>(16,00,000)</u>
Balance used from General Reserve Account	<u>62,00,000</u>
* Used under Section 68 for buy back 32,00,000	
Used under Section 69 for transfer to CRR (W.N 2) <u>30,00,000</u>	
<u>62,00,000</u>	

2. Amount to be transferred to Capital Redemption Reserve account

	Rs.
Nominal value of shares bought back (4,00,000 shares x Rs. 10)	40,00,000
Less: Nominal value of Preference Shares issued for such buy back (1,00,000 shares x Rs. 10)	<u>(10,00,000)</u>
Amount transferred to Capital Redemption Reserve Account	<u>30,00,000</u>

#13. Question | RTP May 2023 Exams |

Pay Limited provides you with the following information as at 31st March, 2022:

	(₹ in Lakhs)
Share Capital:	
Authorised	300
Issued:	

11% Redeemable preference shares of ₹100 each fully paid	125	
Equity shares of ₹10 each fully paid	175	175
Reserves and surplus:		
Capital reserve	35	
Securities premium	105	
Revenue reserves	460	
Profit and loss account	50	650
Current liabilities and provisions		50
Fixed assets: cost	100	
Less: Accumulated depreciation	(90)	10
Non-current investments at cost (Market value ₹400 Lakhs)		200
Current assets		790

- (i) The company redeemed preference shares at a premium of 4% on 1st April, 2022.
(ii) It also bought back 2.5 lakhs equity shares of ₹10 each at ₹40 per share. The payments for the above were made out of the bank balances, which appeared as a part of current assets.

You are asked to:

- (1) Pass journal entries to record the above.
(2) Prepare balance sheet as at 01.04.2022.

Answer

(i) Journal entries in the books of Pay Ltd.

₹ in lakhs

Date	Particulars	Dr.	Cr.
1st		(₹ in lakhs)	
April, 2022	11% Preference share capital A/c	Dr.	125
	Premium payable on Redemption of Preference Shares	Dr.	5
	To Preference shareholders A/c (Being preference share capital account transferred to shareholders account)		130
	Preference shareholders A/c	Dr.	130
	To Bank A/c (Being payment made to shareholders)		130
	Shares buy back A/c	Dr.	100
	To Bank A/c (Being 2.5 lakhs equity shares bought back @ ₹40 per share)		100
	Equity share capital A/c (2.5 lakh x ₹10)	Dr.	25
	Premium payable on buy- back A/c (2.5 lakh x ₹30)	Dr.	75
	To Shares buy back A/c (Being cancellation of shares bought back)		100
	Revenue reserve A/c	Dr.	80
	To Premium payable on Redemption of Pref. Shares		5
	To Premium payable on buy- back A/c (Being premium on preference shares redeemed* and equity shares bought back charged to securities premium account)		75

*Securities premium utilized for premium on preference shares redeemed assuming that the company is not governed under section 133 of the Companies Act. Alternatively, it may not be utilized assuming otherwise.

(ii) Balance Sheet of Pay Ltd as at 1.4.2022

Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000
Property, plant and equipment	46,50,000
Current assets	40,00,000

The Company wants to buy back 25,000 equity shares of ₹10 each, on 1st April, 2021 at ₹15 per share. Buy back of shares is duly authorized by its Articles and necessary resolution has been passed by the Company for this. The buy-back of shares by the Company is also within the provisions of the Companies Act, 2013. The payment for buy back of shares was made by the Company out of sufficient bank balance available shown as part of Current Assets. You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet of the company after buy back of shares.

Answer

As per the information given in the question, buy-back of 25,000 shares @ ₹15, as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

Date	Particulars	Dr.	Cr.
(a)		(₹ in lakhs)	
	Equity shares buy-back account	Dr.	3,75,000
	To Bank account		3,75,000
	(Being buy back of 25,000 equity shares of ₹10 each @ ₹15 per share)		
(b)	Equity share capital account	Dr.	2,50,000
	Premium payable on buyback account	Dr.	1,25,000
	To Equity shares buy-back account		3,75,000
	(Being cancellation of shares bought back)		
©	Securities premium account	Dr.	1,25,000
	To Premium payable on buyback account		1,25,000
	(Being Premium payable on buyback adjusted against securities premium account)		
(d)	Revenue reserve account	Dr.	2,50,000
	To Capital redemption reserve account		2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)		

Balance Sheet of Complicated Ltd. as on 1st April

Particulars	Note No	Amount (₹)
Equity & Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	11,00,000
(b) Reserves and Surplus	2	22,25,000
(2) Non-current liabilities		
(a) Long-term borrowings	3	28,75,000
(3) Current liabilities		
(a) Other current liabilities	4	19,50,000
Total		81,50,000
Assets		
(1) Non-current assets		
(a) Property, plant and Equipment		46,50,000

(2) Current assets (40,00,000-5,00,000)		<u>35,00,000</u>
Total		81,50,000

Notes to Accounts

1. Share Capital		
Equity share capital		
1,10,000 Equity shares of ₹10 each		11,00,000
2. Reserves and Surplus	1,25,000	
Profit and Loss A/c 15,00,000		
Less: Transfer to CRR (2,50,000)	12,50,000	
Securities premium 2,50,000		
Less: Utilization for share buy-back (2,50,000)	-	
Share Option Outstanding Account	4,00,000	
Capital Reserve	2,00,000	
Capital Redemption Reserve	<u>2,50,000</u>	<u>22,25,000</u>
3. Long-term borrowings		
Secured		
12% Debentures	18,75,000	
Unsecured loans	<u>10,00,000</u>	<u>28,75,000</u>
4. Other Current Liabilities		
Current maturities of long term borrowings	16,50,000	
Unpaid dividend	1,00,000	
Application money received for allotment due for refund	<u>2,00,000</u>	<u>19,50,000</u>

#15. Question | RTP November 2021 |

Rohan Ltd. furnishes the following information as at 31-03-2021.

	(₹)	(₹)
Share Capital:		
Equity Share Capital of ₹20 each fully paid up	50,00,000	
10,000, 10% Preference Shares of ₹100 each fully paid up	<u>10,00,000</u>	60,00,000
Reserves & Surplus:		
Capital Reserve	1,00,000	
Security Premium	12,00,000	
Revenue Reserve	5,00,000	
Profit and Loss	<u>25,50,000</u>	43,50,000
12% Debentures		12,50,000
Current Liabilities and Provisions		5,50,000
Property, Plant and Equipment		1,00,75,000
Current Assets:		
Investment	3,00,000	
Inventory	2,00,000	
Cash and Bank	<u>15,75,000</u>	20,75,000

The shareholders adopted the following resolution on 31st March, 2021:

- (1) Buy back 25% of the paid-up capital and it was decided to offer a price of 20% over market price. The prevailing market value of the company's share is ₹30 per share.
- (2) To finance the buy-back of shares, company:
 - (a) Issues 3,000, 14% debentures of ₹100 each at a premium of 20%.

- (b) Issues 2,500, 10% preference shares of ₹100 each.
- (3) Sell investment worth ₹1,00,000 for ₹1,50,000.
- (4) Maintain a balance of ₹2,00,000 in Revenue Reserve.
- (5) Later, the company issue three fully paid up equity shares of ₹20 each by way of bonus for every 15 equity shares held by the equity shareholders. You are required to pass the necessary journal entries to record the above transactions.

Answer

In the books of Rohan Limited

Journal Entries

	Particulars	Dr.	Cr.
1.		(₹ in lakhs)	
	Bank account	Dr.	3,60,000
	To 14 % Debenture A/c		3,00,000
	To Securities Premium A/c		60,000
	(Being 14 % debentures issued to finance buy back)		
2.	Bank A/c	Dr.	2,50,000
	To 10% preference share capital A/c		2,50,000
	(Being 10% preference share issued to finance buy back)		
3.	Bank A/c	Dr.	1,50,000
	To Investment A/c		1,00,000
	To Profit on sale of investment		50,000
	(Being investment sold on profit)		
4.	Equity share capital A/c (62,500 x ₹20)	Dr.	12,50,000
	Premium on buyback or Securities premium A/c (62,500 x ₹16)	Dr.	10,00,000
	To Equity shares buy back A/c (62,500 x ₹36)		22,50,000
	(Being the amount due to equity shareholders on buy back)		
5.	Equity shares buy back A/c	Dr.	22,50,000
	To Bank A/c		22,50,000
	(Being the payment made on account of buy back of 62,500 Equity Shares as per the Companies Act)		
6.	Revenue reserve	Dr.	3,00,000
	Securities premium	Dr.	2,60,000
	Profit and Loss A/c	Dr.	4,40,000
	To Capital redemption reserve A/c		10,00,000
	(Being amount equal to nominal value of buy back shares from free reserves transferred to capital redemption reserve account as per the law) [12,50,000 less 2,50,000]		
7.	Capital redemption reserve A/c	Dr.	7,50,00
	To Bonus shares A/c		7,50,00
	(Being the utilization of capital redemption reserve to issue 37,500 bonus shares)		
8.	Bonus shares A/c	Dr.	7,50,000
	To Equity share capital A/c		7,50,000
	(Being issue of 3 bonus equity share for every 15 equity shares held)		

#16.Question | RTP November 2020, November 2018|

M/s. Vriddhi Infra Ltd. (a non-listed company) provide the following information as on 31.3.2020:

	(₹)
Land and Building	21,50,000
Plant & Machinery	15,00,000
Non- current Investment	2,00,000
Trade Receivables	5,50,000
Inventories	1,80,000
Cash and Cash Equivalent	40,000
Share capital:1,00,000 Equity Shares of ₹10 each fully paid up	10,00,000
Securities Premium	3,00,000
General Reserve	2,50,000
Profit & Loss Account (Surplus)	1,50,000
10% Debentures (Secured by floating charge on all assets)	20,00,000
Unsecured Loans	8,00,000
Trade Payables	1,20,000

On 21st April, 2020 the Company announced the buy back of 15,000 of its equity shares @₹15 per share. For this purpose, it sold all its investment for ₹2.50 lakhs. On 25th April, 2020, the company achieved the target of buy back. On 1st May, 2020 the company issued one fully paid up share of ₹10 each by way of bonus for every eight equity shares held by the equity shareholders. You are required to pass necessary Journal Entries for the above transactions.

Answer**In the books of Vriddhi Infra Ltd. Journal Entries**

Date	Particulars	Dr.	Cr.
2020		(₹ in lakhs)	
April 21	Bank account	Dr.	2,50,000
	To Investment A/c		2,00,000
	To Profit on sale of investment		50,000
	(Being investment sold on profit)		
April 25	Equity share capital A/c	Dr.	1,50,000
	Securities premium A/c	Dr.	75,000
	To Equity shares buy back A/c		2,25,000
	(Being the amount due to equity shareholders on buy back)		
	Equity shares buy back A/c	Dr.	2,25,000
			2,25,000
	(Being the payment made on account of buy back of 15,000 Equity Shares)		
	General Reserve A/c OR P&L A/c	Dr.	1,50,000
	To Capital redemption reserve A/c		1,50,000
	(Being amount equal to nominal value of buy back shares transferred from free reserves to capital redemption reserve account as per the law)		
May 1	Capital redemption reserve A/c	Dr.	1,06,250
	To Bonus shares A/c (W.N.1)		1,06,250
	(Being the utilization of capital redemption reserve to issue bonus shares)		
	Bonus shares A/c	Dr.	1,06,250

To Equity share capital A/c			1,06,250
(Being issue of one bonus equity share for every ten equity shares held)			

Working Note:

Amount of bonus shares = $[(1,00,000 - 15,000) \times 1/8] \times 10$

= ₹1,06,250

#17.Question | RTP November 2020|

Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 2020:

Particulars	(₹)	(₹)
Equity Share Capital (shares of ₹10 each fully paid)		30,00,000
Reserves & Surplus		
General Reserve	32,50,000	
Security Premium Account	6,00,000	
Profit & Loss Account	4,30,000	
Revaluation Reserve	6,20,000	49,00,000
Loan Funds		42,00,000

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy back is ₹30 per share.

Answer

Debt Equity Ratio Test

	Particulars	
a)	Loan funds	42,00,000
b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹ in crores)	21,00,000
c)	Present equity shareholders fund (₹ in crores)	72,80,000
d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
e)	Maximum permitted buy back of Equity (₹ in crores) [(d) - (b)] (See Note 2)	38,85,000 (by simultaneous equation)
f)	Maximum number of shares that can be bought back @ ₹30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Notes:

- Shareholders' funds

Particulars	(₹)
Paid up capital	30,00,000
Free reserves (32,50,000 +6,00,000+4,30,000)	<u>42,80,000</u>
	72,80,000

- 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

$$(72,80,000 - x) - 21,00,000 = y \quad (1)$$

$$\text{Since } 51,80,000 - x = y$$

$$\text{Equation 2 : } \left(\frac{\text{Maximum buy-Back}}{\text{Offer price for buy-back}} \times \text{Nominal Value} \right)$$

= Nominal value of the shares bought -back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10 \right) = x$$

$$3x = y$$

$$x = ₹12,95,000 \text{ crores and } y = ₹38,85,000 \text{ crores}$$

#18.Question | RTP November 2019|

Umesh Ltd. resolves to buy back 4 lakhs of its fully paid equity shares of ₹10 each at ₹22 per share. This buyback is in compliance with the provisions of the Companies Act and does not exceed 25% of Company's paid up capital in the financial year. For the purpose, it issues 1 lakh 11 % preference shares of ₹10 each at par, the entire amount being payable with applications. The company uses ₹16 lakhs of its balance in Securities Premium Account apart from its adequate balance in General Reserve to fulfill the legal requirements regarding buy-back. Give necessary journal entries to record the above transactions.

Journal Entries in the books of Umesh Ltd.

		Dr.	Cr.
		(₹ in lakhs)	
1.	Bank account	Dr. 10,00,000	
	11% Preference share application & allotment A/c (Being receipt of application money on preference shares)		10,00,000
2.	11% Preference share application & allotment A/c To 11% Preference share capital A/c (Being allotment of 1 lakh preference shares)	Dr. 10,00,000	10,00,000
3.	General reserve A/c To Capital redemption reserve A/c (Being creation of capital redemption reserve for buy back of shares)	Dr. 30,00,000	30,00,000
4.	Equity share capital A/c Premium payable on buyback A/c To Equity shareholders/Equity shares buy back A/c (Amount payable to equity shareholder on buy back)	Dr. 40,00,000 Dr. 48,00,000	88,00,000
5.	Equity shareholders/ Equity shares buy back A/c To Bank A/c (Being payment made for buy back of shares)	Dr. 88,00,000	88,00,000
6.	Securities Premium A/c General reserve A/c To Premium payable on buyback A/c (Being premium on buyback charged from securities premium and general reserve)	Dr. 16,00,000 Dr. 32,00,000	48,00,000

Working Notes:

1. Calculation of amount used from General Reserve Account

Particulars	(₹)
Amount paid for buy back of shares (4,00,000 shares x ₹22)	88,00,000
Less: Proceeds from issue of Preference Shares (1,00,000 shares x ₹10)	(10,00,000)

Less: Utilization of Securities Premium Account		(16,00,000)
Balance used from General Reserve Account		62,00,000
* Used under Section 68 for buy back	32,00,000	
Used under Section 69 for transfer to CRR (W.N 2)	30,00,000	
	62,00,000	

2. Amount to be transferred to Capital Redemption Reserve account

Particulars	(₹)
Nominal value of shares bought back (4,00,000 shares x ₹10)	40,00,000
Less: Nominal value of Preference Shares issued for such buy back (1,00,000 shares x ₹10)	(10,00,000)
Amount transferred to Capital Redemption Reserve Account	30,00,000

#19. Question | RTP May 2019 |

Alpha Limited furnishes the following summarized Balance Sheet as at 31st March, 2017:

Liabilities	(₹)	Assets	(₹)
Equity share capital (fully paid up shares of ₹10 each)	2,400	Machinery	3,600
Securities premium	350	Furniture	450
General reserve	530	Investment	148
Capital redemption reserve	400	Inventory	1,200
Profit & loss A/c	340	Trade receivables	500
12% Debentures	1,500	Cash at bank	1,500
Trade payables	1,400		
Other current liabilities	478		
	7,398		7,398

On 1st April, 2017, the company announced the buy back of 25% of its equity shares @ ₹15 per share. For this purpose, it sold all of its investments for ₹150 lakhs. On 5th April, 2017, the company achieved the target of buy back.

You are required to:

1. Pass necessary journal entries for the buy-back.
2. Prepare Balance Sheet of Alpha Limited after buy-back of the shares.

Answer

In the books of Alpha Limited Journal Entries

Date		Dr.	Cr.
2017			
April 1			(₹ in lakhs)
	Bank account	Dr.	150
	To Investment A/c		148
	To Profit on sale of investment		2
	(Being investment sold on profit)		
April 5	Equity share capital A/c	Dr.	600
	Securities premium A/c	Dr.	300
	To Equity shares buy back A/c		900
	(Being the amount due to equity shareholders on buy back)		
	Equity shares buy back A/c	Dr.	900
	To Bank A/c		900

	(Being the payment made on account of buy back of 60 Lakh Equity Shares)			
April 5	General reserve A/c	Dr.	530	
	Profit and Loss A/c	Dr.	70	
	To Capital redemption reserve A/c			600
	(Being amount equal to nominal value of bought back shares from free reserves transferred to capital redemption reserve account as per the law)			

Balance Sheet (After buy back)

Particulars	Note No	(₹ in Lakhs)
Equity and Liabilities		
1. Shareholder's Funds		
(a) Share Capital	1	1,800
(b) Reserves and Surplus	2	1,322
2. Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		1,500
3. Current Liabilities		
(a) Trade payables	3	
(b) Other current liabilities		
Total		6,500
Assets		
1. Non-current assets		
(a) Property, Plant & Equipment		
(i). Tangible assets		4,050
2. Current assets		
(a) Current investments		
(b) Inventory		
(c) Trade receivables		
(d) Cash and cash equivalents (W.N.)		
Total		6,500

Notes to Accounts

Particulars			(₹ in Lakhs)
Share Capital			
1. Shareholder's Funds			
Equity share capital (Fully paid up shares of ₹10 each)			1800
2. Reserves and Surplus			
General Reserve	530		
Less: Transfer to CRR	(530)	1,000	
Securities premium	350		
Less: Adjustment for premium paid on buy back	(300)	50	
Profit & Loss A/c	340		
Add: Profit on sale of investment	2		
Less: Transfer to CRR	(70)	272	1,322
3. Tangible assets			
Machinery		3,600	
Furniture		450	4,050

Working Note:	₹ in lakhs
Cash at bank after buy-back	
Cash balance as on 1st April, 2017	1,500
Add: Sale of investments	<u>150</u>
	1,650
Less: Payment for buy back of shares	<u>(900)</u>
	<u>750</u>

1FIN by IndigoLearn

Accounting for branches including foreign branches

ILLUSTRATIONS

#1. Illustration | May 2025, 6 Marks |

M/s Marena, having head office at Chennai has a branch at Hyderabad. The head office does wholesale trade only at cost plus 60%. The goods are sent to branch at the wholesale price i.e. cost plus 60%. The branch at Hyderabad is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 80%.

Following details are furnished for the year ended 31st March, 2025:

	Chennai office Rs.	Hyderabad office Rs.
Opening Stock	75,000	-
Purchases	9,25,000	-
Goods sent to branch (Cost plus 60%)	3,60,000	-
Sales	10,25,000	2,70,000
Office expenses	9,000	3,000
Staff Salary	13,700	2,500

Prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 2025.

Answer:

Trading and Profit and Loss A/c for the year ended 31st March 2025

	Head office Rs.	Branch Rs.		Head office Rs.	Branch Rs.
To Opening stock	75,000	-	By Sales	10,25,000	2,70,000
To Purchases	9,25,000	-	By Goods sent to branch	3,60,000	-
To Goods received from head office	-	3,60,000	By Closing stock (W.N. 1 & 2)	1,34,375	1,20,000
To Gross profit c/d	<u>5,19,375</u>	<u>30,000</u>			
	<u>15,19,375</u>	<u>3,90,000</u>		<u>15,19,375</u>	<u>3,90,000</u>
To Office expenses	9,000	3,000	By Gross profit b/d	5,19,375	30,000
To Staff salaries	13,700	2,500			
To Branch Stock Reserve (W.N.3)	45,000	-			
To Net Profit	<u>4,51,675</u>	<u>24,500</u>			
	<u>5,19,375</u>	<u>30,000</u>		<u>5,19,375</u>	<u>30,000</u>

Working Notes

(1)	Calculation of closing stock of head office:	Rs.
	Opening Stock of head office	75,000
	Goods purchased by head office	<u>9,25,000</u>
		10,00,000
	Less: Cost of goods sold [(10,25,000 + 3,60,000 x 100/160)]	<u>(8,65,625)</u>
		<u>1,34,375</u>
(2)	Calculation of closing stock of branch:	Rs.
	Goods received from head office [At invoice value]	3,60,000

	Less: Invoice value of goods sold $[2,70,000 \times 160/180]$	(2,40,000)
		<u>1,20,000</u>
(3)	Calculation of unrealized profit in branch stock:	
	Branch stock	Rs. 1,20,000
	Profit included	60% of cost
	Hence, unrealized profit would be = Rs. $1,20,000 \times 60/160$	Rs. 45,000

#2. Illustration | Jan 2025, 6 Marks |

Give Journal Entries (with Narrations) in the books of an Independent Branch of a business entity to rectify or adjust the following:

- (1) Commission (income) of Rs. 7,500 allocated to Branch by Head office but still no entry is passed in the books of branch.
- (2) Head office paid Rs. 12,000 directly to one of branch's supplier. The intimation is received by branch on reconciliation of bank statement of branch with its books.
- (3) A remittance of Rs. 85,000 is sent by branch to Head office has not been received by Head office till date.
- (4) Branch paid Rs. 9,800 as salary to Head office's employee, but the amount paid has been wrongly debited to salary account.
- (5) Branch purchased Furniture for Rs. 18,000 through cheque, but the Furniture account was retained in Head office Books. No entry has yet been passed.
- (6) Branch incurred Rs. 5,500 of expenses on behalf of other branches of head office, this transaction was not recorded in the books of branch.

Answer:

In the books of Branch Journal Entries

	Particulars		Rs.	Rs.
1)	Head office account To Commission Income (Being commission income recognized)	Dr	7,500	7,500
2)	Creditors A/c To Head office account (Being H.O. paid off a creditor directly)	Dr	12,000	12,000
3)	No entry in Branch Books			
4)	Head office account To Salary A/c (Being amount debited to salary account by mistake now rectified)	Dr	9,800	9,800
5)	Head office account To Bank A/c (Being furniture purchased by branch retained by H.O.)	Dr	18,000	18,000
6)	Head Office A/c To Bank A/c (Being expenses incurred on behalf of other branches, due from H.O.)	Dr	5,500	5,500

#3. Illustration | Sep 2024, 6 Marks |

Following is the information of Kullu Branch of M/s Best Enterprises of Shimla for the year ending 31st March 2023 :

1. Goods are invoiced to the branch at cost plus 20%
2. Branch sold goods at invoice price plus 25%.
3. Other Information is as follows:
 - i. Stock (at cost price) as on 1st April, 2022 is Rs. 2,25,000
 - ii. Goods sent by Head office to branch during the year (at cost price) are Rs. 14,85,000
 - iii. Goods returned by Branch to Head office during the year (at Invoice price) are Rs. 75,000
 - iv. Sales by the branch during the year Rs. 19,50,000
 - v. Expenses incurred at Branch Rs. 56,000.

You are required to ascertain the following:

- a. Profit earned by the Branch by Preparing Trading and profit and loss account for the year ended 31st March 2023
- b. Also find the stock reserve on Closing stock

Answer:

**In the books of Kullu Branch
Trading and Profit and Loss Account**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening stock	2,70,000	By Sales	19,50,000
To Goods received by Head office	17,82,000	By Goods returned by Branch	75,000
To Expenses	56,000	By Closing stock (Refer W.N.)	4,17,000
To Net profit (Bal fig)	<u>3,34,000</u>		
	24,42,000		<u>24,42,000</u>

(ii) Calculation of Closing Stock

Cost price	100
Invoice price	120 (100+20)
Sales price	150 (120+25% of 120)
Opening Stock	2,70,000
Goods received	17,82,000
Less: Goods Returned	<u>75,000</u>
	<u>19,77,000</u>
Less: Cost of Goods Sold (Invoice price)	15,60,000
Closing Stock	4,17,000
Stock reserve in respect of unrealised profit	
$= 4,17,000 \times (20/120) = \text{Rs.} 69,500$	

#4. Illustration | Nov 2023, 4 Marks |

Smart Limited is an Indian Company and has its Branch at New York. The following balances in respect of Smart Limited's USA Branch office are provided:

- (i) Debit Balances (in USD)
- | | |
|---|-----------|
| Expenditure (excluding Depreciation) | :1,03,095 |
| Cash & bank balances | :2,175 |
| Debtors | :7,365 |
| Fixed Assets (Gross) | :34,200 |
| (Rate of Depreciation on Fixed Assets: 20%) | |
| Inventory-Stock 'P' | :5,520 |
| Inventory- Stock 'Q' | :1,035 |
- (ii) Credit Balances (in USD)
- | | |
|----------------|------------|
| Incomes | : 1,32,000 |
| Creditors | : 15,570 |
| HO Control a/c | : 5,820 |

The following additional information is provided:

- (1) The average exchange rate during the above financial year was 1 USD = Rs. 56.
- (2) The fixed assets were purchased when the exchange rate was 1 USDRs. 55.
- (3) The closing exchange rate on reporting date is 1 USD = Rs. 58.
- (4) Stock item 'P' is valued at cost of USD 5,520, purchased when the exchange rate was Rs. 56.50. The present net realizable value of this item is Rs. 2,85,000.
- (5) Stock item 'Q' is carried at net realizable value of USD 1,035, but its cost in USD is 1,065, It was purchased when exchange rate was 1 USD = Rs. 53.
- (6) Branch Control Account as per HO books was Rs. 2,66,265.

You are required to show how it will be reflected in the books of Head Office in the form of Trial Balance, if the USA Branch Office is classified as an Integral Foreign Operation.

Answer:

Converted branch trail balance (in the books of head office)

Particular	Dr. \$	Cr. \$	Rate per \$	Rs. Dr.	Rs. Cr.
Expenditure	1,03,095		56	57,73,320	
Cash & bank balance	2,175		58	1,26,150	
Debtors	7,365		58	4,27,170	
Fixed assets	27,360		55	15,04,800	
Depreciation 20%	6,840		55	3,76,200	
Inventory P	5,520		Direct	2,85,000	
Inventory Q	1,065		53	56,445	
Income		1,32,000	56		73,92,000
Creditors		15,570	58		9,03,060
HO control A/c		5,820			2,66,265
				12,240	

Exchange difference					
				85,61,325	85,61,325

Working Note:

Inventory P	\$ 5,520	Inventory Q	\$ 1,065
Purchased Cost rate	56.50	NRV	\$ 1,035
NRV	Rs. 2,85,000	Closing rate	58
Cost	Rs. 3,11,880	Purchased Cost rate	53
Value at cost or NRV whichever is less	Rs. 2,85,000	Value at cost or NRV whichever is less	\$ 1,035 @ Rs. 58 or \$1,065 @ Rs. 53 = 56,445 or 60,030

#5. Illustration | Nov 2023, 10 Marks |

Jolly Industries of Delhi is a trader in spices. It has a branch at Jalandhar to which Head office invoice goods at 20% on sales. The Jalandhar branch sells spices both on cash and credit. Branch remit all the cash received to Head Office Bank account, thus all expenses of branch are also directly paid from head office.

From the following information given, Prepare Branch Accounts in the Head office ledger using Stock and Debtors Method.

Branch does not maintain any books of account, but send fortnightly returns to Head office.

	Rs.
Stock at Jalandhar Branch as on 1 st April, 2022 (Cost Price)	1,00,000
Sundry Debtors at Jalandhar as on 1 st April, 2022	1,10,000
Cash received from Debtors	3,45,000
Bad debts during the year	9,500
Discount allowed to Debtors	5,500
Goods received from Head Office at Invoice Price	6,00,000
Returns to Head office at Invoice Price	60,000
Normal loss of goods during transport (Out of Goods sent by H.O. to Branch)	12,000
Sales returns at Jalandhar Branch	11,000
Salaries and staff welfare expenses at Branch	54,000
Rent and taxes at Branch	9,000
Other Office Expenses	2,500
Sundry Debtors at Branch as at 31 st March 2023	1,55,000
Stock at Jalandhar as on 31 st March, 2023 (Cost Price)	1,20,000

Credit sales at Branch are four times of the cash Sales at Branch.

Answer:

Books of Jolly Industries, Delhi

Jalandhar Branch Stock Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d - Op Stock	1,25,000	By Bank A/c - Cash Sales	1,04,000
To Branch Debtors A/c - Sales Return	11,000	By Branch Debtors A/c - Credit Sales	4,16,000
To Goods sent to Branch A/c (6,00,000 + 12,000)	6,12,000	By Goods sent to Branch (Returns to H.O.)	60,000
		By Branch Stock Adjustment A/c (Normal Loss)	12,000
		By Branch Stock Adjustment A/c (Abnormal Loss)	6,000
		(bal. fig.)	
		By Balance c/d - Closing stock	1,50,000
	7,48,000		7,48,000

Jalandhar Branch Stock Adjustment Account

Particulars	Rs.	Particulars	Rs.
To Goods sent to Branch A/c (1/5 of Rs. 60,000) (on returns)	12,000	By Balance b/d (20% of 1,25,000)	25,000
To Branch Stock A/c (abnormal Loss) (6,000 x 1/5)	1,200	By Goods sent to Branch A/c (1/5 of Rs. 6,12,000)	1,22,400
To Branch Stock A/c (Normal Loss)	12,000		
To Balance c/d (1/5 of Rs. 1,50,000)	30,000		
To Branch P & L A/c (Profit on sale) - Bal fig	92,200		
	1,47,400		1,47,400

Goods Sent to Branch Account

Particulars	Rs.	Particulars	Rs.
To Jalandhar Branch Stock Adjustment A/c	1,22,400	By Jalandhar Branch Stock A/c	6,12,000
To Jalandhar Branch Stock A/c (Returns)	60,000	By Jalandhar Branch Stock Adjustment A/c	12,000
To Purchases A/c	4,41,600		
	6,24,000		6,24,000

Branch Debtors Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,10,000	By Bank	3,45,000
To Branch Stock A/c	4,16,000	By Branch P&L A/c - Discount	5,500

	By Branch P&L A/c - Bad Debts	9,500
	By Branch Stock - Sales Returns	11,000
	By Balance c/d	1,55,000
5,26,000		5,26,000

Branch Expenses Account

Particulars	Rs.	Particulars	Rs.
To Bank A/c (Rent & Taxes)	9,000	By Branch Profit & Loss A/c(Transfer)	65,500
To Bank A/c (Salaries & Staff Welfare expenses)	54,000		
To Bank A/c (office expenses)	2,500		
	65,500		65,500

Branch Profit & Loss Account for the year ending 31st March 2023

Particulars	Rs.	Particulars	Rs.
To Branch Expenses A/c	65,500	By Branch Stock Adj. A/c	92,200
To Branch Debtors A/c	5,500		
To Branch Debtors A/c	9,500		
To Abnormal Loss (cost)	4,800		
To Net Profit transferred to Profit & Loss A/c	6,900		
	92,200		92,200

#6. Illustration | May 2018, 10 Marks |

Ayan Ltd. invoices goods to its branch at cost plus 33 1/3% particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office.

	Rs.
Stock at commencement at Branch at invoice Price	3,60,000
Stock at close at Branch at Invoice Price	2,88,000
Goods sent to Branch during the year at invoice price (including goods invoiced at Rs.48,000 to Branch on 31.03.2018 but not received by Branch before close of the year).	24,00,000
Return of goods to head office (invoice Price)	1,20,000
Credit Sales at Branch	1,20,000
Invoice value of goods pilfered	24,000
Normal loss at Branch due to wastage and deterioration of stock (at invoice price)	36,000
Cash Sales at Branch	21,60,000

Ayan closes its books on 31st March, 2018.

Answer

In the books of Head Office
Branch Stock Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	3,60,000	By Bank A/c (cash Sales)	21,60,000
To Goods sent to Branch A/c	24,00,000	By Branch Debtors A/c (Credit Sales)	1,20,000
To Branch Adjustment A/c balancing fig. (Surplus)***	36,000	By Goods sent to Branch A/c (Returns to H.O.)	1,20,000
		By Branch Adjustment A/c* (Rs. 24,000 x25/100)	6,000
			18,000
		By Branch P&L A/c * (Cost of Abnormal Loss)	36,000
		By Branch Adjustment A/c** (Invoice price of normal loss)	2,88,000
		By Balance c/d: In hand In transit	48,000
	27,96,000		27,96,000

** Alternatively, it may first be transferred to normal Loss account which may ultimately be closed by transfer to Branch Adjustment account. The final amount of net profit will however remain same.

*** It has been considered that the surplus may be due to sale of goods by branch at price higher than invoice price.

Branch Stock Adjustment Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c (Loading on Abnormal Loss)	6,000	By Stock Reserve A/c (Rs.3,60,000 x 25/100)	90,000
To Branch Stock A/c (Normal Loss)	36,000	By Goods Sent to Branch A/c (Rs.24,00,000 – Rs.1,20,000) x 25/100	5,70,000
To Stock Reserve A/c (Rs.3,36,000 x25/100)	84,000	By Branch Stock A/c (Surplus)	36,000
To Gross Profit t/f to P & L A/c	5,70,000		
	6,96,000		6,96,000

Branch Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Branch Stock A/c (Cost of Abnormal Loss)	18,000	By Branch Adjustment A/c (Gross Profit)	5,70,000
To Net Profit t/f to General P & L A/c	5,52,000		

5,70,000

5,70,000

#7. Illustration | May 2019, 8 Marks |

M/s Rani & Co. has head office at Singapore and branch at Delhi (India). Delhi branch is an integral foreign operation of M/s Rani & Co. Delhi branch furnishes you with its Trial Balance as on 31st March, 2019 and the additional information thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 2018	600	-
Purchases and Sales	1,600	2,400
Sundry Debtors and Creditors	800	600
Bills of Exchange	240	480
Wages	1,120	-
Rent, rates and taxes	720	-
Sundry Expenses	320	-
Computers	600	-
Bank Balance	520	-
Singapore Office A/c	-	3,040
Total	6,520	6,520

Additional information:

- Computers were acquired from a remittance of Singapore dollar 12,000 received from Singapore Head Office and paid to the suppliers. Depreciate Computers at the rate of 40% for the year.
- Closing Stock of Delhi branch was Rs.15,60,000 on 31st March, 2019.
- The Rates of Exchange may be taken as follows :
 - on 1.4.2018 @ Rs.50 per Singapore Dollar
 - on 31.3.2019 @ Rs.52 per Singapore Dollar
 - Average Exchange Rate for the year @ Rs.51 per Singapore Dollar.
 - Conversion in Singapore Dollar shall be made up to two decimal accuracy.
- Delhi Branch Account showed a debit balance of Singapore Dollar 59,897.43 on 31.3.2019 in the Head office books and there were no items pending for reconciliation.

In the books of Head office you are required to prepare:

- Revenue statement for the year ended 31st March, 2019 (in Singapore Dollar)
- Balance Sheet as on that date. (in Singapore Dollar)

Answer

Revenue Statement for the year ended 31st March, 2019

Particulars	Singapore dollar	Particulars	Singapore dollar
To Opening Stock	12,000.00	By Sales	47,058.82
To Purchases	31,372.55	By Closing stock	30,000.00
To Wages	21,960.78	(15,60,000/52)	
To Gross profit b/d	11,725.49		
	77,058.82		77,058.82

To Rent, rates and taxes	14,117.65		11,725.49
To Sundry Expenses	6,274.51	By Gross profit c/d	13,466.67
To Depreciation on computers (Singapore dollar 12,000 × 0.4)	4,800.00	By Net loss b/d	
	25,192.16		25,192.16

Balance Sheet of Delhi Branch as on 31st March, 2019

Liabilities	Singapore dollar	Singapore dollar	Assets	Singapore dollar	Singapore dollar
Singapore Office A/c	59,897.43		Computers	12,000.00	
Less: Net Loss	(13,466.67)	46,430.76	Less: Depreciation	(4,800.00)	7,200.00
Sundry creditors		11,538.46	Closing stock		30,000.00
Bills payable		9,230.77	Sundry debtors		15,384.61
			Bank balance		10,000.00
			Bills receivable		4,615.38
		67,199.99			67,199.99

Working Note:

M/s Rani & Co.

Delhi Branch Trial Balance in (Singapore \$) as on 31st March, 2019

			Conversion rate per Singapore dollar	Dr. Singapore dollar	Cr. Singapore dollar
			Rs.		
Stock on 1.4.18	6,00,000.00		50	12,000.00	–
Purchases and sales	16,00,000.00	24,00,000.00	51	31,372.55	47,058.82
Sundry Debtors and Creditors	8,00,000.00	6,00,000.00	52	15,384.61	11,538.46
Bills of exchange	2,40,000.00	4,80,000.00	52	4,615.38	9,230.77
Wages	11,20,000.00		51	21,960.78	–
Rent, rates and taxes	7,20,000.00		51	14,117.65	–
Sundry Expenses	3,20,000.00		51	6,274.51	–
Computers	6,00,000.00		–	12,000.00	–
Bank balance	5,20,000.00		52	10,000.00	–
Singapore office A/c			–		59,897.43
				1,27,725.48	1,27,725.48

#8. Illustration | Nov 2020, 10 Marks |

Vijay & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts, but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (Rs.)
Goods received from Head office at Invoice Price	8,40,000

Goods returned to Head office at Invoice Price	60,000
Cash sales for the year 2019-20	1,85,000
Credit Sales for the year 2019-20	6,25,000
Stock at Branch as on 01-04-2019 at Invoice price	72,000
Sundry Debtors at Patna branch as on 01-04-2019	96,000
Cash received from Debtors	4,38,000
Discount allowed to Debtors	7,500
Goods returned by customer at Patna Branch	14,000
Bad debts written off	5,500
Amount recovered from Bad debts previously written off as Bad	1,000
Rent, Rates & taxes at Branch	24,000
Salaries & wages at Branch	72,000
Office Expenses (at Branch)	9,200
Stock at Branch as on 31-03-2020 at cost price	1,25,000

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit.

Branch Stock Account

Date	Particulars	Rs.	Date	Particulars	Rs.	Rs.	Rs.
1.4.19	To Balance b/d (opening stock)	72,000	31.3.20	By Sales:			
				Cash		1,85,000	
				Credit	6,25,000		
31.3.20	To Goods Sent to Branch A/c	8,40,000		Less: Return	(14,000)		7,96,000
						<u>6,11,000</u>	
	To Branch P&L	94,000		By Goods sent to Branch returns			60,000
				By Balance c/d (closing stock)			1,50,000
		10,06,000					<u>10,06,000</u>
1.4.20	To Balance b/d	1,50,000					

Branch Debtors Account

		Rs.			Rs.
1.4.19	To Balance b/d	96,000	31.3.20	By Cash	4,38,000
31.3.20	To Sales	6,25,000		By Returns	14,000
				By Discounts	7,500
				By Bad debts	5,500
				By Balance c/d	2,56,000
		7,21,000			<u>7,21,000</u>
1.4.20	To Balance b/d	2,56,000			

Branch Expenses Account

		Rs.			Rs.
31.3.20	To Salaries & Wages	72,000	31.3.20	By Branch P&L A/c	1,18,200
	To Rent, Rates & Taxes	24,000			
	To Office Expenses	9,200			
	To Discounts	7,500			
	To Bad Debts	5,500			
		1,18,200			1,18,200

Branch Profit & Loss Account for year ended 31.3.20

		Rs.			Rs.
31.3.20	To Branch Expenses A/c	1,18,200	31.3.20	By Branch stock	94,000
	To Net Profit transferred to General P & L A/c	93,800		By Branch Stock Adjustment account	1,17,000
				By Bad debts recovered	1,000
		2,12,000			2,12,000

Branch Stock Adjustment Account for year ended 31.3.20

		Rs.			Rs.
31.3.20	To Goods sent to branch (60,000x1/6) (return)	10,000	31.3.20	By Balance b/d (72,000x1/6)	12,000
	To Branch P & L A/c	1,17,000		By Goods sent to branch (8,40,000x1/6)	1,40,000
	To Balance c/d (1,50,000x1/6)	25,000			
		1,52,000			1,52,000

#9. Illustration | Jan 2021, 5 Marks |

Give Journal Entries in the books of Branch to rectify or adjust the following:

- (1) Branch paid Rs.5,000 as salary to H.O supervisor, but the amount paid by branch has been debited to salary account in the books of branch.
- (2) Asset Purchased by branch for Rs.25,000, but the Asset account was retained in H.O Books.
- (3) A remittance of Rs.8,000 sent by the branch has not been received by H.O.
- (4) H.O collected Rs.25,000 directly from the customer of Branch but fails to give the intimation to branch.
- (5) Remittance of funds by H.O to branch Rs.5,000 not entered in branch books.

Answer

Journal Entries in Books of Branch A

	Particulars	Dr. Amount Rs.	Cr. Amount Rs.
(i)	Head office account Dr. To Salaries account (Being the rectification of salary paid on behalf of H.O.)	5,000	5,000
(ii)	Head office account Dr. To Bank / Liability A/c (Being Asset purchased by branch but Asset account retained at head office books)	25,000	25,000
(iii)	No Entry in Branch Books	25,000	25,000
(iv)	Head office account Dr. To Debtors account (Being the amount of branch debtors collected by H.O.)		
(v)	Bank A/c Dr. To Head Office (Remittance of Funds by H.O. to Branch)	5,000	5,000

#10. Illustration | July 2021, 10 Marks |

Manohar of Mohali has a branch at Noida to which the goods are supplied from Mohali but the cost thereof is not recorded in the Head Office books. On 31st March, 2020 the Branch Balance Sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	62,000	Debtors Balance	2,24,000
Head Office	1,88,000	Building Extension A/c	
		Closed by transfer to H.O. A/c	-
		Cash at Bank	26,000
	2,50,000		2,00,000

During the six months ending on 30-09-2020, the following transactions took place at Noida:

	Rs.		Rs.
Sales	2,78,000	Manager's salary	16,400
Purchases	64,500	Collections from debtors	2,57,000
Wages Paid	24,000	Discounts allowed	16,000
Salaries (inclusive of advance of 5,000)	15,600	Discount earned	4,600
General Expenses	7,800	Cash paid to creditors	88,500
Fire Insurance (Paid for one year)	11,200	Building Account (further payment)	14,000
Remittance to H.O.	52,900	Cash in Hand	5,600
		Cash at Bank	47,000

Set out the Head Office Account in Noida Books and the Branch Balance Sheet as on 30.09.2020. Also give journal entries in the Noida books.

Answer**Journal Entries in the Books of Noida Branch**

Particulars		Debit (Rs.)	Credit (Rs.)
Salary Advance A/c To Salaries A/c (Being the amount paid as advance adjusted by debit to Salary Advance A/c)	Dr.	5,000	5,000
Prepaid Insurance A/c (11,200 X 6/12) To Fire Insurance A/c (Being the six months premium transferred to the Prepaid Insurance A/c)	Dr.	5,600	5,600
Head Office A/c To Purchases A/c To Wages A/c To Salaries A/c (15,600 - 5000) To General Expenses A/c To Fire Insurance A/c (11,200 X 6/12) To Manager's Salary A/c To Discount Allowed A/c (Being the transfer of various revenue accounts to the HO A/c for closing the accounts)	Dr.	1,44,900	64,500 24,000 10,600 7,800 5,600 16,400 16,000
Sales A/c Discount Earned A/c To Head Office A/c (Being the transfer of various revenue accounts to HO)	Dr. Dr.	2,78,000 4,600	2,82,600
Head Office A/c To Building A/c (Being the transfer of amounts spent on building extension to HO A/c)	Dr.	14,000	14,000

Working Notes:**Cash and Bank Account**

Particulars	Amt (Rs.)	Particulars	Amt (Rs.)
To Balance b/d	26,000	By Wages	24,000
To Collection from debtors	2,57,000	By Salaries	15,600
		By Insurance	11,200
		By General Expenses	7,800

		By HO A/c	52,900
		By Manager's Salary	16,400
		By Creditors	88,500
		By Building A/c	14,000
		By Balance	
		Cash in Hand	5,600
		Cash at bank	47,000
Total	2,83,000	Total	2,83,000

Debtors Account

Particulars	Amt (Rs.)	Particulars	Amt (Rs.)
To Balance b/d	2,24,000	By Cash Collection	2,57,000
To Sales A/c	2,78,000	By Discount (Allowed)	16,000
		By Balance c/d	2,29,000
Total	5,02,000	Total	5,02,000

Creditors Account

Particulars	Amt (Rs.)	Particulars	Amt (Rs.)
To Cash A/c	88,500	By Balance b/d	62,000
To Discount (Earned)	4,600	By Purchases	64,500
To Balance c/d	33,400		
Total	1,26,500	Total	1,26,500

Note:

Since the date of payment of fire insurance has not been mentioned in the question, it is assumed that it was paid on 01 April 2020. Alternative answer considering otherwise also possible.

#11. Illustration | Dec 2021, 10 Marks |

Delta Ltd. has a branch at Kanpur. Goods are invoiced from head office to Branch at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office.

Prepare necessary Ledger accounts in the books of Delta Ltd. under Stock and Debtors system to show profit earned at the branch for the year ending 31st March, 2021.

Following information related to Branch is given:

Stock on 1st April, 2020 (Invoice price)	31,200	Goods returned by Debtors	3,000
Debtors on 1st April, 2020	17,400	Surplus in stock (Invoice price)	600
Goods invoiced at cost	72,000	Expenses at Branch	13,400
Sales at Branch: Cash sales	20,000	Discount allowed to Debtors	700
Credit sales	68,200	Debtors on 31st March, 2021	14,300

Answer

Books of Delta Ltd.

Kanpur Branch Stock Account

	Rs.		Rs.
To Opening Stock	31,200	By Bank A/c – Cash Sales	20,000
To Branch Debtors A/c – Sales Return	3,000	By Branch Debtors A/c - Credit Sales	68,200
To Goods sent to Branch A/c (72,000 +50% of 72,000)	1,08,000	By Closing stock	54,600
To Surplus in stock	600		
	1,42,800		1,42,800

Kanpur Branch Stock Adjustment Account

	Rs.		Rs.
To Branch Profit and Loss	28,400	By Balance b/d(1/3 of 31,200)	10,400
To Balance c/d (1/3 of 54,600)	18,200	By Goods sent to Branch A/c (1/3 of Rs. 1,08,000)	36,000
		By Surplus in stock	200
	46,600		46,600

Goods Sent to Branch Account

	Rs.		Rs.
To Kanpur Branch Stock Adjustment A/c	36,000	By Kanpur Branch Stock A/c	1,08,000
To Purchases A/c	72,000		
	1,08,000		1,08,000

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	17,400	By Bank (Bal fig.)	67,600
To Branch Stock A/c	68,200	By Branch Expenses A/c (Discount allowed)	700
		By Branch Stock - Sales Returns	3,000
		By Balance c/d	14,300
	85,600		85,600

Branch Expenses Account

	Rs.		Rs.
To Bank A/c (expenses)	13,400	By Branch Profit & Loss A/c (Transfer)	14,100
To Branch Debtors A/c (Discount allowed)*	700		
	14,100		14,100

Branch Profit & Loss Account for the year ending 31st March 2021

	Rs.		Rs.
To Branch Expenses A/c	14,100	By Branch Adjustment A/c	28,400
To Net Profit	14,700	By surplus in stock (Cost)	400
	28,800		28,800

Note: * Discount allowed to debtors may be shown in Branch Profit and Loss account directly instead of transferring it through Branch Expenses

Accounting for branches including foreign branches RTP ILLUSTRATIONS

#1.Illustration | Sep 2024 |

From the following particulars relating to Pune branch for the year ending December 31, 2024, prepare Branch Account in the books of Head office.

		Rs.
Stock at Branch on January 1, 2024		10,000
Branch Debtors on January 1, 2024		4,000
Branch Debtors on Dec. 31, 2024		4,900
Petty cash at branch on January 1, 2024		500
Furniture at branch on January 1, 2024		2,000
Prepaid fire insurance premium on January 1, 2024		150
Salaries outstanding at branch on January 1, 2024		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	

Salaries	2,400	
Petty Cash	1,000	
Annual Insurance up to March 31, 2025	<u>600</u>	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31, 2024		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs. 1,200 were destroyed due to fire and a sum of Rs. 1,000 was received from the Insurance Company.

Answer:

Pune Branch Account

Particulars		Rs.	Particulars	Rs.	Rs.
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors Petty		4,000	By Remittances:		
Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
		150	Cash paid by debtors directly to H.O. Received from Insurance Company	2,000	
Prepaid Insurance		80,000		<u>1,000</u>	1,68,000
To Goods sent to Branch Account			By Goods sent to branch (return of goods by the branch to H.O.)		1,000
To Bank (expenses)	2,000				
	2,400				5,000
	1,000				650
Rent Salaries	<u>600</u>	6,000	By Closing Balances: Stock		4,900
Petty Cash		78,950	Petty Cash		1,800
Insurance			Debtors		150
To Net Profit		1,81,600	Furniture (2,000 – 10% depreciation)		1,81,600
			Prepaid insurance (1/4 x Rs. 600)		

Working Note:

Calculation of petty cash balance at the end:	Rs.
Opening balance	500
Add: Cash received form the Head Office	<u>1,000</u>
Total Cash with branch	1,500
Less: Spent by the branch	<u>850</u>
Closing balance	<u>650</u>

#2.Illustration | May 2018 |

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31 st March, 2017.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated before charging his commission but subject to a deduction from such commission equal in 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch in head office.

The following details for the year ended 31st March, 2017 are given as follows:

	Rs.		Rs.
Opening Stock (at cost)	74,736	Chargeable expenses	49,120
Goods sent to branch (at cost)	2,89,680	Closing Stock (Selling Price)	1,23,328
Sales	3,61,280		
Manager's commission paid on account	2,400		

From the above details, you are required to **calculate the commission due to manager** for the year ended 31st March, 2017.

Answer

Step 1: Calculation of Deficiency

Branch stock account (at invoice price)

Particulars	Rs.	Particulars	Rs.
To Opening Stock (Rs. 74,736 + 1/3 of Rs. 74,736)	99,648	By Sales	3,61,280
To Goods sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Deficiency at sale price [Balancing figure]	1,280
	<u>4,85,888</u>		<u>4,85,888</u>

Step 2: Calculation of Net Profit before Commission

Branch account

Particulars	Rs.	Particulars	Rs.
To Opening [Rs.74,736 + 1/3 of Rs. 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
To Expenses	49,120	By Stock Reserve A/c	24,912

To Stock Reserve A/c	30,832	By goods sent to Branch A/c	96,560
(Rs. 1,23,328 x 25/100)			
To Net Profit – subject to manager's commission	40,240		
	<u>6,06,080</u>		<u>6,06,080</u>

Step 3: Calculation of Commission still due to manager

	Rs.
A Calculation at 10% profit before charging his commission [Rs. 40,240 x 10/100]	4,024
B Less: 25% of cost of deficiency in stock (25% of (75% of Rs. 1,280))	(240)
C Commission for the year [A-B]	3,784
D Less: Paid on account	(2,400)
E Balance due (C-D)	1,384

#3.Illustration | Nov 2018 |

Pass necessary Journal entries in the books of an independent Branch of M/s TPL Sons, wherever required, to rectify or adjust the following transactions:

- Branch paid Rs. 5,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.
- A remittance of Rs. 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.
- Branch assets accounts retained at head office, depreciation charged for the year Rs.15,000 not recorded by Branch.
- Head Office expenses Rs. 75,000 allocated to the Branch, but not yet been recorded by the Branch.
- Head Office collected Rs. 60,000 directly from a Branch Customer. The intimation of the fact has not been received by the Branch.
- Goods dispatched by the Head office amounting to Rs. 50,000, but not received by the Branch till date of reconciliation.
- Branch incurred advertisement expenses of Rs. 10,000 on behalf of other Branches, but not recorded in the books of Branch.
- Head office made payment of Rs. 16,000 for purchase of goods by branch, but not recorded in branch books.

Books of Branch

Journal Entries

		Amounts Rs.	
		Dr.	Cr.
(i)	Head Office Account Dr. To Salaries Account (Being rectification of salary paid on behalf of Head Office)	5,000	5,000
(ii)	No entry in Branch Books is required.		
(iii)	Depreciation A/c Dr. To Head Office Account (Being depreciation of assets accounted for)	15,000	15,000
(iv)	Expenses Account Dr. To Head Office Account (Being allocated expenses of Head Office recorded)	75,000	75,000
(v)	Head Office Account Dr. To Debtors Account (Being adjustment entry for collection from Branch Debtors directly by Head Office)	60,000	60,000
(vi)	Goods in-transit Account Dr. To Head Office Account (Being goods sent by Head Office still in-transit)	50,000	50,000
(vii)	Head Office Account Dr. To expenses Account (Being expenditure incurred, wrongly recorded in books)	10,000	10,000
(vii)	Purchases account A/c Dr. To Head Office Account (Being purchases booked)	16,000	16,000

#4.Illustration | May 2019 |

M/s ABC & Co. has head office at New York (U.S.A.) and branch in Bangalore (India). Bangalore branch is an integral foreign operation of ABC & Co.

Bangalore branch furnishes you with its trial balance as on 31st March, 2018 and the additional information given thereafter:

	Dr.	Cr.
	(Rupees in thousands)	
Stock on 1st April, 2017	300	
Purchases and Sales	800	1,200
Sundry Debtors & Creditors	400	300
Bills of Exchange	120	240
Wages & Salaries	560	-
Rent, Rates & Taxes	360	-
Sundry Charges	160	-
Computers	240	-
Bank Balance	420	-
New York Office A/c	-	1,620
	<u>3,360</u>	<u>3,360</u>

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 Bangalore branch was worth Rs. 4,20,000 on 31st March, 2018.
- The rates of exchange may be taken as follows:
 - On 01.04.2017 @ Rs. 55 per US \$
 - On 31.03.2018 @ Rs. 60 per US \$
 - Average exchange rate for the year @ Rs. 58 per US \$
 - Conversion in \$ shall be made up to two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2018 and the balance sheet as on that date of Bangalore branch as would appear in the books of New York head office of ABC & Co. You are informed that Bangalore branch account showed a debit balance of US \$ 29845.35 on 31.3.2018 in New York books and there were no items pending reconciliation

Answer

M/s ABC & Co.

Bangalore Branch Trial Balance in (US \$) as on 31st March, 2018

	Conversion rate per US \$ (Rs.)	Dr. US \$	Cr. US \$
Stock on 1.4.17	55	5,454.55	–
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	–
Rent, rates and taxes	58	6,206.90	–
Sundry charges	58	2,758.62	–
Computers	–	6,000.00	–
Bank balance	60	7,000.00	–
New York office A/c	–	–	29,845.35
		59,535.01	59,535.01

	US \$		US \$
To Opening Stock	5,454.55	By Sales	20,689.66
To Purchases	13,793.10	By Closing stock (Rs. 4,20,000/60)	7,000.00
To Wages and salaries	9,655.17	By Gross Loss c/d	
			1,213.16
	28,902.82		28,902.82
To Gross Loss b/d	1,213.16	By Net Loss	13,778.68
To Rent, rates and taxes	6,206.90		
To Sundry charges	2,758.62		
To Depreciation on computers (US \$ 6,000 × 0.6)	3,600.00		
	13,778.68		13,778.68

Liabilities		US \$	Assets	US \$	US \$
New York Office A/c	29,845.35		Computers	6,000.00	

Less: Net Loss	(13,778.68)	16,066.67	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		5,000.00	Closing stock		7,000.00
Bills payable		4,000.00	Sundry debtors		6,666.67
			Bills receivable		2,000.00
			Bank balance		7,000.00
		25,066.67			25,066.67

#5.Illustration | Nov 2019 |

From the following particulars relating to Pune branch for the year ending December 31, 2018, prepare Branch Account in the books of Head office.

		Rs.
Stock at Branch on January 1, 2018		10,000
Branch Debtors on January 1, 2018		4,000
Branch Debtors on Dec. 31, 2018		4,900
Petty cash at branch on January 1, 2018		500
Furniture at branch on January 1, 2018		2,000
Prepaid fire insurance premium on January 1, 2018		150
Salaries outstanding at branch on January 1, 2018		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Annual Insurance up to March 31, 2019	<u>600</u>	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000

Stock on December 31,2018		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs. 1,200 were destroyed due to fire and a sum of Rs. 1,000 was received from the Insurance Company.

Answer

Pune Branch Account

Particulars		Rs.	Particulars	Rs.	Rs.
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash paid by debtors directly to H.O.	2,000	
			Received from Insurance Company	<u>1,000</u>	1,68,000
To Goods sent to					
Branch Account		80,000	By Goods sent to branch (return of goods		
To Bank (expenses)			by the branch to H.O.)		1,000
Rent	2,000		By Closing Balances:		
Salaries	2,400		Stock		5,000
Petty Cash	1,000		Petty Cash		650
Insurance	<u>600</u>	6,000	Debtors		4,900
To Net Profit		78,950	Furniture (2,000 –10% depreciation)		1,800
			Prepaid insurance (1/4 x Rs. 600)		150
		1,81,600			1,81,600

Working Note:

Calculation of petty cash balance at the end:	Rs.

Opening balance	500
Add: Cash received form the Head Office	<u>1,000</u>
Total Cash with branch	1,500
Less: Spent by the branch	<u>850</u>
Closing balance	<u>650</u>

#6.Illustration | May 2020 |

On 31st March, 2019 Chennai 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, 2018	60
Goods Received from Head Office	288
Debtors	20
Cash at bank and in hand	8
Carriage Inwards	<u>7</u>
	<u>448</u>
Credit Balances	
Outstanding Expenses	3
Goods Returned to Head Office	5
Sales	360
Head Office	<u>80</u>
	<u>448</u>

Additional Information:

Stock on 31st March, 2019 was valued at Rs. 62 lacs. On 29th March, 2019 the Head Office dispatched goods costing Rs. 10 lacs to its branch. Branch did not receive these goods before 1st April, 2019. Hence, the figure of goods received from Head Office does not include these goods. Also the head

office has charged the branch Rs. 1 lac for centralized services for which the branch has not passed the entry.

You are required to : (i) pass Journal Entries in the books of the Branch to make the necessary adjustments and (ii) prepare Final Accounts of the Branch including Balance Sheet.

Answer

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, 2019)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

Trading and Profit & Loss Account of the Branch for the year ended 31st March, 2019

	Rs. in lacs		Rs. in lacs
To Opening Stock	60	By Sales	360
To Goods received from Head Office	288	By Closing Stock	62
Less: Returns	(5)		
To Carriage Inwards	7		
To Gross Profit c/d	72		
	422		422
To Salaries	25	By Gross Profit b/d	72
To Depreciation on Furniture	2		
To Rent	10		
To Advertising	6		

To Telephone, Postage & Stationery	3	
To Sundry Office Expenses	1	
To Head Office Expenses	1	
To Net Profit Transferred to Head Office A/c	<u>24</u>	
	<u>72</u>	<u>72</u>

Balance Sheet as on 31st March, 2019

Liabilities	Rs. in lacs		Assets	Rs. in lacs	
Head Office	80		Furniture & Equipment	20	
Add: Goods in transit	10		Less: Depreciation	(2)	18
Head Office Expenses	1		Stock in hand		62
Net Profit	<u>24</u>	115	Goods in Transit		10
Outstanding Expenses		3	Debtors		20
			Cash at bank and in hand		<u>8</u>
		<u>118</u>			<u>118</u>

#7.Illustration | Nov 2020, Nov 2022 |

M & S Co. of Lucknow has an integral foreign branch in Canberra, Australia. At the end of 31st March 2020, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra.

	Lucknow office (Rs. In thousand)		Canberra Branch (Aust. Dollars in thousand)	
	Dr.	Cr.	Dr.	Cr.
Capital		2,000		
Reserves & Surplus		1,000		

Land	500			
Buildings (Cost)	1,000			
Buildings Dep. Reserves		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery Dep. Reserves		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1- 4-2019	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salaries	75		45	
Rent			12	
Office Expenses	25		18	
Commission Receipts		256		100
Branch/HO Current Account	120			7
	4,880	4,880	390	390

You are required to convert the Branch Trial Balance given above into rupees by using the following exchange rates:

Opening rate 1 A \$ = Rs. 50

Closing rate 1 A \$ = Rs. 53

Average rate 1 A \$ = Rs. 51.00

for Fixed Assets 1 A \$ = Rs. 46.00

Answer

M & S Co. Ltd.

Canberra, Australia Branch Trial Balance As on 31st March 2020

	(\$ 'thousands)		(Rs. 'thousands)

	Dr.	Cr.	Conversion rate per \$	Dr.	Cr.
Plant & Machinery (cost)	200		Rs. 46	9,200	
Plant & Machinery Dep. Reserve		130	Rs. 46		5,980
Trade receivable/payable	60	30	Rs. 53	3,180	1,590
Stock (1.4.2019)	20		Rs. 50	1,000	
Cash & Bank Balances	10		Rs. 53	530	
Purchase / Sales	20	123	Rs. 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		Rs. 51	2,295	
Rent	12		Rs. 51	612	
Office expenses	18		Rs. 51	918	
Commission Receipts		100	Rs. 51		5,100
H.O. Current A/c		7	Actual		120
				18,855	19,063
Foreign Exchange Loss (bal.fig.)				208	
	390	390		19,063	19,063

#8. Illustration | May 2021 |

Alpha Ltd. has a retail shop under the supervision of a manager. The ratio of gross profit at selling price is constant at 25 per cent throughout the year to 31 st March, 2020.

Branch manager is entitled to a commission of 10 per cent of the profit earned by his branch, calculated before charging his commission but subject to a deduction from such commission equal to 25 per cent of any ascertained deficiency of branch stock. All goods were supplied to the branch from head office.

The following details for the year ended 31st March, 2020 are given as follows:

	Rs.		Rs.
Opening Stock (at cost)	74,736	Chargeable expenses	49,120

Goods sent to branch (at cost)	2,89,680	Closing Stock(Selling Price)	1,23,328
Sales	3,61,280		
Manager's commission paid on account	2,400		

From the above details, you are required to calculate the commission due to manager for the year ended 31st March, 2020.

Answer

In the books of Alpha Ltd.

Step 1: Calculation of Deficiency

Branch stock account (at invoice price)

Particulars	Rs.	Particulars	Rs.
To Opening Stock (Rs. 74,736 + 1/3 of Rs. 74,736)	99,648	By Sales	3,61,280
To Goods sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
		By Deficiency at sale price [Balancing figure]	<u>1,280</u>
	<u>4,85,888</u>		<u>4,85,888</u>

Step 2: Calculation of Net Profit before Commission

Branch account

Particulars	Rs.	Particulars	Rs.
To Opening Stock [Rs.74,736 + 1/3 of Rs. 74,736]	99,648	By Sales	3,61,280
To Gross sent to Branch A/c (Rs. 2,89,680 + 1/3 of Rs. 2,89,680)	3,86,240	By Closing Stock	1,23,328
To Expenses	49,120	By Stock Reserve A/c	24,912
To Stock Reserve A/c [Rs. 1,23,328 x 25/100]	30,832	By Goods sent to Branch A/c	96,560
To Net Profit – subject to manager's commission	<u>40,240</u>		
	<u>6,06,080</u>		<u>6,06,080</u>

Step 3: Calculation of Commission still due to manager

		Rs.

A	Calculation at 10% profit before charging his commission [Rs. 40,240 x 10/100]	4,024
B	Less: 25% of cost of deficiency in stock [25% of (75% of Rs. 1,280)]	(240)
C	Commission for the year [A-B]	3,784
D	Less: Paid on account	(2,400)
E	Balance due (C-D)	1,384

#9. Illustration | Nov 2021 |

Lal & Co. of Jaipur has a branch in Patna to which goods are sent @ 20% above cost. The branch makes both cash & credit sales. Branch expenses are paid direct from Head office and the branch has to remit all cash received into the bank account of Head office. Branch doesn't maintain any books of accounts but sends monthly returns to the head office.

Following further details are given for the year ended 31st March, 2020:

	Amount (Rs.)
Goods received from Head office at Invoice Price	4,20,000
Goods returned to Head office at Invoice Price	30,000
Cash sales for the year 2019-20	92,500
Credit Sales for the year 2019-20	3,12,500
Stock at Branch as on 01-04-2019 at Invoice price	36,000
Sundry Debtors at Patna branch as on 01-04-2019	48,000
Cash received from Debtors	2,19,000
Discount allowed to Debtors	3,750
Goods returned by customer at Patna Branch	7,000
Bad debts written off	2,750
Amount recovered from Bad debts previously written off as Bad	500
Rent, Rates & taxes at Branch	12,000
Salaries & wages at Branch	36,000
Office Expenses (at Branch)	4,600
Stock at Branch as on 31-03-2020 at cost price	62,500

Prepare necessary ledger accounts in the books of Head office by following Stock and Debtors method and ascertain Branch profit.

Answer

Branch Stock Account

			Rs.				Rs.	Rs.
1.4.19	To	Balance b/d (opening stock)	36,000	31.3.20	By	Sales:		
	To	Goods Sent to Branch A/c	4,20,000			Cash	92,500	
31.3.20	To	Branch P&L	47,000			Credit	3,12,500	
						Less: Return	(7,000)	
								3,98,000
					By	Goods sent to branch		30,000
					By	returns		75,000
						Balance c/d (closing stock)		
			5,03,000					5,03,000
1.4.20	To	Balance b/d	75,000					

Branch Debtors Account

			Rs.				Rs.
1.4.19	To	Balance b/d	48,000	31.3.20	By	Cash	2,19,000
31.3.20	To	Sales	3,12,500		By	Returns	7,000
					By	Discounts	3,750
					By	Bad debts	2,750
					By	Balance c/d	1,28,000
			3,60,500				3,60,500
1.4.20	To	Balance b/d	1,28,000				

Branch Expenses Account

			Rs.				Rs.
31.3.20	To	Salaries & Wages	36,000	31.3.20	By	Branch P&L A/c	59,100
	To	Rent, Rates & Taxes	12,000				
	To	Office Expenses	4,600				
	To	Discounts	3,750				

	To	Bad Debts	2,750				
			59,100				59,100

Branch Profit & Loss Account for year ended 31.3.20

			Rs.				Rs.
31.3.20	To	Branch Expenses A/c	59,100	31.3.20	By	Branch stock	47,000
	To	Net Profit transferred to General P & L A/c	46,900		By	Branch Stock Adjustment account	58,500
			1,06,000		By	Bad debts recovered	500
							106,000

Branch Stock Adjustment Account for year ended 31.3.20

			Rs.				Rs.
31.3.20	To	Goods sent to branch (30,000x1/6)	5,000	31.3.20	By	Balance b/d (36,000x1/6)	6,000
		-returns					
	To	Branch P & L A/c	58,500		By	Goods sent to branch (4,20,000x1/6)	70,000
	To	Balance c/d (75,000x1/6)	12,500				
			76,000				76,000

#10. Illustration | May 2022 |

Mr. Chena Swami of Chennai trades in Refined Oil and Ghee. It has a branch at Salem. He despatches 30 tins of Refined Oil @ Rs. 1,500 per tin and 20 tins of Ghee @ Rs. 5,000 per tin on 1st of every month. The Branch has incurred expenditure of Rs. 45,890 which is met out of its collections; this is in addition to expenditure directly paid by Head Office.

Following are the other details:

	Chennai H.O.	Salem B.O.
	Amount (Rs.)	Amount (Rs.)
Purchases:		
Refined Oil	27,50,000	

Ghee	48,28,000	
Direct Expenses	6,35,800	
Expenses paid by H.O.		76,800
Sales:		
Refined Oil	24,10,000	5,95,000
Ghee	38,40,500	14,50,000
Collection during the year		20,15,000
Remittance by Branch to Head Office		19,50,000

Chennai H.O.		
Balance as on	01-04-2020 Amount (Rs.)	31-03-2021 Amount (Rs.)
Stock:		
Refined Oil	44,000	8,90,000
Ghee	10,65,000	15,70,000
Building	5,10,800	7,14,780
Furniture & Fixtures	88,600	79,740
Salem Brach Office		
Balance as on	01-04-2020 Amount (Rs.)	31-03-2021 Amount (Rs.)
Stock:		
Refined Oil	22,500	19,500
Ghee	40,000	90,000
Sundry Debtors	1,80,000	?
Cash in hand	25,690	?
Furniture & Fixtures	23,800	21,420

Additional information:

- (i) Addition to Building on 01-04-2020 Rs. 2,41,600 by H.O.
- (ii) Rate of depreciation: Furniture & Fixtures @ 10% and Building @ 5% (already adjusted in the above figure)
- (iii) The Branch Manager is entitled to 10% commission on Branch profits (after charging his commission).

(iv) The General Manager is entitled to a salary of Rs. 20,000 per month.

(v) General expenses incurred by Head Office is Rs. 1,86,000.

You are requested to prepare Branch Account in the Head Office books and also prepare Chena Swami's Trading and Profit & loss Account (excluding branch transactions) for the year ended 31st March, 2021.

Answer

In the books of Mr. Chena Swami Salem Branch Account

	Rs.		Rs.
To Balance b/d		By Bank (Remittance to H.O.)	19,50,000
Opening stock:			
Ghee	40,000	By Balance c/d	
Refined Oil	22,500	Closing stock:	
Debtors	1,80,000	Refined oil	19,500
Cash on hand	25,690	Ghee	90,000
Furniture & fittings	23,800	Debtors (W.N. 1)	2,10,000
To Goods sent to Branch A/c		Cash on hand (W.N. 2)	44,800
Refined Oil	5,40,000	Furniture & fittings	21,420
(30 x Rs. 1,500x12)			
Ghee	12,00,000		
(20 x Rs. 5,000 x12)			
To Bank (Expenses paid by H.O.)	76,800		
To Manager's commission in profits			
10% (2,26,930x10/110)	20,630		
To Net Profit transferred			
to General P & L A/c	<u>2,06,300</u>		
	<u>23,35,720</u>		<u>23,35,720</u>

Mr. Chena Swami

Trading and Profit and Loss account

for the year ended 31st March, 2021 (Excluding branch transactions)

	Rs.		Rs.
To Opening Stock:		By Sales:	

Refined Oil	44,000	Refined Oil	24,10,000
Ghee	10,65,000	Ghee	38,40,500
To Purchases:		By Closing Stock:	
Refined Oil	27,50,000	Refined Oil	8,90,000
Less: Goods sent		Ghee	15,70,000
to Branch	(5,40,000)		
Ghee	48,28,000		
Less: Goods sent			
to Branch	(12,00,000)		
To Direct Expenses	6,35,800		
To Gross Profit	11,27,700		
	87,10,500		87,10,500
To Manager's Salary	2,40,000	By Gross Profit	11,27,700
To General Expenses	1,86,000	By Branch Profit	2,06,300
To Depreciation		transferred	
Furniture (88,600 - 79,740)	8,860		
Building			
(5,10,800 + 2,41,600 - 7,14,780)	37,620		
To Net profit	8,61,520		
	13,34,000		13,34,000

Working Notes:

(1) Debtors Account

	Rs.		Rs.
To Balance b/d	1,80,000	By Cash Collections	20,15,000
To Sales made during		By Balance c/d	2,10,000
the year:		(Bal. Figure)	
Refined oil	5,95,000		
Ghee	14,50,000		
	22,25,000		22,25,000

(2) Branch Cash Account

	Rs.		Rs.
To Balance b/d	25,690	By Remittance	19,50,000
To Collections	20,15,000	By Exp.	45,890
		By Balance c/d (Bal. Figure)	44,800
	20,40,690		20,40,690

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Chapter 4 – Amalgamation of Companies

Past Exams and RTP Questions Compiler

#1. Question | May 2025 Exam, 14 marks |

The following is summarized Balance Sheet of Pickles Ltd. as on 31/03/2025.

	Particulars	Notes	Rs.
1	Equity and Liabilities		
	Shareholders' Funds		
	A Share Capital	1	11,00,000
	B Reserves and Surplus	2	2,10,000
2	Non-Current liabilities		
	A Long term borrowings	3	1,00,000
	B Long term Provisions	4	60,000
3	Current liabilities		
	A Trade Payables		1,75,000
	B Other Current Liabilities		<u>65,000</u>
	Total		17,10,000
	Assets		
1	Non-current Assets		
	A Property, Plant and Equipment	5	7,50,000
	B Intangible assets	6	75,000
2	Current Assets		
	A Inventories		5,25,000
	B Trade receivables		3,00,000
	C Cash and Cash equivalents		<u>60,000</u>
	Total		17,10,000

Notes to Accounts

		Rs.
1	Share Capital	
	6,000 Equity Shares of Rs. 100 each	6,00,000
	5,000 6% Preference Shares of Rs. 100 each	<u>5,00,000</u>
		<u>11,00,000</u>
2	Reserves and Surplus	
	General reserve	1,00,000
	Profit and Loss account	<u>1,10,000</u>
		<u>2,10,000</u>
3	Long term borrowings	
	8% Debentures	1,00,000
4	Long term Provisions	
	Retirement Gratuity Fund	60,000
5	Property, Plant and Equipment	
	Land and Building	3,50,000
	Plant and Machinery	3,00,000
	Furniture and Fittings	<u>1,00,000</u>

6	Intangible Assets		<u>7,50,000</u>
		Patents	75,000

On 31/03/2025, Foods Ltd. acquires the business of Pickles Ltd. on the following terms:

- Foods Ltd. to take over all assets (except cash) and liabilities at their book values.
- Part of the Furniture and Fixtures is disposed off by Pickles Ltd. for Rs. 55,000 at cost.
- The retirement of employees was due on 31/03/2025. A portion of Rs. 35,000 from Retirement Gratuity Fund was earmarked towards the payment due to them. • Foods Ltd. decided to pay for each Preference share in Pickles Ltd., Rs. 27 in cash and one 8% Preference share of Rs. 100 in Foods Ltd.
- For each Equity share in Pickles Ltd., it was decided to pay Rs. 30 in cash and one Equity share of Foods Ltd. for Rs. 145. (Face value of each share of Foods Ltd. is Rs. 100)
- Liquidation expenses of Rs. 22,500 paid by Pickles Ltd. were subsequently reimbursed by Foods Ltd.
- The fixed assets of Pickles Ltd were not revalued for the purpose of amalgamation.

You are required to pass the necessary Journal entries and also prepare Realisation Account and cash account in the books of Pickles Ltd.

Answer:

Journal Entries in the Books of Pickles Ltd.

		Debit (Rs.)	Credit (Rs.)
Realisation A/c	Dr.	16,50,000	
To Land & Building A/c			3,50,000
To Plant & Machinery A/c			3,00,000
To Furniture & Fixtures A/c			1,00,000
To Patent A/c			75,000
To Inventories A/c			5,25,000
To Trade Receivables A/c			3,00,000
(Being assets transferred to Realisation A/c)			
8% Debentures A/c	Dr.	1,00,000	
Trade Payables A/c	Dr.	1,75,000	
Other Current Liabilities A/c	Dr.	65,000	
Retirement Gratuity Fund A/c	Dr.	35,000	
To Realisation A/c			3,75,000
(Being liabilities transferred to Realisation A/c)			
Cash A/c	Dr.	55,000	
To Realisation A/c			55,000
(Being part of furniture sold)			
Foods Ltd. A/c	Dr.	16,85,000	
To Realisation A/c			16,85,000
(Being purchase consideration receivable)			
Cash A/c	Dr.	3,15,000	
Equity Shares in Foods Ltd A/c	Dr.	8,70,000	
Preference Shares in Foods Ltd A/c	Dr.	5,00,000	
To Foods Ltd. A/c			16,85,000
(Being consideration received)			
6% Preference Share Capital A/c	Dr.	5,00,000	

Realization A/c To Preference Shareholders A/c (Being amount due to preference shareholders for capital and extra amount payable under the scheme of acquisition)	Dr.	1,35,000	6,35,000
Preference Shareholders A/c To Cash A/c To Pref. Shares in Foods Ltd A/c (Being payment made to preference shareholders)	Dr.	6,35,000	1,35,000 5,00,000
Equity Share Capital A/c General Reserve A/c Profit & Loss A/c Retirement Gratuity fund To Equity Shareholders A/c (Being various accounts representing capital, reserve, profit and loss account and others transferred to equity shareholder account)	Dr. Dr. Dr. Dr.	6,00,000 1,00,000 1,10,000 25,000	8,35,000
Equity Shareholders A/c To Cash A/c To Equity Shares in Foods Ltd A/c (Being payment made to equity shareholders)		11,65,000	2,95,000 8,70,000
Foods Ltd A/c To Cash A/c (Being liquidation expenses paid)	Dr.	22,500	22,500
Cash A/c To Foods Ltd A/c (Being reimbursement by Foods Ltd.)	Dr.	22,500	22,500
Realisation A/c To Equity Shareholders A/c (Being Profit on realization is transferred to equity shareholders)	Dr.	3,30,000	3,30,000

Realisation Account
(Journal Entries)

	Particulars	Amount (Rs.)		Particulars	Amount (Rs.)
To	Land & Building	3,50,000	By	Debentures	1,00,000
To	Plant & Machinery	3,00,000	By	Trade Payables	1,75,000
To	Furniture & Fixtures	1,00,000	By	Other Current Liabilities	65,000
To	Patent	75,000	By	Ret. Gratuity Fund	35,000
To	Inventories	5,25,000	By	Cash (Sale of Furniture)	55,000
To	Trade Receivables	3,00,000	By	Foods Ltd (PC)	16,85,000
To	Preference shareholder	1,35,000			
To	Equity Shareholder A/c (Profit on realization)	<u>3,30,000</u>			

		21,15,000		21,15, 000

Cash Account

	Particulars	Amount (Rs.)		Particulars	Amount (Rs.)
To	Balance b/d	60,000	By	Foods Ltd. A/c (Expenses)	22,500
To	Realisation A/c (Furniture Sale)	55,000	By	Pref. Shareholders A/c	1,35,000
To	Foods Ltd. A/c (Reimbursement)	22,500	By	Equity Shareholders A/c	2,95,000
To	Foods Ltd (Cash Part of PC) (1,35,000 + 1,80,000)	3,15,000			
		4,52,500			4,52,500

Working Notes:

1. Purchase Consideration

	Rs.	Rs.	Form
(i) Preference Shares: Rs. 27 per share	1,35,000		Cash
Preference shares	<u>5,00,000</u>	6,35,000	Preference shares
(ii) Equity shares: Rs. 30 per share	1,80,000		Cash
6,000 equity shares in Food Ltd. @ Rs. 145	<u>8,70,000</u>	<u>10,50,000</u>	Equity shares
		16,85,000	

#2. Question | Sep 2025 Exam, 4 marks |

Rubber Ltd. purchased 70% of shares of Tyre Ltd. on 31/03/2024 for Rs. 4,05,000. The following is the position of Tyre Ltd. as on that date:

Particulars	Amount (Rs.)
Issued share capital of Tyre Ltd. on 31/03/2024	5,00,000
Balance in Profit and Loss A/c of Tyre Ltd. on 31/03/2024	70,000
Profit earned during the year 2024-25	45,000
5% Dividend declared and paid by Tyre Ltd. for 2023-24	25,000

You are required to calculate:

- The capital reserve / goodwill at the date of acquisition.

The calculations are to be made under the following assumptions:

Case (i) It is assumed that the dividend is paid out of post-acquisition profits. Case (ii) It is assumed that the dividend is received for pre-acquisition period.

Answer:

Calculation of capital reserve/goodwill at the date of acquisition Case (i) it is assumed Dividend is paid out of post-acquisition profits

Total dividend paid is Rs. 25,000 hence dividend received by Rubber will be credited to P & L.

Rubber Ltd.'s share of dividend = Rs. 25,000 X 70% = Rs. 17,500

Goodwill on consolidation (at the date of acquisition):	Rs.	Rs.
Cost of shares		4,05,000

Less: Face value of capital i.e. 70% of capital 5,00,000	3,50,000	
Add: Share of capital profits [70,000X 70%]	<u>49,000</u>	(3,99,000)
Goodwill		<u>6,000</u>

Case (ii) it is assumed Dividend is received out of pre-acquisition profits.

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Goodwill on consolidation (at the date of acquisition):	Rs.	Rs.
Cost of shares		4,05,000
Less: dividend received		<u>(17,500)</u>
		3,87,500
Less: Face value of capital i.e. 70% of capital 5,00,000	3,50,000	
Add: Share of capital profits [70,000 X 70%]	<u>49,000</u>	<u>(3,99,000)</u>
Capital reserve		<u>11,500</u>

#3. Question |Jan 2025 Exam, 14 marks |

Following are the summarized Balance Sheet of Light Limited and Bright Limited as at 31st March,2024:

Particulars	Notes	Light Limited (Rs. in Lakhs)	Bright Limited (Rs. in Lakhs)
Equity and Liabilities			
Shareholders' Funds			
(a) Share Capital	1	50.00	40.00
(b) Reserves and Surplus	2	27.00	24.00
Non- Current Liabilities			
Long Term Provisions		1.50	-
Current Liabilities			
Trade Payables		<u>3.40</u>	<u>2.00</u>
Total		<u>81.90</u>	<u>66.00</u>
Assets			
Non-Current Assets			
Property, Plant and Equipment	3	68.70	50.25
Current Assets			
(a) Inventories		5.75	7.10
(b) Trade Receivables		4.30	5.80
(c) Cash and Cash equivalents		<u>3.15</u>	<u>2.85</u>
Total		<u>81.90</u>	<u>66.00</u>

Notes to Accounts:

Particulars	Light Limited (Rs. in Lakhs)	Bright Limited (Rs. in Lakhs)
1. Share Capital		

50,000 Equity Shares of Rs. 100 each	50.00	40.00
2. Reserves and Surplus		
Statutory Reserve	2.00	-
General Reserve	18.00	15.00
Securities Premium	-	5.00
Profit and Loss	<u>7.00</u>	<u>4.00</u>
	<u>27.00</u>	<u>24.00</u>
3. Property, Plant and Equipment		
Land and Building	58.00	44.00
Plant and machinery	7.50	4.50
Other Assets	<u>3.20</u>	<u>1.75</u>
	<u>68.70</u>	<u>50.25</u>

Other Information:

- A company Rainbow Limited is formed to acquire the Assets and Liability of both the companies. Assets were acquired at book values except Land and Building of Light Limited, which is revalued at Rs. 62 lakhs.
- Other Assets of Bright Limited are obsolete and are scrapped and sold for Rs. 50,000 by Bright Limited itself before acquisition of its assets and liabilities by Rainbow Limited.
- Light Limited and Bright Limited will be issued 80,000 and 64,000 equity shares of Rs. 100 each respectively of new company Rainbow Limited in lieu of purchase consideration due to them.

You are required to Prepare:

- Realisation Account and Equity Shareholders Account in the books of Light Limited and Bright Limited;
- Opening Balance Sheet of Rainbow Limited as at 31st March, 2024.

Answer:

Adjustment in bank balance and profit & loss account before amalgamation

Other assets of Bright limited

	Rs. In lakhs
Book value	1.75
Less: Sale proceeds	<u>(0.50)</u>
Loss on sale of other assets (debited to Profit & Loss A/c)	<u>1.25</u>

The new balance of Bank = $2.85 + 0.5 = 3.35$ (Rs. In lakhs)

The new balance of Profit & Loss A/c = $4 - 1.25 = 2.75$ (Rs. In lakhs)

(a) (i) **Realisation Account**

	Light Ltd. (Rs. In lakhs)	Bright Ltd. (Rs. In lakhs)		Light Ltd. (Rs. In lakhs)	Bright Ltd. (Rs. In lakhs)
To Sundry Assets, transfer :			By Long term provision	1.50	-
To Land & Building,	58.00	44.00	By Trade payables	3.40	2.00
To Plant & machinery	7.50	4.50	By Rainbow Ltd. - purchase	80.00	64.00
To Other assets	3.20	-			
To Inventories	5.75	7.10			
To Trade receivable	4.30	5.80			
To Cash & Bank	3.15	3.35			

Balance					
To Equity Shareholders - profit	3.00	1.25			
	84.90	66.00		84.90	66.00

Shareholders Account

	Light Ltd. (Rs. In lakhs)	Bright Ltd. (Rs. In lakhs)		Light Ltd. (Rs. In lakhs)	Bright Ltd. (Rs. In lakhs)
To Shares in Rainbow Ltd.	80.00	64.00	By Share Capital A/c - transfer	50.00	40.00
			By Statutory reserve	2.00	-
			By General Reserve	18.00	15.00
			By Securities premium	-	5.00
			By Profit & Loss A/c	7.00	2.75
			By Realisation A/c	3.00	1.25
	80.00	64.00		80.00	64.00

Balance Sheet of Super Rainbow Ltd

Particulars	Notes	(Rs. In lakhs)
Equity and Liabilities		
1 Shareholders' funds		
A Share capital	1	144.00
B Reserves and Surplus	2	1.00
2 Non-current liabilities		
A Long-term provisions		1.50
3 Current liabilities		
A Trade Payables		<u>5.40</u>
Total		<u>151.90</u>
Assets		
1 Non-current assets		
A Property, Plant and Equipment	3	121.20
B Intangible assets	4	1.25
2 Current assets		
Inventories		12.85
Trade receivables		10.10
Cash and cash equivalents		<u>6.50</u>
Total		<u>151.90</u>

Notes to Accounts

		(Rs. In lakhs)
1.	Share Capital	

	Equity share capital	
	Issued, subscribed and paid up	
	1,44,000 Equity shares of Rs. 100 each	144.00
	(all shares are issued for consideration other than cash)	
2.	Reserves and Surplus	
	Statutory Reserves	2.00
	Amalgamation Adjustment Reserves	(2.00)
	Capital Reserves	1.00
		1.00
3.	Property, Plant and Equipment	
	Land and Buildings	106.00
	Plant and Machinery	12.00
	Other Assets	3.20
		121.20
4	Intangible assets	
	Goodwill	1.25

Working notes:

1. Calculation of purchase consideration

	Light Ltd. (Rs. In lakhs)	Bright Ltd. (Rs. In lakhs)
80,000 Equity Shares of Rs. 100	80	
64,000 Equity Shares of Rs. 100		64

2. Calculation of Net assets taken over

		(Rs. In lakhs)	
Particulars		Light Ltd.	Bright Ltd.
<i>Assets taken over:</i>			
Land and Buildings		62.00	44.00
Plant and Machinery		7.50	4.50
Other Assets		3.20	-
Inventory		5.75	7.10
Trade Receivable		4.30	5.80
Cash at Bank (2.85 + 0.50)		<u>3.15</u>	<u>3.35</u>
	(i)	<u>85.90</u>	<u>64.75</u>
<i>Liabilities taken over:</i>			
Long term provisions		1.50	-
Trade payable		<u>3.40</u>	<u>2.00</u>
	(ii)	<u>4.90</u>	<u>2.00</u>
Net assets taken over	(i) – (ii)	81.00	62.75

3. Calculation of Goodwill/Capital Reserve

	(Rs. In lakhs)	
Particulars	Light Ltd.	Bright Ltd.

Net Assets takeover	81.00	62.75
Less: Purchase Consideration	(80.00)	(64.00)
Goodwill/ (Capital Reserve)	(1.00)	1.25

#4. Question | September 2024 Exam, 14 marks |

The following are the summarized Balance Sheets of Well Ltd. and Nice Ltd. as at 31st March, 2024 :

	Particulars	Notes	Nice Ltd. (Rs. in '000)	Well Ltd. (Rs. in '000)
1.	Equity and Liabilities			
	Shareholder's funds			
a.	Share capital	1	41,000	14,300
b.	Reserves and Surplus	2	19,500	(7,350)
2.	Non-current liabilities			
a.	Long-term borrowings	3	20,500	5,425
3.	Current Liabilities			
a.	Trade Payables		15,740	4,850
b.	Short-term Borrowings		-	1,975
	Total		96,740	19,200
	Assets			
1.	Non-current Assets			
a.	Property, plant, and equipment	4	62,550	16,380
b.	Non-current Investments		22,500	-
2.	Current assets			
a.	Inventories		300	870
b.	Trade Receivables		6,590	1,950
c.	Cash and Cash equivalents		4,800	-
	Total		96,740	19,200

Notes to Accounts

		Nice Ltd. (Rs. in '000)	Well Ltd. (Rs. in '000)
1.	Share Capital		
	Equity Share Capital		
	Issued, subscribed & paid up capital		
	Equity Shares of Rs. 100 each	31,500	12,500
	Preference Share Capital		
	Issued, subscribed & paid up capital		
	9% Preference Shares of Rs. 100 each	9,500	
	10% Preference Shares of Rs. 100 each		<u>1,800</u>
	Total	41,000	14,300
2.	Reserves and Surplus		
	Balance of Profit and Loss A/c	19,500	(7,350)
3.	Long-term borrowings		

9% Debentures of Rs. 100 each	11,200	
10% Debentures of Rs. 100 each		900
Loan from Banks	<u>9,300</u>	<u>4,525</u>
	20,500	5,425

Details of Trade receivables and Trade payables are as under :

		Nice Ltd. (Rs. in '000)	Well Ltd. (Rs. in '000)
1.	Trade receivables		
	Debtors	6,200	1,800
	Bills Receivables	390	150
		6,590	1,950
	Trade payables		
	Creditors	14,750	4,400
	Bills Payables	990	450
		15,740	4,850

On 31.03.2024, Nice Ltd. absorbs the business of Well Ltd. on the following terms:

- For every five equity shares held by the equity shareholders of Well Ltd., they receive three equity shares of Nice Ltd. issued at a premium of Rs. 20 per share.
- The 10% debenture-holders of Well Ltd. were to be allotted such 9% debentures in Nice Ltd. as would bring the same amount of interest.
- 10% Preference Shareholders of Well Ltd. are to be paid at 10% discount by issue of 9% Preference Shares at par in Nice Ltd.
- Banks agreed to waive off the loan of Rs. 270 thousand of Well Ltd.
- Expenses of Liquidation of Well Ltd. are to be reimbursed by Nice Ltd. Rs. 55 thousand.
- Inventory of Well Ltd. is taken over at 10% more than their book value by Nice Ltd.
- Debtors of Nice Ltd. include Rs. 215 thousand receivables from Well Ltd.
- Property, Plant, and Equipment of Well Ltd. are revalued at 20% above their book value.
- The remaining Assets and Liabilities of Well Ltd. are taken over at book value by Nice Ltd.

You are required to :

1. Record Journal Entries in the books of Nice Ltd.
2. Prepare Balance Sheet of Nice Ltd. after absorption as at 31 March, 2024.

Answer:

Journal Entries in the Books of Nice Ltd.

		Dr. Rs.in '000	Cr. Rs.in '000
Business Purchase Account	Dr.	10,620	
To Liquidator of Well Ltd.			10,620
(Consideration payable for the business taken over from Well Ltd.)			
Property, Plant and Equipment (120% of Rs.16,380)	Dr.	19,656	
Inventory (110% of Rs.870)	Dr.	957	
Trade receivables	Dr.	1,950	
Goodwill A/c (Balancing figure)	Dr.	137	

To Trade payables		4,850
To Debenture Holders Account		1,000
To Loan from bank (4,525-270)		4,255
To Short term borrowings		1,975
To Business Purchase Account		10,620
(Incorporation of various assets and liabilities taken over from Well Ltd. at agreed values and difference of net assets and purchase consideration debited to Goodwill A/c))		
Liquidator of Well Ltd.	Dr.	10,620
To Equity Share Capital (75,000x 100)		7,500
To 9% Preference Share Capital		1,620
To Securities premium (7,5000x 20)		1,500
(Discharge of consideration for Well Ltd.'s business)		
Debenture holders A/c	Dr.	1,000
To 9% Debentures A/c		1,000
(Being 9% debentures issued to 10% debentureholders)		
Sundry Creditors of Well Ltd.	Dr.	215
To Sundry Debtors of Nice Ltd.		215
(Cancellation of mutual owing)		
Goodwill	Dr.	55
To Bank		55
(Being liquidation expenses reimbursed to Well Ltd.)		

Working Note:

The purchase consideration will be:

	Rs.	Form
Preference shareholders: $16,200 \times 100$	16,20,000	9% Pref. shares
Equity shareholders: $1,25,000 \times \frac{3}{5} \times 120$	<u>90,00,000</u>	Equity shares
		<u>1,06,20,000</u>
10 % Preference shares		18,00,000
Less: 10% discount		<u>1,80,000</u>
		<u>16,20,000</u>

Debenture calculation

		Interest
10% Debenture	9,00,000	<u>90,000</u>
Therefore 9% debentures	$90,000/9\% =$	
	10,00,000	

Balance Sheet of Nice Ltd. (After absorption) as at 31st March 2024

	Particulars	Notes	Rs. in '000
1	Equity and Liabilities		
	Shareholders' funds		

2	(a)	Share capital	1	50,120
	(b)	Reserves and Surplus	2	21,000
3		Non-current liabilities		
	(a)	Long-term borrowings	3	25,755
1		Current liabilities		
	(a)	Trade payables	4	20,375
2	(b)	Short term borrowing		1,975
		Total		1,19,225
1	II	Assets		
		Non-current assets		
2	(a)	Property, Plant and Equipment and Intangibles	5	
	(i)	Property, plant and equipment		82,206
2	(ii)	Intangible assets		192
	(b)	Non-current investments		22,500
2		Current assets		
	(a)	Inventories	6	1,257
2	(b)	Trade receivables	7	8,325
	(c)	Cash and Cash equivalents	8	4,745
		Total		1,19,225

Notes to accounts

			Rs. in '000
1	Share Capital		
	Equity share capital		
	Issued, subscribed and paid up		
	3,90,000 Equity shares of Rs. 100 each (out of above 75,000 shares are issued for consideration other than cash)		39,000
	Preference Shares		
	Issued, subscribed and paid up		
	1,11,200 9% Preference Shares of Rs. 100 each (9,500 + 1,620) (out of above 16,200 shares are issued for consideration other than cash)		11,120
			50,120
2	Reserves and Surplus		
	Securities premium	1,500	
	Reserves and surplus	<u>19,500</u>	21,000
3	Long-term borrowings		
	9 % Debentures (11,200+1,000)	12,200	
	Loan from bank (9,300+4255)	<u>13,555</u>	<u>25,755</u>
4	Trade Payable		
	Nice Limited	15,740	
	Well Limited	<u>4,850</u>	
		20,590	

	Less: Inter Company holdings	(215)	20,375
5	Property, Plant and Equipment and Intangibles		
	Property, Plant and Equipment	62,550	
	Acquired during the year	<u>19,656</u>	82,206
	Intangibles		
	Goodwill (137+55)		192
6	Inventories	300	
	Acquired during the year	<u>957</u>	1,257
7	Trade receivables	6,590	
	Acquired during the year (1,585+150)	<u>1,735</u>	8,325
8	Cash and Cash Equivalents		
	Nice Limited	4,800	
	Less: Expenses on liquidation	(55)	4,745

#5. Question | May 2024 Exam, 14 marks |

Intelligent Limited and Diligent Limited are carrying their business independently for last two years. Following financial information in respect of both the companies as at 31st March, 2024 has been given to you:

Particulars	Intelligent Limited (Rs.)	Diligent Limited (Rs.)
Equity Shares Capital of Rs. 100 each	12,00,000	10,00,000
8% Preference shares of Rs. 100 each	3,00,000	2,00,000
Trade Payables	12,00,000	4,00,000
Retirement Gratuity Fund (Long Term)	3,00,000	2,00,000
Profit and Loss Account		
Opening balance	4,50,000	2,50,000
Profit for the current year	2,50,000	1,50,000
Land and Buildings	10,00,000	8,00,000
Plant and Machinery Inventories	10,00,000	6,00,000
Trade Receivables	7,00,000	4,00,000
Cash and Bank	6,00,000	3,00,000
	4,00,000	1,00,000

On 1st April, 2024, both the companies agreed to amalgamate and form a new company 'Genius Limited, with an authorized capital of Rs. 40,00,000 divided into 30,000 equity shares of Rs. 100 each and 10,000 8% preference shares of Rs. 100 each.

The amalgamation has to be carried out on the basis of following agreement:

- (1) Assets of both the companies were to be revalued as follows:

Particulars	Intelligent Limited (Rs.)	Diligent Limited (Rs.)
Land and Buildings	11,00,000	8,50,000
Plant and Machinery	9,00,000	4,00,000
Inventories	6,00,000	3,00,000

- (2) Trade payables of Intelligent Limited includes Rs. 1,00,000 due to Diligent Ltd. and the Trade receivables of Diligent Limited shows Rs. 1,00,000 receivables from Intelligent Limited.
- (3) The purchase consideration is to be discharged in the following manner:

- (i) Issue 22,000 Equity Shares of Rs. 100 each fully paid up in the proportion of the sum of their profitability in the preceding two financial years.
- (ii) Preference shareholders of both companies are issued equivalent number of 8% Preference Shares of Rs. 100 each of Genius Limited at a price of Rs. 125 per share.
- (iii) 12% debentures of Rs. 100 each in Genius Limited at par to provide an income equivalent to 10% return on the basis of net assets in their respective business as on 1st April, 2024 after revaluation of assets.

You are required to:

- (a) Compute the amount of Shares & Debentures to be issued to Intelligent Limited and Diligent Limited.
- (b) Prepare a Balance Sheet of Genius Limited showing the position immediately after amalgamation.

Answer:

Computation of shares and debentures to be issued

		Intelligent Ltd.	Diligent Ltd.
(i) Equity shares	22,000 x 7/11 = 14,000 (W.N.1)	14,00,000	
	22,000 x 4/11 = 8,000 (W.N.1)		8,00,000
(ii) Preference shares	$\left(\frac{3,00,000}{100} \times 125\right)$	3,75,000	
	$\left(\frac{2,00,000}{100} \times 125\right)$		2,50,000
(iii) Debentures	Refer (W.N.3)	<u>17,50,000</u>	<u>11,25,000</u>
Total Purchase Consideration (i + ii + iii)		<u>35,25,000</u>	<u>21,75,000</u>

Balance Sheet of Genius Limited

as at 1st April, 2024 (after amalgamation)

		Notes no.	Rs.
I.	Equity and Liabilities		
(1)	Shareholder's fund		
(a)	Share Capital	1	27,00,000
(b)	Reserves & Surplus	2	1,25,000
(2)	Non-current Liabilities		
(a)	Long term borrowings	3	28,75,000
(b)	Other non-current liabilities	4	5,00,000
(3)	Current Liabilities		
(a)	Trade Payables		15,00,000
	(12,00,000 + 4,00,000 – 1,00,000)		
	Total		77,00,000
II.	Assets		
(1)	Non-current Assets		
(a)	Property, Plant & Equipment	5	32,50,000
(b)	Intangible Assets	6	22,50,000
(2)	Current Assets		
(a)	Inventories (6,00,000 + 3,00,000)		9,00,000

(b)	Trade Receivables (6,00,000 + 3,00,000 - 1,00,000)	8,00,000
(c)	Cash & Cash Equivalents	5,00,000
	Total	77,00,000

Notes to Accounts:

Sr. No.	Particular	Rs.
1.	<u>Share Capital</u>	
	<u>Authorized Share Capital</u>	
a)	Equity Share Capital 30,000 Equity Shares of Rs. 100 each	30,00,000
b)	Preference Share Capital 10% 10,000 Preference Shares Rs. 100 each	<u>10,00,000</u>
	<u>Issued, Subscribed & Paid-up Capital</u>	
	Equity Share Capital 22,000 Equity Shares of Rs.100 each (out of the above all shares are issued for consideration other than cash)	22,00,000
	Preference Share Capital 10% 5,000 Preference Shares of Rs.100 each (out of the above all shares are issued for consideration other than cash)	<u>5,00,000</u>
	Reserves & Surplus	<u>27,00,000</u>
	Securities Premium	1,25,000
	Long term borrowings 12% Debentures of Rs. 100 each	28,75,000
	Other Non-current Liabilities Gratuity Fund	5,00,000
	Property, Plant & Equipment Land & Building (11,00,000 + 8,50,000) Plant & Machinery (9, 00,000 + 4,00,000)	19,50,000 <u>13,00,000</u>
	Intangible Assets	<u>32,50,000</u>
	Goodwill	22,50,000

Working Notes:

1. Calculation of Ratio of Equity Shares

	Intelligent Ltd.	Diligent Ltd
□ Opening balance P&L	4,50,000	2,50,000
Profit for the current year	<u>2,50,000</u>	<u>1,50,000</u>
Total	<u>7,00,000</u>	<u>4,00,000</u>

As the company has been in existence for two years, the opening balance of profit and loss account has been assumed to be the profit of the previous year.

The total profits- Rs. 7,00,000+ Rs. 4,00,000 = Rs. 11,00,000.

No. of shares to be issued = 22,000 equity shares in the proportion of the preceding 2 years' profits. i.e. in 7:4.

Calculation of Net assets as on 31.3.2024

Particulars	Intelligent Ltd.	Diligent Ltd
Assets (after revaluation)		
Land and Buildings	11,00,000	8,50,000
Plant & Machinery	9,00,000	4,00,000
Inventories	6,00,000	3,00,000
Trade Receivables	6,00,000	3,00,000
Cash & Cash Equivalents	<u>4,00,000</u>	<u>1,00,000</u>
Total (a)	<u>36,00,000</u>	<u>19,50,000</u>
Liabilities		
Trade Payables	12,00,000	4,00,000
Gratuity Fund	<u>3,00,000</u>	<u>2,00,000</u>
Total (b)	<u>15,00,000</u>	<u>6,00,000</u>
Net Assets (a – b)	21,00,000	13,50,000

Calculation of 12% Debentures to be issued to Intelligent Ltd. and Diligent Ltd.

	Intelligent Ltd.	Diligent Ltd
	Rs.	Rs.
Net assets (Refer working note)	21,00,000	13,50,000
10% return on Net assets	2,10,000	1,35,000
12% Debentures to be issued	17,500	
$[2,10,000 \times \frac{100}{12}] = 17,50,000$ of Rs. 100 each		
$[1,35,000 \times \frac{100}{12}] = 11,25,000$ of Rs. 100 each		11,250

Calculation of Goodwill / Capital Reserve

S. No.	Particulars	Intelligent Ltd.	Diligent Ltd.	
(i)	Purchase Consideration Paid	35,25,000	21,75,000	
(ii)	Less: Net Assets	<u>21,00,000</u>	<u>13,50,000</u>	
(iii)	Goodwill	<u>14,25,000</u>	<u>8,25,000</u>	<u>22,50,000</u>

Alternatively:

Calculation of Goodwill / Capital Reserve

S. No.	Particulars	Intelligent Ltd.	Diligent Ltd	
(i)	Purchase Consideration Paid	35,25,000	21,75,000	
(ii)	Less: Net Assets*	<u>22,00,000</u>	<u>12,50,000</u>	
(iii)	Goodwill	<u>13,25,000</u>	<u>9,25,000</u>	<u>22,50,000</u>

Calculation of Net assets taken over

Particulars	Intelligent Ltd.	Diligent Ltd
Assets (after revaluation)		
Land and Buildings	11,00,000	8,50,000
Plant & Machinery	9,00,000	4,00,000

Inventories	6,00,000	3,00,000
Trade Receivables	6,00,000	2,00,000*
Cash & Cash Equivalents	<u>4,00,000</u>	<u>1,00,000</u>
Total (a)	<u>36,00,000</u>	<u>18,50,000</u>
Liabilities		
Trade Payables	11,00,000**	4,00,000
Gratuity Fund	<u>3,00,000</u>	<u>2,00,000</u>
Total (b)	<u>14,00,000</u>	<u>6,00,000</u>
Net Assets (a – b)	22,00,000	12,50,000

*Rs. 3,00,000 - Rs. 1,00,000 = Rs. 2,00,000

**Rs. 12,00,000 - Rs. 1,00,000 = Rs. 11,00,000

#6. Question | Nov 2023 Exam, 5 marks |

Raman Limited and Naman Limited decided to amalgamate and form a new company Rana Limited as on 31st March, 2023 and provided you the following information:

Particulars	As on 31 st March, 2023		Revalued Figures for Amalgamation	
	Raman Limited (Rs.)	Naman Limited (Rs.)	Raman Limited (Rs.)	Naman Limited (Rs.)
Equity shares of Rs. 10 each	6,72,000	2,52,000		
10% Preference Shares of Rs. 100 each	3,36,000	1,68,000		
Reserves and Surplus	5,44,240	2,65,480		
Trade Payables	84,000	1,76,000	80,640	1,68,960
Property, Plant and Equipment	7,69,000	4,36,400	10,58,100	5,20,100
Goodwill	1,62,000	-	1,62,000	-
Inventories	1,89,000	1,17,600	2,78,620	2,06,780
Trade Receivables	2,81,000	1,47,000	2,47,140	1,38,180
Cash & Cash Equivalents	2,35,240	1,60,480		

The purchase consideration is to be satisfied as follows:

- By issue of 4 Preference Shares of Rs. 100 each in Rana Limited @ Rs. 85 paid up and at a premium of Rs. 30 per share for every 3 preference shares held in both the companies.
- By issue of 5 Equity shares of Rs. 10 each in Rana Limited @ Rs. 7 paid up and at a premium of Rs. 5 per share for every 3 equity shares held in both the companies.
- In addition, necessary cash should be paid to equity shareholders of both the companies as required to adjust the rights of shareholders of both the companies in accordance with the intrinsic value of the shares of both the companies.

You are required to compute the purchase consideration for both the companies.

Answer:

Purchase Consideration

	Raman Ltd	Naman Ltd
Payable to preference shareholders: Preference shares at Rs. 115 per share	5,15,200 (3,360 X 4/3)	2,57,600 (1,680 X 4/3)

Equity Shares at Rs. 12 per share	13,44,000 (67,200 X 5/3)	5,04,000 (25,200 X 5/3)
Cash [See W.N.]	41,260	94,980
	19,00,460	8,56,580

Working note:

	<i>Raman Ltd.</i>	<i>Naman Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Goodwill	1,62,000	
PPE	10,58,100	5,20,100
Trade receivables	2,47,140	1,38,180
Inventory	2,78,620	2,06,780
Cash & Cash Equivalent	<u>2,35,240</u>	<u>1,60,480</u>
	19,81,100	10,25,540
Less: Trade payables	<u>(80,640)</u>	<u>(1,68,960)</u>
	19,00,460	8,56,580
Payable in shares	<u>18,59,200</u>	<u>7,61,600</u>
Payable in cash	<u>41,260</u>	<u>94,980</u>

#7. Question | May 2022 Exam, 20 marks |

The summarized Balance Sheet of A Ltd. and B Ltd. as at 31st March,2022 are as under:

	A Ltd. (in ₹)	B Ltd. (in ₹)
Equity shares of ₹10 each, fully paid up	30,00,000	24,00,000
Securities Premium Account	4,00,000	
General Reserve	6,20,000	5,00,000
Profit and Loss Account	3,60,000	3,20,000
Retirement Gratuity Fund Account	1,00,000	
10% Debentures	20,00,000	
Unsecured Loan (including loan from A Ltd.)	6,00,000	8,20,000
Trade Payables	1,00,000	3,40,000
	71,80,000	43,80,000
Land and Buildings	28,00,000	21,00,000
Plant and Machinery	20,00,000	7,60,000
Long term advance to B Ltd.	2,20,000	7,00,000
Inventories	10,40,000	5,20,000
Trade Receivables	8,20,000	3,00,000
Cash and Bank	3,00,000	
	71,80,000	43,80,000

B Ltd. is to declare and pay ₹ 1 per equity share as dividend, before the following amalgamation takes place with Z Ltd.

Z Ltd. was incorporated to take over the business of both A Ltd. and B Ltd.

- a) The authorized share capital of Z Ltd. is ₹ 60 lakhs divided into ₹ 6 lakhs equity shares of ₹ 10 each.

- b) As per Registered Valuer the value of equity shares of A Ltd. is ₹ 18 per share and of B Ltd. is ₹ 12 per share respectively and agreed by respective shareholders of the companies.
- c) 10% Debentures of A Ltd. to be issued 12% Debentures of Z Ltd. at par in consideration of their holdings.
- d) A contingent liability of A Ltd. of ₹ 2,00,000 is to be treated as actual liability.
- e) Liquidation expenses including Registered Valuer fees of A Ltd. ₹ 50,000 and B Ltd. ₹ 30,000 respectively to be borne by Z Ltd.
- f) The shareholders of A Ltd. and B Ltd. is to be paid by issuing sufficient number of fully paid up equity shares of ₹ 10 each at a premium of ₹ 10 per share.

Assuming amalgamation in the nature of purchase, you are required to pass the necessary journal entries (narrations not required) in the books of Z Ltd. and Prepare Balance Sheet of Z Ltd. immediately after amalgamation of both the companies.

Answer

		₹	₹
Business Purchase A/c	Dr.	54,00,000	
To Liquidator of A Ltd. A/c			54,00,000
Land & Building A/c	Dr.	28,00,000	
Plant & Machinery A/c	Dr.	20,00,000	
Long term advance to B Ltd. A/c	Dr.	2,20,000	
Inventories A/c	Dr.	10,40,000	
Trade Receivables A/c	Dr.	8,20,000	
Cash and Bank A/c	Dr.	3,00,000	
Goodwill A/c	Dr.	12,20,000	
To Retirement Gratuity Fund A/c			1,00,000
To 10% Debentures A/c			20,00,000
To Unsecured Loan A/c			6,00,000
To Trade Payables A/c			1,00,000
To Other liabilities A/c			2,00,000
To Business Purchase A/c			54,00,000
10% Debentures A/c	Dr.	20,00,000	
To 12% Debentures A/c			20,00,000
Liquidator of A Ltd. A/c	Dr.	54,00,000	
To Equity Share Capital A/c			27,00,000
To Securities Premium A/c			27,00,000
Business Purchase A/c	Dr.	28,80,000	
			28,80,000
Land and Building A/c	Dr.	21,00,000	
Plant & Machinery A/c	Dr.	7,60,000	
Inventories A/c	Dr.	7,00,000	
Trade Receivables A/c	Dr.	5,20,000	
Cash and Bank (less dividend) A/c	Dr.	60,000	
To Unsecured Loan A/c			8,20,000
To Trade Payables A/c			3,40,000
To Business Purchase A/c			28,80,000
To Capital Reserve A/c			1,00,000
Liquidators of B Ltd. A/c	Dr.	28,80,000	
To Equity Share Capital A/c			14,40,000
To Securities Premium A/c			14,40,000
Unsecured Loans A/c	Dr.	2,20,000	

To Long term Advance to B Ltd. A/c			2,20,000
*Capital Reserve A/c	Dr.	1,00,000	
To Cash and Bank A/c (Liquidation expenses)			80,000
To Goodwill A/c			20,000

Note:

1. The journal entries for A Ltd. and B Ltd. have been given separately in the above solution. Alternatively, the entries may be given as combined for both companies.
2. *Alternatively, following set of entries may be given in place of the last entry given in the above solution:

		₹	₹
Goodwill A/c	Dr.	50,000	
To Cash & Bank A/c (Liquidation expenses of A Ltd.)			50,000
Capital Reserve A/c	Dr.	30,000	
To Cash and Bank A/c (Liquidation expenses of B Ltd.)			30,000
Capital Reserve A/c	Dr.	70,000	
To Goodwill A/c			70,000

Balance Sheet of Z Ltd. as at 31st March, 2022

Particulars	Notes	₹ (in Lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	41,40,000
(b) Reserves and Surplus	2	41,40,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	20,00,000
(b) Long term provisions	4	1,00,000
(3) Current Liabilities		
(a) Short-term borrowings	5	12,00,000
(b) Trade payables	6	4,40,000
Other liability		2,00,000
Total		1,22,20,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	7	76,60,000
(b) Intangible assets (Goodwill 12,20,000-20,000)		12,00,000
(2) Current assets		
(a) Inventories	8	17,40,000
(b) Trade receivables	9	13,40,000
(c) Cash and cash equivalents	10	2,80,000
Total		1,22,20,000

1 Unsecured loans have been considered as short-term borrowings. Alternatively, it may be considered as long-term borrowings and presented accordingly

Notes to Accounts

		₹	₹
1. Share Capital			
Authorized Share Capital			
6,00,000 Equity shares of ₹ 10 each			60,00,000

	Issued: 4,14,000 Equity shares of ₹ 10 each (all these shares were Issued for consideration other than cash)		41,40,000
2. Reserves and surplus			
	Securities Premium Account (4,14,000 shares × ₹ 10)		41,40,000
3. Long-term borrowings			
	12% Debentures		20,00,000
4. Long term Provisions			
	Retirement gratuity fund		1,00,000
5. Short-term borrowings			
	Unsecured loans		
	A Ltd. 6,00,000		
	B Ltd. 8,20,000	14,20,000	
	Less: Mutual	(2,20,000)	12,00,000
6. Trade payables			
	A Ltd.	1,00,000	
	B Ltd.	3,40,000	4,40,000
7. Property, plant & equipment			
	Land and Building		
	A Ltd.	28,00,000	
	B Ltd.	7,60,000	27,60,000
8. Inventories			76,60,000
	A Ltd.	10,40,000	
	B Ltd.	7,00,000	17,40,000
9. Trade receivables			
	A Ltd.	8,20,000	
	B Ltd.	5,20,000	13,40,000
10. Cash & cash equivalents			
	A Ltd.	3,00,000	
	B Ltd. [3,00,000-2,40,000(dividend)]	60,000	
		3,60,000	
	Less: Liquidation Expenses	(80,000)	2,80,000

Working Note:

Calculation of amount of Purchase Consideration

	A Ltd.	B Ltd.
Existing shares	3,00,000	2,40,000
Agreed value per share	₹ 18	₹ 12
Purchase consideration	54,00,000	28,80,000
No. of shares to be issued of ₹ 20 each (including ₹ 10 premium)	2,70,000	1,44,000
Purchase consideration	54,00,000	28,80,000
Face value of shares at ₹ 10	27,00,000	14,40,000
Premium of shares at ₹ 10	27,00,000	14,40,000

#8. Question | December 2021 Exam, 15 marks |

Dark Ltd. and Fair Ltd. were amalgamated on and from 1st April, 2021. A new company Bright Ltd. was formed to take over the business of the existing companies. The balance Sheets of Dark Ltd. and Fair Ltd. as at 31st March, 2021 are given below:

Particulars	Note No.	Dark Ltd.	Fair Ltd.

Equity and Liabilities			
Shareholders' Funds			
Share Capital	1	1,650	1,425
Reserves and Surplus	2	630	495
Non-Current Liabilities Long Term Borrowings: 10% Debentures of ₹100 each		90	45
Current Liabilities Trade Payables		630	285
Total		3,000	2,250
Assets			
Non - Current Assets			
Property, Plant and Equipment		1,350	975
Non - Current Investments		225	75
Current Assets			
Inventories		525	375
Trade Receivables		450	300
Cash and Cash Equivalents		450	300
Total		3,000	2,250

Notes to Accounts

		Dark Ltd. (₹ in Lakh)	Fair Ltd. (₹ in Lakh)
1. Share Capital			
Equity Shares of ₹100 each		1,200	1,125
14% Preference Shares of ₹100 each		450	300
		1,650	1,425
2. Reserves and Surplus			
Revaluation Reserve		225	150
General Reserve		255	225
Investment Allowance Reserve		75	75
Profit and Loss Account		75	45
		630	495

Additional Information:

- Bright Limited will issue 5 equity shares for each equity share of Dark Limited and 4 equity shares for each equity share of Fair Limited. The shares are to be issued @ ₹35 each having a face value of ₹10 per share.
- reference shareholders of the two companies are issued equivalent number of 16% preference shares of Bright Limited at a price of ₹160 per share (face value ₹100).
- 10% Debenture holders of Dark Limited and Fair Limited are discharged by Bright Limited, issuing such number of its 16% Debentures of ₹100 each so as to maintain the same amount of interest.
- Investment allowance reserve is to be maintained for 4 more years.
- Liquidation expenses are for Dark Limited ₹6,00,000 and for Fair Limited ₹3,00,000. It is decided that these expenses would be borne by Bright Limited.
- All the assets and liabilities of Dark Limited and Fair Limited are taken over at book value.
- Authorized equity share capital of Bright Limited is ₹15,00,00,000 divided into equity share of ₹10 each. After issuing required number of shares to the liquidators of Dark Limited and Fair Limited, Bright Limited issued balance shares to public. The issue was fully subscribed.

You are required to prepare Balance Sheet of Bright Limited as at 1st April, 2021 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

Answer

Balance Sheet of Bright Ltd. as at 1st April, 2021

Particulars	Notes	₹ (in Lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,250
(b) Reserves and Surplus	2	4,200
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	84.375
(3) Current Liabilities		
(c) Trade payables	4	915
Total		7,449.375
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	5	2,325
(b) Intangible assets	6	633.375
(3) Current assets		
(d) Inventories	8	900
(e) Trade receivables	9	975
(f) Cash and cash equivalents	10	2,316
Total		7,449.375

Notes to Accounts

		₹ (in Lakhs)	₹ (in Lakhs)
1.	Share Capital		
	Authorized Share Capital		
	1,50,00,000 Equity shares of ₹10 each	1500	
	7,50,000 16% Preference Share of ₹100 each	750	
	Issued: 1,50,00,000 Equity shares of ₹10 each (Out of which 1,05,00,000 Shares were Issued for consideration other than cash)	1500	
	7,50,000 16% Preference Shares of 100 each (Issued for consideration other than cash)	750	2,250
2.	Reserves and surplus		
	Securities Premium Account (1,50,00,000 shares × ₹25) 3750 (7,50,000 shares × ₹60) 450	4,200	
	Investment Allowance Reserve	150	
	Amalgamation Adjustment Reserve	(150)	4,200
3.	Long-term borrowings		
	16% Debentures (56,25,000+28,12,500) (W.N. 3)		84.375
4.	Trade payables		
	Dark Ltd.	630	
	Fair Ltd.	285	915
5.	Property, plant & equipment		
	Land and Building	1,350	
	Plant and Machinery	975	2,325
6.	Intangible assets		
	Goodwill [W.N. 2]	624.375	
	Add: liquidation exp. (6+3)	9.00	633.375
7.	Non-current Investments		

	Investments (225+75)		300
8.	Inventories		
	Dark Ltd.	525	
	Fair Ltd.	375	900
9.	Trade receivables		
	Dark Ltd.	450	
	Fair Ltd.	525	975
10.	Cash & cash equivalents	450	
	Dark Ltd.	300	
	Liquidation Expenses (6+3)	(9)	
	Shares issued for cash (45 lakh shares x ₹35)	1,575	2316

Working Notes:

		₹ (in Lakhs)	
		Dark Ltd.	Fair Ltd.
1.	Computation of Purchase consideration		
	(a) Preference shareholders:		
	$\left(\frac{4,50,00,000}{100}\right)$		
	i.e. 4,50,000 shares × ₹160 each		
	$\left(\frac{3,00,00,000}{100}\right)$	720	
	i.e. 3,00,000 shares × ₹160 each		480
	(b) Equity shareholders:		
	$\left(\frac{12,00,00,000 \times 5}{100}\right)$	2,100	
	i.e. 60,00,000 shares × ₹35 each		
	$\left(\frac{11,25,00,000 \times 4}{100}\right)$		
	i.e. 45,00,000 shares × ₹35 each		1,575
	Amount of Purchase Consideration	2,820	2,055
2.	Assets taken over:		
	Property Plant & Equity	1,350	975
	Non-Current Investments	225	75
	Inventory	525	375
	Trade receivables	450	525
	Cash and bank	<u>450</u>	<u>300</u>
		3,000	2,250
	Less: Liabilities taken over:		
	10% Debentures 56.25		28.125
	Trade payables <u>630</u>	(686.25)	285 (313.125)
	Net assets taken over	2,313.75	1936.875
	Purchase consideration	2,820	2055.00
	Goodwill	506.25	118.125
	Total goodwill		624.375

3. Issue of Debentures

Debentures	₹90,00,000	₹45,00,000
Interest 10%	₹9,00,000	₹4,50,000
	$\left(\frac{9,00,000 \times 100}{16}\right)$	$\left(\frac{4,50,000 \times 100}{16}\right)$

	= 56,25,000	= 28,12,500

NOTE: In the above solution ₹35 has been considered as the issue price of Equity shares for public issue also. Alternative considering this as ₹10 also possible. In that case, the balance of cash and cash equivalents will be ₹1,191 lakhs and securities premium will be ₹3,075 lakhs in place of the balances given in the balance sheet in the above solution.

#9. Question | July 2021, 10 Marks |

The summarized Balance Sheets of Black Limited and White Limited as on 31st March, 2020 is as follows:

Particulars	Note No.	Black Limited (₹ In 000)	White Limited (₹ In 000)
Equity and Liabilities			
Shareholders' Funds			
Share Capital	1	6,000	3,600
Reserves and Surplus	2	1,080	660
Current Liabilities			
Trade payables		600	360
Total		7,680	4,620
Assets			
Non - Current Assets			
Property, Plant and Equipment		3,600	2,400
Current Investments		225	75
Current Assets			
Inventories		960	720
Trade Receivables		1,680	1,080
Cash and Cash Equivalents		1,440	420
Total		7,680	4,620

Note No.	Particulars	Black Limited (₹ in 000)	White Limited (₹ in 000)
1.	Share Capital Equity Shares of ₹100 each	6,000	3,600
	Reserves and Surplus		
2.	General Reserve	360	180
	Profit and Loss Account	720	480
	Total	1,080	660

Black Limited takes over White Limited on 1st July, 2020.

No Balance Sheet of White Limited is available as on that date. It is, however estimated that White Limited earned profit of ₹2,40,000 after charging proportionate depreciation @ 10% p.a. on Property Plant and Equipment, during April-June, 2020.

Estimated profit of Black Limited during these 3 months was ₹4,80,000 after charging proportionate depreciation @ 10% p.a. on Property Plant and Equipment.

Both the companies have declared and paid 10% dividend within this 3 months' period.

Goodwill of White Limited is valued at ₹2,40,000 and Property Plant and Equipment are valued at ₹1,20,000 above the depreciated book value on the date of takeover.

Purchase consideration is to be satisfied by Black Limited by issuing shares at par. Ignore income tax. You are required to:

- (i) Compute No. of shares to be issued by Black Limited to White Limited against purchase consideration.
- (ii) Calculate the balance of Net Current Assets of Black Limited and White Limited as on 1st July, 2020.
- (iii) Give balance of Profit or Loss of Black Limited as on 1st July, 2020
- (iv) Give balance of Property Plant and Equipment as on 1st July, 2020 after takeover.

Answer

(i) No. of shares issued by Black Ltd. to White Ltd. against purchase consideration

White Ltd.	₹	₹
Goodwill		2,40,000
Property, plant and equipment	24,00,000	
Less: Depreciation $[24,00,000 \times 10\% \times 3/12]$	<u>(60,000)</u>	
	23,40,000	
Add: Appreciation	<u>1,20,000</u>	24,60,000
Inventory		7,20,000
Trade receivables		10,80,000
Cash and Bank balances	4,20,000	
Add: Profit after depreciation 2,40,000		
Add: Depreciation (non-cash) <u>60,000</u>	3,00,000	
Less: Dividend $[36,00,000 \times 10\%]$	<u>(3,60,000)</u>	<u>3,60,000</u>
		48,60,000
Less: Trade payables		<u>(3,60,000)</u>
Purchase Consideration		45,00,000
Number of shares to be issued by Black Ltd. @ ₹100 each		45,000 shares

(ii) Calculation of Net Current Assets as on 01.07.2020

		Black Ltd.		White Ltd
Current assets:				
Inventory		9,60,000		7,20,000
Trade receivables		16,80,000		10,80,000
Cash and Bank	14,40,000		4,20,000	
Less: Dividend	<u>(6,00,000)</u>		<u>(3,60,000)</u>	
Add: Profit after depreciation	4,80,000		2,40,000	
Add: Depreciation being non cash	<u>90,000</u>	<u>14,10,000</u>	<u>60,000</u>	<u>3,60,000</u>
		40,50,000		21,60,000
Less: Trade payables		<u>(6,00,000)</u>		<u>(3,60,000)</u>
		<u>34,50,000</u>		<u>18,00,000</u>

(iii) Profit and Loss Account balance of Black Ltd. as on 1.07.2020

	₹
P & L A/c balance as on 31.03.2020	7,20,000
Less: Dividend paid	<u>(6,00,000)</u>
	1,20,000
Add: Estimated profit for 3 months after charging depreciation	<u>4,80,000</u>
	6,00,000

(iv) Property, plant and equipment as on 01.07.2020

Property, plant and equipment of Black Ltd. as on 31.03.2020		36,00,000
Less: Depreciation for 3 months $[36,00,000 \times 10\% \times 3/12]$		<u>(90,000)</u>
Property, plant and equipment of White Ltd. Taken over as on 31.03.2020	24,00,000	35,10,000
Less: Proportionate depreciation for 3 months on fixed assets	<u>(60,000)</u>	
Add: Appreciation above the estimated book value	<u>1,20,000</u>	<u>24,60,000</u>

#10.Question | January 2021 Exams, 20 Marks|

Galaxy Ltd. and Glory Ltd., are two companies engaged in the same business of chemicals. To mitigate competition, a new company Glorious Ltd, is to be formed to which the assets and liabilities of the existing companies, with certain exception, are to be transferred. The summarized Balance Sheet of Galaxy Ltd. and Glory Ltd. as at 31st March, 2020 are as follows:

Particulars	Galaxy Ltd.	Glory Ltd.
	₹	₹
Equity and Liabilities		
Shareholders' Funds		
Share Capital		
Equity shares of ₹10 each	8,40,000	4,55,000
Reserves and Surplus		
General Reserve	4,48,000	40,000
Profit & Loss A/c	1,12,000	72,000
Non-current Liabilities		
Secured Loan		
6% Debentures	-	3,30,000
Current Liabilities		
Trade payables	4,20,000	1,83,000
Total	18,20,000	10,80,000
Assets		
Non - Current Assets		
Property, Plant and Equipment		
Freehold property, at cost	5,88,000	3,36,000
Plant & Machinery, at cost less depreciation	1,40,000	84,000
Motor vehicles, at cost less depreciation	56,000	-
Current Assets		
Inventories	3,36,000	4,38,000
Trade Receivables	4,62,000	1,18,000
Cash at Bank	2,38,000	1,04,000
Total	18,20,000	10,80,000

Assets and Liabilities are to be taken at book value, with the following exceptions:

- The Debentures of Glory Ltd. are to be discharged, by the issue of 8% Debentures of Glorious Ltd. at a premium of 10%.
- Plant and Machinery of Galaxy Ltd. are to be valued at ₹2,52,000.
- Goodwill is to be valued at : Galaxy Ltd. ₹4,48,000 Glory Ltd. ₹1,68,000
- Liquidator of Glory Ltd. is appointed for collection from trade debtors and payment to trade creditors. He retained the cash balance and collected ₹1,10,000 from debtors and paid ₹1,80,000 to trade creditors. Liquidator is entitled to receive 5% commission for collection and 2.5% for payments. The balance cash will be taken over by new company. You are required to:
 - Compute the number of shares to be issued to the shareholders of Galaxy Ltd. and Glory Ltd, assuming the nominal value of each share in Glorious Ltd. is ₹10.
 - Prepare Balance Sheet of Glorious Ltd., as on 1st April, 2020 and also prepare notes to the accounts as per Schedule III of the Companies Act, 2013

Answer**(i) Calculation of Purchase consideration (or basis for issue of shares of Glorious Ltd.**

Particulars	Galaxy Ltd.	Glory Ltd.
Purchase Consideration:	₹	₹
Goodwill	4,48,000	1,68,000
Freehold property	5,88,000	3,36,000
Plant and Machinery	2,52,000	84,000
Motor vehicles	56,000	-
Inventory	3,36,000	4,38,000
Trade receivables	4,62,000	-
Cash at Bank	2,38,000	24,000
	23,80,000	10,50,000
Less: Liabilities:		
6% Debentures (3,00,000 x 110%)	-	(3,30,000)
Trade payables	(4,20,000)	-
Net Assets taken over	<u>19,60,000</u>	<u>7,20,000</u>
To be satisfied by issue of shares of Glorious. Ltd. @ ₹10 each	1,96,000	72,000

(ii) Balance Sheet of Glorious Ltd. as at 1st April, 2020

Particulars	Note No.	Amount
Equity and Liabilities		
Shareholders' Funds		
Share Capital	1	26,80,000
Reserves and Surplus	2	30,000
Non - Current Liabilities		
Long-term borrowings	3	3,00,000
Current liabilities		
Trade payables		4,20,000
Total		34,30,000
Assets		
Non - Current Assets		
Property, Plant and Equipment	4	13,16,000
Intangible assets	5	6,16,000
Current Assets		
Inventories	6	7,74,000
Trade Receivables		4,62,000
Cash and Cash Equivalents	7	<u>2,62,000</u>
Total		34,30,000

Notes to accounts:

Note No	Particulars	₹	₹
1.	Share Capital		
	Equity share capital 2,68,000 shares of ₹10 each (All the above shares are issued for consideration other than cash)		26,80,000
2.	Reserves and surplus		
	Securities Premium (10% premium on debentures of ₹3,00,000)		30,000
3.	Long-term borrowings		3,00,000

	Secured 8% 3,000 Debentures of ₹100 each		
4.	Property Plant and Equipment		
	Freehold property		
	Galaxy Ltd.	5,88,000	
	Glory Ltd.	<u>3,36,000</u>	9,24,000
	Plant and Machinery		
	Galaxy Ltd.	2,52,000	
	Glory Ltd.	<u>84,000</u>	3,36,000
	Motor vehicles - Galaxy Ltd.		<u>56,000</u>
			<u>13,16,000</u>
5.	Intangible assets		
	Goodwill		
	Galaxy Ltd.	4,48,000	
	Glory Ltd.	1,68,000	6,16,000
6.	Inventories		
	Galaxy Ltd.	3,36,000	
	Glory Ltd.	<u>4,38,000</u>	7,74,000
7.	Cash and cash equivalents		
	Galaxy Ltd.	2,38,000	
	Glory Ltd.(As per working note)	<u>24,000</u>	2,62,000

#11.Question | November 2020, 15 Marks |

High Ltd. and Low Ltd. were amalgamated on and from, 1st April, 2020. A new company Little Ltd. was formed to take over the business of the existing Companies. The summarized Balance sheets of High Ltd. and Low Ltd. as on 31st March, 2020 are as under:

(₹ in Lakhs)

Liabilities	High Ltd.	Low Ltd.	Assets	High Ltd.	Low Ltd.
Share Capital:			Property, Plant and Equipment:		
Equity Shares of ₹ 100 each	1000	850	Land & Building	670	385
14% Pref Shares of ₹100 each	320	175	Plant & Machinery	475	355
Reserves & Surplus:			Investments	95	80
Revaluation Reserve	225	110	Current Assets:		
General Reserve	360	240	Stock	415	389
Investment Allowance Reserve	80	40	Sundry Debtors	322	213
P & L Account	85	82	Bills Receivables	35	-
Non-Current Liabilities:			Cash & Bank	303	166
Secured Loans:					
13% Debentures (₹ 100 each)	100	56			
Unsecured Loans (Public Deposits)	50	-			
Current Liabilities & Provisions:		-			
Sundry Creditors	65	35			
Bills Payable	30	-			
Total	2315	1588	Total	2315	1588

Other Information :

- (1) 13% Debenture holders of High Ltd. & Low Ltd. are discharged by Little Ltd. by issuing such number of its 15% Debentures of ₹100 each so as to maintain the same amount of interest.
- (2) Preference Shareholders of the two companies are issued equivalent number of 15% Preference shares of Little Ltd. at a price of ₹125 per share (Face Value ₹100)
- (3) Little Ltd. will issue 4 Equity Shares for each Equity Share of High Ltd. & 3 equity shares for each Equity Share of Low Ltd. The shares are to be issued at ₹35 each having a face value of ₹10 per share.
- (4) Investment Allowance Reserve is to be maintained for two more years. Prepare the Balance sheet of Little Ltd. as on 1st April, 2020 after the amalgamation has been carried out in basis of in the nature of Purchase.

Answer**Balance Sheet of Little Ltd. as at 1st April, 2020**

Particulars	Notes	₹ (in Lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,150.0
(b) Reserves and Surplus	2	2,437.8
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	135.2
(b) Other Borrowings – Unsecured Loans		50
(3) Current Liabilities		
(a) Trade payables	4	50
Total		3,903
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	5	1,885
(b) Non-current investment (95 + 80)		175
(4) Current assets		
(a) Inventories (415+389)		804
(b) Trade receivables	6	570
(c) Cash and cash equivalents (303 + 166)		469
Total		3,903

Notes to Accounts

	₹ (in Lakhs)	₹ (in Lakhs)
1. Share Capital		
Equity share capital (W.N.1)		
65,50,000 ¹ Equity shares of 10 each	655	
4,95,000 ² Preference shares of ₹100 each	495	
(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		1,150
2. Reserves and surplus		
Securities Premium Account (W.N.3) (1080+ 681.25)	1,761.25	
Capital Reserve (W.N. 2)(283.33 + 393.22)	676.55	
Investment Allowance Reserve (80 + 40)	120	
Amalgamation Adjustment Reserve (80 + 40)	(120)	2,437.8

3.	Long-term borrowings		
	15% Debentures		135.2
4.	Trade payables		
	Sundry Creditors:		
	High Ltd.	65	
	Low Ltd.	35	
	Bills Payable: High Ltd.	30	130
5.	Property, plant & equipment		
	Land and Building: High Ltd 670 Low Ltd <u>385</u>	1055	
	Plant and Machinery: High Ltd. 475 Low Ltd. <u>355</u>	830	1,885
6.	Trade receivables		
	Sundry Debtors: High Ltd.	322	
	Low Ltd.	213	
	Bills Receivables: High Ltd.	35	570

Working Notes:

		₹ (in Lakhs)	
		High Ltd.	Low Ltd.
1.	Computation of Purchase consideration		
	(a) Preference shareholders:		
	$\left(\frac{3,20,00,000}{100}\right)$	400	
	i.e. 3,20,000 shares × ₹125 each		
	$\left(\frac{1,75,00,000}{100}\right)$		
	i.e. 1,75,000 shares × ₹125 each		218.75
	(b) Equity shareholders:		
	$\left(\frac{10,00,00,000}{100}\right)$	1400	
	i.e. 40,00,000 shares × ₹35 each		
	$\left(\frac{8,50,00,000}{100}\right)$		
	i.e. 25,50,000 shares × ₹35 each		892.5
	Amount of Purchase Consideration	1,800	1,111.25
2.	Assets taken over:		
	Land and Building	670	385
	Plant and Machinery	475	355
	Investments	95	80
	Inventory	415	389
	Trade receivables	322	213
	Bills Receivables	35	-
	Cash and bank	<u>303</u>	<u>166</u>
		2,315	1,588
	Less: Liabilities taken over:		
	Debentures 86.67	48.53	
	Unsecured loan 50		
	Creditors 65	<u>35</u>	
	Bills Payable <u>30</u>	<u>231.67</u>	<u>83.53</u>

	Net assets taken over	2083.33	1,504.47
	Purchase consideration	<u>1,800</u>	<u>1,111.25</u>
	Capital reserve	<u>283.33</u>	<u>393.22</u>
3.	Computation of securities premium		
	On preference share capital		
	High Ltd.- 3,20,000 x 25	80	
	Low Ltd.- 1,75,000 x 25		43.75
	On equity share capital		
	High Ltd.- 40,00,000 x 25	1000	
	Low Ltd.- 25,50,000 x 25		637.5
	Total	1080	681.25
4.	Issue of Debentures (₹ In Lakhs)		
	High Ltd - 15% fresh issue of debenture for 13% old debentures = $100 \times 13\% / 15\%$		
	= 86.67(rounded off)		
	Low Ltd - 15% fresh issue of debenture for 13% old debentures = $56 \times 13\% / 15\%$		
	= 48.53 (rounded off)		
	Total number of debentures issued = 86.67 + 48.53 = 135.20 Lakhs		

#12. Question | RTP Jan 2025 |

The Summarized Balance Sheets of Gyan Ltd. And Kiran Ltd. as on 31st March 2024 are given below:

	Gyan Ltd. (Rs. in lakhs)	Kiran Ltd. (Rs. in lakhs)
<u>Liabilities</u>		
Share capital		
Equity share capital of Rs.10 each fully paid- up	650	600
10% Preference shares of Rs. 100 each fully paid-up	150	200
Reserves and Surplus		
General Reserve	-	360
Profit and Loss Account	(260)	
Non-Current Liabilities		
12% Debentures	75	100
Loans from Bank	40	-
Current Liabilities		
Bank overdraft	15	-
Trade payables	95	105
Dividend payable	<u>-</u>	<u>60</u>
	<u>765</u>	<u>1,425</u>
<u>Assets</u>		
Non-Current Assets		
PPE	700	900
Investments	-	250
Current Assets		
Trade receivables	65	135
Cash at bank	<u>-</u>	<u>140</u>
	<u>765</u>	<u>1,425</u>

Gyan Ltd. has acquired the business of Kiran Ltd. as on 31 March 2024 as per following scheme of merger:

- (1) Banks agreed to waive-off 50% loan of Gyan Ltd.
- (2) Gyan Ltd. will reduce its shares to Rs. 2 per share and then consolidate 5 such shares into one share of Rs. 10 (new share).
- (3) Gyan Ltd. will issue 2 equity shares (new) for 3 equity shares of Kiran Ltd. The new shares are to be issued @ Rs. 20 each having a face value of Rs. 10 per share.
- (4) Preference shareholders of Kiran Ltd. will be paid off by issuing equivalent number of 10% Preference shares of Gyan Ltd. of Rs. 100 each at a price of Rs. 105 per share.
- (5) Dividend of Kiran Ltd. will be paid after merger to the shareholders of Kiran Ltd.
- (6) Trade payables of Gyan Ltd. include Rs. 50 lakhs payable to Kiran Ltd.

Pass necessary Journal entries in the books of Gyan Ltd. and prepare Balance Sheet after merger.

Answer:

Journal Entries in the books of Gyan Ltd.

Date			(Rs. in lakhs)	
			Dr.	Cr.
31 March	Loan from bank A/c (40 x 50%)	Dr.	20	
	To Reconstruction A/c			20
	(Being loan from bank waived off to the extent of 50%)			
	Equity share capital A/c (Rs. 10)	Dr.	650	
	To Equity Share Capital Rs.2 X (650/10 X 2)			130
	To Reconstruction A/c (650 -130)			520
	(Being Equity share of Rs. 10 each reduced to Rs. 2 each)			
	Equity share capital A/c (Rs. 2)	Dr.	130	
	To Equity share capital A/c (Rs. 10 each)			130
	(Being 5 Equity shares of Rs. 2 each consolidated to one share of Rs. 10 each)			
	Reconstruction A/c (20 + 520)	Dr.	540	
	To Profit and loss A/c (loss)			260
	To Capital reserve A/c			280
	(Being debit balance of P/L A/c set off against reconstruction account and balance transferred to capital reserve account)			
	Business purchase A/c	Dr.	1010	
	To Liquidator of Kiran Ltd.			1010
	(Being purchase of business of Kiran Ltd.)			
	PPE A/c	Dr.	900	
	Investment A/c	Dr.	250	
	Trade receivables A/c	Dr.	135	
	Cash at bank A/c	Dr.	140	
	To Trade payables A/c			105
	To Dividend payable A/c			60
	To 12% Debenture A/c			100
	To Business purchase A/c			1010
	To General Reserves A/c			150

	(Being assets, liabilities and reserves taken over under pooling of interest method)			
	Liquidator of Kiran Ltd. A/c	Dr.	1010	
	To Equity share capital A/c			400
	To 10% Preference share capital			200
	To Securities Premium [(40 x 10) + (2 x 5)]			410
	(Being payment made to liquidators of Kiran Ltd. by allotment of 40 lakh @ Rs. 10 new equity shares and 2 lakh preference shares @ Rs. 105)			
	Trade payables A/c	Dr.	50	
	To Trade receivables A/c			50
	(Being mutual owing cancelled)			
	Dividend Payable A/c	Dr.	60	
	To Bank A/c			60
	(Being dividend paid off)			

Balance Sheet of Gyan Ltd. (and reduced) after merger as on 31.3.2024

Particulars	Note No.	(Rs. in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	880
(b) Reserves and Surplus	2	840
(2) Non-Current Liabilities		
Long-term borrowings	3	195
(3) Current Liabilities		
(a) Trade Payables	4	150
(b) Borrowings	5	<u>15</u>
Total		<u>2,080</u>
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,600
(b) Investment	7	250
(2) Current assets		
(a) Trade receivables	8	150
(b) Cash and cash equivalents	9	<u>80</u>
Total		<u>2,080</u>

Notes to Accounts

		(Rs. in lakhs)	(Rs. in lakhs)
1.	Share Capital		
	50 lakhs (13 lakh + 40 lakh) Equity shares of 10 each fully paid	530	
	(Out of the above, 40 lakh shares have been issued for consideration other than cash)	<u>350</u>	

	3.5 lakhs (1.5 + 2) 10% Preference share of Rs. 100 each fully paid (Out of which 2 lakhs shares have been issued for consideration other than cash)		880
2.		280	
		410	
	Reserves and Surplus Capital	<u>150</u>	840
3.	reserve Securities Premium		
	General reserve	175	
	Non-current Borrowings	<u>20</u>	195
4.	12% Debentures (75 + 100)		150
5.	Loan from bank (40 - 20)		
	Trade Payables (95+105-50) Current		15
6.	Borrowings		1,600
	Bank overdraft		250
7.	Property, plant and equipment (700 + 900)		150
8.			
9.	Investment		80
	Trade Receivables (65 + 135 - 50) Cash and cash equivalents		
	Cash at Bank (140 - 60)		

Working Note:

Calculation of purchase consideration

	Shares
2 shares of Gyan Ltd. will be issued in exchange of every 3 shares of Kiran Ltd. (i.e. 40,00,000 equity shares of Gyan Ltd will be issued against 60,00,000 equity shares of Kiran Ltd.) (60 lakhs x 2/3)	40,00,000
	Rs. in lakhs
Payment to equity shareholders (40 lakhs x Rs. 20)	800
Payment to preference shareholders (2 lakhs x Rs. 105)	<u>210</u>
Total Purchase consideration	<u>1,010</u>

#13.Question | RTP Sep 2025 |

X Co. Ltd. having share capital of Rs.50 lakhs divided into equity shares of Rs.10 each was taken over by Y Co. Ltd. X Co. Ltd. has General Reserve of Rs.10,00,000 and Profit and Loss account Cr. Rs.5,00,000. Y Co. Ltd. issued 11 equity shares of Rs.10 each for every 10 shares of X Co. Ltd. How the journal entry would be passed in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interest method' of amalgamation.

Answer:

In the books of Y Co. Ltd.

Journal Entries

		Rs.	Rs.
Business Purchase A/c	Dr.	55,00,000	
To Liquidator of X Co. Ltd.			55,00,000

(Being business of X Co. Ltd. purchased)			
Assets A/c (Bal. Fig.)	Dr.	65,00,000	
To Business Purchase A/c			55,00,000
To General Reserve A/c* (10,00,000 – 5,00,000)			5,00,000
To Profit and Loss A/c			5,00,000
(Being assets and reserves and surplus taken over)			
Liquidator of X Co. Ltd.	Dr.	55,00,000	
To Equity share capital A/c			55,00,000
(Being purchase consideration discharged through equity shares of Y Co. Ltd.)			

Working note:

Purchase consideration (11/10*50 lakh)	Rs. 55,00,000
Less: Share capital of X Co. Ltd.	<u>Rs. 50,00,000</u>
To be adjusted from general reserve	<u>Rs. 5,00,000</u>

#14. Question | RTP Jan 2025 |

Astha Ltd. is absorbed by Nistha Ltd.; the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding Rs. 10,000 (actual cost Rs. 9,000); the payment of the 9% debentures of Rs. 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value and the payment of Rs.15 per share in cash and allotment of three 11% preference shares of Rs. 10 each and four equity shares of Rs.10 each at a premium of 20% fully paid for every five shares in Astha Ltd.

The number of shares of the vendor company are 1,50,000 of Rs. 10 each fully paid. Calculate purchase consideration as per AS 14.

Answer:

As per AS 14 'Accounting for Amalgamations', the term 'consideration' has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration.

Computation of Purchase Consideration

	Rs.
Cash payment Rs.15 x 1,50,000	22,50,000
11% Preference Shares of Rs. 10 each [(1,50,000 x 3/5) x Rs. 10]	9,00,000
Equity shares of Rs. 10 each @ 20% premium [(1,50,000 x 4/5) x Rs. 12]	<u>14,40,000</u>
Total Purchase consideration	<u>45,90,000</u>

The following are the summarized Balance Sheet of VT Ltd. and MG Ltd. as on 31st March, 2018:

Particulars	VT Ltd. (₹)	MG Ltd. (₹)
Equity and Liabilities		
Equity Shares of ₹10 each	12,00,000	6,00,000
10% Pref. Shares of ₹100 each	4,00,000	2,00,000
Reserve and Surplus	6,00,000	4,00,000
12% Debentures	4,00,000	3,00,000
Trade Payables	5,00,000	3,00,000
Total	31,00,000	18,00,000
Assets		
Property, Plant & Equipment	14,00,000	5,00,000
Investment	1,60,000	1,60,000
Inventory	4,80,000	6,40,000
Trade Receivables	8,40,000	4,20,000
Cash at Bank	2,20,000	80,000
Total	31,00,000	18,00,000

Details of Trade receivables and trade payables are as under:

Particulars	Galaxy Ltd (₹)	Glory Ltd. (₹)
Trade Receivable		
Debtors	7,20,000	3,80,000
Bills Receivable	1,20,000	40,000
	8,40,000	4,20,000
Trade Payables		
Sundry Creditors	4,40,000	2,50,000
Bills Payable	60,000	50,000
	5,00,000	3,00,000

Property, Plant & Equipment of both the companies are to be revalued at 15% above book value. Inventory in Trade and Debtors are taken over at 5% lesser than their book value.

Both the companies are to pay 10% equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, VT Ltd. will absorb MG Ltd. on the following terms:

- VT Ltd. will issue 16 Equity Shares of Rs. 10 each at par against 12 Shares of MG Ltd.
- 10% Preference Shareholders of MG Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹100 each, at par, in VT. Ltd.
- 12% Debenture holders of MG Ltd. are to be paid at 8% premium, by 12% Debentures in VT Ltd., issued at a discount of 10%.
- ₹60,000 is to be paid by VT Ltd. to MG Ltd. for Liquidation expenses.
- Sundry Debtors of MG Ltd. includes ₹20,000 due from VT Ltd. You are required to prepare:
 - Journal entries in the books of VT Ltd.
 - Statement of consideration payable by VT Ltd.

Answer

(i) Journal Entries in the Books of VT Ltd.

		Dr.(₹)	Cr. (₹)
Property, Plant & Equipment	Dr.	2,10,000	
To Revaluation Reserve			2,10,000

(Revaluation of fixed assets at 15% above book value)			
Reserve and Surplus	Dr.	1,20,000	
To Equity Dividend			1,20,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	1,20,000	
To Bank Account			1,20,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	9,80,000	
To Liquidator of MG Ltd.			9,80,000
(Consideration payable for the business taken over from MG Ltd.)			
Property, Plant & Equipment (115% of ₹5,00,000)	Dr.	5,75,000	
Inventory (95% of ₹6,40,000)	Dr.	6,08,000	
Debtors	Dr.	3,80,000	
Bills Receivable	Dr.	40,000	
Investment	Dr.	1,60,000	
Cash at Bank	Dr.	20,000	
(₹80,000 – ₹60,000 dividend paid)			
To Provision for Bad Debts (5% of ₹3,60,000)			18,000
To Sundry Creditors			2,50,000
To 12% Debentures in MG Ltd.			3,24,000
To Bills Payable			50,000
To Business Purchase Account			9,80,000
To Capital Reserve (Balancing figure)			1,61,000
(Incorporation of various assets and liabilities taken over from MG Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of MG Ltd.	Dr.	9,80,000	
To Equity Share Capital			8,00,000
To 10% Preference Share Capital			1,80,000
(Discharge of consideration for MG Ltd.'s business)			
12% Debentures in MG Ltd. (₹3,00,000 × 108%)	Dr.	3,24,000	
Discount on Issue of Debentures	Dr.	36,000	
To 12% Debentures			3,60,000
(Allotment of 12% Debentures to debenture holders of MG Ltd. at a discount of 10%)			
Sundry Creditors	Dr.	20,000	
To Sundry Debtors			20,000
(Cancellation of mutual owing)			
Goodwill	Dr.	60,000	
To Bank			60,000
(Being liquidation expenses reimbursed to MG Ltd.)			
Capital Reserve/P&L A/c	Dr.	60,000	
To Goodwill			60,000
(Being goodwill set off)			

(ii) Statement of Consideration payable by VT Ltd. for 60,000 shares (payment method)

	₹

(i) Shares to be allotted $60,000/12 \times 16 = 80,000$ shares of VT Ltd. Issued 80,000 shares of ₹10 each i.e.	8,00,000
(ii) For 10% preference shares, to be paid at 10% discount $₹2,00,000 \times 90/100$	1,80,000
(iii) Consideration amount [(i) + (ii)]	9,80,000

#16.Question | May 2018 Exam, 20 Marks | RTP November 2020

The financial position of X Ltd. and Y Ltd. as on 31st March, 2018 was as under:

Particulars	X Ltd. (₹)	Y Ltd. (₹)
Equity and Liabilities		
Equity Shares of ₹10 each	30,00,000	9,00,000
9% Pref. Shares of ₹100 each	3,00,000	-
10% Preference Shares of Rs. 100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	<u>3,90,000</u>	<u>2,40,000</u>
Total	<u>40,50,000</u>	<u>17,10,000</u>
Assets		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	<u>1,50,000</u>	<u>60,000</u>
Total	<u>40,50,000</u>	<u>17,10,000</u>

X Ltd. absorbs Y Ltd. on the following terms:

- 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.
- Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of preceding three financial years (2016-17 : ₹90,000; 2015-16 : ₹78,000 and 2014-15: ₹72,000). The profits of 2014-15 included credit of an insurance claim of Rs. 25,000 (fire occurred in 2013-14 and loss by fire ₹30,000 was booked in Profit and Loss Account of that year). In the year 2015-16, there was an embezzlement of cash by an employee amounting to ₹10,000.
- Land & Buildings are valued at ₹5,00,000 and the Plant & Machinery at ₹4,00,000.
- Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.
- There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to ₹15,000 and such asset was also taken over by X Ltd.
- The trade payables of Y Ltd. included ₹20,000 payable to X Ltd.
- Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium.

You are required to

- Prepare Realisation A/c in the books of Y Ltd.
- Show journal entries in the books of X Ltd.
- Prepare the Balance Sheet of X Ltd. after absorption as at 31st March, 2018.

Answer

In the Books of Y Ltd. Realization Account

		₹		₹

To Sundry Assets :			By Retirement Gratuity Fund	60,000
Goodwill	75,000			
Land & Building	3,00,000		By Trade payables	2,40,000
Plant & Machinery	4,50,000		By X Ltd. (Purchase Consideration)	15,90,000
Inventory	5,25,000			
Trade receivables	3,00,000			
Bank	<u>60,000</u>	17,10,000		
To Preference Shareholders		30,000		
(Premium on Redemption)				
To Equity Shareholders				
(Profit on Realisation)	<u>1,50,000</u>			
	18,90,000			18,90,000

In the Books of X Ltd. Journal Entries

		Dr.(₹)	Cr. (₹)
Business Purchase A/c	Dr.	15,90,000	
To Liquidators of Y Ltd. Account			15,90,000
(Being business of Y Ltd. taken over)			
Goodwill Account	Dr.	1,50,000	
Land & Building Account	Dr.	5,00,000	
Plant & Machinery Account	Dr.	4,00,000	
Inventory Account	Dr.	4,72,500	
Trade receivables Account	Dr.	3,00,000	
Bank Account	Dr.	60,000	
Unrecorded assets Account	Dr.	15,000	
To Retirement Gratuity Fund Account			60,000
To Trade payables Account			2,40,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			15,90,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Y Ltd. A/c	Dr.	15,90,000	
To 9% Preference Share Capital A/c			3,30,000
To Equity Share Capital A/c			12,00,000
To Securities Premium A/c			60,000
(Being Purchase Consideration satisfied as above)			

Balance Sheet of X Ltd. (after absorption) as at 31st March, 2018

Particulars	Notes	₹ (in Lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	48,30,000
(b) Reserves and Surplus	2	2,70,000
(2) Non-Current Liabilities		
(a) Long term provisions	3	2,10,000
(3) Current Liabilities		
(a) Trade payables	4	6,10,000

(b) Short term provision	5	7,500
Total		59,27,500
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	33,00,000
(b) Intangible assets	7	3,00,000
(2) Current assets		
(a) Inventories	8	12,22,500
(b) Trade receivables	9	8,80,000
(c) Other current Assets	10	15,000
(d) Cash and cash equivalents	11	2,10,000
Total		59,27,500

Notes to accounts

Note No	Particulars	₹
1	Share Capital	
	Equity share capital	
	4,20,000 Equity Shares of ₹10 each fully paid (Out of above 1,20,000	
	Equity Shares were issued in consideration other than for cash)	42,00,000
	Preference share capital	
	6,300 9% Preference Shares of ₹100 each (Out of above 3,300 Preference Shares were issued in consideration other than for cash)	6,30,000
	Total	<u>48,30,000</u>
2	Reserves and Surplus	
	Securities Premium	60,000
	General Reserve	<u>2,10,000</u>
	Total	<u>2,70,000</u>
3	Long-term provisions	
	Retirement Gratuity fund	<u>2,10,000</u>
4	Trade payables (3,90,000 + 2,40,000 - 20,000)* Mutual Owings eliminated.	<u>6,10,000</u>
5	Short term Provisions	
	Provision for Doubtful Debts	<u>7,500</u>
6	Tangible assets	
	Land & Buildings	14,00,000
	Plant & Machinery	<u>19,00,000</u>
	Total	<u>33,00,000</u>
7	Intangible assets	
	Goodwill (1,50,000 + 1,50,000)	<u>3,00,000</u>
8	Inventories (7,50,000 + 4,72,500)	<u>12,22,500</u>
9	Trade receivables (6,00,000 + 3,00,000 - 20,000)	8,80,000
10	Other current Assets	<u>15,000</u>
11	Cash and cash equivalents (1,50,000 + 60,000)	<u>2,10,000</u>

Working Notes:

Computation of goodwill	₹
Profit of 2016-17	90,000
Profit of 2015-16 adjusted ₹78,000 + 10,000)	88,000
Profit of 2014-15 adjusted (₹72,000 - 25,000)	<u>47,000</u>
	<u>2,25,000</u>
Average profit	75,000

Goodwill to be valued at 2 times of average profits = ₹75,000 x 2 =	
₹1,50,000	
Purchase Consideration:	
Goodwill	1,50,000
Land & Building	5,00,000
Plant & Machinery	4,00,000
Inventory	4,72,500
Trade receivables	3,00,000
Unrecorded assets	15,000
Cash at Bank	<u>60,000</u>
	18,97,500
Less: Liabilities:	
Retirement Gratuity 60,000	
Trade payables 2,40,000	
Provision for doubtful debts <u>7,500</u>	<u>(3,07,500)</u>
Net Assets/ Purchase Consideration	15,90,000
To be satisfied as under:	
10% Preference Shareholders of Y Ltd.	3,00,000
Add: 10% Premium	<u>30,000</u>
9% Preference Shares of X Ltd.	3,30,000
Equity Shareholders of Y Ltd. to be satisfied by issue of 1,20,000 equity Shares of X Ltd. at 5% Premium	<u>12,60,000</u>
Total	15,90,000

#17.Question | RTP November 2022|

The balance sheets of Truth Limited and Myth Limited as at 31.03.2021 is given below. Myth Limited is to be amalgamated with Truth Limited from 1.04.2021. The amalgamation is to be carried out in the nature of purchase

Particulars	Notes	Truth Ltd. (₹)	Myth Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	10,00,000	4,00,000
(b) Reserves and Surplus	2	11,35,000	4,13,000
(2) Non-Current Liabilities	3	-	1,50,000
(3) Current Liabilities	4	1,40,000	1,82,000
Total		22,75,000	11,45,000
II. Assets			
(1) Non-current assets			
(a) Property, plant and equipment		15,75,000	6,80,000
(b) Investments		1,87,500	1,00,000
(2) Current assets	5	5,12,500	3,65,000
Total		22,75,000	11,45,000

Note No	Particulars	Truth Limited (₹)	Myth Limited (₹)
1	Share Capital	10,00,000	4,00,000
	Equity shares of ₹10 each		
2	Reserves and Surplus		
	General Reserve	5,05,000	2,30,000
	Profit & Loss A/c	4,45,000	1,58,000

	Export Profit Reserve	1,85,000	25,000
3	Non- Current Liabilities	11,35,000	4,13,000
	14% Debentures	-	1,50,000
4	Current Liabilities		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
5	Current Assets	1,40,000	1,82,000
	Inventory	2,15,000	85,000
	Trade Receivables	2,02,500	1,75,000
	Cash and Cash equivalents	95,000	1,05,000
		5,12,500	3,65,000

Truth Limited would issue 12% debentures to discharge the claim of the debenture holders of Myth Limited so as to maintain their present annual interest income. Non-trade investment, which constitute 80% of their respective total investments yielded income of 20% to Truth Limited and 15% to Myth Limited. This income is to be deducted from profits while computing average profit for the purpose of calculating goodwill. Profit before tax of both the companies during the last 3 years were as follows:

	Truth Limited (₹)	Myth Limited (₹)
2018-2019	8,20,000	2,55,000
2019-2020	7,45,000	2,15,000
2020-2021	6,04,000	2,14,000

Goodwill is to be calculated on the basis of simple average of three years profit by using Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the amalgamation.

Answer

Balance Sheet of Truth Ltd. (after amalgamated with Myth Ltd.) as at 1.4.2021

Particulars	Notes	Truth Ltd. (₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	13,13,750
(b) Reserves and Surplus	2	20,76,250
(2) Non-Current Liabilities		
12% Debentures	3	1,75,000
(3) Current Liabilities		
(a) Trade payables	4	2,32,000
(b) Other current liabilities	5	90,000
Total		38,87,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	22,55,000
(b) Intangible assets (Goodwill) [WN 1]		4,67,000
(c) Non-current investments	7	2,87,500
(2) Current assets		
(a) Inventories (2,15,000 + 85,000)		3,00,000
(b) Trade receivables (2,02,500 + 1,75,000)		3,77,500
(c) Cash & cash equivalents (95,000+1,05,000)		2,00,000
Total		38,87,000

Notes to Accounts

		(₹)	(₹)

1.	Share Capital		
	1,31,375 Equity Shares of ₹10 each [1,00,000 + 31,375]		13,13,750
	(of the above shares, 31,375 shares were issued to the vendors otherwise than for cash)		
2.	Reserves and surplus		
	General Reserve	5,05,000	
	Profit and Loss A/c	4,45,000	
	Securities Premium [31,375 x 30]	9,41,250	
	Export profit reserve 1,85,000		
	Add: Balance of Myth Ltd. 25,000	2,10,000	
	Amalgamation Adjustment Reserve	(25,000)	20,76,250
3.	Long Term Borrowings		
	12% Debentures issued to Myth Ltd.		1,75,000
4.	Trade payables		
	Trade payables	90,000	
	Add: Taken over	1,42,000	2,32,000
5.	Other Current Liabilities		
	Truth Ltd.	50,000	
	Myth Ltd.	40,000	90,000
6.	Property, Plant & Equipment		
	Truth Ltd.	15,75,000	
	Myth Ltd.	6,80,000	22,55,000
7.	Investment		
	Truth Ltd.	1,87,500	
	Myth Ltd.	1,00,000	2,87,500

Working Notes:

(1) Valuation of Goodwill

(i) Capital Employed

	Truth Ltd. (₹)		Myth Limited	
	(₹)	(₹)	(₹)	(₹)
Assets as per Balance Sheet		22,75,000		11,45,000
Less: Non-trade Investment		(1,50,000)		(80,000)
Less: Liabilities:				
14% Debentures	-		1,50,000	
Trade payables	90,000		1,42,000	
Other current liabilities	50,000	(1,40,000)	40,000	(3,32,000)
Capital Employed		19,85,000		7,33,000

(ii) Average Profit before Tax

	Truth Ltd. (₹)		Myth Limited	
2018-2019		8,20,000		2,55,000
2019-2020		7,45,000		2,15,000
2020-2021		6,04,000		2,14,000
Total profit of 3 years (a)		21,69,000		6,84,000
Simple Average [(a)/3]		7,23,000		2,28,000
Less: Non-trading income*		(30,000)		(12,000)
(iii) Goodwill		6,93,000		2,16,000
Capitalised value of average profit	[(6,93,000 / 18) x 100]	38,50,000	[(2,16,000 / 18) x 100]	12,00,000
Less: Capital Employed [From (i) above]		(19,85,000)		(7,33,000)
Goodwill		18,65,000		4,67,000

* For Truth Ltd. = 1,87,500 x 80% x 20% = 30,000; and

Myth Ltd. = 1,00,000 x 80% x 15% = 12,000

(2) Intrinsic Value per Share

	Truth Ltd. (₹)		Myth Limited	
Goodwill [W.N. 1]	18,65,000		4,67,000	
Other Assets	22,75,000	41,40,000	11,45,000	16,12,000
Less: Liabilities				
12% Debentures	-		1,75,000**	
Trade payables	90,000		1,42,000	
Provision for Tax	50,000	(1,40,000)	40,000	(3,57,000)
Net Assets		40,00,000		12,55,000
Intrinsic value per share [Net Assets / No. of Shares]		40,00,000 / 1,00,000		12,55,000 / 40,000
		= ₹40		= ₹31.375

$$** 1,50,000 \times \frac{14\%}{12\%} = 1,75,000$$

(3) Purchase Consideration & manner of its discharge

Intrinsic Value of Myth Ltd. [a]	₹31.375 per share
No. of shares [b]	40,000 shares
Purchase Consideration c= [a x b]	₹12,55,000
Intrinsic Value of Truth Ltd. [d]	₹40 per share
No. of shares to be issued [c / d]	31,375 shares

#18. Question | RTP May 2022 |

The following are the Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

Particulars	Note No.	Aakash Limited (₹)	Ganga Limited (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	80,00,000	4,00,000
(b) Reserves and Surplus	2	(3,24,00,000)	56,00,000
(2) Non-Current Liabilities			
(a) Secured Loans	3	3,20,00,000	1,60,00,000
(b) Unsecured Loans	4	1,72,00,000	-
(3) Current Liabilities			
(a) Trade Payables		56,00,000	36,00,000
(b) Other Current Liabilities	5	2,04,00,000	56,00,000
Total		5,08,00,000	3,28,00,000
II. Assets			
(1) Non-current assets			
(a) Property, plant and equipment		68,00,000	1,36,00,000
(2) Current assets			
(a) Inventories		3,68,00,000	-
(b) Other Current Assets		72,00,000	1,92,00,000
Total		5,08,00,000	3,28,00,000

Notes to Accounts:

		Aakash Limited (₹)	Ganga Limited (₹)
1.	Share Capital		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of ₹10 each	60,00,000	-
	20,000 Preference Shares of ₹100 each	20,00,000	-
	2,00,000 Equity Shares of ₹10 each	-	20,00,000
		80,00,000	20,00,000

2.	Reserves and Surplus		
	General Reserve	8,00,000	56,00,000
	Surplus	(3,32,00,000)	-
		(3,24,00,000)	56,00,000
3.	Secured Loans (Secured Loans of Aakash Limited are secured against pledge of Inventories)	3,20,00,000	1,60,00,000
4.	Unsecured Loans	1,72,00,000	-
5.	Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000
	Liability to Employees	60,00,000	36,00,000
		2,04,00,000	56,00,000

Both the companies go into liquidation and a new company 'AakashGanga Limited' is formed to take over their business. The following information is given:

- All Current Assets of two companies, except pledged inventory are taken over by Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.
- Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.
- Secured Loans include ₹32,00,000 accrued interest in case of Ganga Limited.
- 4,00,000 Equity Shares of ₹10 each are allotted by AakashGanga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.
- Preference Shareholders in Aakash Limited are issued Equity Shares in AakashGanga Ltd. worth ₹4,00,000 in lieu of their present holdings.
- Secured Loan agree to continue the balance amount of their loans to AakashGanga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.
- Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.
- Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.
- Statutory Liabilities are taken over by AakashGanga Limited at full value and Trade Payables are taken over at 80% of the book value.

You are required to prepare the opening Balance Sheet of AakashGanga Limited as at 1.4.2021.

Answer

Balance sheet of Aakash Ganga Ltd. as at 1st April, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,40,00,000
(2) Non-Current Liabilities		
(a) Long term borrowings	2	2,12,60,000
(3) Current Liabilities		
(a) Trade Payables	3	73,60,000
(b) Other Current Liabilities	4	1,64,00,000
Total		5,90,20,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	5	2,04,00,000
(b) Intangible assets	6	1,54,20,000

(2) Current assets		
(a) Cash and cash equivalents		40,00,000
(b) Other Current Assets	7	1,92,00,000
Total		5,90,20,000

Notes to Accounts

			(₹)
1.	Share Capital		
	Issued, Subscribed & Paid up :		
	14,00,000 equity shares of Rs. 10 each, fully paid up (W.N.4)		1,40,00,000
	(of the above 10,00,000 shares have been issued for consideration other than cash)		
2.	Long Term borrowings		
	Secured Loans		
	Aakash Limited 25,60,000		
	Ganga Limited 1,44,00,000	1,69,60,000	
	Unsecured Loans	43,00,000	2,12,60,000
3.	Trade Payables (W.N.1)		
	Aakash Limited	44,80,000	
	Ganga Limited	20,00,000	1,64,00,000
4.	Other current liabilities		
	Statutory Liabilities		
	Aakash Limited	1,44,00,000	
	Ganga Limited	20,00,000	1,64,00,000
5.	Property, Plant & Equipment		
	Aakash Limited	68,00,000	
	Ganga Limited	1,36,00,000	2,04,00,000
6.	Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7.	Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

1. Value of total liabilities taken over by AakashGanga Ltd.

	Aakash Limited		Ganga Limited	
	(₹)	(₹)	(₹)	(₹)
Current liabilities				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	44,80,000	2,48,80,000	28,80,000	84,80,000
Secured loans				
Given in Balance Sheet	3,20,00,000		1,60,00,000	
Interest waived	-		16,00,000	1,44,00,000
Value of Inventory (80% of ₹3,68,00,000)	2,94,40,000	25,60,000		
Unsecured Loans (25% of ₹1,72,00,000)		43,00,000		-
		3,17,40,000		2,28,80,000

2. Assets taken over by AakashGanga Ltd.

	Aakash Limited	Ganga Limited
	(₹)	(₹)
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets		

(80% and 70% respectively of book value)	57,60,000	1,34,40,000
	1,25,60,000	2,70,40,000

3. Goodwill / Capital Reserve on amalgamation

		(₹)	(₹)
Liabilities taken over (W.N. 1)		3,17,40,000	2,28,80,000
Equity shares to be issued to Preference Shareholders		4,00,000	-
	A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N. 2)	B	(1,25,60,000)	(2,70,40,000)
	A-B	1,95,80,000	(41,60,000)
		Goodwill	Capital Reserve
Net Goodwill (1,95,80,000- 41,60,000)		1,54,20,000	

4. Equity shares issued by AakashGanga Ltd.

(i)	For Cash		40,00,000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	96,00,000	
(iii)	To Preference shareholders	4,00,000	1,00,00,000
			1,40,00,000
	No. of shares @ ₹10		14,00,000

#19.Question | RTP November 2021, May 2018 |

P Ltd. and Q Ltd. agreed to amalgamate their business. The scheme envisaged a share capital, equal to the combined capital of P Ltd. and Q Ltd. for the purpose of acquiring the assets, liabilities and undertakings of the two companies in exchange for share in PQ Ltd. The Summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March, 2017 (the date of amalgamation) are given below:

Summarized balance sheets as at 31-03-2017

Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
Equity & liabilities:			Assets:		
Shareholders Fund			Non-current Assets:		
a. Share Capital	6,00,000	8,40,000	Property, Plant & Equipment (excluding Goodwill)	7,20,000	10,80,000
b. Reserves	10,20,000	6,00,000	Current Assets		
Current Liabilities			a. Inventories	3,60,000	6,60,000
Bank Overdraft	-	5,40,000	b. Trade receivables	4,80,000	7,80,000
Trade payables	2,40,000	5,40,000	c. Cash at Bank	3,00,000	-
	18,60,000	25,20,000		18,60,000	25,20,000

The consideration was to be based on the net assets of the companies as shown in the above Balance Sheets, but subject to an additional payment to P Ltd. for its goodwill to be calculated as its weighted average of net profits for the three years ended 31st March, 2017. The weights for this purpose for the years 2014-15, 2015-16 and 2016-17 were agreed as 1, 2 and 3 respectively. The profit had been: 2014-15 ₹3,00,000; 2015-16 Rs. 5,25,000 and 2016-17 ₹6,30,000. The shares of PQ Ltd. were to be issued to P Ltd. and Q Ltd. at a premium and in proportion to the agreed net asset value of these companies. In order to raise working capital, PQ Ltd proceeded to issue 72,000 shares of Rs. 10 each at the same rate of premium as issued for discharging purchase consideration to P Ltd. and Q Ltd.

You are required to :

- Calculate the number of shares issued to P Ltd. and Q Ltd; and
- Prepare required journal entries in the books of PQ Ltd.; and
- Prepare the Balance Sheet of PQ Ltd. as per Schedule III after recording the necessary journal entries.

Answer**(i) Calculation of number of shares issued to P Ltd. and Q Ltd.:**

Amount of Share Capital as per balance sheet	₹
P Ltd.	6,00,000
Q Ltd.	<u>8,40,000</u>
	14,40,000

Share of P Ltd. = ₹14,40,000 × [21,60,000 / (21,60,000 + 14,40,000)]

= ₹8,64,000 or 86,400 shares

Securities premium = ₹21,60,000 – ₹8,64,000 = ₹12,96,000

Premium per share = ₹12,96,000 / ₹86,400 = ₹15

Issued 86,400 shares @ ₹10 each at a premium of ₹15 per share

Share of Q Ltd. = ₹14,40,000 × [14,40,000 / (21,60,000 + 14,40,000)]

= ₹5,76,000 or 57,600 shares

Securities premium = ₹14,40,000 – ₹5,76,000 = ₹8,64,000

Premium per share = ₹8,64,000 / ₹57,600 = ₹15

Issued 57,600 shares @ ₹10 each at a premium of ₹15 per share

(ii) Journal Entries in the books of PQ Ltd.

Particulars		Dr.(₹)	Cr. (₹)
Business purchase account	Dr.	36,00,000	
To Liquidator of P Ltd. account			21,60,000
To Liquidator of Q Ltd. account			14,40,000
(Being the amount of purchase consideration payable to liquidator of P Ltd. and Q Ltd. for assets taken over)			
Goodwill	Dr.	5,40,000	
Property, Plant & Equipment account	Dr.	7,20,000	
Inventory account	Dr.	3,60,000	
Trade receivables account	Dr.	4,80,000	
Cash at bank	Dr.	3,00,000	
To Trade payables account			2,40,000
To Business purchase account			21,60,000
(Being assets and liabilities of P Ltd. taken over)			
Property, Plant & Equipment account	Dr.	10,80,000	
Inventory account	Dr.	6,60,000	
Trade receivables account	Dr.	7,80,000	
To bank overdraft account			5,40,000
To Trade payables account			5,40,000
To Business purchase account			14,40,000
(Being assets and liabilities of Q Ltd. taken over)			
Liquidator of P Ltd. Account	Dr.	21,60,000	
To Equity share capital account (86,400 × ₹10)			8,64,000
To Securities premium (86,400 × ₹15)			12,96,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Liquidator of Q Ltd. account	Dr.	14,40,000	
To Equity share capital account (57,600 × ₹10)			5,76,000
To Securities premium (57,600 × ₹15)			8,64,000
(Being the allotment of shares as per agreement for discharge of purchase consideration)			
Bank A/c	Dr.	18,00,000	

To Equity share capital account			7,20,000
To Securities premium(Equity share capital issued to raise working capital)			10,80,000

(iii) Balance Sheet of PQ Ltd. on 31st March, 2017 after amalgamation

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share capital	1	21,60,000
(b) Reserves and Surplus	2	32,40,000
(2) Current Liabilities		
(a) Trade Payables (2,40,000 + 5,40,000)		7,80,000
Total		61,80,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment (7,20,000 + 10,80,000)		2,04,00,000
(b) Intangible assets	3	5,40,000
(2) Current assets		
(a) Inventories (3,60,000 + 6,60,000)		10,20,000
(b) Trade receivables (4,80,000 + 7,80,000)		12,60,000
(c) Cash and cash equivalents	4	15,60,000
Total		61,80,000

Notes to accounts

		₹
1	Share Capital	
	Issued, subscribed and paid up share capital	
	2,16,000 Equity shares of ₹10 each	21,60,000
	(Out of the above 1,44,000 shares issued for non-cash consideration under scheme of amalgamation)	
2	Reserves and Surplus	
	Securities premium	32,40,000
	(@ ₹15 for 2,16,000 shares)	
3	Cash and cash equivalents	
	Cash at Bank	15,60,000
4	Intangible Assets	
	Goodwill	5,40,000

Working Notes:

1. Calculation of goodwill of P Ltd.

Particulars	Amount	Weight	Weighted amount
	₹	₹	₹
2014-15	3,00,000	1	3,00,000
2015-16	5,25,000	2	10,50,000
2016-17	6,30,000	3	18,90,000
Total (a+b+c)	14,55,000	6	32,40,000
weighted Average = [Total weighted amount/Total of weight] [₹32,40,000/6] Goodwill			5,40,000

2. Calculation of Net assets

	P Ltd. ₹	Q Ltd. ₹
Assets		

Goodwill	5,40,000	
Property, Plant & Equipment	7,20,000	10,80,000
Inventory	3,60,000	6,60,000
Trade receivable	4,80,000	7,80,000
Cash at bank	3,00,000	
Less: Liabilities		
Bank overdraft	5,40,000	
Trade payables	<u>2,40,000</u>	<u>5,40,000</u>
Net assets or Purchase consideration	<u>21,60,000</u>	<u>14,40,000</u>
New authorized capital		
= ₹14,40,000 + ₹12,00,000 = ₹26,40,000		
Cash and Cash equivalents		
P Ltd. Balance	3,00,000	
Cash received from Fresh issue (72,000 X ₹25)	<u>18,00,000</u>	<u>21,00,000</u>
Less: Bank Overdraft	<u>5,40,000</u>	15,60,000*

*The balance of cash and equivalents has been shown after setting off overdraft amount.

#20. Question | RTP May 2021 |

Mohan Ltd. gives you the following information as on 31st March, 2020:

Share capital:	
Equity shares of ₹10 each	3,00,000
6,000, 9% cumulative preference shares of ₹10 each	60,000
Profit and Loss Account (Dr. balance)	1,70,000
10% Debentures of ₹100 each	2,00,000
Interest payable on Debentures	20,000
Trade Payables	1,50,000
Property, Plant and Equipment	3,40,000
Goodwill	10,000
Inventory	80,000
Trade Receivables	1,10,000
Bank Balance	20,000

A new company Ravi Ltd. is formed with authorised share capital of ₹4,00,000 divided into 40,000 Equity Shares of ₹10 each. The new company will acquire the assets and liabilities of Mohan Ltd. on the following terms:

- (i)
 - (a) Mohan Ltd.'s debentures are paid by similar debentures in new company and for outstanding accrued interest on debentures, equity shares of equal amount are issued at par.
 - (b) The trade payables are paid by issue of 12,000 equity shares at par in full and final settlement of their claims.
 - (c) Preference shareholders are to get equal number of equity shares issued at par. Dividend on preference shares is in arrears for three years. Preference shareholders to forgo dividend for two years. For balance dividend, equity shares of equal amount are issued at par.
 - (d) Equity shareholders are issued one share at par for every three shares held in Mohan Ltd.
- (ii) Current Assets are to be taken at book value (except inventory, which is to be reduced by 10%). Goodwill is to be eliminated. The Property, plant and equipment is taken over at ₹3,08,400.
- (iii) Remaining equity shares of the new company are issued to public at par fully paid up.
- (iv) Expenses of ₹5,000 to be met from bank balance of Mohan Ltd. This is to be adjusted from the bank balance of Mohan Ltd. before acquisition by Ravi Ltd.

You are required to prepare:

- (a) Realization account and Equity Shareholders' account in the books of Mohan Ltd.
- (b) Bank Account and Balance Sheet with notes to accounts in the books of Ravi Ltd.

Answer

In the books of Mohan Ltd.

(i) Realisation Account

		₹			₹
To	Goodwill	10,000	By	10% Debentures	2,00,000
To	Property, plant and equipment	3,40,000	By	Interest accrued on debentures	20,000
To	Inventory	80,000	By	Trade payables	1,50,000
To	Trade receivables	1,10,000	By	Ravi Ltd. (Purchase consideration) (W.N. 1)	1,65,400
To	Bank (20,000 - 5,000)		By	Equity shareholders A/c (loss on realization) (Bal. fig.)	25,000
To	Preference share holders A/c (W.N.2)	<u>5,400</u>			
		5,60,400			5,60,400

(ii) Equity shareholders' Account

		₹			₹
To	Profit & loss A/c	1,70,000	By	Equity Share capital	3,00,000
To	Expenses*	5,000			
To	Equity shares in Ravi Ltd.	1,00,000			
To	Realization A/c	25,000			
		3,00,000			3,00,000

*Alternatively, expenses may be routed through Realization account.

In the books of Ravi Ltd.**(iii) Bank Account**

		₹			₹
To	Business Purchase	15,000	By	Balance c/d (Bal. fig.)	1,09,600
To	Equity shares application & allotment A/c (W.N. 3)	94,600			
		<u>1,09,600</u>			<u>1,09,600</u>

(iv) Balance Sheet as at 31st March, 2020

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share capital	1	4,00,000
(2) Non - Current Liabilities		
(a) Long-term borrowings	2	2,00,000
Total		6,00,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		3,08,400
(2) Current assets		
(a) Inventories		72,000
(b) Trade receivables		1,10,000
(c) Cash and cash equivalents		<u>1,09,600</u>
Total		6,00,000

Notes to Accounts

		₹
1	Share Capital	
	Authorised share capital	

	40,000 equity shares of ₹10 each	4,00,000
	Issued and Subscribed	
	40,000 shares of ₹10 each fully paid up	4,00,000
	(out of the above, 30,540 (W.N.3) shares have been allotted as fully paid-up pursuant to contract without payment being received in cash)	
2	Long Term Borrowings	
	10% Debentures	2,00,000

Working Notes:

1. Calculation of Purchase consideration

	₹
Payment to preference shareholders	
6,000 equity shares @ ₹10	60,000
For arrears of dividend: $(6,000 \times ₹10) \times 9\%$	5,400
Payment to equity shareholders	
$(30,000 \text{ shares} \times 1/3) @ ₹10$	<u>1,00,000</u>
Total purchase consideration	<u>1,65,400</u>

2. Preference shareholders' Account in books of Mohan Ltd.

		₹			₹
To	Equity Shares in Ravi Ltd.	65,400	By	Preference Share capital	60,000
			By	Realization A/c (Bal. fig.)	5,400
		65,400			65,400

3. Calculation of number of Equity shares issued to public

	Number of shares	
Authorized equity shares		40,000
Less: Equity shares issued for interest accrued on debentures	2,000	
Re Trade payables of Mohan Ltd.	12,000	
Preference shareholders of Mohan Ltd.	6,000	
Arrears of preference dividend	540	
Equity shareholders of Mohan Ltd.	<u>10,000</u>	<u>(30,540)</u>
		9,460

#21. Question | RTP May 2020 |

P Ltd. and Q Ltd. agreed to amalgamate and form a new company called PQ Ltd. The summarized balance sheets of both the companies on the date of amalgamation stood as below:

Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
Equity & liabilities:			Land & Building	4,50,000	3,40,000
Equity Shares	8,20,000	3,20,000	Furniture & Fittings	1,00,000	50,000
(₹100 each)					
9% Pref. Shares	3,80,000	2,80,000	Plant & Machinery	6,20,000	4,50,000
(₹100 each)			Trade receivables	3,25,000	1,50,000
8% Debentures	2,00,000	1,00,000	Inventory	2,33,000	1,05,000
General Reserve	1,50,000	50,000	Cash at bank	2,08,000	1,75,000
Profit & Loss A/c	3,52,000	2,05,000	Cash in hand	54,000	20,000
Unsecured Loan	-	1,75,000			
Trade payables	88,000	1,60,000			
	19,90,000	12,90,000		19,90,000	12,90,000

PQ Ltd. took over the assets and liabilities of both the companies at book value after creating provision @ 5% on inventory and trade receivables respectively and depreciating Furniture & Fittings by @ 10%, Plant and Machinery by @ 10%. The trade receivables of P Ltd. include ₹25,000 due from Q Ltd. PQ Ltd. will issue:

- (i) 5 Preference shares of ₹20 each @ ₹18 paid up at a premium of ₹4 per share for each pref. share held in both the companies.
- (ii) 6 Equity shares of ₹20 each @ ₹18 paid up at a premium of ₹4 per share for each equity share held in both the companies.
- (iii) 6% Debentures to discharge the 8% debentures of both the companies.
- (iv) 20,000 new equity shares of ₹20 each for cash @ ₹18 paid up at a premium of ₹4 per share. PQ Ltd. will pay cash to equity shareholders of both the companies in order to adjust their rights as per the intrinsic value of the shares of both the companies.

You are required to prepare ledger accounts in the books of P Ltd. and Q Ltd. to close their books.

In the Books of P Ltd.

Realisation Account

		₹			₹
To	Land & Building	4,50,000	By	By 8% Debentures	2,00,000
To	Plant & Machinery	6,20,000	By	Trade Payables	88,000
To	Furniture & Fitting	1,00,000	By	PQ Ltd.	16,02,100
To	Trade receivables	3,25,000		(Purchase consideration)	
To	Cash at Bank	2,08,000	By	By Equity Shareholders A/c	1,37,900
To	Cash in Hand	54,000	By		
To	Preference shareholders	38,000			
		20,28,000			20,28,000

Equity Shareholders Account

		₹			₹
To	Equity shares in PQ Ltd.	4,22,400	By	By Share Capital	3,20,000
To	Realization	90,750	By	Profit & Loss A/c	2,05,000
To	Cash	61,850	By	General Reserve	50,000
		5,75,000			5,75,000

9% Preference Shareholders Account

		₹			₹
To	Preference Shares in PQ Ltd.	3,08,000	By	By Share Capital	2,80,000
To			By	Realization A/c	28,000
		3,08,000			3,08,000

Q Ltd. Account

		₹			₹
To	Realization A/c	7,92,250	By	Equity shares in PQ Ltd	
				For Equity	4,22,400
				Preference	<u>3,08,000</u>
				By Cash	61,850
		7,92,250			7,92,250

8% Debentures holders Account

		₹			₹
To	6% Debentures	1,00,000	By	8% Debentures	1,00,000
		1,00,000			1,00,000

Working Notes:**(i) Purchase consideration**

	P Ltd. ₹	Q Ltd. ₹
Payment to preference shareholders:		
Preference shares at ₹22 per share	4,18,000	3,08,000
Equity Shares at ₹22 per share	10,82,400	4,22,400
Cash [See W.N. (ii)]	1,01,700	61,850
	16,02,100	7,92,250

(ii) Value of Net Assets

	(₹)	P Ltd. (₹)	(₹)	Q Ltd. (₹)
Land & Building		4,50,000		3,40,000
Plant & Machinery less 10% Depreciation		5,58,000		4,05,000
Furniture & Fittings less 10% Depreciation		90,000		45,000
Trade receivables less 5%		3,08,750		1,42,500
Inventory less 5%		2,21,350		99,750
Cash at Bank		2,08,000		1,75,000
Cash in hand		<u>54,000</u>		<u>20,000</u>
		18,90,100		12,27,250
Less: Debentures	2,00,000		1,00,000	
Trade payables	88,000		1,60,000	
Secured Loans	--	<u>(2,88,000)</u>	1,75,000	<u>(4,35,000)</u>
			16,02,100	7,92,250
Payable in shares			<u>15,00,400</u>	<u>7,30,400</u>
Payable in cash*			<u>1,01,700</u>	<u>(61,850)</u>

(iii)

	P Ltd. ₹	Q Ltd. ₹
Plant & Machinery	6,20,000	4,50,000
Less: Depreciation 10%	<u>62,000</u>	<u>45,000</u>
	5,58,000	4,05,000
Furniture & Fixtures	1,00,000	50,000
Less: Depreciation 10%	<u>10,000</u>	<u>5,000</u>
	90,000	45,000

*This cash is paid to equity shareholders of both the companies for adjustment of their rights as per intrinsic value of both companies.

#22. Question | RTP November 2019 |

The following is the summarized Balance Sheet of A Ltd. as at 31st March, 2019 :

Liabilities	₹	Assets	₹
8,000 Equity shares of ₹100 each	8,00,000	Building	3,40,000
10% Debentures	4,00,000	Machinery	6,40,000
Loans	1,60,000	Inventory	2,20,000
Trade payables	3,20,000	Trade receivables	2,60,000
General Reserve	80,000	Bank	1,36,000
		Patent	1,30,000
		Share issue Expenses	34,000
	17,60,000		17,60,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

- (1) B Ltd. would take over all assets, except bank balance and Patent at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.
- (2) B Ltd. is to take over trade payables at book value.
- (3) The purchase consideration is to be paid in cash to the extent of ₹6,00,000 and the balance in fully paid equity shares of ₹100 each at ₹125 per share.
- The average profit is ₹1,24,400. The liquidation expenses amounted to ₹16,000. B Ltd. sold prior to 31st March, 2018 goods costing ₹1,20,000 to A Ltd. For ₹1,60,000. ₹1,00,000 worth of goods are still in Inventory of A Ltd. on 31st March, 2018. Trade payables of A Ltd. include ₹40,000 still due to B Ltd. Show the necessary Ledger Accounts to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2019 after the takeover.

Answer

Books of A Limited Realization Account

		₹			₹
To	Building	3,40,000	By	Trade payables	3,20,000
To	Machinery	6,40,000	By	B Ltd.	12,10,000
To	Inventory	2,20,000	By	Equity Shareholders (Loss)	76,000
To	Trade receivables	2,60,000			
To	Patent	1,30,000			
To	Bank (Exp.)	16,000			
		16,06,000			16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realization (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% Debentures	4,00,000
			By	Loan	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

10% Debentures Account

To	Balance b/d	4,00,000	By	Balance b/d	4,00,000
		4,00,000			4,00,000

Loan Account

To	Bank	1,60,000	By	Balance b/d	1,60,000
		1,60,000			1,60,000

Share Issue Expenses Account

To	Balance b/d	34,000	By	Equity shareholders	34,000
		34,000			34,000

General Reserve Account

To	Equity shareholders	80,000	By	Balance b/d	80,000
		80,000			80,000

B Ltd. Account

To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd. (4,880 shares at ₹125 each)	6,10,000
		12,10,000			12,10,000

Equity Shares in B Ltd. Account

To	B Ltd.	6,10,000	By	Equity shareholders	6,10,000
		6,10,000			6,10,000

Equity Share Holders Account

To	Realization Account	76,000	By	Equity share capital	8,00,000
To	Share issue Expenses	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd

Balance Sheet as on 1st April, 2019 (An extract)

Particulars	Notes	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share capital	1	4,88,000
(b) Reserves and Surplus	2	1,07,000
(2) Non - Current Liabilities		
(a) Long-term borrowings	3	2,80,000
(b) Bank overdraft		6,00,000
Total		14,75,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		3,08,400
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
Total		14,75,000

Notes to Accounts

			₹
1	Share Capital		
	Equity share capital		
	4,880 Equity shares of ₹100 each (Shares have been issued for consideration other than cash)		4,88,000
2	Reserves and Surplus (an extract)		
	Securities Premium		1,22,000
	Profit and loss account		
	Less: Unrealized profit	(15,000)	(15,000)
			1,07,000
3	Trade payables		
	Opening balance	3,20,000	
	Less: Inter-company transaction cancelled upon amalgamation	(40,000)	2,80,000
4	Tangible assets		
	Buildings		3,06,000
	Machinery		5,76,000
			8,82,000
5	Intangible assets		
	Goodwill		2,16,000
6	Inventories		

	Opening balance	1,98,000	
	Less: Cancellation of profit upon amalgamation	(15,000)	1,83,000
7	Trade receivables		
	Opening balance	2,34,000	
	Less: Intercompany transaction cancelled upon amalgamation	(40,000)	1,94,000

Working Notes :

1. Valuation of Goodwill	₹
Average profit	1,24,400
Less: 8% of ₹8,80,000	(70,400)
Super profit	54,000
Value of Goodwill = 54,000 x 4	2,16,000
2. Net Assets for purchase consideration	
Goodwill as valued in W.N.1	2,16,000
Building	3,06,000
Machinery	5,76,000
Inventory	1,98,000
Trade receivables (2,60,000-26,000)	<u>2,34,000</u>
Total Assets	15,30,000
Less: Trade payables	<u>(3,20,000)</u>
Net Assets	12,10,000

Out of this ₹6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) ₹6,10,000 in shares of ₹125. Thus, the number of shares to be allotted $6,10,000/125 = 4,880$ shares.

3. Unrealized Profit on Inventory	₹
The Inventory of A Ltd. includes goods worth ₹1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this Inventory will be $\frac{40,000}{1,60,000} \times 1,00,000$	25,000
As B Ltd purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the Inventory i.e., 10% of ₹1,00,00	10,000
Amount of unrealized profit 15,000	10,000

#23. Question | RTP May 2019|

P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2016 Their summarized Balance Sheets as on 31.03.2016 were as follows:

Particulars	P Ltd.₹	Q Ltd.₹
Source of Funds:		
Equity share capital (₹10 each)	300	280
9% preference share Capital (₹100 each)	60	40
Investment allowance Reserve	70	60
Profit and Loss Account	8	12
10 % Debentures	100	60
Trade Payables	50	30
Tax provision	<u>14</u>	<u>8</u>
Total	602	490
Application of Funds:		
Building	120	100
Plant and Machinery	160	140
Investments	80	50
Trade receivables	90	70
Inventories	72	80
Cash and Bank	<u>80</u>	<u>50</u>
Total	602	490

From the following information, you are required to prepare the Balance Sheet as on 01.04.2016 of a new company, R Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

- (i) 50 % Debenture are to be converted into Equity Shares of the New Company.
- (ii) Investments are non - current in nature.
- (iii) Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.
- (iv) 10 % of trade receivables were doubtful for both the companies. Inventories to be carried at cost.
- (v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.
- (vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of ₹10 each of the new company at a premium of ₹5 per share.

Give your Answer on the basis that amalgamation is in the nature of purchase

Answer

Particulars	Notes	(₹) in 000
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share capital	1	6,55,980
(b) Reserves and Surplus	2	2,77,990
(2) Non - Current Liabilities		
(a) Long-term borrowings	3	80,000
(3) Current liabilities		
(a) Trade Payables	4	80,000
(b) Short term provision	5	22,000
Total		11,15,970
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		
Tangible assets	6	5,60,000
(b) Non-current investments	7	1,30,000
(3) Current assets		
(a) Inventories	8	1,52,000
(b) Trade receivables	9	1,44,000
(c) Cash and cash equivalents	10	1,29,970
Total		11,15,970

Note accounts

1. Calculation of value of equity shares issued to transferor companies

	P Ltd. (₹)		Q Ltd. (₹)
Assets taken over:			
Building	1,32,000		1,05,000
Plant and machinery	1,76,000		1,47,000
Investments	80,000		50,000
Inventories	72,000		80,000
Trade receivables	81,000		63,000
Cash & Bank	<u>80,000</u>		<u>50,000</u>
	6,21,000		4,95,000
Less: Liabilities			
10% Debentures	1,00,000	60,000	
Trade payables	50,000	30,000	
Tax Provision	<u>14,000</u>	<u>1,64,000</u>	<u>8,000</u>
		4,57,000	3,97,000
Less: Preference Share Capital		<u>60,000</u>	<u>40,000</u>

		3,97,000		3,57,000

2. Number of shares issued to equity shareholders, debenture holders and preference shareholders

	P Ltd.	Q Ltd.	Total
Equity shares issued @ ₹15 per share (including ₹5 premium)			
₹3,97,000/15	26,466 shares		
1,00,000/2 = 50,000/15 60,000/2 = 30,000/15	3,332 shares		
		2,000 shares	5,332 shares
Equity share capital @ ₹10	₹33,320	₹20,000	₹53,320
Securities premium @ ₹5	₹1,32,330	₹1,19,000	₹2,51,330
	₹3,96,990	₹3,57,000	₹7,53,990

50% of Debentures are converted into equity shares @ ₹15 per share

	26,466 shares		
₹3,57,000/15		23,800 shares	50,266 shares
Equity share capital @ ₹10	₹2,64,660	₹2,38,000	₹5,02,660
Securities premium @ ₹5	₹16,660	₹10,000	₹26,660
9% Preference share capital issued	₹49,980	₹30,000	₹79,980
	₹60,000	₹40,000	₹1,00,000

#24. Question | RTP November 2018|

The financial position of two companies Alex Ltd. and Beta Ltd. as on 31st March, 2017 was as under:

Particulars	Alex Ltd. ₹	Beta Ltd. ₹
Assets		
Goodwill	1,40,000	70,000
Building	8,40,000	2,80,000
Machinery	14,00,000	4,20,000
Inventory	7,00,000	4,90,000
Trade receivables	5,60,000	2,80,000
Cash at Bank	<u>1,40,000</u>	<u>56,000</u>
	37,80,000	15,96,000
Liabilities		
Share Capital:		
Equity Shares of ₹10 each	28,00,000	8,40,000
8% Preference Shares of ₹100 each	2,80,000	-
10% Preference Shares of ₹100 each	-	2,80,000
General Reserve	1,96,000	1,96,000
Retirement Gratuity fund	1,40,000	56,000
Trade payables	<u>3,64,000</u>	<u>2,24,000</u>
	37,80,000	15,96,000

Beta Ltd. is absorbed by Alex Ltd. on the following terms:

- 10% Preference Shareholders are to be paid at 10% premium by issue of 8% Preference Shares of Alex Ltd.
- Goodwill of Beta Ltd. is valued at ₹1,40,000, Buildings are valued at ₹4,20,000 and the Machinery at ₹4,48,000.
- Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.
- Equity Shareholders of Beta Ltd. will be issued Equity Shares of Alex Ltd. @ 5% premium. You are required to:
 - Prepare necessary Ledger Accounts to close the books of Beta Ltd.
 - Prepare the acquisition entries in the books of Alex Ltd.
 - Also prepare the Balance Sheet after absorption as at 31st March, 2017.

Answer

(a) In the Books of Beta Ltd.**Realization Account**

		₹			₹
To	Sundry Assets	15,96,000	By	Retirement Gratuity Fund	56,000
To	Preference Shareholders (Premium on Redemption)	28,000	By	Retirement Gratuity Fund	56,000
To	Equity Shareholders	1,40,000	By	Trade payables	2,24,000
	(Profit on Realisation)		By	Alex Ltd.	14,84,000
		17,64,000			17,64,000

Equity Shareholders Account

		₹			₹
To	Equity Shares of Alex Ltd.	11,76,000	By	Share Capital	8,40,000
			By	General Reserve	1,96,000
			By	Realisation Account	1,40,000
				(Profit on Realisation)	
		11,76,000			11,76,000

Preference Shareholders Account

		₹			₹
To	8% Preference Shares of Alex Ltd.	3,08,000	By	Preference Share Capital	2,80,000
			By	Realisation Account	28,000
				(Premium on Redemption of Preference Shares)	
		3,08,000			3,08,000

Alex Ltd. Account

		₹			₹
To	Realisation Account	14,84,000	By	8% Preference Shares	3,08,000
			By	Equity Shares	11,76,000
		14,84,000			14,84,000

(b) In the Books of Alex Ltd.**Journal Entries**

Particulars		Dr.(₹)	Cr. (₹)
Business purchase account	Dr.	14,84,000	
To Liquidators of Beta Ltd. Account			14,84,000
(Being business of Beta Ltd. taken over)			
Goodwill Account	Dr.		
Building Account	Dr.		
Machinery Account	Dr.		
Inventory Account	Dr.		
Trade receivables Account	Dr.		
Bank Account	Dr.		
To Retirement Gratuity Fund Account			56,000
To Trade payables Account			2,24,000
To Provision for Doubtful Debts Account			21,000
To Business Purchase A/c			14,84,000
(Being Assets and Liabilities taken over as per agreed valuation).			

Liquidators of Beta Ltd. A/c	Dr.	14,84,000	
To 8% Preference Share Capital A/c			3,08,000
To Equity Share Capital A/c			11,20,000
To Securities Premium A/c (Being Purchase Consideration satisfied as above).			

(c) Balance Sheet of Alex Ltd. (after absorption) as at 31st March, 2017

Particulars	Notes	(₹) in 000
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share capital	1	45,08,000
(b) Reserves and Surplus	2	2,52,000
(2) Non - Current Liabilities		
(a) Long-term provisions		1,96,000
(3) Current liabilities		
(a) Trade Payables		5,88,000
(b) Short term provision		21,000
Total		55,65,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		
Tangible assets	3	31,08,000
Intangible assets		2,80,000
(2) Current assets		
(a) Inventories		11,41,000
(b) Trade receivables		8,40,000
(c) Cash and cash equivalents		1,96,000
Total		55,65,000

Notes to accounts:

		₹
1	Share Capital	
	Equity share capital	
	3,92,000 Equity Shares of 10 each fully paid (Out of above 1,12,000 Equity Shares were issued inconsideration other than for cash)	39,20,000
	Preference share capital	
	5,880 8% Preference Shares of ₹100 each (Out of above 3,080 Preference Shares were issued in consideration other than for cash)	5,88,000
	Total	45,08,000
2	Reserves and Surplus	
	Securities Premium	56,000
	General Reserve	1,96,000
	Total	2,52,000
3	Tangible assets	
	Buildings	12,60,000
	Machinery	18,48,000
	Total	31,08,000

Working Notes :

Purchase Consideration:	₹
Goodwill	1,40,000
Building	4,20,000
Machinery	4,48,000

Inventory	4,41,000
Trade receivables	2,59,000
Cash at Bank	56,000
Less: Liabilities:	
Retirement Gratuity	(56,000)
Trade payables	<u>(2,24,000)</u>
Net Assets/ Purchase Consideration	14,84,000
To be satisfied as under:	
Preference Shareholders of Beta Ltd.	2,80,000
Add: 10% Premium	<u>28,000</u>
Satisfied by issue of 3,080 no. of 8% Preference Shares of Alex Ltd.	3,08,000
Equity Shareholders of Beta Ltd. to be satisfied by issue of 1,12,000	
Equity Shares of Alex Ltd. at 5% Premium	<u>11,76,000</u>
Total	14,84,000

2. Amount to be transferred to Capital Redemption Reserve account

Particulars	(₹)
Nominal value of shares bought back (4,00,000 shares x ₹10)	40,00,000
Less: Nominal value of Preference Shares issued for such buy back (1,00,000 shares x ₹10)	<u>(10,00,000)</u>
Amount transferred to Capital Redemption Reserve Account	30,00,000

Chapter 5 – Internal Reconstruction

Past Exams and RTP Questions Compiler

#1. Question |Jan 2025 Exam, 4 marks |

Given below is the Balance Sheet of Sky and Associates as on 31st March,2023:

Liabilities	Rs.	Assets	Rs.
Capital	1,60,000	Machinery	1,80,000
Profit & Loss Account	93,000	Stock	1,15,000
8% Loan	40,000	Trade Receivables	75,000
Trade Payables	66,000	Deferred Expenditure	9,000
Bank Overdraft	<u>20,000</u>		<u> </u>
	3,79,000		3,79,000

Additional information:

- (1) The firm is planning to shut down its business with immediate effect from 1st April, 2024.
- (2) The sale and purchase of the firm for the year 2023-24 amounts to Rs. 8,20,000 and Rs. 6,50,000 respectively.
- (3) The value of Closing Stock as on 31-3-2024 was Rs. 65,000. The net realizable value is estimated at 120% of cost.
- (4) Other expenses for the period amount to Rs. 25,000.
- (5) Deferred expenditure is getting amortized over 5 years starting from 31-3-2022.
- (6) The remaining life of Machinery is expected to be 3 years. The realizable value of Machine is expected at Rs. 1,65,000, an expense of Rs. 5,000 is to be incurred to realize the same.
- (7) Out of trade receivables, Rs. 5,000 is expected to be unrealizable due to an ongoing dispute.
- (8) Bank has charged a penalty of Rs. 2,500 for crossing the overdraft limit.
- (9) The lender has agreed to forgo 50% of interest charge for the year.
- (10) The firm is expecting a discount of Rs. 4,000 from creditors at the time of full and final settlement.

You are required to prepare a Profit & Loss A/c for the year ended 31st March, 2024 to ascertain its Profit/Loss for the period.

Answer:

Profit and Loss Account of Sky & Associate for the year ended 31st March, 2024

Particulars	Rs.	Particulars	Rs.
To Opening Stock	1,15,000	By Sales	8,20,000
To Purchases	6,50,000	By Closing Stock	78,000
To Gross Profit *	1,33,000		
	<u>8,98,000</u>		<u>8,98,000</u>
		By Gross Profit	1,33,000
To Deferred Expense	9,000	By Discount	4,000
To Other Expenses	25,000		
To Bad Debts	5,000		
To Penalty	2,500		
To Depre. (180 – 160)	20,000		
To Interest on loan	1,600		

To Net Profit	73,900		
	1,37,000		<u>1,37,000</u>

#2. Question | Sep 2024 Exam, 6 marks |

The following scheme of reconstruction has been approved for Equity shareholders and Debenture holders of TP Ltd.

(i) The Equity shareholders to receive in lieu of their present holding of 1,50,000 shares of Rs. 10 each, the following :

1. For Rs. 50,000, equivalent cash
2. For Rs. 9,00,000, 10% debentures issued at premium of 20% (Face value of debenture is Rs. 100 each)
3. For balance Rs. 5,50,000, Equity shareholders agreed to accept 50,000 equity shares of Rs. 10 each in full settlement.

(ii) 8% Debenture Rs. 5,00,000.

Debenture holders agreed to accept Freehold property (Book value Rs. 3,50,000) at a valuation of Rs. 4,45,000 in full settlement of their claim. Pass necessary Journal Entries in the Books of TP Ltd. for the above reconstruction. Narration for Journal entries is not required to be given.

Answer:

Journal Entries

		Rs.	Rs.
Equity Share Capital (old) A/c To Equity Share Capital (Rs. 10) A/c To Cash A/c To 10% Debentures A/c To Securities premium To Capital Reduction/ReconstructionA/c (Being new equity shares, 8% Debentures issued, cash of Rs. 50,000 and the balance transferred to Reconstruction account as per the Scheme)	Dr.	15,00,000	5,00,000 50,000 7,50,000 1,50,000 50,000
8% Debentures A/c To Freehold Property A/c To Capital Reduction/ReconstructionA/c (Being the debenture holders claim settled partly and foregone partly as per reconstruction scheme)	Dr.	5,00,000	4,45,000 55,000
Capital Reduction/Reconstruction A/c To Capital Reserves A/c (Being balance in capital reduction account transferred to Capital Reserves A/c)	Dr.	1,05,000	1,05,000

#3. Question | May 2024 Exam, 14 marks |

Following is the summarized Balance Sheets of Z Limited as on 31 st March, 2024:

Particulars	(Rs.)

EQUITY AND LIABILITIES:	
Share Capital	
Equity shares of Rs. 100 each	60,00,000
8% Preference shares of Rs. 100 each 10%	21,00,000
Debentures of Rs. 100 each	18,00,000
Trade Payables	16,80,000
Total	1,15,80,000
ASSETS:	
Goodwill	81,000
Property, Plant and Equipment Trade Receivables	72,00,000
Inventories Cash at Bank	13,75,000
Own Debentures (Nominal value of Rs. 6 lakhs)	9,80,000
Profit and Loss A/c	1,33,000
	5,76,000
	12,35,000
Total	1,15,80,000

On 1st April, 2024, court approved the following reconstruction scheme for Z Limited:

- Each equity share shall be sub-divided into 10 equity shares of Rs. 10 each fully paid up. After sub-division, equity share capital will be reduced by 40%.
- Preference share dividends are in arrear for last 4 years. Preference shareholders agreed to waive 75% of their dividend claim and accept payment for the balance.
- Own debentures of Rs. 2,40,000 (nominal value) were sold at 98 cum interest and remaining own debentures were cancelled.
- Debenture holders of Rs. 6,00,000 agreed to accept one machinery of book value of Rs. 9,00,000 in full settlement.
- Remaining Property, Plant and Equipment were valued at Rs. 60,00,000.
- Trade Payables, Trade Receivables and Inventories were valued at Rs. 15,00,000, Rs. 13,00,000 and Rs. 9,44,000 respectively. Goodwill and Profit and Loss Account (Debit balance) are to be written off.
- Company paid Rs. 60,000 as penalty to avoid capital commitments of Rs. 12 lakhs.
- Interest on 10% Debentures is paid every year on 31st March.

You are required to:

- Pass necessary journal entries in the books of Z Limited to implement the above schemes.
- Prepare Capital Reduction Account.
- Prepare Bank Account

Answer:

Journal entries

In the Books of Z Ltd. as on 1st April 2024

	Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
01.04.2024				
1.	Equity share capital A/c (Rs. 100) To Equity share capital A/c (Rs. 10) (Being sub-division of one share of Rs. 100 each into 10 shares of Rs. 10 each)	Dr.	60,00,000	60,00,000
2.	Equity share capital A/c (Rs. 10) To Capital reduction A/c (Being reduction of Equity capital by 40%)	Dr.	24,00,000	24,00,000
3.	Capital reduction A/c	Dr.	1,68,000	

	To Bank A/c (Being payment in cash of 25% of arrear of preference dividend) [21,00,000x8%] x 4 years			1,68,000
4.	Bank A/c To Own debentures A/c (5,76,000/6,00,000) x 2,40,000	Dr.	2,35,200	2,30,400
	To Capital reduction A/c (Being profit on sale of own debentures of Rs. 2,40,000 transferred to capital reduction A/c)			4,800
5.	10% Debentures A/c (6,00,000 - 2,40,000) To Own debentures A/c To Capital reduction A/c (Being profit on cancellation of own debentures transferred to capital reduction A/c)	Dr.	3,60,000	3,45,600 14,400
6.	10% Debentures A/c Capital reduction A/c To Machinery or PPE A/c (Being machinery taken up by debenture holders for Rs. 6,00,000)	Dr. Dr.	6,00,000 3,00,000	9,00,000
7.	Capital reduction A/c (balancing figure) To PPE A/c (72,00,000 - 9,00,000 - 60,00,000) (Being PPE revalued)	Dr.	3,00,000	3,00,000
8.	Trade payables A/c (16,80,000 - 15,00,000) To Trade receivables A/c (13,75,000-13,00,000) To Inventory A/c (9,80,000-9,44,000) To Capital Reduction A/c (Being assets and liabilities revalued)	Dr.	1,80,000	75,000 36,000 69,000
9.	Capital reduction A/c To Goodwill A/c To Profit and Loss A/c (Being the above assets written off)	Dr.	13,16,000	81,000 12,35,000

10.	Capital reduction A/c	Dr.	60,000	
	To Bank A/c			60,000
	(Being penalty paid for avoidance of capital commitments)			
11.	Capital reduction A/c	Dr.	3,44,200	
	To Capital reserve A/c			3,44,200
	(Being the credit balance in Capital Reduction A/c transferred to Capital Reserve)			

Capital Reduction Account

	(Rs.)		(Rs.)
To Bank	1,68,000	By Equity Share Capital	24,00,000
To Property, Plant & Equipment	3,00,000	By Trade Payable	1,80,000
To Property, Plant & Equipment	3,00,000	By Bank A/c (Profit on Sale)	4,800
To Trade Receivables	75,000	By 10% debentures A/c (Profit on cancellation)	14,400
To Inventory	36,000		
To Goodwill	81,000		
To Profit and Loss A/c	12,35,000		
To Cash/Bank A/c	60,000		
To Capital Reserve	<u>3,44,200</u>		
	<u>25,99,200</u>		<u>25,99,200</u>

Bank Account

	Rs.		Rs.
To To balance b/d	1,33,000	By Capital Reduction	1,68,000
To Own Debenture (2,30,400 + 4,800)	2,35,200	By Capital Reduction A/c	60,000
		By balance c/d	<u>1,40,200</u>
	<u>3,68,200</u>		<u>3,68,200</u>

#4. Question | November 2023 Exam, 20 marks |

Following is the Balance Sheet of Tourma Limited as at 31st March, 2023:

Particulars	Notes	Rs. in lakhs
Equity and Liabilities		
1. Shareholders' funds		
A. Share Capital	1	24.00
B. Reserves and Surplus	2	(9.10)
2. Non-current liabilities		
A. Long-term borrowings	3	3.20
3. Current liabilities		

A. Trade Payables		1.15
B. Short Term Borrowings – Bank Overdraft		1.40
C. Other current liabilities	4	0.32
D. Short term provisions	5	<u>0.42</u>
Total		<u>21.39</u>
Assets		
1. Non-current assets		
A. Property, Plant and Equipment	6	7.80
B. Intangible Assets	7	1.70
C. Non-Current Investments	8	1.80
2. Current Assets		
A. Inventory		5.12
B. Trade receivables		4.32
C. Cash and cash equivalents		0.65
Total		<u>21.39</u>

Notes to Accounts:

		Rs. in lakhs
1	Share Capital	
	Equity share capital	
	16,000 Equity Shares of Rs. 100 each	16.00
	8,000 6% Preference Shares of Rs. 100 each	<u>8.00</u>
		<u>24.00</u>
2	Reserves and Surplus	
	Debit balance of Profit and loss Account	<u>(9.10)</u>
		<u>(9.10)</u>
3	Long-term borrowings	
	3,200 10% Debentures	<u>3.20</u>
		<u>3.20</u>
4	Other current liabilities	
	Interest payable on debentures	<u>0.32</u>
		<u>0.32</u>
5	Short term provisions	
	Provision for taxation	<u>0.42</u>
		<u>0.42</u>
6	Property, Plant and Equipment	
	Plant & Machinery	5.00
	Furniture & Fixture	<u>2.80</u>
		<u>7.80</u>
7	Intangible Assets	
	Patents & Copyrights	<u>1.70</u>
		<u>1.70</u>
8	Non-current Investments	
	Investments (Market Value Rs. 1,10,000)	<u>1.80</u>
		<u>1.80</u>

As on 1st April, 2023, the following scheme of reconstruction was finalized for which necessary resolution was passed and approvals were obtained from appropriate authorities. Accordingly, it was decided that:

- (i) Each equity share is to be sub-divided into ten fully paid-up equity shares of Rs. 10 each. After sub-division, each shareholder shall surrender to the company 40 % of his holding, for the purpose of reissue to trade payables as necessary.

- (ii) Preference shareholders would give up 30% of their capital and 12% Debentures (face value Rs. 100 each) shall be issued to them for balance holdings.
- (iii) The company would issue additional 12% Debentures (face value Rs. 100 each) for Rs. 4,00,000 for meeting its working capital requirement and final settlement of Bank Overdraft at 90% of the amount.
- (iv) Existing debenture holders would accept Furniture & Fixture in full settlement of their dues.
- (v) Trade payables claim shall be reduced to 70%, it is to be settled by the issue of equity shares of Rs. 10 each out of shares surrendered.
- (vi) The shares surrendered and not re-issued shall be cancelled.
- (vii) The taxation liability is to be settled at 50,000.
- (viii) Investments value to be reduced to market price.
- (ix) Balance of profit and loss account is to be written off.
- (x) The value of inventories is to be increased by Rs. 32,000 and provision for Doubtful Debts is to be created at 5% of Trade Receivables.

You are required to:

- (i) Pass necessary journal entries in the books of account of Tourma Limited.
- (ii) Prepare Reconstruction Account, and
- (iii) Prepare Balance Sheet of the company after internal reconstruction

Answer:

Journal Entries in the books of Tourma Ltd.

		Dr. Rs. In lakhs	Cr. Rs. In lakhs
Equity Share Capital (Rs. 100) A/c	Dr.	16.00	
To Share Surrender A/c			6.40
To Equity Share Capital (Rs. 10) A/c			9.60
(Subdivision of 16,000 equity shares of Rs. 100 each into 1,60,000 equity shares of Rs. 10 each and surrender of 64,000 of such subdivided shares as per capital reductionscheme)			
Preference Share Capital (Rs. 100) A/c	Dr.	8.00	
To 12% Debentures A/c	Dr.		5.60
To Reconstruction (Rs. 100) A/c			2.40
(12% Debenture issued to Preference Shareholders and 30% of the capital foregone by them)			
Bank A/c	Dr.	4.00	
To 12% Debentures (Rs. 100) A/c			4.00
(Being 12% debentures issued)			
Bank Overdraft A/c	Dr.	1.40	
To Bank A/c			1.26
To Reconstruction A/c			0.14
(Being bank overdraft amount paid)			
10% Debentures A/c	Dr.	3.20	
Interest payable A/c	Dr.	0.32	
To Debenture holders A/c			3.52
(Being Interest payable on the 10% debentures credited to debenture holders A/c)			
10% Debentures A/c	Dr.	3.52	
To Furniture & fixtures A/c			2.80
To Reconstruction A/c			0.72

Trade payables A/c To Reconstruction A/c (Transferred claims of the trade payables to reconstruction account, 70% of which is being clear reduction and equity shares are being issued in consideration of the balance)	Dr.	1.15	1.15
Share Surrender A/c To Equity Share Capital A/c To Reconstruction A/c (Issued equity shares to discharge the claims of the trade payables respectively as per scheme and the balance in share surrender account is being transferred to reconstruction account)		6.40	0.805 5.595
Provision for Taxation A/c Reconstruction A/c To Liability for taxation A/c (Being conversion of the provision for taxation into liability for taxation.)	Dr. Dr.	0.42 0.08	0.50
Liability for taxation A/c To Cash/Bank A/c (Being taxation liability settled)		0.50	0.50
Reconstruction A/c To Investment A/c (Being investments' value reduce to market price)	Dr.	0.70	0.70
Inventory A/c To Reconstruction A/c To Provision for doubtful debts (4,32,000 x 5%) (Being inventory revalued and provision for doubtful debts created)	Dr. Dr.	0.32	0.104 0.216
Reconstruction A/c To Profit and Loss A/c To Capital Reserve A/c (Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)	Dr.	9.329	9.10 0.229

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

Particulars	Note No.	Rs. In lakhs
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	10.405
(b) Reserves and Surplus	2	0.229
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	9.60
(3) Current Liabilities		
Total		20.234
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	4	5.00

(b) Intangible assets	5	1.70
(c) Non-current investments	6	1.10
(2) Current assets		
(a) Inventories	7	5.44
(b) Trade receivables	8	4.104
(c) Cash and cash equivalents (W.N)		2.89
Total		20.234

Notes to Accounts

			Rs. In lakhs
1.	Share Capital <u>Equity Share Capital</u> Issued Capital: 10.405 Equity Shares of Rs.10 each (9.6 + 0.805) (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)		10.405
2.	Reserve and Surplus Capital Reserve		<u>0.229</u>
3.	Long-term borrowings Unsecured Loans 12% Debentures (5.60 + 4)		<u>9.60</u>
4.	Property, plant and Equipment Plant & Machinery		<u>5.00</u>
5.	Intangible assets Patents & copyrights		<u>1.70</u>
6.	Non-Current Investments Investments		1.10
7.	Inventory Add: Appreciation under scheme of Reconstruction	5.12 <u>0.32</u>	<u>5.44</u>
8.	Trade Receivables	<u>4.32</u>	<u>4.104</u>
	Less: Provision for doubtful debts	<u>0.216</u>	

#5. Question | November 2022 Exam, 20 marks |

The following is the Balance Sheet of Purple Limited as at 31st March, 2022:

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	15,00,000
(b) Reserves and Surplus	2	(3,00,000)
(2) Current Liabilities		
(a) Short-term borrowings		2,00,000
(b) Trade payables		2,20,000
Total		16,20,000

II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	3	10,20,000
(b) Intangible assets	4	1,20,600
(2) Current assets		
(a) Inventories		1,70,000
(b) Trade receivables		3,01,800
(c) Cash and cash equivalents		7,600
Total		16,20,000

Notes to Accounts

		₹	₹
1	Share Capital		
	90,000 Equity Shares of ₹ 10 each fully paid	9,00,000	
	6% Preference Share Capital	6,00,000	15,00,000
2	Reserves & Surplus		
	Profit & Loss account		(3,00,000)
3	Property, Plant and Equipment		
	Land and Building	5,40,000	
	Plant and Machinery	4,80,000	10,20,000
4	Intangible Assets		
	Goodwill	84,600	
	Patents	36,000	1,20,600

Dividends on preference shares are in arrears for 3 years

On the above date, the company adopted the following scheme of reconstruction:

- The preference shares are converted from 6% to 8% but revalued in a manner in which the total return on them remains unaffected.
- The value of equity shares is brought down to ₹ 8 per share.
- The arrears of dividend on preference shares are cancelled.
- The debit balance of Goodwill account is written off entirely.
- Land and Building and Plant and Machinery are revalued at 85% and 80% of their respective book values.
- Book debts amounting to ₹ 14,400 are to be treated as bad and hence to be written off.
- The company expects to earn a profit at the rate of ₹ 90,000 per annum from the current year which would be utilized entirely for reducing the debit balance of Profit and loss accounts for 3 years. The remaining balance of the said account would be written off at the time of capital reduction process.
- The balance of total capital reduction is to be utilized in writing down Patents.
- A secured loan of ₹ 4,80,000 bearing interest at 12% per annum is to be obtained by mortgaging tangible fixed assets for repayment of bank overdraft and for providing additional funds for working capital.

You are required to give journal entries incorporating the above scheme of reconstruction, capital reduction account and prepare the reconstructed Balance Sheet.

Answer

			₹	₹
			Debit	Credit
1.	6% Preference share capital A/c	Dr.	6,00,000	
	To 8% Preference share capital A/c			4,50,000
	To Capital reduction A/c			1,50,000

	(Being 6% preference shares converted to 8% preference shares so that return to pref. shareholders remains unaffected)			
2.	Equity share capital A/c (₹ 10)	Dr.	9,00,000	
	To Equity share capital A/c (₹ 8)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being equity capital reduced to nominal value of ₹ 8 each)			
3.	Capital Reduction A/c	Dr.	3,30,000	
	To Goodwill A/c			84,600
	To Land and Building A/c			81,000
	To Plant and Machinery A/c			96,000
	To Trade Receivables A/c (Book debts)			14,400
	To Patents A/c (Bal. fig.)			24,000
	To Profit and loss A/c			30,000
	(Being losses and assets written off to the extent required)			
4.	Bank A/c	Dr.	4,80,000	
	To Bank Loan A/c			4,80,000
	(Being Loan taken)			
5.	Bank overdraft A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being Bank overdraft repaid)			

Capital Reduction Account

		₹			₹
To	Goodwill A/c	84,600	By	Equity Share Capital A/c	1,80,000
To	Land & Building A/c	81,000	By	6% Preference Share Capital A/c	1,50,000
To	Plant and Machinery A/c	96,000			
To	Trade receivables (Book Debts) A/c	14,400			
To	Profit & Loss A/c	30,000			
To	Patents A/c (Bal. fig.)	24,000			
		3,30,000			3,30,000

Balance Sheet of Purple Ltd. (and reduced) as at 31.3.2022

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	11,70,000
(b) Reserves and Surplus	2	(2,70,000)
(2) Current Liabilities		
(a) Short-term borrowings		4,80,000
(b) Trade payables		2,20,000
Total		16,00,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	3	8,43,000
(b) Intangible assets	4	12,000

(2) Current assets		
(a) Inventories		1,70,000
(b) Trade receivables	5	2,87,400
(c) Cash and cash equivalents (7,600+4,80,000-2,00,000)		2,87,600
Total		16,00,000

Notes to Accounts:

		₹	₹
1	Share Capital		
	Authorized Issued, subscribed and paid up:		
	90,000 Equity Shares of ₹ 8 each fully paid	7,20,000	
	8% Preference Share Capital	4,50,000	11,70,000
2	Reserves & Surplus		
	Profit & Loss account (Dr. balance)		(2,70,000)
3	Property, Plant and Equipment		
	Land and Building	4,59,000	
	Plant and Machinery	3,84,000	8,43,000
4	Intangible Assets		
	Patents ₹ (36,000 - 24,000)		12,000
5	Trade Receivables		
	Sundry Debtors	3,01,800	
	Less: Bad debts	(14,400)	2,87,400

Note: *Face value of preference share is not given in the question (pre and post reconstruction) and hence any suitable value of preference share may be assumed.

Working Notes:

- Calculation of new Preference Shares
Rate of return : 6% on Preference Shares

Dividend	$(6/100) \times ₹ 6,00,000$	₹ 36,000
Rate of return	8% on Preference Shares	
Dividend	$(8/100) \times X =$	₹ 36,000
	$X = (36,000/8) \times 100 =$	₹ 4,50,000

New Preference Share Capital	=	₹ 36,000
Old Preference Share Capital	=	₹ 6,00,000
(6,00,000 - 4,50,000)	=	₹ 1,50,000 Amount taken to Capital Reduction A/c.

- Since the company expects to earn a profit of ₹ 90,000 p.a. consecutively for three years and it shall be used to write-off debit balance of P & L account, hence ₹ 2,70,000 being loss shall be shown in the Balance Sheet under Reserve & Surplus head and ₹ 30,000 shall be written-off from Capital Reduction A/c.
- Calculation of Amount written off on Land & Building and Plant & Machinery

Land & Building	$= (85/100) \times 5,40,000$	= ₹ 4,59,000
Plant & Machinery	$= (80/100) \times 4,80,000$	= ₹ 3,84,000
Reduced by:		
Land & Building	$= (5,40,000 - 4,59,000)$	= ₹ 81,000
Plant & Machinery	$= (4,80,000 - 3,84,000)$	= ₹ 96,000

#6. Question | July 2021 Exam, 5 marks |

Sapra Limited has laid down the following terms upon the sanction of the reconstruction scheme by the court.

- (i) The shareholders to receive in lieu of their present holding at 7,50,000 shares of ₹ 10 each, the following:
 - New fully paid ₹ 10 Equity Shares equal to 3/5th of their holding.
 - Fully paid ₹ 10, 6% Preference Shares to the extent of 2/5th of the above new equity shares.
 - 7% Debentures of ₹ 250,000.
- (ii) Goodwill which stood at ₹ 2,70,000 is to be completely written off.
- (iii) Plant & Machinery to be reduced by ₹ 1,00,000, Furniture to be reduced by ₹ 88,000 and Building to be appreciated by ₹ 1,50,000.
- (iv) Investment of ₹ 6,00,000 to be brought down to its existing market price of ₹ 1,80,000.
- (v) Write off Profit & Loss Account debit balance of ₹ 2,25,000.

In case of any shortfall, the balance of General Reserve of ₹ 42,000 can be utilized to write off the losses under reconstruction scheme.

You are required to show the necessary Journal Entries in the books of Sapra Limited of the above reconstruction scheme considering that balance in General Reserve is utilized to write off the losses.

Answer**Journal Entries**

		Debit ₹	Credit ₹
Equity Share Capital (old) A/c	Dr.	75,00,000	
To Equity Share Capital (₹ 10) A/c			45,00,000
To 6% Preference Share Capital (₹ 10) A/c			18,00,000
To 7% Debentures A/c			2,50,000
To Capital Reduction A/c			9,50,000
(Being new equity shares, 6% Preference Shares, 7% Debentures issued and the balance transferred to Reconstruction account as per the Scheme)			
Building A/c	Dr.	1,50,000	
Capital Reduction A/c	Dr.	9,53,000	
To Goodwill Account			2,70,000
To Plant and Machinery Account			1,00,000
To Furniture Account			
To Investment A/c			4,20,000
To Profit & Loss A/c			2,25,000
(Being Capital Reduction Account utilized for writing off of Goodwill, Plant and Machinery, furniture, investment and Profit & Loss as per the scheme)			
General reserve A/c	Dr.	3,000	
To Capital Reduction A/c			3,000
(Being general reserve utilized to write off the balance in Capital reduction A/c)			

Note: In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used in the above journal entries.

#7. Question | November 2019, 15 Marks | RTP May 2023

Following is the summarized Balance Sheet of Fortunate Ltd. as on 31st March, 2019.

Particulars	Amount ₹
Liabilities	
Authorized and Issued Share Capital	
(a) 15,000 8% Preference shares of ₹ 50 each	7,50,000
(b) 18,750 Equity shares of ₹ 50 each	9,37,500

Profit and Loss Account	(5,63,750)
Loan	7,16,250
Trade Payables	2,58,750
Other Liabilities	<u>43,750</u>
Total	<u>21,42,500</u>
Assets	
Building at cost less depreciation	5,00,000
Plant at cost less depreciation	3,35,000
Trademarks and goodwill at cost	3,97,500
Inventory	5,00,000
Trade Receivables	<u>4,10,000</u>
Total	21,42,500

(Note: Preference shares dividend is in arrear for last five years).

The Company is running with the shortage of working capital and earnings profits. A scheme of reconstruction has been approved by both the classes of shareholders. The summarized scheme of reconstruction is as follows:

- (1) The equity shareholders have agreed that their ₹50 shares should be reduced to ₹5 by cancellation of ₹45,00 per shares of ₹5.00 each for each equity share held.
- (2) The preference shareholders have agreed to forego the arrears of dividends and to accept for each ₹50 preference share 4 new 6% preference shares of ₹10 each, plus 3 new equity shares of ₹5.00 each, all credited as fully paid.
- (3) Lenders to the company for ₹1,87,500 have agreed to convert their loan into shares and for this purpose they will be allotted 15,000 new preference shares of ₹10 each and 7,500 new Equity shares of ₹5.00 each.
- (4) The directors have agreed to subscribe in cash for 25,000 new equity shares of ₹5.00 each in addition to any shares to be subscribed by them under (1) above.
- (5) Of the cash received by the issue of new shares, ₹2,50,000 is to be used to reduce the loan due by the company.
- (6) The equity share capital cancelled is to be applied:
 - (i) To write off the debit balance in the Profit and Loss A/c and
 - (ii) To write off ₹43,750 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill. The nominal capital as reduced is to be increased to ₹8,12,500 for preference share capital and ₹9,37,500 for equity share capital.

You are required to pass Journal entries to show the effect of above scheme and prepare the Balance Sheet of the Company after reconstruction.

Answer

In the books of Fortunate Ltd.

Journal Entries

			₹	₹
			Debit	Credit
1.	Equity share capital A/c (₹ 50)	Dr.	9,37,500	
	To Equity share capital A/c (₹ 5)			93,750
	To Capital reduction A/c*			8,43,750
	(Being equity capital reduced to nominal value of ₹ 5 each)			
2.	Bank A/c	Dr.	2,81,250	
	To Equity share capital			2,81,250
	(Being 3 right shares against each share was issued and subscribed)			

3.	8% Preference share capital A/c (₹ 50)	Dr.	7,50,000	
	Capital reduction A/c	Dr.	75,000	
	To 6% Preference share capital (₹ 10)			6,00,000
	To equity share capital (₹ 50)			2,25,000
	(Being 8% preference shares of ₹ 50 each converted to 6% preference shares of ₹ 10 each and also given to them 3 equity shares for every share held)			
4.	Loan A/c	Dr.	1,87,500	
	To 6% Preference share capital A/c (15,000 x ₹ 10)			1,50,000
	To Equity share capital A/c (7,500 x ₹ 5)			37,500
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c (25,000 x ₹ 5)	Dr.	1,25,000	
	To Equity share application A/c			1,25,000
	(Being shares subscribed by the directors)			
6.	Equity share application A/c	Dr.	1,25,000	
	To Equity share capital A/c			1,25,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,50,000	
	To Bank A/c			2,50,000
	(Being loan repaid)			

Balance sheet of Fortunate Ltd. (and reduced) as on 31.3.2019

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	15,12,500
(2) Non-Current Liabilities		
(a) Long-term borrowings (7,16,250 – 1,87,500 – 2,50,000)		2,78,750
(3) Current liabilities		
a) Trade Payables		2,58,750
b) Other current liabilities		43,750
Total		20,93,750
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	2	7,91,250
(b) Intangible assets	3	2,36,250
(2) Current assets		
(a) Inventories		5,00,000
(b) Trade receivables		4,10,000
(c) Cash and cash equivalents	4	1,56,250
Total		20,93,750

Notes to accounts:

		₹	₹
1	Share Capital		
	Authorized capital:		
	81,250 Preference shares of ₹ 10 each	8,12,500	

	1,87,500 Equity shares of ₹ 5 each	<u>9,37,500</u>	<u>17,50,000</u>
	Issued, subscribed and paid up:		
	1,52,500 equity shares of ₹ 5 each	7,62,500	
	75,000, 6% Preference shares of ₹ 10 each	<u>7,50,000</u>	<u>15,12,500</u>
2	Property, Plant and Equipment		
	Building at cost less depreciation	5,00,000	
	Plant at cost less depreciation	<u>2,91,250</u>	7,91,250
3	Intangible Assets		
	Trademarks and goodwill		2,36,250
4	Cash and cash equivalents		
	Bank (2,81,250+1,25,000-2,50,000)		1,56,250

Note: *In place of Capital Reduction Account, Reconstruction Account or Internal Reconstruction Account may also be used.

#8. Question | November 2018 Exams, 10 Marks|

The summarized Balance Sheet of SK Ltd. as on 31st March, 2018 is given below.

Particulars	Amount (₹ in '000)
Liabilities Equity Shares of ₹10 each	43,750
8%, Cumulative Preference Shares of ₹100 each	17,500
6% Debentures of ₹ 100 each	14,000
Sundry Creditors	17,500
Provision for taxation	<u>350</u>
Total	84,350
Property, Plant & Equipment	43,750
Investments (Market value ₹3325 thousand)	3,500
Current Assets (Including Bank Balance)	35,000
Profit and Loss Account	<u>2,100</u>
Total	84,350

The following Scheme of Internal Reconstruction is approved and put into effect on 31st March, 2018.

- Investments are to be brought to their market value.
- The Taxation Liability is settled at ₹5,25,000 out of current Assets.
- The balance of Profit and Loss Account to be written off.
- All the existing equity shares are reduced to ₹4 each.
- All preference shares are reduced to ₹60 each.
- The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange them for fresh debentures of ₹ 80 each. Each old debenture is exchanged for one new debenture.
- Balance of Current Assets left after settlement of taxation liability are revalued at ₹1,57,50,000.
- Property, Plant & Equipment are written down to 80%.
- One of the creditors of the Company for ₹70,00,000 gives up 50% of his claim. He is allotted 8,75,000 equity shares of ₹4 each in full and final settlement of his claim. Pass journal entries for the above transactions.

Answer

Journal Entries in the books of SK Ltd.

		₹ '000	₹ '000
		Debit	Credit
1.	Equity share capital A/c (₹ 10)	Dr.	35,000

	To Equity Share Capital (₹ 4) A/c			14,000
	To Capital Reduction A/c			21,000
	(Being conversion of equity share capital of ₹ 10 each into ₹ 4 each as per reconstruction scheme)			
2.	8% Cumulative Preference Share capital (₹ 100) A/c	Dr.	17,500	
	To 8% Cumulative Preference Share Capital (₹ 60) A/c			10,500
	To Capital Reduction A/c			7,000
	(Being conversion of 6% cumulative preference shares capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)			
3.	6% Debentures (₹ 100) A/c	Dr.	14,000	
	To 9% Debentures (₹ 80) A/c			11,200
	To Capital Reduction A/c			2,800
	(Being 9% debentures of ₹ 80 each issued to existing 6% debenture holders The balance transferred to capital reduction account as per reconstruction scheme)			
4.	Sundry Creditors A/c	Dr.	7,000	
	To Equity Share Capital (₹ 4) A/c			3,500
	To Capital Reduction A/c			3,500
	(Being a creditor of ₹ 70,00,000 agreed to surrender his claim by 50% and was allotted 8,75,000 equity shares of ₹ 4 each in full settlement of his dues as per reconstruction scheme)			
5.	Provision for Taxation A/c	Dr.	350	
	Capital Reduction A/c	Dr.	175	
	To Liability for Taxation A/c			525
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
6.	Liability for Taxation A/c	Dr.	525	
	To Current Assets (Bank A/c)			525
	(Being the payment of tax liability)			
7.	Capital Reduction A/c	Dr.	34,125	
	To P & L A/c			2,100
	To Fixed Assets A/c			8,750
	To Current Assets A/c			18,725
	To Investments A/c			175
	To Capital Reserve A/c (Bal. fig.)			4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)			

Working Note:

Capital Reduction Account

		₹			₹
To	Liability for taxation A/c	175	By	By Equity share capital	21,000
To	P & L A/c	2,100	By	8% Cumulative preferences Share capital	7,000
To	Property, Plant & Equipment	8,750	By	6% Debentures	2,800
To	Current assets	18,725	By	Sundry creditors	3,500
To	Investment	175			
To	Capital Reserve (Bal.fig.)	4,375			

		34,300			34,300

#9. Question | RTP November 2022 |

Planet Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the balance sheet of the company as on 31 st March, 2022 before reconstruction:

Particulars	Notes	Amount (₹ in Lakh)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	2,100
(b) Reserves & Surplus	2	(783)
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	1,050
(3) Current liabilities		
a) Trade Payables	4	153
b) Other current liabilities	5	36
Total		2,556
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,125
(b) Current Investments	7	300
(3) Current assets		
(a) Inventories	8	450
(b) Trade receivables	9	675
(c) Cash and cash equivalents	10	6
Total		2,556

Notes to Accounts:

		₹ In lakh
1	Share Capital	
	Authorized:	
	300 lakh Equity shares of ₹10 each	3,000
	12 lakh, 8% preference Shares of ₹100 each	1,200
	Issued, Subscribed and Paid up:	4,200
	150 Lakh Equity Shares of ₹10 each, fully paid up	1,500
	6 lakh 8% Preference Shares of ₹100 each, fully paid up	600
2	Reserves & Surplus	2,100
	Profit & Loss account (Dr. balance)	(783)
3	Long term borrowings	
	6% Debentures (Secured by freehold property)	600
	Director's Loan	450
4	Trade payables	1,050
	Trade payables for Goods	153
5	Other Liabilities	
	Interest Accrued and Due on 6% Debentures	36
6	PPE	

	Freehold Property	825
	Plant & machinery	300
7	Current Investment	1,125
	Investment in Equity Instruments	300
8	Inventories	
	Finished Goods	450
9	Trade Receivables	
	Trade receivables for Goods	675
10	Cash and Cash equivalents	
	Balance with bank	6

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

- (1) Preference Shares are to be written down to ₹75 each and Equity Shares to ₹2 each.
- (2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹2 each to be allotted.
- (3) Debenture holders agreed to take one Freehold Property at its book value of ₹450 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
- (4) Interest accrued and due on Debentures to be paid in cash.
- (5) Remaining Freehold Property to be valued at ₹550 lakh.
- (6) All investments sold out for ₹425 lakh.
- (7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹2 each to be allotted.
- (8) 40% of Trade receivables and 80% of Inventories to be written off.
- (9) Company's contractual commitments amounting to ₹900 lakh have been settled by paying penalty of ₹72 lakhs.

You are required to:

- a) Pass Journal Entries for all the transactions related to internal reconstruction;
- b) Prepare Capital Reduction Account, Bank Account; and

Prepare Notes to Accounts on Share Capital and PPE, immediately after the implementation of internal reconstruction.

Answer

Journal Entries related to internal reconstruction in the books of Planet Ltd.

(₹ in lakhs)

			₹ '000	₹ '000
			Debit	Credit
1.	8% Preference share capital A/c (₹100 each)	Dr.	600	
	To 8% Preference share capital A/c (₹75 each)			450
	To Capital reduction A/c			150
	(Being the preference shares of ₹100 each reduced to ₹75 each as per the approved scheme)			
2.	Equity share capital A/c (₹10 each)	Dr.	1,500	
	To Equity share capital A/c (₹2 each)			300
	To Capital reduction A/c			1,200
	(Being the equity shares of ₹10 each reduced to ₹2 each)			
3.	Capital reduction A/c	Dr.	48	
	To Equity share capital A/c (₹2 each)			48
	(Being 1/3rd of arrears of preference share dividend of three years to be satisfied by issue of 24 lakh equity shares of ₹2 each)			
4.	6% Debentures A/c	Dr.	450	

	To Freehold property A/c			450
	(Being claim settled in part by transfer of freehold property)			
5.	Accrued debenture interest A/c	Dr.	36	
	To Bank A/c			36
	(Being accrued debenture interest paid)			
6.	Freehold property A/c	Dr.	175	
	To Capital reduction A/c			175
	(Being appreciation (550-375) in the value of freehold property)			
7.	Bank A/c	Dr.	425	
	To Investment A/c			300
	To Capital reduction A/c			125
	(Being investment sold on profit)			
8.	Director's loan A/c	Dr.	450	
	To Equity share capital A/c (₹2 each)			135
	To Capital reduction A/c			315
	(Being director's loan waived by 70% and balance being discharged by issue of 67.5 lakh equity shares of ₹2 each)			
9.	Capital Reduction A/c	Dr.	1,485	
	To Profit and loss A/c			783
	To Trade receivables A/c (675 x 40%)			270
	To Inventories-in-trade A/c (450 x 80%)			360
	To Bank A/c			72
	(Being various assets, penalty on cancellation of contract, profit and loss account debit balance written off through capital reduction account)			
10.	Capital Reduction A/c	Dr.	432	
	To Capital reserve A/c			432
	(Being balance transferred to capital reserve account as per the scheme)			

b) Capital Reduction Account

(₹ in lakhs)

		₹			₹
To	Equity Share Capital	48	By	8% Pref. Share Capital	150
To	P & L A/c	783	By	Equity Share Capital	1,200
To	Trade Receivables	270	By	Freehold property	175
To	Inventories	360	By	Bank (profit on sale of investment)	125
To	Bank	72	By	Director's loan	315
To	Capital Reserve	432			
		1,965			1,965

c) Note to Accounts on Share Capital and PPE after implementation of internal reconstruction

	₹ In lakh
Share Capital	
Authorised:	
300 lakh shares of ₹2 each	600
12 lakh, 8% Preference shares of ₹75 each	900
Issued, subscribed and paid up:	1,500
241.5 lakh Equity shares of ₹2 each	483

(Out of which 91.5 lakh shares have been issued for consideration other than cash)	450
6 lakh, 8% Preference shares of ₹75 each fully paid up	450
Total	933
PPE	
Freehold property	825
Less: Utilised to pay Debenture holders	(450)
Add: Appreciation	175
Plant and machinery	300
Total	850

Working Note:

Calculation of number of equity shares issued	
To equity shareholders	150 Lakh
To Preference shareholders (in lieu of arrear of preference dividend)	24 Lakh
To Directors	67.5 Lakh
	241.5 Lakh

#10. Question | RTP May 2022, November 2020, November 2018 |

Z Limited provides the following information as on 31st March, 2021:

Particulars	Amount in ₹
Share Capital:	
5,00,000 Equity shares of ₹10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account (Dr. balance)	14,60,000
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Non-Current Assets:	
Property, plant and Equipment:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
Intangible Assets:	
Goodwill	11,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000

Note: Preference dividend is in arrears for last 2 years

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹1,00,000 and ₹60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

- (i) All the equity shares to be converted into fully paid equity shares of ₹5.00 each.
- (ii) The Preference shares be reduced to ₹50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.
- (iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹1,00,000 and ₹60,000 respectively in cash and to receive new 12% debentures for the balance amount.
- (iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.
- (v) Directors also waived 60% of their loans and accepted equity shares for the balance.
- (vi) Capital commitments of ₹3.00 lacs were cancelled on payment of ₹15,000 as penalty.
- (vii) Directors refunded ₹1,00,000 of the fees previously received by them.
- (viii) Reconstruction expenses paid ₹15,000.
- (ix) The taxation liability of the company was settled for ₹75,000 and was paid immediately.
- (x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to pass journal entries for all the above-mentioned transactions including amounts to be written off for Goodwill, Patents and Loss in Profit and Loss account. Also prepare Bank Account and Reconstruction A/c.

Answer

Journal Entries in the Books of Z Ltd.

			₹	₹
			Debit	Credit
1.	Equity share capital A/c (₹ 10)	Dr.	50,00,000	
	To Equity Share Capital (₹5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹10 each fully paid into same number of fully paid equity shares of ₹5 each as per scheme of reconstruction.)			
2.	9% Preference Share Capital (₹100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹100 each into same number of 10% preference share of ₹50 each and claims of preference dividends settled as per scheme of reconstruction.)			
3.	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000

	(Being ₹11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
4.	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables	Dr.	60,000	
	Interest on debentures payable A/c	Dr.	64,000	
	Bank A/c	Dr.	60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
5.	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
6.	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 8,000 equity shares of ₹5 each as per scheme of reconstruction.)			
7.	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹3 Lakhs.)			
8.	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
9.	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses.)			
10.	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			
11.	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			
12.	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c			11,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000

(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

		₹			₹
To	Reconstruction (Y)	1,00,000	By	Balance b/d (overdraft)	1,00,000
To	Reconstruction(Z)	60,000	By	Reconstruction A/c	15,000
To	Reconstruction A/c (Refund of earlier fees by directors)	1,00,000		(Capital commitment penalty paid)	
			By	Reconstruction A/c (reconstruction expenses paid)	15,000
			By	Balance c/d	55,000
		2,60,000			2,60,000

Reconstruction Account

		₹			₹
To	Bank (Penalty)	15,000	By	Equity Share Capital A/c	10,00,000
To	Bank (reconstruction expenses)	15,000	By	Mr. Y (Settlement)	5,78,000
			By	Mr. Z (Settlement)	3,82,000
			By	Trade Payables A/c	1,70,000
			By	Director's loan	60,000
			By	Bank	1,00,000
			By	Provision for tax	25,000
			By	Land and Building	2,00,000
		50,15,000			50,15,000

#11.Question | RTP November 2021 |

Shine Ltd. provides the following information as on 31st March, 2021: (₹ in '000)

	₹
Equity Shares of ₹10 each	35,000
8%, Cumulative Preference Shares of ₹100 each	17,500
6% Debentures of ₹100 each	14,000
Sundry Creditors	17,500
Provision for taxation	350
Property, Plant and Equipment	43,750
Investments (Market value ₹3325 thousand)	3,500
Current Assets (Including Bank Balance)	35,000
Profit and Loss Account (Dr. balance)	2,100

- All the existing equity shares are reduced to ₹4 each.
- All preference shares are reduced to ₹60 each.
- The rate of interest on debentures is increased to 9%. The Debenture holders surrender their existing debentures of ₹100 each and exchange them for fresh debentures of ₹80 each. Each old debenture is exchanged for one new debenture.
- Investments are to be brought to their market value.
- The Taxation Liability is settled at ₹5,25,000 out of current Assets.
- The balance of Profit and Loss Account to be written off and balance of Current Assets left after settlement of taxation liability are revalued at ₹1,57,50,000.

- (vii) One of the creditors of the Company for ₹70,00,000 gives up 50% of his claim. He is allotted 8,75,000 equity shares of ₹4 each in full and final settlement of his claim.
- (viii) Property, plant and equipment to be written down to 80%.
- You are required to give journal entries for the above transactions and prepare capital reduction account.

Answer

Journal Entries in the books of Shine Ltd.

			₹ '000	₹ '000
			Debit	Credit
1.	Equity share capital A/c (₹ 10)	Dr.	35,000	
	To Equity Share Capital (₹4) A/c			14,000
	To Capital Reduction A/c			21,000
	(Being conversion of equity share capital of ₹10 each into ₹4 each as per reconstruction scheme)			
2.	8% Cumulative Preference Share capital (₹100) A/c	Dr.	17,500	
	To 8% Cumulative Preference Share Capital (₹60)			10,500
	To Capital Reduction A/c			7,000
	(Being conversion of 6% cumulative preference shares capital of ₹100 each into ₹60 each as per reconstruction scheme)			
3.	6% Debentures (₹100) A/c	Dr.	14,000	
	To 9% Debentures (₹80) A/c			11,200
	To Capital Reduction A/c			2,800
	(Being 9% debentures of ₹80 each issued to existing 6% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)			
4.	Sundry Creditors A/c	Dr.	7,000	
	To Equity Share Capital (₹4) A/c			3,500
	To Capital Reduction A/c			3,500
	(Being a creditor of ₹70,00,000 agreed to surrender his claim by 50% and was allotted 8,75,000 equity shares of ₹4 each in full settlement of his dues as per reconstruction scheme)			
5.	Provision for Taxation A/c	Dr.	350	
	Capital Reduction A/c	Dr.	175	
	To Liability for Taxation A/c			525
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
6.	Liability for Taxation A/c	Dr.	525	
	To Current Assets (Bank A/c)			525
	(Being the payment of tax liability)			
7.	Capital Reduction A/c	Dr.	34,125	
	To P & L A/c			2,100
	To PPE A/c			8,750
	To Current Assets A/c			18,725
	To Investments A/c			175
	To Capital Reserve A/c (Bal. fig.)			4,375
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Property, Plant & Equipment,			

	Current Assets, Investments and the Balance transferred to Capital Reserve)			

Capital Reduction Account

		₹			₹
To	Liability for taxation A/c	175	By	Equity Share Capital A/c	21,000
To	P & L A/c	2,100	By	8% Cumulative preferences Share capital	7,000
To	Property, Plant Equipment	8,750	By	6% Debentures	2,800
To	Investment	175	By	Sundry Creditors	3,500
To	Capital Reserve (Bal. fig.)	4,375			
		34,300			34,300

#12.Question | RTP May 2021 |

Recover Ltd decided to reorganize its capital structure owing to accumulated losses and adverse market condition. The Balance Sheet of the company as on 31st March 2020 is as follows

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	3,50,000
(b) Reserves and Surplus	2	(70,000)
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	55,000
(3) Current liabilities		
a) Trade Payables		80,000
b) Short term Borrowings – Bank overdraft		90,000
Total		5,05,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	4	3,35,000
(b) Intangible assets	5	50,000
(c) Non-current investments	6	40,000
(2) Current assets		
(a) Inventories		30,000
(b) Trade receivables		50,000
Total		5,05,000

Notes to accounts:

		₹
1	Share Capital	
	Equity share capital:	
	20,000 Equity Shares of ₹ 10 each	2,00,000
	Preference Share Capital:	
	15,000 8% Cumulative Preference Shares of ₹10 each (preference dividend has been in arrears for 4 years)	<u>1,50,000</u>
		3,50,000
2	Reserves & Surplus	
	Securities premium	10,000
	Profit & Loss account (debit balance)	<u>(80,000)</u>

		(70,000)
3	Long-term borrowings	
	Secured	
	9% Debentures (secured on the freehold property)	50,000
	Accrued interest on 9% debentures	<u>5,000</u>
		55,000
4	Property, Plant and Equipment	
	Freehold property	1,20,000
	Leasehold property	85,000
	Plant and machinery	<u>1,30,000</u>
		3,35,000
5	Intangible assets	
	Goodwill	<u>50,000</u>
		50,000
6	Non-current investments	
	Non-Trade investments at cost	<u>40,000</u>
		40,000

Subsequent to approval by court of a scheme for the reduction of capital, the following steps were taken:

- The preference shares were reduced to ₹2.5 per share, and the equity shares to ₹1 per share.
- One new equity share of ₹1 was issued for the arrears of preferred dividend for past 4 years.
- The balance on Securities Premium Account was utilized and was transferred to capital reduction account.
- The debenture holders took over the freehold property at an agreed figure of ₹75,000 and paid the balance to the company after deducting the amount due to them.
- Plant and Machinery was written down to ₹1,00,000.
- Non-trade Investments were sold for ₹32,000.
- Goodwill and obsolete stock (included in the value of inventories) of ₹10,000 were written off.
- A contingent liability of which no provision had been made was settled at ₹7,000 and of this amount, ₹6,300 was recovered from the insurance.

You are required:

- to show the Journal Entries, necessary to record the above transactions in the company's books and
- to prepare the Balance Sheet, after completion of the scheme.

Answer

In the books of Recover Ltd

		₹	₹
		Debit	Credit
8% Cumulative Preference share capital (₹10) A/c	Dr.	1,50,000	
To 8% Cumulative Preference share capital (₹2.5) A/c			37,500
To Capital reduction (₹7.5) A/c			
(Preference shares being reduced to shares of ₹2.5 per share and remaining transferred to capital reduction account as per capital reduction scheme)			
Equity share capital A/c (₹10)	Dr.	2,00,000	
To Equity Share Capital A/c (₹1)			20,000
To Capital reduction A/c (₹9)			1,80,000
(Equity shares reduced to ₹1 per share with the remaining amount transferred to capital reduction a/c as a part of the internal reconstruction scheme.)			

Securities Premium A/c	Dr.	10,000	
To Capital reduction A/c			10,000
(Amount from the securities premium utilized towards the capital reduction a/c as a part of the internal reconstruction scheme)			
9% Debentures A/c	Dr.	50,000	
Accrued interest on debentures A/c	Dr.	5,000	
Bank A/c	Dr.	20,000	
Capital reduction A/c	Dr.	45,000	
To Freehold property A/c			1,20,000
(Debenture holders being paid by the sale of property, which is sold at a loss debited to the capital reduction account. Amount received in excess being refunded to company by debenture holders as a part of the internal reconstruction scheme.)			
Capital reduction A/c	Dr.	90,000	
To Plant and Machinery Ac			30,000
To Goodwill A/c			50,000
To Inventory A/c			10,000
(The assets written off as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	32,000	
Capital reduction A/c	Dr.	8,000	
To Investments A/c			40,000
(Investments sold at a loss debited to capital reduction account as a part of the internal reconstruction scheme)			
Contingent Liability A/c	Dr.	7,000	
To Bank A/c			7,000
(Contingent liability paid as a part of the internal reconstruction scheme)			
Bank A/c	Dr.	6,300	
Capital reduction A/c	Dr.	700	
To Contingent Liability A/c			7,000
(The insurance company remitting part of the contingency payment amount)			
Capital reduction A/c	Dr.	80,000	
To Profit and loss A/c			80,000
(Accumulated losses written off to capital reduction account as a part of the internal reconstruction scheme).			
Capital reduction A/c	Dr.	30,800	
To Capital reserve A/c			30,800
(The balance in capital reduction account transferred to capital reserve as a part of the internal reconstruction scheme)			

Balance sheet of Recover Ltd. as at 31st March 2020 (and reduced)

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,05,500
(b) Reserves and Surplus	2	30,800
(2) Non-Current Liabilities		
(a) Long-term borrowings		-

(3) Current liabilities		
a) Trade Payables		80,000
b) Short term Borrowings – Bank overdraft		90,000
Total		3,06,300
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	3	1,85,000
(2) Current assets		
(a) Inventories		20,000
(b) Trade receivables		50,000
(c) Cash and cash equivalents	4	51,300
Total		3,06,300

Notes to accounts:

1	Share Capital	₹
	Equity share capital	
	68,000 Equity Shares of ₹1 each	68,000
	Preference share capital	
	15,000 8% Cumulative Preference Shares of ₹2.5 each	<u>37,500</u>
		1,05,500
2	Reserves and surplus	
	Capital reserve	
3	Property, Plant and Equipment	
	Leasehold property	85,000
	Plant and machinery	<u>1,00,000</u>
4	Cash and cash equivalents	1,85,000
	Bank A/c (20,000+32,000-7000+6,300)	

#13. Question | RTP May 2020 |

The following is the Balance Sheet of Star Ltd. as on 31st March, 2019:

Equity & Liabilities	
Shareholders' Fund:	
Share Capital:	
9,000 7% Preference Shares of ₹100 each fully paid	9,00,000
10,000 Equity Shares of ₹100 each fully paid	10,00,000
Reserve & Surplus:	
Profit & Loss Account	(2,00,000)
Non-current liabilities:	
"A" 6% Debentures (Secured on Bombay Works)	3,00,000
"B" 6% Debentures (Secured on Chennai Works)	3,50,000
Current Liabilities and Provisions:	
(a) Workmen's Compensation Fund:	
Bombay Works	10,000
Chennai Works	5,000
(b) Trade Payables	1,25,000
Total	24,90,000
Assets:	
Non- current Assets:	

PPE:	
Bombay Works	9,50,000
Chennai Works	7,75,000
Investment:	
Investments for Workman's Compensation Fund	15,000
Current Assets:	
(a) Inventories	4,50,000
(b) Trade Receivables	2,50,000
(c) Cash at Bank	50,000
Total	24,90,000

A reconstruction scheme was prepared and duly approved. The salient features of the scheme were as follows:

- (i) Paid up value of 7% Preference Share to be reduced to ₹80, but the rate of dividend being raised to 9%.
- (ii) Paid up value of Equity Shares to be reduced to ₹10.
- (iii) The directors to refund ₹50,000 of the fees previously received by them.
- (iv) Debenture holders forego their interest of ₹26,000 which is included among the trade payables.
- (v) The preference shareholders agreed to waive their claims for preference share dividend, which is in arrears for the last three years.
- (vi) "B" 6% Debenture holders agreed to take over the Chennai Works at ₹4,25,000 and to accept an allotment of 1,500 equity shares of ₹10 each at par, and upon their forming a company called Zia Ltd. (to take over the Chennai Works) they allotted 9,000 equity shares of ₹10 each fully paid at par to Star Ltd.
- (vii) The Chennai Workmen's compensation fund disclosed that there were actual liabilities of ₹1,000 only. As a consequence, the investments of the fund were realized to the extent of the balance. Entire investments were sold at a profit of 10% on book value and the proceeds were utilized for part payment of the creditors.
- (viii) Inventory was to be written off by ₹1,90,000 and a provision for doubtful debts is to be made to the extent of ₹20,000.
- (ix) Chennai works completely written off.
- (x) Any balance of the Capital Reduction Account is to be applied as two-third to write off the value of Bombay Works and one-third to Capital Reserve.

Pass necessary Journal Entries in the books of Star Ltd. after the scheme has been carried into effect.

Answer

In the books of Star Ltd. Journal Entries

			₹	₹
			Debit	Credit
(i)	7% Preference share capital (₹100)	Dr.	9,00,000	
	To 9% Preference share capital (₹80)			7,20,000
	To Capital reduction A/c			1,80,000
	(Being preference shares reduced to ₹80 and also rate of dividend raised from 7% to 9%)			
(ii)	Equity share capital A/c (₹100 each)	Dr.	10,00,000	
	To Equity share capital A/c (₹10 each)			1,00,000
	To Capital reduction A/c			9,00,000
	(Being reduction of nominal value of one share of ₹100 each to ₹10 each)			
(iii)	Bank A/c	Dr.	50,000	
	To Capital reduction A/c			50,000
	(Being directors refunded the fee amount)			
(iv)	Trade payables A/c (Interest on debentures)	Dr.	26,000	
	To Capital reduction A/c			26,000

	(Being interest forgone by the debenture holders)			
(v)	No entry required			
(vi)	a. 'B' 6% Debentures A/c	Dr.	3,50,000	
	To Debentures holders A/c			3,50,000
	(Being amount due to Debentures holders)			
	b. Debentures holders A/c	Dr.	4,40,000	
	To Chennai Works A/c			4,25,000
	To Equity share capital A/c			15,000
	(Being Chennai works taken over and equity shares issued to 'B' 6% Debenture holders)			
	c. Equity share of Zia Ltd. A/c	Dr.	90,000	
	To Debentures holders A/c			90,000
	(Being 9,000 equity shares of Zia Ltd. issued by Debentures holders)			
(vii)	a. Chennai Works – Workmen Compensation Fund	Dr.	4,000	
	To Capital reduction A/c			
	(Being difference due to reduced amount of actual liability transferred to capital reduction account)			
	b. Bank A/c	Dr.	15,400	
	To Investment for Workmen Compensation Fund			14,000
	To Capital reduction A/c			1,400
	c. Trade Payables A/c	Dr.	15,400	
	To Bank A/c			15,400
	(Being part payment made to trade payables)			
(viii)	Capital reduction A/c	Dr.	2,10,000	
	To Provision for Doubtful Debts A/c			20,000
	To Inventory A/c			1,90,000
	(Being assets revalued)			
(ix)	Capital reduction A/c	Dr.	4,01,400	
	To PPE – Bombay Works			2,67,600
	To Capital reserve A/c			1,33,800
	(Being assets revalued and remaining amount transferred to capital reserve account)			
(x)	Capital reduction A/c	Dr.	4,01,400	
	To PPE – Bombay Works			2,67,600
	To Capital reserve A/c			1,33,800
	(Being assets revalued and remaining amount transferred to capital reserve account)			

#14. Question | RTP November 2019, May 2018 |

Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the draft Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital		Goodwill	22,00,000
50,000 shares of ₹50 each fully paid up	25,00,000	Land & Building	42,70,000
Capital Reserve	5,00,000	Machinery	8,50,000
8% Debentures of ₹100 each	4,00,000	Computers	5,20,000
12% Debentures of ₹100 each	6,00,000	Inventories	3,20,000

Trade payables	12,40,000	Cash at Bank	2,68,000
Outstanding Expenses	10,60,000	Profit & Loss Account	7,82,000
Total	1,03,00,000	Total	1,03,00,000

Following is the interest of Mr. Shiv and Mr. Ganesh in Platinum Limited:

	Mr. Shiv	Mr. Ganesh
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

- (1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹40 each.
 - (2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for ₹12,50,000.
 - (3) Trade payables are given option of either to accept fully paid equity shares of ₹40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade payables for ₹7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
 - (4) Mr. Shiv agrees to cancel debentures amounting to ₹2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agrees to subscribe further 15% Debentures in cash amounting to ₹1,00,000.
 - (5) Mr. Ganesh agrees to cancel debentures amounting to ₹50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.
 - (6) Land & Building to be revalued at ₹51,84,000, Machinery at ₹7,20,000, Computers at ₹4,00,000, Inventories at ₹3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.
 - (7) Outstanding Expenses are fully paid in cash.
 - (8) Goodwill and Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.
- You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

Answer

Journal Entries in the books of Platinum Ltd.

		₹	₹
		Debit	Credit
Bank A/c (1,00,000 x ₹10)	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Being money on final call received)			
Equity share capital (₹50) A/c	Dr.	75,00,000	
To Equity share capital (₹40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of ₹50 each into ₹40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at ₹40 each)			
Trade payables A/c	Dr.	12,40,000	
To Equity share capital A/c			7,50,000
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000

(Being payment made to trade payables in shares or cash to the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To Shiv A/c			7,00,000
(Being cancellation of 8% and 12% debentures of Shiv)			
Bank A/c	Dr.	1,00,000	
To Shiv A/c			1,00,000
(Being new debentures subscribed by Shiv)			
Shiv A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c	Dr.	2,00,000	
To Ganesh A/c			3,00,000
(Being cancellation of 8% and 12% debentures of Ganesh)			
Ganesh A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Land and Building (51,84,000 – 42,70,000)	Dr.	9,14,000	
Inventories	Dr.	30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000
(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Goodwill A/c			22,00,000
To Profit and Loss A/c			7,82,000
(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance, goodwill and downfall in value of other assets)			
Capital Reserve A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being debit balance of capital reduction account adjusted against capital reserve)			

Balance Sheet (as reduced) as on 31.3.2019

Particulars	Notes	Amount ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	80,00,000
(2) Non-Current Liabilities		

(a) Long-term borrowings	2	8,50,000
Total		88,50,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment		
Tangible assets	3	63,04,000
(2) Current assets		
(a) Inventories		3,50,000
(b) Trade receivables		9,81,000
(c) Cash and cash equivalents		12,15,000
Total		88,50,000

Notes to accounts

1	Share Capital	₹
	Share Capital	
	2,00,000 Equity shares of ₹40	80,00,000
2	Long-term borrowings	
	Secured	
	15% Debentures (assumed to be secured)	8,50,000
3	Tangible assets	
	Land & Building	51,84,000
	Machinery	7,20,000
	Computers	<u>4,00,000</u>
		63,04,000

Working Notes:

1. Cash at Bank Account

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

2. Capital Reduction Account

To	Machinery A/c	1,30,000	By	Equity Share Capital	15,00,000
To	Computers A/c	1,20,000	By	Trade Creditors A/c	1,47,000
To	Trade receivables A/c	1,09,000	By	Shiv A/c	2,00,000
To	Goodwill A/c	22,00,000	By	Ganesh A/c	50,000
To	Profit and Loss A/c	7,82,000	By	Land & Building	9,14,000
			By	Inventories	30,000
			By	Capital Reserve A/c	5,00,000
		33,41,000			33,41,000

Chapter 7 – Consolidated Financial Statements

Past Exams and RTP Questions Compiler

#1. Question | Sep 2025 Exam, 10 marks |

Birds Ltd. and its subsidiary Rooster Ltd provided the following information for the year ended 31/03/2025.

Particulars	Birds Ltd. (Rs.)	Rooster Ltd. (Rs.)
Equity Share Capital	10,00,000	3,00,000
Sales	28,40,000	10,40,000
Purchases (Finished Goods)	9,15,000	1,75,000
Salaries	7,75,000	3,78,000
Rent received	5,40,000	
General and Administration expenses	2,81,500	1,98,000
Selling and Distribution Expenses	2,21,000	90,000
Dividend Income	1,35,000	28,000
Finished Goods Inventory on 01/04/2024	3,35,000	1,20,000
Finished Goods Inventory on 31/03/2025	7,85,000	2,90,000
Other Non-operating Income	2,38,000	57,000

Other Information:

- On 1st April 2022 Birds Ltd. acquired 2,500 shares of Rs. 100 each fully paid up in Rooster Ltd.
- Rooster Ltd. paid a dividend of 12% for the year ended 31/03/2024. The dividend was correctly accounted for by Birds Ltd.
- Rooster Ltd. pays Rs. 11,250 per month to Birds Ltd. towards rent for the portion of premises occupied.

Selling and Distribution Expenses of Rooster Ltd. include Rs. 15,000 received from Birds Ltd.

Prepare Consolidated Profit and Loss Account of Birds Ltd. and its subsidiary Rooster Ltd. for the year ended 31/03/2025.

Answer:

Consolidated statement of profit and loss of Birds Ltd. and its subsidiary Rooster Ltd. for the year ended on 31st March, 2025

Particulars	Note No.	Rs.
Revenue from operations	1	38,80,000
Other Income	2	<u>8,33,000</u>
Total revenue (I)		<u>47,13,000</u>
Expenses:		
Cost of material purchased/consumed	3	10,90,000
Changes (Increase) in inventories of finished goods	4	(6,20,000)
Employee benefit expense	5	11,53,000
Other expenses	6	<u>6,55,500</u>
Total expenses (II)		<u>22,78,500</u>
Profit before tax (II-III)		<u>24,34,500</u>

Notes to Accounts

			Rs.	Rs.
1.	Revenue from operations Sales and other operating revenues Birds Ltd. Rooster Ltd.		28,40,000 <u>10,40,000</u>	38,80,000
2.	Other Income Dividend income: Birds Ltd. <i>Less: Dividend received from</i> Rooster Ltd. (2,50,000 × 12%) Rooster Ltd. Other Non-operating Income Birds Ltd. Rooster Ltd. Rent received Birds Ltd. <i>Less: Rent received by Birds Ltd. from</i> Rooster Ltd. (11,250 × 12)	1,35,000 (30,000) <u>28,000</u> 2,38,000 <u>57,000</u> 5,40,000 (1,35,000)	 1,33,000 2,95,000 <u>4,05,000</u>	 8,33,000
3.	Cost of material purchased/ consumed Birds Ltd. Rooster Ltd.	9,15,000 <u>1,75,000</u>		10,90,000
4.	Changes (Increase) in inventories of finished goods Birds Ltd. (7,85,000 - 3,35,000) Rooster Ltd. (2,90,000 - 1,20,000)		4,50,000 <u>1,70,000</u>	6,20,000
5.	Employee benefits and expenses Salaries: Birds Ltd. Rooster Ltd.		7,75,000 <u>3,78,000</u>	11,53,000
6.	Other expenses General & Administrative expenses: Birds Ltd. Rooster Ltd. <i>Less: Rent paid to Birds Ltd.</i> Selling and distribution Expenses: Birds Ltd. <i>Less: paid to Rooster Ltd</i> Rooster Ltd. Add: Received from Birds Ltd.	2,81,500 1,98,000 <u>(1,35,000)</u> 2,21,000 (15,000) 90,000 <u>15,000</u>	 3,44,500 3,11,000	 6,55,500

Note:

An amount of Rs. 15,000 was added under Selling and Distribution Expenses of Rooster Ltd. due to a rectification entry, while Rs. 15,000 was deducted from Birds Ltd. under the same head to account for the set-off of inter- company transactions.

#2. Question |Jan 2025 Exam, 14 marks |

The summarized Balance Sheets of Super Limited and Clear Limited as on 31st March,2024 is as below:

Particulars	Note	Super Limited Rs.	Clear Limited Rs.
Equity and Liabilities			
Shareholders' Funds			
(a) Share Capital	1	95,00,000	50,00,000
(b) Reserves and Surplus	2	25,75,000	12,25,000
Non-Current Liabilities			
(a) Long term borrowings	3	5,00,000	2,00,000
Current Liabilities			
(a) Short term borrowings		4,50,000	-
(b) Trade Payables		<u>3,65,000</u>	<u>2,45,000</u>
Total		<u>1,33,90,000</u>	<u>66,70,000</u>
Assets			
Non-current assets			
(a) Property, Plant and Equipment	4	77,00,000	54,00,000
(b) Non-Current Investment	5	41,50,000	-
Current Assets			
(a) Inventories		6,75,000	5,65,000
(b) Trade Receivables		5,85,000	4,90,000
(c) Cash and Cash equivalents		<u>2,80,000</u>	<u>2,15,000</u>
Total		<u>1,33,90,000</u>	<u>66,70,000</u>

Notes to Accounts:

Particulars	Super Limited Rs.	Clear Limited Rs.
1. Share Capital		
8,00,000 Equity Shares of Rs. 10 each fully paid up	80,00,000	
5,00,000 Equity Shares of Rs. 10 each fully paid up	-	50,00,000
15,000 Preference Shares of Rs. 100 each fully paid up	<u>15,00,000</u>	<u>-</u>

	<u>95,00,000</u>	<u>50,00,000</u>
2. Reserves and Surplus		
General Reserve	15,50,000	6,50,000
Profit and Loss Account	<u>10,25,000</u>	<u>5,75,000</u>
	<u>25,75,000</u>	<u>12,25,000</u>
3. Long term borrowing		
10% Debentures	5,00,000	-
9% Debentures	-	2,00,000
4. Property, Plant & Equipment		
Land & Building	65,00,000	45,50,000
Plant & Machinery	9,50,000	6,75,000
Furniture & Fittings	<u>2,50,000</u>	<u>1,75,000</u>
	<u>77,00,000</u>	<u>54,00,000</u>
5. Non-Current Investment		
Investment in Clear Limited	41,50,000	-

Additional Information:

- Super Limited holds 75% of Equity Shares in Clear Limited since the incorporation of Clear Limited.
- 25% of Trade Receivables of Super Limited is due from Clear Limited.
- During the year Super Limited sold inventory costing Rs. 2,00,000 to Clear Limited at a price of 15% above cost. The entire inventory remains unsold with Clear Limited at the end of financial year.

You are required to prepare Consolidated Balance Sheet of Super Limited and Clear Limited as on 31st March, 2024.

Answer:

**Consolidated Balance Sheet of Super Ltd.
and its subsidiary Clear Ltd. as at 31st March, 2024**

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	95,00,000
(b) Reserves and Surplus	2	34,63,750
(2) Minority Interest [W.N.4]		15,56,250
(3) Non-current Liabilities		
(a) Long term borrowings	3	7,00,000
(4) Current Liabilities		
(a) Short-term borrowings		4,50,000
(b) Trade payables	4	4,63,750
Total		1,61,33,750
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	5	1,31,00,000

(b) Intangible Assets – Goodwill		4,00,000
(2) Current assets		
(a) Inventory	6	12,10,000
(b) Trade Receivables	7	9,28,750
(c) Cash and Cash Equivalents		4,95,000
Total		1,61,33,750

Notes to Accounts

		Rs.	Rs.
1.	Share Capital		
	Equity Share Capital		
	8,00,000 Equity Shares of Rs. 10 each fully paid up		80,00,000
	Preference Share Capital		
	15,000 Preference Shares of Rs. 100 each fully paid up		<u>15,00,000</u>
	Total		<u>95,00,000</u>
2.	Reserves and Surplus		
	General Reserve (WN 5)		20,37,500
	Profit & Loss A/c (WN 5)		<u>14,26,250</u>
	Total		<u>34,63,750</u>
3.	Long term borrowings		
	10% Debentures		5,00,000
	9% Debentures		<u>2,00,000</u>
	Total		<u>7,00,000</u>
4.	Trade payables		
	Super Ltd.	3,65,000	
	Clear Ltd.	2,45,000	
	Less: Mutual Owing	<u>(1,46,250)</u>	4,63,750
5.	Property Plant & Equipment		
	Land & Building		
	Super Ltd.	65,00,000	
	Clear Ltd.	<u>45,50,000</u>	1,10,50,000
	Plant & Machinery		
	Super Ltd.	9,50,000	
	Clear Ltd.	<u>6,75,000</u>	16,25,000
	Furniture & Fittings		
	Super Ltd.	2,50,000	
	Clear Ltd.	1,75,000	4,25,000
6.	Inventory		
	Super Ltd.	6,75,000	
	Clear Ltd.	5,65,000	

7	Less: Unrealized profit	(30,000)	12,10,000
	Trade Receivables		
	Super Ltd.	5,85,000	
	Clear Ltd.	4,90,000	
	Less: Mutual Owing	(1,46,250)	9,28,750

Working Notes:

1. Shareholding Pattern

Super Ltd	5,00,000 Shares
Holding 75%	3,75,000 shares
Minority Interest 25%	1,25,000 shares

2. Analysis of Profit of Clear Ltd.

	Capital Profit	Revenue Reserve	Revenue Profit
Opening Balance of General Reserve	-	6,50,000	-
Opening Balance of P&L	-	-	5,75,000
Total Rs.		6,50,000	5,75,000
Share of Minority (25%)		1,62,500	1,43,750
Share of Holding (75%)		4,87,500	4,31,250

3. Computation of Cost of Control (Goodwill / Capital Reserve)

	Computation	Rs.
Cost of Investment	Given	41,50,000
Less: Share of Equity Capital in Clear Ltd.	$50,00,000 \times 75\%$	(37,50,000)
Less: Pre-acquisition Profit	WN 2	-
Goodwill		4,00,000

4. Calculation of Minority Interest

Particulars		Rs.
Share in Equity Share Capital	$50,00,000 \times 25\%$	12,50,000
Share in Revenue Reserve	$6,50,000 \times 25\%$	1,62,500
Share in profit & loss	$5,75,000 \times 25\%$	1,43,750
Total		15,56,250

5. General Reserve and Consolidated Profit & Loss A/c

Particulars	General Reserve	Profit & Loss A/c
Balance from Balance Sheet	15,50,000	10,25,000
Revenue Profit (WN 2)	-	4,31,250
Revenue Reserve (WN 2)	4,87,500	-
Unrealized Profit	-	(30,000)
Total	20,37,500	14,26,250

#3. Question | September 2024 Exam, 14 marks |

On 1st February, 2024, Best Ltd. acquired 80% Equity shares of Cool Ltd. for Rs. 14,80,000.

On 31st March, 2024, Best Ltd. also acquired 25% Equity shares of Good Ltd. for Rs. 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. Amount in Rs.	Cool Ltd. Amount in Rs.	Good Ltd. Amount in Rs.
Equity Shares of Rs. 100 each fullypaid	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 (CreditBalance)	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 BillsPayable)	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 Rs. 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 the date, Best Ltd. held only Rs. 3,00,000 of these acceptances in hand, the rest having been endorsed in favour of its creditor.
- Best Ltd. purchased goods costing Rs. 5,00,000 from Cool Ltd. on 1st June, 2023 at a price of Rs. 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)

Answer:

1. Trade payable (Consolidated)

Best limited	3,80,000
Add: Cool Ltd	4,10,000
Less: Elimination	<u>(3,00,000)</u>
Total	<u>4,90,000</u>

2. Current assets (Consolidated)

Best limited		9,65,000
Add: Cool Ltd		5,60,000
Less: Elimination of inter company owing	(3,00,000)	
Less: Unrealized stock profit	<u>(1,50,000)</u>	<u>(4,50,000)</u>
Total		<u>10,75,000</u>

3. Minority interest Cool Ltd

Share Capital (20,00,000 x 20%)		4,00,000
Add: Securities premium (2,20,000 x 20%)		44,000
Add: General Reserve (84,000 x 20%)		16,800
Add: Profit and loss balance	2,70,000	
Less: Adjustment of unrealised profit stock	(1,50,000)	
Balance	1,20,000	
20% of above balance		<u>24,000</u>
Total		<u>4,84,800</u>

4. Goodwill/Capital Reserve on Acquisition of Cool Ltd.:

Purchase Consideration		14,80,000
Less: Share Capital (20,00,000 x 80%)		16,00,000
Less: Securities premium (2,20,000 x 80%)		1,76,000
Less: General Reserve (84,000 x 80%)		67,200
Less: Profit and loss balance opening (30,000 x 80%)		24,000
Less: Pre acquisition profits		
(2,70,000-30,000) x 10/12 x 80%	1,60,000	
Less: Unrealised profit stock (1,50,000 x 80%)	<u>1,20,000</u>	<u>40,000</u>
Capital Reserves		<u>4,27,200</u>

5. Goodwill/Capital Reserve on Acquisition of Good Ltd.

Purchase Consideration	3,80,000
Less: Share Capital (10,00,000 x 25%)	2,50,000
Less: General Reserve (1,20,000 x 25%)	30,000
Less: Profit and loss balance (50,000 x 25%)	<u>12,500</u>
Goodwill	87,500

6. Profit and Loss Account (Consolidated)

Best limited	3,26,000
Add: Post acquisition profit of Cool Ltd	
{(2,70,000-30,000) x 2/12}80%	<u>32,000</u>
Total	<u>3,58,000</u>

7. General Reserve (Consolidated)

Best limited	2,69,000

With reference to para no 15 of AS 21

If an enterprise makes two or more investments in another enterprise at different dates and eventually obtains control of the other enterprise, the consolidated financial statements are presented only from the date on which holding-subsidiary relationship comes in existence. If two or more investments are made over a period of time, the equity of the subsidiary at the date of investment, for the purposes of paragraph 13 above, is generally determined on a step-by-step basis; however, if small investments are made over a period of time and then

an investment is made that results in control, the date of the latest investment, as a practicable measure, may be considered as the date of investment.

And para no 22 of AS 21 The results of operations of a subsidiary are included in the consolidated financial statements as from the date on which parent-subsidiary relationship came in existence. The results of operations of a subsidiary with which parent- subsidiary relationship ceases to exist are included in the consolidated statement of profit and loss until the date of cessation of the relationship. The difference between the proceeds from the disposal of investment in a subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognised in the consolidated statement of profit and loss as the profit or loss on the disposal of the investment in the subsidiary. In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.

8. Revenue (Consolidated) as per para no 15 and 22 of AS 21

Revenue of Best Ltd	56,00,000
Add: Revenue of Cool Ltd. (38,00,000 × 2/ 12)	<u>6,33,333</u>
	<u>62,33,333</u>

9. Cost of materials purchased/consumed (Consolidated) as per para no 15 and 22 of AS 21

Raw material of Best Ltd	36,50,000
Add: Raw material of Cool Ltd (31,20,000x 2/12)	<u>5,20,000</u>
	<u>41,70,000</u>

#4. Question | May 2024 Exam, 14 marks |

The Balance Sheets of Art Limited and Craft Limited as on 31 March 2024 are as below:

Particulars	Note No	Art Limited (Rs.)	Craft Limited (Rs.)
I. Equity and Liabilities			
a. Shareholder's Fund			
i. Share Capital	1	6,50,000	4,00,000
ii. Reserve & Surplus	2	3,12,000	2,48,000
b. Current Liabilities			
i. Trade Payables		1,45,000	92,000
ii. Short term borrowings	3	70,000	-
		<u>11,77,000</u>	<u>7,40,000</u>
II. Assets			
a. Non-current Assets			
i. Property, Plant & Equipment	4	4,21,000	3,60,000
ii. Non-current investment	5	4,32,000	-
b. Current Assets			
i. Inventories		1,66,000	2,05,000
ii. Trade Receivables		1,33,500	1,68,300
iii. Cash & Cash equivalent	6	24,500	6,700
		<u>11,77,000</u>	<u>7,40,000</u>

Notes to Accounts:

		Art Limited (Rs.)	Craft Limited (Rs.)
1.	Share capital 6,500 shares of Rs. 100 each fully paid up 4,000 shares of Rs. 100 each fully paid-up	6,50,000 -	4,00,000
	Total	6,50,000	4,00,000
2.	Reserves and Surplus		
	General Reserve	1,20,000	40,000
	Profit and Loss account	1,92,000	2,08,000
	Total	3,12,000	2,48,000
3.	Short term borrowings Bank Overdraft	70,000	-
4.	Property Plant & Equipment Land & Building Plant & Machinery	1,90,000 2,31,000	1,35,000 2,25,000
	Total	4,21,000	3,60,000
5.	Non-current investments Investment in Craft Limited (Cost)	4,32,000	-
6.	Cash & Cash equivalents Cash	24,500	6,700

Additional information:

- Art Limited acquired 3,200 ordinary shares of Craft Limited on 1st October, 2023. The Reserve & Surplus and Profit & Loss Account of Craft Limited showed a credit balance of Rs. 40,000 and Rs. 58,700 respectively as on 1st April, 2023.
- The Plant & Machinery of Craft Limited which stood at Rs. 2,50,000 as on 1st April, 2023 was considered worth Rs. 2,20,000 on the date of acquisition. The depreciation on Plant & Machinery is calculated @ 10% p.a. on the basis of useful life. The revaluation of Plant & Machinery is to be considered at the time of consolidation.
- Craft Limited deducts 1% from Trade Receivables as a general provision against doubtful debts. This policy is not followed by Art Limited.
- On 31st March 2024, Craft Limited's inventory includes goods which it had purchased from Art Limited for 1,03,500 which made a profit of 15% on cost price.

You are required to prepare a consolidated Balance Sheet as on 31 st March 2024.

Answer:
Consolidated Balance Sheet of Art and Craft Ltd As on 31st March, 2024

	Particulars	Note no.	Rs.
I.	Equity & Liabilities		
(1)	Shareholders' fund		
(a)	Share Capital	1	6,50,000
(b)	Reserves & Surplus	2	3,73,460
(2)	Minority Interest	3	1,26,740
(3)	Current Liabilities		
(a)	Short term borrowings	4	70,000
(b)	Trade Payables (1,45,000 + 92,000)		<u>2,37,000</u>
	Total		<u>14,57,200</u>

II.	Assets		
(1)	Non-current Assets		
(a)	Property, Plant & Equipment	5	7,65,000
(2)	Current Assets		
(a)	Inventories	6	3,57,500
(b)	Trade Receivables	7	3,03,500
(c)	Cash & Cash Equivalents	8	<u>31,200</u>
	Total		<u>14,57,200</u>

Notes to Accounts:

Sr. No.	Particulars	Rs.
1.	Share Capital <u>Issued, Subscribed & Paid-up Capital</u> a) Equity Share Capital 6,500 Equity Shares of Rs. 100 each	6,50,000
2.	Reserves & Surplus Profit & Loss A/c (WN 5) General Reserve (WN 5) Capital Reserve (W.N. 3)	2,40,100 1,20,000 <u>13,360</u> <u>3,73,460</u>
3.	Minority interest in Craft Ltd. (W.N.4)	1,26,740
4.	Short-term borrowings Bank Overdraft	70,000
5.	Property, Plant & Equipment Land & Building Art Ltd. 1,90,000 Craft Ltd. <u>1,35,000</u> Plant & Machinery Art Ltd. 2,31,000 Craft Ltd. (2,25,000-17,500+1,500) <u>2,09,000</u>	3,25,000 <u>4,40,000</u> <u>7,65,000</u>
6.	Inventories Art Ltd. 1,66,000 Craft Ltd. 2,05,000 Less: unrealized profit <u>(13,500)</u>	3,57,500
7.	Trade Receivables Art Ltd. 1,33,500 Craft Ltd. <u>1,70,000</u>	3,03,500

8.	Cash & Cash Equivalents	
	Art Ltd.	24,500
	Craft Ltd.	<u>6,700</u>
		<u>31,200</u>

Working Notes:

1. Shareholding Pattern

Total 4,000 shares	
3,200 shares	800 shares
Art Ltd (80%)	20% Minority Interest

2. Analysis of Profit

	General reserve	Profit and loss account
Opening balance	40,000	58,700
Closing balance	40,000	<u>2,08,000</u>
Changes during the year		<u>1,49,300</u>

Analysis of Profit

Particulars	Pre acquisition profit (6 months) (Rs.)	Post acquisition profit (6 months) (Rs.)
Opening Balances (40,000 + 58,700)	98,700	
Profit for 6 months (1,49,300 x 6/12)	74,650	74,650
Provision reversed (1,700) (W.N. 8)	850	850
Revaluation Loss (W.N. 6)	(17,500)	-
Savings in depreciation (W.N. 6)	<u>-</u>	<u>1,500</u>
Total	<u>1,56,700</u>	<u>77,000</u>
Holding (80%)	1,25,360	61,600
Minority Interest (20%)	31,340	15,400

3. Cost of Control

Particulars	Rs.	Rs.
Cost of Investment (Given)		4,32,000
Less: Share in Net Assets:		
		(4,45,360)
a) Share Capital (3,200 shares x Rs.100)	3,20,000	
b) Capital Profit (W.N. 2)	1,25,360	
Capital Reserve		13,360

4. Minority Interest

Particulars	Rs.
Share Capital (800 shares x 100)	80,000
Capital Profit (W.N. 2)	31,340

Revenue Profit (W.N. 2)	<u>15,400</u>
Total	<u>1,26,740</u>

5. **Consolidated Profit and General Reserve of Art Ltd**

Particulars	Profit and loss account Rs.	General reserve Rs.
Balance as per Balance Sheet	1,92,000	1,20,000
Revenue Profit	61,600	-
Unrealized Profit (Downstream)	<u>(13,500)</u>	
Total	<u>2,40,100</u>	<u>1,20,000</u>

6. **Calculation of Revaluation Profit /Loss**

Particulars	Rs.
Balance as on 01.04.2023 (given)	2,50,000
Depreciation for 6 months $(2,50,000 \times 10\% \times 6/12)$	<u>(12,500)</u>
WDV as on date of acquisition	2,37,500
Revalued amount	<u>2,20,000</u>
Revaluation Loss	17,500

7. **Savings in Depreciation**

= Depreciation Provided for 6 months – Depreciation Should be
= 12,500 – $(2,20,000 \times 10\% \times 6/12)$
= 1,500

8. **Calculation of provision reversed**

Trade Receivable (Given) = 1,68,300 it is after provision i.e 99% So, 100% will be 1,70,000 therefore provision will be 1,700

As per para 20 and 21 of AS 21, Consolidated financial statements: Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

#5. Question | November 2023 Exam, 15 marks |

GB Limited acquired 80% of equity shares of TB Limited on 1st April, 2016 at a cost of Rs. 58,00,000 when TB Limited had an Equity share capital of Rs. 50,00,000 and Reserves and Surplus of Rs. 4,64,000.

The following information is provided:

Year	Profit /(Loss) of TB Limited (Rs.)
2016-17	(14,50,000)
2017-18	(23,20,000)
2018-19	(29,00,000)
2019-20	(6,96,000)
2020-21	1,90,000
2021-22	6,80,000
2022-23	12,70,000

You are required to calculate the minority interests and cost of control at the end of each year for the purpose of consolidation.

Answer:

Year	Profit /(Loss)	Minority Interest (20%)	Additional Consolidated P & L (Dr.) Cr.	Minority's Share of losses borne by GB Ltd.		Cost of Control
				Rs.	Balance	
At the time of acquisition in 2016		10,92,800 - (W.N.)	-			
2016-17	(14,50,000)	(2,90,000)	(11,60,000)			14,28,800 (W.N.)
Balance		8,02,800				
2017-18	(23,20,000)	(4,64,000)	(18,56,000)			14,28,800
Balance		3,38,800				
2018-19	(29,00,000)	(5,80,000)	(23,20,000)			14,28,800
		(2,41,200)				
	Loss of minority borne by Holding Co.	2,41,200	(2,41,200)	2,41,200	2,41,200	
Balance		Nil	(25,61,200)			
2019-20	(6,96,000) Loss of minority borne by Holding Co.	(1,39,200) 1,39,200	(5,56,800) (1,39,200)			14,28,800
Balance		Nil	(6,96,000)			
2020-21	1,90,000	38,000	1,52,000			14,28,800
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(38,000)	38,000	(38,000)	3,42,400	
Balance		Nil	1,90,000			
2021-22	6,80,000 Profit share of minority	1,36,000 (1,36,000)	5,44,000 1,36,000	(1,36,000)	2,06,400	14,28,800

	adjusted against losses of minority absorbed by Holding Co.					
Balance		Nil	6,80,000			
2022-23	12,70,000	2,54,000	10,16,000	(2,06,400)	Nil	14,28,800
		(2,06,400)	2,06,400			
Balance		47,600	12,22,400			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.2016

		Share of Holding Co.	Minority Interest
	100%	80%	20%
	(Rs.)	(Rs.)	(Rs.)
Share Capital	50,00,000	40,00,000	10,00,000
Reserve	4,64,000	<u>3,71,200</u>	<u>92,800</u>
		43,71,200	<u>10,92,800</u>
Less: Cost of investment		<u>(58,00,000)</u>	
Goodwill		14,28,800	

#6. Question | November 2022 Exam, 15 marks |

H Ltd. and S Ltd. provide the following information as at 31st March, 2022:

	H Ltd. ₹	S Ltd. ₹
Property, Plant and Equipment	2,00,000	2,60,000
Investments (14,000 Equity Shares of S Ltd.)	2,52,000	-
Current Assets	1,48,000	1,40,000
Share capital (Fully paid equity shares of ₹ 10 each)	3,00,000	2,00,000
Profit and loss account	1,00,000	80,000
Trade Payables	2,00,000	1,20,000

Additional information:

H Ltd. acquired the shares of S Ltd. on 1st July, 2021 and Balance of profit and loss account of S Ltd. on 1st April, 2021 was ₹ 60,000. Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 2022.

Answer

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	1,10,500
(2) Minority Interest	3	84,000
(3) Current Liabilities		

(a) Trade payables	4	3,20,000
Total		8,14,500
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	5	4,60,000
(b) Intangible assets	6	66,500
(2) Current assets	7	2,88,000
Total		8,14,500

Notes to Accounts

		₹
1	Share Capital	
	30,000 Equity Shares of ₹ 10 each	3,00,000
2	Reserves & Surplus	
	Profit & Loss account (₹ 1,00,000 + 70% of 9/12 x 20,000 i.e. ₹ 10,500)	1,10,500
3	Minority Interest (W/N 2)	84,000
4	Trade payables	
	- H Ltd.	2,00,000
	- S Ltd.	1,20,000
		3,20,000
5	Property, Plant and Equipment	
	- H Ltd.	2,00,000
	- S Ltd.	2,60,000
		4,60,000
6	Intangible Assets	
	Goodwill (W/N 3)	66,500
7	Current Assets	
	- H Ltd.	1,48,000
	- S Ltd.	1,40,000
		2,88,000

Working Notes:

1. Percentage of holding

	No. of Shares	Percentage
Holding Co.	14,000	(70%)
Minority shareholders	6,000	(30%)
Total Shares	20,000	

2. Calculation of Minority Interest

Share capital (30% of ₹ 2,00,000)	60,000	
Share in Profit and loss account (₹ 80,000 X 30%)	24,000	84,000

3. Calculation of Cost of Control (Goodwill)

Cost of Investment	2,52,000
Less: Paid up value of shares (70% of ₹ 2,00,000)	(1,40,000)
70% of [60,000 + 3/12(80,000-60,000)]	<u>(45,500)</u>
	66,500

#7. Question | May 2022 Exam, 15 marks |

White Ltd. acquired 2,250 shares of Black Ltd. on 1st October, 2020. The summarized balance sheets of both the companies as on 31st March, 2021 are given below:

	White Ltd. ₹	Black Ltd. ₹
(I) Equity and Liabilities		
(1) Shareholder's fund		
Share capital (Equity shares of ₹ 100 each fully paid up)	6,50,000	3,00,000
Reserves and Surplus General Reserve	60,000	30,000
Profit and loss account	1,50,000	90,000
(2) Current Liabilities		
Trade payables Due to White Ltd.	1,15,000	75,000
Total	9,75,000	5,25,000
(II) Assets:		
Non-current assets		
Property, Plant and Equipment	5,80,000	3,51,000
Investments		
Shares in Black Ltd. (2,250 shares)	2,70,000	
Current assets		
Inventories	50,000	1,20,000
Due from Black Ltd.	36,000	
Cash and Cash equivalents	39,000	54,000
Total	9,75,000	5,25,000

Other information:

- During the year, Black Limited fabricated a machine, which is sold to White Ltd. for ₹ 39,000, the transaction being completed on 30th March, 2021.
- Cash in transit from Black Ltd. to White Ltd. was ₹ 6,000 on 31st March, 2021. Profits during the year 2020-2021 were earned evenly
- The balances of Reserve and Profit and Loss account as on 1st April, 2020 were as follows:

	Reserves ₹	Profit and Loss A/c ₹
White Ltd.	30,000	15,000 Profit
Black Ltd.	30,000	10,000 Loss

You are required to prepare consolidated Balance Sheet of the group as on 31st March, 2021 as per the requirement of Schedule III of the Companies Act, 2013

Answer

Consolidated Balance Sheet of White Ltd. and its Subsidiary Black Ltd. as at 31st March, 2021

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,50,000
(b) Reserves and Surplus	2	2,55,000
(2) Minority Interest	3	1,05,000
(3) Current Liabilities		
(a) Trade payables	4	1,90,000
Total		12,00,000
II. Assets		
(1) Non-current assets		

(a) Property, plant and equipment	5	9,31,000
(2) Current assets		
(a) Inventory	6	1,70,000
(b) Cash & cash equivalent	7	99,000
Total		12,00,000

Notes to Accounts

		₹	₹
1	Share Capital		
	6,500 equity shares of ₹ 100 each, fully paid up		6,50,000
2	Reserves & Surplus		
	General Reserves		60,000
	Profit and Loss Account	1,50,000	
	Add: 75% share of Black Ltd.'s post-acquisition profits (W.N.1)	37,500	1,87,500
	Capital reserve (W.N. 5)		7,500
	Total		2,55,000
3	Minority interest in Black Ltd. (WN 4)		1,05,000
4	Trade payables		
	- White Ltd.	1,15,000	
	- Black Ltd.	3,51,000	1,90,000
5	Property, Plant and Equipment		
	- White Ltd.	5,80,000	
	- Black Ltd.	3,51,000	9,31,000
6	Inventory		
	- White Ltd.	50,000	
	- Black Ltd.	1,20,000	1,70,000
7	Cash & cash equivalent		
	- White Ltd.	39,000	
	- Black Ltd.	54,000	
	Cash in transit	6,000	99,000

Working Notes:

1. Post-acquisition profits of Black Ltd.	₹
Profits earned during the year = ₹ 90,000 + ₹10,000	1,00,000
Pre-acquisition profits (1.4.20 to 30.9.20)	50,000
Post-acquisition profits (1.10.20 to 31.3.21)	50,000
White Ltd.'s share 75% of 50,000	37,500
Minority Interest 25% of 50,000	12,500
2. Pre-acquisition profits and reserves of Black Ltd.	
Reserves as on 1.4.2020	30,000
Profit and Loss Account [10,000 (loss as on 1.4.20) +50,000 (6 month Adjusted pre-acquisition profits)]	40,000
	70,000
White Ltd.'s = (75%) × 70,000	52,500
Minority Interest= (25%) × 70,000	17,500
3. Post-acquisition reserves of Black Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 30,000 – 30,000)	Nil

4. Minority Interest		
Paid-up value of (3,000 – 2,250) = 750 shares		75,000
held by outsiders i.e. $750 \times ₹ 100$		17,500
Add: 25% share of pre-acquisition reserves & Profit 25% share of post-acquisition profit		12,500
		1,05,000
5. Capital Reserve		
Price paid by White Ltd. for 2,250 shares (A)		2,70,000
Intrinsic value of the shares-		
Paid-up value of 2,250 shares held by White Ltd. i.e. $2,250 \times ₹ 100$	2,25,000	
Add 75% share of pre-acquisition reserves & profit ($70,000 \times 75\%$)	52,500 (B)	2,77,500
Capital reserve (A – B)		7,500

#8. Question | December 2021 Exam, 5 Marks |

Moon Ltd. and its subsidiary Star Ltd. provided the following information for the year ended 31st March, 2021:

	Moon Ltd. ₹	Star Ltd. ₹
Equity Share Capital	20,000,000	6,000,000
Finished Goods Inventory as on 01.04.2020	4,200,000	3,010,000
Finished Goods Inventory as on 31.03.2021	8,575,000	3,762,500
Dividend Income	1,680,000	437,500
Other non-operating Income	350,000	105,000
Raw material consumed	13,930,000	4,725,000
Selling and Distribution Expenses	3,325,000	1,575,000
Production Expenses	3,150,000	1,400,000
Loss on sale of investments	262,500	Nil
Sales and other operating income	33,250,000	19,075,000
Wages and Salaries	13,300,000	2,450,000
General and Administrative Expenses	2,800,000	1,225,000
Royalty paid	Nil	50,000
Depreciation	315,000	140,000
Interest expense	175,000	52,500

Other information

- On 1st September 2018 Moon Ltd., acquired 50,000 equity shares of Rs. 100 each fully paid up in Star Ltd.
- Star Ltd. paid a dividend of 10% for the year ended 31st March 2020. The dividend was correctly accounted for by Moon Ltd.
- Moon Ltd. sold goods of ₹17,50,000 to Star Ltd. at a profit of 20% on selling price. Inventory of Star Ltd. includes goods of ₹7,00,000 received from Moon Ltd.
- Selling and Distribution expenses of Star Ltd. include ₹2,12,500 paid to Moon Ltd. as brokerage fees.
- General and Administrative expenses of Moon Ltd. include ₹2,80,000 paid to Star Ltd. as consultancy fees.
- Star Ltd. used some resources of Moon Ltd., and Star Ltd. paid ₹50,000 to Moon Ltd. as royalty.

Prepare Consolidated Statement of Profit and Loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended 31st March, 2021 as per Schedule III to the Companies Act, 2013.

Answer

Consolidated statement of profit and loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended on 31st March, 2021

Particulars	Notes	Amount in ₹
Revenue from operations	1	5,00,32,500
Other Income	2	23,10,000
Total revenue (I)		5,23,42,500
Expenses:		
Cost of material purchased/consumed	3	2,14,55,000
Changes (Increase) in inventories of finished goods	4	(49,87,500)
Employee benefit expense	5	1,57,50,000
Finance cost	6	2,27,500
Depreciation and amortization expense	7	4,55,000
Other expenses	8	84,32,500
Total expenses (II)		4,13,32,500
Profit before tax (II-III)		1,10,10,000

Notes to Accounts:

		₹	₹
1	Revenue from operations		
	Sales and other operating revenues		
	- Moon Ltd.	3,32,50,000	
	- Star Ltd.	190,75,000	
		523,25,000	
	Less: Inter-company sales	(17,50,000)	
	Consultancy fees received by Star Ltd. from Moon Ltd.	(2,80,000)	
	Royalty received by Moon Ltd. from Star Ltd.	(50,000)	
	Brokage received by Moon Ltd. from Star Ltd.	(2,12,500)	5,00,32,500
2	Other Income		
	Dividend income:		
	- Moon Ltd.	16,80,000	
	- Star Ltd.	<u>4,37,500</u>	21,17,500
	Loss on sale of investments Star Ltd.		
	Other Non-operating Income		
	- Moon Ltd.	3,50,000	
	- Star Ltd.	<u>1,05,000</u>	4,55,000
3	Cost of material purchased/consumed		
	- Moon Ltd.	1,39,30,000	
	- Star Ltd.	47,25,000	
		<u>1,86,55,000</u>	
	Less: Purchases by Star Ltd. From Moon Ltd.	<u>(17,50,000)</u>	1,69,05,000
	Direct expenses (Production)		
	- Moon Ltd.	31,50,000	
	- Star Ltd.	<u>14,00,000</u>	45,50,000
4	Changes (Increase) in inventories of finished goods		
	- Moon Ltd.	43,75,000	
	- Star Ltd.	7,52,500	
		51,27,500	
	Less: Unrealized profits ₹7,00,000 × 20/100	(1,40,000)	49,87,500

5	Employee benefits and expenses		
	Wages and salaries:		
	- Moon Ltd.	1,33,00,000	
	- Star Ltd.	24,50,000	1,57,50,000
6	Finance cost		
	Interest:		
	- Moon Ltd.	1,75,000	
	- Star Ltd.	52,500	2,27,500
7	Depreciation		
	- Moon Ltd.	3,15,000	
	- Star Ltd.	1,40,000	4,55,000
8	Other expenses		
	General & Administrative expenses:		
	- Moon Ltd.	28,00,000	
	- Star Ltd.	<u>12,25,000</u>	
		40,25,000	
	Less: Consultancy fees received by Star Ltd. from Moon Ltd.	<u>(280,000)</u>	37,45,000
	Royalty:		
	Star Ltd.	50,000	
	Less: Received by Moon Ltd.	(50,000)	Nil
	Selling and distribution Expenses:		
	- Moon Ltd.	33,25,000	
	- Star Ltd.	15,75,000	
		49,00,000	
	Less: Brokerage received by Moon Ltd from Star Ltd.	(2,12,500)	46,87,500
			84,32,500

#9. Question | July 2021 Exam, 5 Marks |

Long Limited acquired 60% stake in Short Limited for a consideration of ₹112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was ₹100 lakhs, Revenue Reserve was ₹40 lakhs and balance in Profit & Loss Account was ₹30 lakhs. From the above information you are required to calculate Goodwill / Capital Reserve in the following situations:

- On consolidation of Balance Sheet.
- If Long Limited showed the investment in subsidiary at a carrying amount of ₹104 lakhs.
- If the consideration paid for acquiring the 60% stake was ₹92 lakhs.

Answer

	₹
60% of the Equity Share Capital ₹100 Lakhs	60
60% of Accumulated Reserve ₹70 Lakhs (40+30) Lakhs	<u>42</u>
Book value of shares of Short Ltd.	102

- Goodwill / Capital Reserve computation on consolidation of balance sheet
Long Ltd. paid a positive differential of ₹10 Lakhs (112 - 102). This differential ₹10 Lakhs is called goodwill and is shown in the balance sheet under the head intangibles.
- If Long Ltd. showed the investment in Short Ltd. at carrying amount of ₹104 Lakhs, then the goodwill will be ₹2 Lakhs.
- If the consideration paid is ₹92 lakhs, then there would have been capital reserve amounting ₹10 Lakhs (102- 92).

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

	X Limited (₹ In 000)		Y Limited (₹ In 000)	
	Dr.	Cr.	Dr.	Cr.
Equity Share capital (Share of ₹100 each)		2,000		400
7% Preference share capital		-		400
Reserves		600		200
6% Debentures		400		400
Trade Receivables/Trade Payables	160	180	100	120
Profit & Loss A/c balance		40		30
Purchases /Sales	1,000	1,800	1,200	1,900
Wages and Salaries	200		300	
Debenture Interest	24		24	
General Expenses	160		120	
Preference share dividend up to 30.09.2020		7	14	
Inventory (as on 31.03.2021)	200		100	
Cash at Bank	27		12	
Investment in Y Limited	1,056		-	
Property, Plant & Equipment	2,200		1,580	
Total	5,027	5,027	3,450	3,450

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

- After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being ₹1,20,000, one fourth of such goods were still lying in inventory at the end of the year.
- Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Property, Plant & Equipment.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021

Answer

Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, 2021

Particulars	Notes	Amount (₹)
I. Revenue from operations	1	<u>35,80,000</u>
II. Total revenue		35,80,000
III. Expenses		
Cost of Material purchased/Consumed	2	20,80,000
Changes of Inventories of finished goods		-
Employee benefit expense	3	5,00,000
Finance cost	4	48,000
Depreciation and amortization expense	5	4,57,000
Other expenses	6	2,80,000
Total expenses		33,65,000
IV. Profit before Tax (II-III)		2,15,000
Profit transferred to Consolidated Balance Sheet		
Profit After Tax		2,15,000
Preference dividend		7,000
Preference dividend payable		<u>7,000</u>
		<u>(14,000)</u>

		2,01,000
Share in pre-acquisition loss (WN 3)		1,800
Share of Minority interest in losses (WN 1)		1,800
Less: Investment Account- dividend for 3 months (prior to acquisition)		(3,500)
Inventory reserve (WN 2)		(6,000)
Profit to be transferred to consolidated balance sheet		1,95,100

Notes to Accounts

		₹	₹
1	Revenue from Operations		
	X Ltd.	18,00,000	
	Y Ltd.	<u>19,00,000</u>	
	Total	37,00,000	
	Less: Intra-group sales (X sold to Y)	<u>(1,20,000)</u>	35,80,000
2	Cost of Materials Purchased/Consumed		
	X Ltd.	10,00,000	
	Y Ltd.	<u>12,00,000</u>	
	Total	22,00,000	
	Less: Intra-group sales (X sold to Y)	<u>(1,20,000)</u>	20,80,000
3	Employee benefit and expenses		
	Wages and salaries		
	X Ltd.	2,00,000	
	Y Ltd.	<u>3,00,000</u>	5,00,000
4	Finance cost		
	Interest		
	X Ltd.	24,000	
	Y Ltd.	<u>24,000</u>	48,000
5	Depreciation		
	X Ltd.	2,20,000	
	Y Ltd.	<u>2,37,000</u>	4,57,000
6	Other expenses		
	X Ltd.	1,60,000	
	Y Ltd.	<u>1,20,000</u>	2,80,000

Working Note

1. Profit of Subsidiary

		₹
Revenue from Operations		19,00,000
Less: Expenses		
Cost of Material purchased/Consumed	12,00,000	
Changes of Inventories of finished goods	-	
Employee benefit expense	3,00,000	
Finance cost	24,000	
Depreciation and amortization expense	2,37,000	
Other expenses	<u>1,20,000</u>	
Total expenses		<u>(18,81,000)</u>
Profit Before Tax		<u>19,000</u>
Less: Preference Dividend	14,000	

Less: Preference Dividend Payable	<u>14,000</u>	<u>(28,000)</u>
Profit available for shareholders		<u>(9,000)</u>
Minority Share (20% of loss ₹9,000)		<u>(1,800)</u>

2. Inventory reserve = $\left(\frac{1,20,000}{4} \times \frac{25}{125} \right) = 6,000$

3. Pre-acquisition loss = 80% of 3 month's profit up to 30th June, 2020 i.e. 80 % of $\frac{1}{4}$ of loss ₹9,000. Hence, pre-acquisition loss = ₹1,800

4. Investment account includes Preference dividend for 3 months prior to acquisition i.e. ₹4,00,000 X 50% X 7% X $\frac{1}{4}$ = ₹3,500

#11. Question | January 2021 Exam, 20 Marks |

On 31st March, 2020 the summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

	H Ltd.	S Ltd.
	₹	₹
Shareholders' Fund		
Issued and subscribed		
Equity shares of ₹10 each	13,40,000	2,40,000
Reserves and Surplus	4,80,000	1,80,000
Profit & Loss Account	2,40,000	60,000
Secured Loans		
12% Debentures	1,00,000	-
Current Liabilities		
Trade Payables	2,00,000	1,22,000
Bank Overdraft	1,00,000	-
Bills Payable	60,000	14,800
Total	25,20,000	6,16,800
Assets		
Non-Current Assets		
(a) Property, Plant & Equipment		
Machinery	7,20,000	2,16,000
Furniture	3,60,000	40,800
(b) Investments		
Investments in S Ltd. (19,200 shares at ₹20 each)	3,84,000	-
Current Assets		
Trade Receivables	3,00,000	90,000
Bill Receivables	1,00,000	30,000
Cash at Bank	56,000	40,000
Total	25,20,000	6,16,800

The following information is also provided to you:

- H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹60,000 and ₹36,000 respectively.
 - Machinery (Book value ₹2,40,000) and Furniture (Book value ₹48,000) of S Ltd were revalued at ₹3,60,000 and ₹36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%).
 - On 31st March, 2020, Bills payable of ₹12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.
- You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.

Answer

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	13,40,000
(b) Reserves and Surplus	2	8,27,040
(2) Minority Interest		1,15,560
(3) Non-Current Liabilities		
(a) 12% Debentures		
(4) Current Liabilities		
(a) Trade payables	3	3,84,800
(b) Short term Borrowings (Bank overdraft)		1,00,000
Total		28,67,400
II. Assets		
(2) Non-current assets		
(a) Property, plant and equipment	4	14,34,600
(b) Intangible assets	5	28,500
(3) Current assets		
(a) Inventory (6,00,000+2,00,000)		8,00,000
(b) Trade Receivables	6	5,08,000
(c) Cash and Cash equivalents		96,000
Total		28,67,400

Notes to Accounts

			₹
1. Share Capital			
Equity share capital 1,34,000 shares of ₹10 each fully paid up			13,40,000
2. Reserves and Surplus			
Reserves		4,80,000	
Add: 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3)		96,000	5,76,000
Profit and Loss Account		2,40,000	
Add: 4/5th share of S Ltd.'s post-acquisition profits (W.N.4)		<u>11,040</u>	<u>2,51,040</u>
			8,27,040
3. Trade Payables			
H Ltd.	2,00,000		
S Ltd	<u>1,22,000</u>	3,22,000	
4. Property Plant and Equipment			
Machinery			
H Ltd.		7,20,000	
S Ltd	2,40,000		
Add: Appreciation	<u>1,20,000</u>		
	3,60,000		
Less: Depreciation (3,60,000 X 10%)	<u>(36,000)</u>	3,24,000	
Furniture			
H Ltd.		3,60,000	

	S Ltd	48,000		
	Less: Decrease in value	<u>(12,000)</u>		
		36,000		
	Less: Depreciation (36,000 X 15%)	<u>5,400</u>	<u>30,600</u>	14,34,600
5.	Intangible assets			
	Goodwill [WN 6]			28,800
6.	Trade receivables			
	H Ltd.	3,00,000		
	S Ltd.	<u>90,000</u>	3,90,000	
	Bills Receivables			
	H Ltd.	1,00,000		
	S Ltd.	<u>30,000</u>	<u>1,30,000</u>	
			5,20,000	
	Less: Mutual Owings		<u>(12,000)</u>	5,08,000

Working Notes:

1. Pre-acquisition profits and reserves of S Ltd.	₹
Reserves	60,000
Profit and Loss Account	<u>36,000</u>
	96,000
H Ltd.'s = $\frac{4}{5}$ (or 80%) $\times$ 96,000	76,800
Minority Interest = $\frac{1}{5}$ (or 20%) $\times$ 96,000	19,200
2. Profit on revaluation of assets of S Ltd.	
Profit on Machinery ₹ (3,60,000 – 2,40,000)	1,20,000
Less: Loss on Furniture ₹ (48,000 – 36,000)	<u>(12,000)</u>
Net Profit on revaluation	1,08,000
H Ltd.'s share $\frac{4}{5} \times 1,08,000$	86,400
Minority Interest $\frac{1}{5} \times 1,08,000$	21,600
3. Post -acquisition profits of S Ltd.	
Total reserves	1,80,000
Less: Pre- acquisition reserves	<u>(60,000)</u>
Post-acquisition reserves	1,20,000
H Ltd.'s share $\frac{4}{5} \times 1,20,000$	96,000
Minority interest $\frac{1}{5} \times 1,20,000$	24,000
4. Post-acquisition profits of S Ltd.	
Post-acquisition profits (Profit & loss account less pre-acquisition profits = ₹(60,000 – 36,000)	24,000
Add: Excess depreciation charged on furniture @ 15% on ₹12,000 i.e. (48,000 – 36,000)	1,800
	25,800
Less: Under depreciation on machinery @ 10% on ₹1,20,000 i.e. (3,60,000 – 2,40,000)	<u>(12,000)</u>
Adjusted post-acquisition profits	13,800
H Ltd.'s share $\frac{4}{5} \times 13,800$	11,040
Minority Interest $\frac{1}{5} \times 13,800$	2,760
5. Minority Interest	
Paid-up value of (24,000 – 19,200) = 4,800 shares held by outsiders i.e. 2,40,000 X 20%	48,000
Add: 1/5th share of pre-acquisition profits and reserves	19,200

1/5th share of profit on revaluation	21,600
1/5th share of post-acquisition reserves	24,000
1/5th share of post-acquisition profit	2,760
	1,15,560
6. Cost of Control or Goodwill	
Price paid by H Ltd. for 19,200 shares (A)	3,84,000
Less: Intrinsic value of the shares	
Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80%	1,92,000
Add: 4/5th share of pre-acquisition profits and reserves	76,800
4/5th share of profit on the revaluation	86,400
Intrinsic value of shares on the date of acquisition (B)	3,55,200
Cost of control or Goodwill (A-B)	28,800

#12. Question | November 2020 Exam, 15 Marks |

H Limited acquired 64000 Equity Shares of Rs. 10 each in S Ltd. as on 1st October, 2019. The Balance Sheets of the two companies as on 31st March, 2020 were as under:

	H Ltd.	S Ltd.
	₹	₹
Shareholders' Fund		
Equities and Liabilities:		
Equity shares of ₹10 each	20,00,000	8,00,000
General Reserve (1st April, 2019)	9,60,000	4,20,000
Profit & Loss Account	2,28,800	3,28,000
Preliminary Expenses (1st April, 2019)	-	(20,000)
Bank Overdraft	3,00,000	-
Bills Payable	-	52,000
Trade Payables	1,66,400	80,000
Total	36,55,200	16,60,000
Assets:		
Land and Building	7,20,000	7,60,000
Plant & Machinery	9,60,000	5,40,000
Investment in Equity Shares of S Ltd.	12,27,200	-
Inventories	4,56,000	1,68,000
Trade Receivables	1,76,000	1,60,000
Bills Receivable	59,200	-
Cash in Hand	56,800	32,000
Total	36,55,200	16,60,000

Additional Information:

- (1) The Profit & Loss Account of S Ltd. showed credit balance of ₹1,20,000 on 1st April, 2019. S Ltd. paid a dividend of 10% out of the same on 1st November, 2019 for the year 2018-19. The dividend was correctly accounted for by H Ltd.
 - (2) The Plant & Machinery of S Ltd. which stood at ₹6,00,000 on 1st April, 2019 was considered worth ₹5,20,000 on the date of acquisition by H Ltd. S Ltd. charges depreciation @ 10% per annum on Plant & Machinery.
- Prepare consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2020 as per Schedule III of the Companies Act, 2013.

Answer

Consolidated Balance Sheet of H Ltd. and its subsidiary, S Ltd. as at 31st March, 2020

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	13,07,200
(2) Minority Interest (W.N 4)		2,96,400
(3) Current Liabilities		
(a) Trade payables	3	2,98,400
(b) Short term Borrowings		3,00,000
Total		42,02,000
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	4	29,34,000
(b) Intangible assets (W.N.5)		1,60,000
(2) Current assets		
(a) Inventory	5	6,24,000
(b) Trade Receivables	6	3,95,200
(c) Cash and Cash equivalents	7	88,800
Total		42,02,000

Notes to Accounts

		₹	₹
1. Share Capital			
2,00,000 equity shares of ₹10 each			20,00,000
2. Reserves and Surplus			
Reserves	9,60,000		
Profit & loss			
H Ltd	2,28,800		
S Ltd. (As per W.N. 3)	1,18,400	<u>3,47,200</u>	13,07,200
3. Trade Payables			
H Ltd.	1,66,400		
S Ltd. (80,000+52,000)	<u>1,32,000</u>		2,98,400
4. Property, Plant and Equipment			
Land and building			
H Ltd.	7,20,000		
S Ltd.	<u>7,60,000</u>		
Plant & Machinery			
H Ltd.	9,60,000		
S Ltd. (As per W.N. 7)	4,94,000		
5. Inventories			
H Ltd.	4,56,000		
S Ltd.	1,68,000		6,24,000
6. Trade Receivables			
H Ltd.	1,76,000		
S Ltd.	<u>1,60,000</u>	3,36,000	
Bills receivable: H Ltd.		<u>59,200</u>	3,95,200
7. Cash & Cash equivalents			
Cash			

	H Ltd.	56,800	
	S Ltd.	<u>32,000</u>	88,800

Working Notes:

1. Share Holding Pattern

Total Shares of S Ltd 80,000 shares. Shares held by H Ltd 64,000 shares i.e. 80 %; Minority Shareholding 16,000 shares i.e. 20 %

2. Capital profits of S Ltd.

	₹	₹
Reserve on 1st October, 2019 (Assumed there is no movement in reserves during the year and hence balance as on 1st October, 2019 is same as of 31st March 2020)		4,20,000
Profit & Loss Account Balance on 1st April, 2019	1,20,000	
Less: Dividend paid	<u>(80,000)</u>	40,000
Profit for year:		
Total ₹3,28,000		
Less: ₹40,000 (opening balance)		
<u>₹2,88,000</u>		
Proportionate up to 1st October, 2019 on time basis (2,88,000/2)		1,44,000
Reduction in value of Plant & Machinery (WN 6)		<u>(50,000)</u>
		5,54,000
Less: Preliminary expenses written off		(20,000)
Total Capital Profit		5,34,000
Holding company's share (5,34,000 X 80%)		4,27,200
Minority Interest (5,34,000 X 20%)		1,06,800

Note: Preliminary expenses as on 1st April, 2019 amounting ₹20,000 have been written off.

3. Revenue profits of S Ltd.

Profit after 1st October, 2019 (3,28,000 - 40,000)/2		1,44,000
Less: 10% depreciation on ₹5,20,000 for 6 months	(26,000)	
Add: Depreciation already charged for 2nd half year on 6,00,000	<u>30,000</u>	<u>4,000</u>
		<u>1,48,000</u>
Holding company's share (1,48,000 X 80%)		1,18,400
Minority Interest (1,48,000 X 20%)		29,600

4. Minority interest

Par value of 16,000 shares (8,00,000 X 20%)	1,60,000
Add: 1/5 Capital Profits [WN 2]	1,06,800
1/5 Revenue Profits [WN 3]	<u>29,600</u>
	2,96,400

5. Cost of Control

Amount paid for 64,000 shares		12,27,200
Less: Par value of shares (8,00,000 X 80%)	6,40,00	
Capital Profits – share of H Ltd. [WN 2]	<u>4,27,200</u>	<u>(10,67,200)</u>
Cost of Control or Goodwill		1,60,000

6. Calculation of revaluation loss on Plant and Machinery of S Ltd. on 1st October, 2019

	₹
Value of plant and machinery as on 1st April, 2019	6,00,000
Less: Depreciation for the six months	(30,000)

Value of plant and machinery as on 1st October, 2019	5,70,000
Less: Plant and machinery valued by H Ltd. on 1st October, 2019	(5,20,000)
Revaluation Loss	50,000

7. Value of plant & Machinery of S Ltd. On 31st March, 2020

Value of machinery on 1st October, 2019	5,20,000
Less: depreciation for next six month	<u>(26,000)</u>
	4,94,000

#13. Question | November 2019 Exam, 10 Marks |

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.

	2017-18	2018-19
	₹	₹
Share Capital		
Issued and subscribed 7500 Equity Shares of ₹100 each	7,50,000	7,50,000
Reserve and Surplus		
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Current Liabilities and Provisions		
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000
Provision for Taxation	<u>2,62,000</u>	<u>4,30,000</u>
	15,88,000	23,08,000
Assets		
Fixed Assets (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	<u>(1,70,000)</u>	<u>(2,82,500)</u>
	7,50,000	6,37,500
Investment at Cost		
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	<u>52,700</u>	<u>42,500</u>
	15,88,000	23,08,000

Other Information:

- (1) MNT Ltd. is a subsidiary of LTC Ltd.
- (2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹5,000 at the end of 2017-2018 and increased by ₹12,000 at the end of 2018-2019. (Inventory of 2017-18 has been sold out during the year 2018-19)
- (3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.
- (4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹25,000 in 2017-18 and ₹12,500 in 2018-19 being part of initial Sales Promotion expenditure of Rs. 37,500 in 2017-18, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2017-18. Restate the balance sheet of MNT Ltd. as on 31st March, 2019 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

Answer

Particulars	Notes	Amount in ₹

I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
a) Trade Payables		2,46,000
b) Short term Borrowings	2	1,70,000
c) Short-term provision	3	4,30,000
Total		23,14,500
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	4	6,37,500
(b) Non-current investments		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables (3,43,000/98 X100)		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		23,14,500

Notes to Accounts

		₹	₹
1. Reserves & Surplus			
Revenue Reserve (refer W.N.)	5,11,500		
Securities Premium	<u>2,07,000</u>		7,18,500
2. Short-term borrowings			
Bank overdraft			1,70,000
3. Short-term provision			
Provision for taxation			4,30,000
4. Property, Plant and Equipment			
Cost	9,20,000		
Less: Depreciation to date	<u>(2,82,500)</u>		6,37,500
5. Inventories	6,90,000		
Increase in value as per FIFO	<u>12,000</u>		7,02,000
6. Other current assets			
Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)			52,500

Working Note:

Adjusted revenue reserves of MNT Ltd.:

	₹	₹
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98]	7,000	
Add: Increase in value of inventory	<u>12,000</u>	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		<u>(12,500)</u>
Adjusted revenue reserve		<u>5,11,500</u>

#14. Question | May 2019, November 2019 Exam, 5 Marks | RTP November 2020

From the following data determine in each case : Minority Interest at the date of acquisition and at the date of consolidation.

Case	Subsidiary Company	% of Share Owned	Cost	Date of Acquisition		Consolidation date	
				01-01-2018		31-12-2018	
				Share Capital ₹	Profit and Loss a/c ₹	Share Capital ₹	Profit and Loss a/c ₹
Case - A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case -B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case-C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case-D	M	95%	75,000	60,000	35,000	60,000	55,000
Case - E	N	100%	1,00,000	40,000	40,000	40,000	65,000

Answer

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2018

B = Profit & loss account balance on 1.1.2018

C = Share capital on 31.12.2018

D = Profit & loss account balance on 31.12.2018

	Minority % Shares Owned [E]	Minority interest as at the date of acquisition [E] x [A + B] ₹	Minority interest as at the date of consolidation [E]X[C+D] ₹
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750
Case E [100-100]	NIL	NIL	NIL

#15. Question | May 2019 Exam, 10 Marks | RTP May 2023

H Ltd. acquire 70% of equity share of S Ltd. as on 1st January, 2011 at a cost of ₹5,00,000 when S Ltd. had an equity share capital of ₹5,00,000 and reserves and surplus of ₹40,000. Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. performed badly and suffered losses of ₹1,25,000, ₹2,00,000, ₹2,50,000 and ₹60,000 respectively.

Thereafter in 2015, S Ltd. experienced turnaround and registered an annual profit of ₹25,000. In the next two years i.e. 2016 and 2017, S Ltd. recorded annual profits of ₹50,000 and ₹75,000 respectively.

Show the Minority Interests and Cost of Control at the end of each year for the purpose of consolidation.

Answer

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	Profit / (Loss)	Minority Interest (30%)	Additional Consolidated P&L (Dr.) or Cr.	Minority's Share of losses borne by H Ltd.		Cost of Control
				₹	Balance	

At the time of			-			
acquisition on	1,62,000					
1.1.2011	(W.N.)					
2011 (1,25,000)	(37,500)	(87,500)				1,22,000 (W.N.)
Balance	1,24,500					
2012 (2,00,000)	(60,000)	(1,40,000)				1,22,000
Balance	64,500					
2013 (2,50,000)	(75,000)	(1,75,000)				1,22,000
Loss of	10,500	(10,500)	10,500	10,500		
minority						
borne by						
Holding Co.						
Balance	Nil	(1,85,500)				
2014 (60,000)	(18,000)	(42,000)				1,22,000
Loss of						
minority						
borne by						
Holding Co.	18,000	(18,000)	18,000	28,500		
Balance	Nil	(60,000)				
2015 25,000	7,500	17,500				1,22,000
Profit	(7,500)	7,500	(7,500)	21,000		
share of						
minority						
adjusted						
against						
losses of						
minority						
absorbed						
By Holding Co.						
Balance	Nil	25,000				
2016 50,000	15,000	35,000	(15,000)	6,000		1,22,000
	(15,000)	15,000				
Balance	Nil	50,000				
2017 75,000	22,500	52,500	(6,000)	Nil		1,22,000
	(6,000)	6,000				
Balance	16,500	58,500				

Working Note:

Calculation of Minority interest and Cost of control on 1.1.2011

	100% (₹)	Share of Holding Co. 70% (₹)	Minority Interest 30% (₹)
Share Capital	5,00,000	3,50,000	1,50,000
Reserve	40,000	28,000	12,000
		3,78,000	1,62,000
Less: Cost of investment		(5,00,000)	
Goodwill		1,22,000	

#16. Question | November 2018 Exam, 10 Marks |

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 are given below:

Incomes	A Ltd. ₹ in Lakhs	B Ltd. ₹ in Lakhs
Sales and other income	7,500	1,500
Increase in Inventory	<u>1,500</u>	<u>300</u>
Total	9,000	1,800
Expenses		
Raw material consumed	1,200	300
Wages and Salaries	1,200	225
Production expenses	300	150
Administrative expenses	300	150
Selling and distribution expenses	300	75
Interest	150	75
Depreciation	<u>150</u>	<u>75</u>
Total	<u>3,600</u>	<u>1,050</u>
Profit before tax	5,400	750
Provision for tax	<u>1,800</u>	<u>300</u>
Profit after tax	<u>3,600</u>	<u>450</u>
Dividend paid	<u>1,800</u>	<u>225</u>
Balance of Profit	<u>1,800</u>	<u>225</u>

The following information is also given:

- A Ltd sold goods of ₹180 Lakhs to B Ltd at cost plus 25%. (1/6 of such goods were still in inventory of B Ltd at the end of the year)
- Administrative expenses of B Ltd include ₹8 Lakhs paid to A Ltd as consultancy fees.
- Selling and distribution expenses of A Ltd include ₹15 Lakhs paid to B Ltd as commission.
- A Ltd holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2016-17 is ₹1,500 Lakhs
- Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2018.

Answer

Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd. for the year ended on 31st March, 2018

Particulars	Notes	₹ in Lakhs
I. Revenue from operations	1	<u>8,797</u>
II. Total revenue		8,797
III. Expenses		
Cost of Material purchased/Consumed	3	1,770
Changes of Inventories of finished goods	2	(1,794)
Employee benefit expense	4	1,425
Finance cost	6	225
Depreciation and amortization expense	7	225
Other expenses	5	<u>802</u>
Total expenses		<u>2,653</u>
IV. Profit before Tax (II-III)		6,144
V. Tax Expenses	8	<u>2,100</u>
VI. Profit After Tax		<u>4,044</u>

Notes to Accounts

	₹ in Lakhs	₹ in Lakhs
1. Revenue from Operations		

	Sales and other income		
	A Ltd.	7,500	
	B Ltd.	<u>1,500</u>	
		9,000	
	Less: Inter-company Sales	(180)	
	Consultancy fees received by A Ltd. from B Ltd.	(8)	
	Commission received by B Ltd. from A Ltd.	<u>(15)</u>	8,797
2.	Increase in Inventory		
	A Ltd.	1,500	
	B Ltd.	<u>300</u>	
		1,800	
	Less: Unrealised profits ₹180×1/6 x 25/125	(6)	<u>1,794</u>
3.	Cost of Material purchased/consumed		
	A Ltd.	1,200	
	B Ltd.	<u>300</u>	
		1,500	
	Less: Purchases by B Ltd. from A Ltd.	<u>(180)</u>	1,320
	Direct Expenses		
	A Ltd.	300	
	B Ltd.	<u>150</u>	<u>450</u>
			1,770
4.	Employee benefits and expenses		
	Wages and Salaries:		
	A Ltd.	1,200	
	B Ltd.	<u>225</u>	<u>1,425</u>
5.	Other Expenses		
	Administrative Expenses		
	A Ltd.	300	
	B Ltd.	<u>150</u>	
		450	
	Less: Consultancy fees received by A Ltd. from BLtd.	(8)	442
	Selling and Distribution Expenses:		
	A Ltd.	300	
	B Ltd.	<u>75</u>	
		375	
	Less: Commission received from B Ltd. from A Ltd.	<u>(15)</u>	<u>360</u>
			802
6.	Finance Cost		
	Interest:		
	A Ltd.	150	
	B Ltd.	<u>75</u>	225
7.	Depreciation and Amortisation		
	Depreciation:		
	A Ltd.	150	
	B Ltd.	<u>75</u>	225
8.	Provision for tax		
	A Ltd.	1800	
	B Ltd.	<u>300</u>	2100

Note: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. **Alternative Answer** is possible considering is otherwise.

#17.Question | May 2018 Exam, 20 Marks | RTP November 2019

The following summarized Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2017:

	H Ltd.₹	S Ltd.₹
Equity and Liabilities		
Shareholders' Funds		
Equity Share Capital (fully paid up shares of ₹10 each)	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
Total	22,37,000	5,43,000
Assets		
Non-Current Assets		
Property, Plant & Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ ₹20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000
Total	22,37,000	5,43,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2016. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹50,000 and ₹30,000 respectively. Machinery (book value ₹2,00,000) and Furniture (book value ₹40,000) of S Ltd. were revalued at ₹3,00,000 and Rs. 30,000 respectively on 1st April, 2016 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives : Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing Rs. 55,000 purchased from S Ltd. You are required to prepare the Consolidated Balance Sheet as at 31st March, 2017

Answer

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2017

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital (1,20,000 equity shares of ₹10 each)		12,00,000
(b) Reserves and Surplus	1	8,16,200
(2) Minority Interest (W.N.4)		99,300
(3) Current Liabilities		
(a) Trade payables	2	4,10,000

	Total		25,25,500
II. Assets			
(1) Non-current assets			
(a) Property, plant and equipment	3	13,10,500	
(b) Intangible assets	4	24,000	
(4) Current assets			
(a) Inventories	5	3,25,000	
(b) Trade Receivables	6	6,70,000	
(c) Cash at Bank	7	1,96,000	
Total			25,25,500

Notes to Accounts

1. Reserves and Surplus			
General Reserves		4,35,000	
Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3)		<u>84,000</u>	5,19,000
Profit and Loss Account		2,80,000	
Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3)	21,200		
Less: Unrealized gain	<u>(4,000)</u>	<u>17,200</u>	<u>2,97,200</u>
			<u>8,16,200</u>
2. Trade Payables			
H Ltd.		3,22,000	
S Ltd.		1,23,000	
Less: Mutual transaction		<u>(35,000)</u>	<u>4,10,000</u>
3. Tangible Assets			
Machinery			
H. Ltd.	2,00,000	6,40,000	
S Ltd.	<u>1,00,000</u>		
	<u>3,00,000</u>		
Less: Depreciation	<u>(30,000)</u>	2,70,000	<u>9,10,000</u>
Furniture			
H. Ltd.	40,000		
S Ltd.	<u>(10,000)</u>		
	30,000		
Less: Depreciation	<u>(4,500)</u>	<u>25,500</u>	<u>4,00,500</u>
			<u>13,10,500</u>
4. Intangible assets			
Goodwill [WN 5]			24,000
5. Inventories			
H Ltd.		2,68,000	
S Ltd.		<u>62,000</u>	3,30,000
6. Trade Receivables			
H Ltd.		4,70,000	
S Ltd.		<u>2,35,000</u>	
			7,05,000
Less: Mutual transaction			<u>(35,000)</u>
			<u>6,70,000</u>

7. Cash and Bank			
H. Ltd.		1,64,000	
S Ltd.		<u>32,000</u>	<u>1,96,000</u>

Working Notes:

1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2016

	₹
Machinery	
Revaluation as on 1.4.2016	3,00,000
Less: Book value as on 1.4.2016	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2016	30,000
Less: Book value as on 1.4.2016	<u>(40,000)</u>
Loss on revaluation	<u>(10,000)</u>

2. Calculation of short/excess depreciation

	Machinery	Furniture
Upward/ (Downward) Revaluation (W.N. 4)	1,00,000	(10,000)
Rate of depreciation	10% p.a.	15% p.a.
Difference [(short)/excess]	<u>(10,000)</u>	<u>1,500</u>

3. Analysis of reserves and profits of S Ltd. as on 31.03.2017

Pre-acquisition profit upto 1.4.2016 (Capital profits)		Post-acquisition profits (1.4.2016 – 31.3.2017)	
		General Reserve	Profit and loss account
General reserve as on 31.3.2017	50,000	1,05,000	
Profit and loss account as on 31.3.2017	30,000		35,000
Upward Revaluation of machinery as on 1.4.2016	1,00,000		
Downward Revaluation of Furniture as on 1.4.2016	(10,000)		
Short depreciation on machinery (W.N. 5)			(10,000)
Excess depreciation on furniture (W.N. 5)			1,500
Total	1,70,000	1,05,000	26,500

4. Minority Interest

	₹
Paid-up value of (2,00,000 x 20%)	40,000
Add: 20% share of pre-acquisition profits and reserves [(20% of (50,000 + 30,000))]	16,000
20% share of profit on revaluation	18,000
20% share of post-acquisition reserves	21,000
20% share of post-acquisition profit	<u>5,300</u>
	1,00,300
Less: Unrealised Profit on Inventory (55,000 x 10/110)* x 20%	<u>(1,000)</u>
	99,300

* considered that ₹55,000 is cost to H Ltd. Alternative solution considering it as cost to S Ltd. is also possible

5. Cost of Control or Goodwill

Cost of Investment		3,20,000

Less: Paid-up value of 80% shares	1,60,000	
80% share of pre-acquisition profits and reserves (₹64,000 + ₹72,000)	<u>1,36,000</u>	<u>(2,96,000)</u>
Cost of control or Goodwill		24,000

#18. Question | RTP November 2022 |

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Equity Share Capital – Authorised	5,000	3,000
Issued and subscribed in Equity Shares of ₹10 each fully paid	4,000	2,400
General Reserve	928	690
Profit and Loss Account (Cr. Balance)	1,305	810
Trade payables	611	507
Provision for Taxation	220	180
Other Provisions	65	17
Plant and Machinery	2,541	2,450
Furniture and Fittings	615	298
Investment in the Equity Shares of S Ltd.	1,500	-
Inventory	983	786
Trade receivables	820	778
Cash and Bank Balances	410	102
Sundry Advances (Dr. balances)	260	190

Following Additional Information is available:

- H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the following balances stood in the books of S Ltd.:
General Reserve ₹1,500 thousand; Profit and Loss Account ₹633 thousand.
- On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.
- On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of ₹10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.
- On 31st March, 2021, the Inventory of S Ltd. included goods purchased for ₹50 thousand from H Ltd., which had made a profit of 25% on cost.
- Details of Trade payables and Trade receivables:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Trade payables		
Bills Payable	124	80
Sundry creditors	487	427
	611	507
Trade receivables		
Debtors	700	683
Bills Receivables	120	95
	820	778

Prepare a consolidated Balance Sheet as on 31st March, 2022.

Answer

Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2022

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(b) Reserves and Surplus	2	3,063
(2) Minority Interest (W.N.6)		1,560
(3) Current Liabilities		
(a) Trade payables	3	1,118
(b) Short term provisions	4	482
Total		10,223
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade Receivables	7	1,598
(c) Cash and Cash equivalents	8	512
(d) Short term loans and advances	9	450
Total		10,223

Notes to Accounts

		(₹ in 000's)	(₹ in 000's)
1.	Share Capital		
	Authorised share capital		
	5 lakhs equity shares of ₹10 each		5,000
	Issued, Subscribed and Paid up		
	4 lakhs equity shares of ₹10 each fully paid		4,000
2.	Reserves and surplus		
	Capital Reserve (Note 5)	679.8	
	General Reserve	928	
	Profit and Loss Account:		
	H Ltd. ₹1,305		
	Add: Share in S Ltd ₹340.20		
	₹1,645.20		
	Less: Dividend wrongly credited ₹(180)		
	₹1,465.20		
	Less: Unrealised profit (50 X 1/5) ₹(10)	1,455.20	3,063
3.	Trade payables		
	H Ltd.	611	
	S Ltd.	507	1,118
4.	Short-term provisions		
	Provision for Taxation H Ltd. ₹220		
	S Ltd. ₹180	400	
	Other Provisions H Ltd ₹65		
	S Ltd. ₹17	82	482
5.	PPE		
	Plant and Machinery		
	H Ltd. ₹2,541		

	S Ltd.	₹2,450	4,991	
	Furniture and fittings			
	H Ltd.	₹ 615		
	S Ltd.	₹298	913	5,904
6.	Inventories			
	Inventory			
	H Ltd.	₹983		
	S Ltd.	₹786	1,769	
	Less: Unrealised profit (₹50 x 1/5)		(10)	1,759
7.	Trade receivables			
	H Ltd.		820	
	S Ltd.		778	1,598
8.	Cash and cash equivalents			
	Cash and Bank Balances: H Ltd		410	
	S Ltd.		102	512
9.	Short term loans and advances			
	Sundry Advances H Ltd.		260	
	S Ltd.		190	450

Working Notes:

Share holding pattern

Particulars	Number of Shares	% of holding
a. S Ltd		
(i) Purchased on 01.04.2021	90,000	
(ii) Bonus Issue (90,000/5 x 3)	54,000	
Total	1,44,000	60% (1,44,000 / 2,40,000* x 100)
b. Minority Interest	96,000	40%

*2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022

	(in 000)₹		(in 000)₹
To General Reserve	90	By Balance b/d	633
To Dividend paid on 14.7.2021	300	By Net Profit for the year (Balancing figure)	567*
To Balance c/d	810		
	1,200		1,200

* Out of ₹5,67,000 profit for the year, ₹90,000 has been transferred to reserves by S Ltd.

#19.Question | RTP May 2022 |

From the following information of Beta Ltd. and its subsidiary Gamma Ltd. drawn up at 31st March, 2021, prepare a consolidated balance sheet as at that date:

	Beta Ltd.	Gamma Ltd.
Share Capital:		
Shares of ₹100 each	15,00,000	2,50,000
Reserves	5,00,000	1,87,500
Profit and Loss Account	2,50,000	62,500
Trade Payables	3,75,000	1,42,500
Property, plant and Equipment:		

Machinery	7,50,000	2,25,000
Furniture	3,75,000	42,500
Other non-current assets	11,00,000	3,75,000
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at ₹200 each	4,00,000	

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at ₹62,500 and ₹37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020. Machinery (Book-value ₹2,50,000) and Furniture (Book value ₹50,000) of Gamma Ltd. were revalued at ₹3,75,000 and ₹37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Answer

Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd. as at 31st March, 2021

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		15,00,000
(b) Reserves and Surplus	1	8,61,500
(2) Minority Interest (W.N.5)		1,20,375
(3) Current Liabilities		
(b) Trade payables	2	5,17,500
Total		29,99,375
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	3	14,94,375
(b) Intangible assets	4	30,000
(c) Other non- current assets	5	14,75,000
Total		29,99,375

Notes to Accounts

			₹ in Lakhs
1.	Reserves and Surplus		
	Reserves	5,00,000	
	Add: 4/5th share of Gamma Ltd.'s postacquisition reserves (W.N.3)	1,00,000	6,00,000
	Profit and Loss Account	2,50,000	
	Add: 4/5th share of Gamma Ltd.'s postacquisition profits (W.N.4)	11,500	2,61,500
2.	Trade Payables		8,61,500
	Beta Ltd.	3,75,000	
	Gamma Ltd.	1,42,500	5,17,500
3.	Property, Plant & Equipment		
	Machinery		
	Beta Ltd.	7,50,000	
	Gamma Ltd.	2,50,000	
	Add: Appreciation	1,25,000	
		3,75,000	
	Less: Depreciation	(37,500)	3,37,500

	Furniture			
	Beta Ltd.		3,75,000	
	Gamma Ltd.	50,000		
	Less: Decrease in value	(12,500)		
		37,500		
	Less: Depreciation	(5,625)	31,875	14,94,375
4.	Intangible assets			
	Goodwill [WN 6]			30,000
5.	Other non-current assets			
	Beta Ltd.		11,00,000	
	Gamma Ltd.		3,75,000	14,75,000

Working Notes:

1. Pre-acquisition profits and reserves of Gamma Ltd.	
Reserves	62,500
Profit and Loss Account	37,500
	1,00,000
Beta Ltd.'s = $4/5 \times 1,00,000$	80,000
Minority Interest = $1/5 \times 1,00,000$	20,000
2. Profit on revaluation of assets of Gamma Ltd.	
Profit on Machinery ₹(3,75,000 – 2,50,000)	1,25,000
Less: Loss on Furniture ₹(50,000 – 37,500)	12,500
Net Profit on revaluation	1,12,500
Beta Ltd.'s share $4/5 \times 1,12,500$	90,000
Minority Interest $1/5 \times 1,12,500$	22,500
3. Post-acquisition reserves of Gamma Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹1,87,500 – 62,500)	1,25,000
Beta Ltd.'s share $4/5 \times 1,25,000$	1,00,000
Minority interest $1/5 \times 25,000$	25,000
4. Post -acquisition profits of Gamma Ltd.	
Post-acquisition profits (Profit & loss account balance less preacquisition profits = ₹62,500 – 37,500)	25,000
Add: Excess depreciation charged on furniture @ 15% on ₹12,500 i.e. (50,000 – 37,500)	1,875
Less: Under depreciation on machinery @ 10% on ₹1,25,000 i.e. (3,75,000 – 2,50,000)	26,875
	(12,500)
Adjusted post-acquisition profits	14,375
Beta Ltd.'s share $4/5 \times 14,375$	11,500
Minority Interest $1/5 \times 14,375$	2,875
5. Minority Interest	
Paid-up value of (2,500 – 2,000) = 500 shares held by outsiders i.e. $500 \times ₹100$	50,000
Add: 1/5th share of pre-acquisition profits and reserves	20,000
1/5th share of profit on revaluation	22,500
1/5th share of post-acquisition reserves	25,000
1/5th share of post-acquisition profit	2,875
6. Cost of Control or Goodwill	
	1,20,375
Paid-up value of 2,000 shares held by Beta Ltd. i.e. $2,000 \times ₹100$	2,00,000

Add: 4/5th share of pre-acquisition profits and reserves	80,000
4/5th share of profit on the revaluation	90,000
Intrinsic value of shares on the date of acquisition	3,70,000
Price paid by Beta Ltd. for 2,000 shares	4,00,000
Less: Intrinsic value of the shares	(3,70,000)
Cost of control or Goodwill	30,000

#20. Question | RTP November 2021 |

On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹12,00,000. The position of Q Ltd. on that date was as under:

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

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

	P Ltd. ₹	Q Ltd. ₹
Equity shares of ₹10 each fully paid (before bonus issue)	45,00,000	15,00,000
Securities Premium	9,00,000	-
Pre-incorporation profits	-	30,000
General Reserve	60,00,000	19,05,000
Profit and Loss Account	15,75,000	4,20,000
Trade payables	5,55,000	2,10,000
Property, plant and equipment	79,20,000	23,10,000
Investment: 1,05,000 Equity shares in Q Ltd. at cost	12,00,000	-
Current Assets	44,10,000	17,55,000

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of ₹10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:

- Before issue of bonus shares.
- Immediately after issue of bonus shares.

Answer

Shareholding pattern

Particulars	Number of Shares	% of holding
a. P Ltd.		
(i) Purchased on 31.03.2015	1,05,000	
(ii) Bonus Issue (1,05,000/2)	<u>52,500</u>	
Total	<u>1,57,500</u>	70%
b. Minority Interest	67,500	30%

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 2021:

(a) Before issue of bonus shares

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

(b) Immediately after issue of bonus shares

(i)	Cost of control/capital reserve	₹	₹
	Face value of investments (₹10,50,000 + ₹5,25,000)	15,75,000	
	Capital Profits (W.N.)	<u>63,000</u>	16,38,000
	Less: Investment in Q Ltd.		<u>(12,00,000)</u>
	Capital reserve		4,38,000
(ii)	Minority Interest		
	Share Capital (₹4,50,000 + ₹2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		<u>4,54,500</u>
			11,56,500
(iii)	Consolidated Profit and Loss Account – P Ltd.		
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		<u>10,60,500</u>
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits	Revenue Profits	
	(Before and after issue of bonus shares) ₹	Before Bonus Issue ₹	After Bonus Issue ₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.2015	60,000		
	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 2015 to 31 st March, 2021 (₹4,20,000 – ₹60,000)		3,60,000	3,60,000
		22,65,000	15,15,000

P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

#21. Question | RTP May 2021 |

A Ltd. acquired 70% equity shares of B Ltd. @ ₹20 per share (Face value - ₹10) on 31st March, 2021 at a cost of ₹140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021

	₹ in lakhs
Property, plant and equipment	360
Investments	90
Current Assets	140
Loans & Advances	30
15% Debentures	180
Current Liabilities	100

Answer

Net assets of B Ltd. as on 31st March, 2021

	₹ in lakhs	₹ in lakhs
Property, plant and equipment		360
Investments		90
Current Assets		140
Loans and Advances		30
Total Assets		620
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		340
Share of Minority Interest in net assets (30% of 340)		102
A Ltd.'s share in net assets (70% of 340)		238
A Ltd.'s cost of acquisition of shares of B Ltd. (₹140 lakhs)		(140)
Capital reserve		98

#22. Question | RTP November 2020 |

A Ltd holds 75% of the equity capital and voting power in B Ltd. A Ltd purchases inventories costing ₹150 lacs from B Ltd at a price of ₹200 lacs. The entire inventories remain unsold with A Ltd at the financial year end i.e. 31 March 2019. Suggest the accounting treatment for this transaction in the consolidated financial statements of A Ltd giving reference of the relevant accounting standard.

Answer

As per para provisions of AS 21, **Intragroup balances and intragroup transactions** and resulting **unrealized profits should be eliminated** in full. **Unrealized losses** resulting from intragroup transactions should also be eliminated unless cost cannot be recovered. Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and Property, Plant & Equipment, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. One also needs to see whether the intragroup transaction is **"upstream" or "down-stream"**. Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be **eliminated from minority interest as well as from consolidated profit** on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

The case given in the **Question is the case of upstream transaction**. In the consolidated profit and loss account for the year ended 31 March 2019, entire transaction of sale and purchase of ₹200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹50 lacs (i.e. ₹200 lacs – ₹150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 2019, by reducing the value of closing inventories by ₹50 lacs as of 31 March 2019. In the consolidated balance sheet as of 31 March 2019, A Ltd's share of profit from B Ltd will be reduced by ₹37.50 lacs (being 75% of ₹50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹12.50 lacs (being 25% of ₹50 lacs).

#23. Question | RTP May 2020 |

From the following summarized balance sheets of Kedar Ltd. and its subsidiary Vijay Ltd. drawn up at 31st March, 2019, prepare a consolidated balance sheet as at that date, having regard to the following:

- Reserves and Profit and Loss Account of Vijay Ltd. stood at ₹62,500 and ₹37,500 respectively on the date of acquisition of its 80% shares by Kedar Ltd. on 1st April, 2018.
- Machinery (Book-value ₹2,50,000) and Furniture (Book value ₹50,000) of Vijay Ltd. were revalued at ₹3,75,000 and ₹37,500 respectively on 1st April, 2018 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Summarised Balance Sheet of Kedar Ltd. and Vijay Ltd. as on 31st March, 2019

Liabilities	Kedar Ltd. ₹	Vijay Ltd. ₹	Assets	Kedar Ltd. ₹	Vijay Ltd. ₹
Equity and Liabilities			Non-current assets		
Shareholders' funds			Fixed assets		
Share Capital			Machinery	7,50,000	2,25,000
Shares of ₹100 each	15,00,000	2,50,000	Furniture	3,75,000	42,500
Reserves	5,00,000	1,87,500	Other non-current assets		
Profit and Loss Account	2,50,000	62,500	Non-current Investments	11,00,000	3,75,000
Trade Payables	3,75,000	1,42,500	Shares in Vijay Ltd.:		
			2,000 shares at ₹200 each		
			Non-current assets		
			Fixed assets	4,00,000	
	26,25,000	6,42,500		26,25,000	6,42,500

Answer

Consolidated Balance Sheet of Kedar Ltd. and its Subsidiary Vijay Ltd. as at 31st March, 2019

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		

(1) Shareholder's Funds		
(a) Share Capital		15,00,000
(b) Reserves and Surplus	1	8,61,500
(2) Minority Interest (W.N 5)		1,20,375
(3) Current Liabilities		
(c) Trade payables	2	5,17,500
Total		29,99,375
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	3	14,94,375
(b) Intangible assets (W.N.5)	4	30,000
(2) Other non - Current assets	5	14,75,000
Total		29,99,375

Notes to Accounts

1. Reserves and Surplus			
Reserves		5,00,000	
Add: 4/5th share of Vijay Ltd.'s Post acquisition reserves (W.N.3)		<u>1,00,000</u>	6,00,000
Profit and Loss Account		2,50,000	
Add: 4/5th share of Vijay Ltd.'s post acquisition profits (W.N.4)		11,500	2,61,500
2. Trade Payables			
Kedar Ltd.		3,75,000	
Vijay Ltd.		<u>1,42,500</u>	5,17,500
3. Property, Plant & Equipment			
Machinery			
Kedar Ltd.		7,50,000	
Vijay Ltd.	2,50,000		
Add: Appreciation	<u>1,25,000</u>		
	3,75,000		
Less: Depreciation	<u>(37,500)</u>	3,37,500	
Furniture	-		
Kedar Ltd.	-	3,37,500	
Vijay Ltd.	50,000		
Less: Decrease in value	(12,500)		
	37,500		
Less: Depreciation	<u>(5,625)</u>	31,875	14,94,375
4. Intangible assets			
Goodwill [WN 6]			30,000
5. Other non-current assets			
Kedar Ltd.		11,00,000	
Vijay Ltd.		<u>3,75,000</u>	14,75,000

Working Notes:

1. Pre-acquisition profits and reserves of Vijay Ltd.	
Reserves	62,500
Profit and Loss Account	<u>37,500</u>
	<u>1,00,000</u>

Kedar Ltd.'s = $\frac{4}{5} \times 1,00,000$	80,000
Minority Interest = $\frac{1}{5} \times 1,00,000$	20,000
2. Profit on revaluation of assets of Vijay Ltd.	
Profit on Machinery ₹ (3,75,000 – 2,50,000)	1,25,000
Less: Loss on Furniture ₹ (50,000 – 37,500)	<u>12,500</u>
Net Profit on revaluation	1,12,500
Kedar Ltd.'s share $\frac{4}{5} \times 1,12,500$	90,000
Minority Interest $\frac{1}{5} \times 1,12,500$	22,500
3. Post-acquisition reserves of Vijay Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹1,87,500 – 62,500)	1,25,000
4. Post -acquisition profits of Vijay Ltd.	
Post-acquisition profits (Profit & loss account balance less preacquisition profits = ₹62,500 – 37,500)	25,000
Add: Excess depreciation charged on furniture @ 15% on ₹12,500 i.e. (50,000 – 37,500)	<u>1,875</u>
	26,875
Less: Under depreciation on machinery @ 10% on ₹1,25,000 i.e. (3,75,000 – 2,50,000)	(12,500)
Adjusted post-acquisition profits	14,375
Kedar Ltd.'s share $\frac{4}{5} \times 14,375$	11,500
Minority Interest $\frac{1}{5} \times 14,375$	2,875
5. Minority Interest	
Paid-up value of (2,500 – 2,000) = 500 shares held by outsiders i.e. $500 \times ₹100$	50,000
Add: 1/5th share of pre-acquisition profits and reserves	20,000
1/5th share of profit on revaluation	22,500
1/5th share of post-acquisition reserves	25,000
1/5th share of post-acquisition profit	2,875
6. Cost of Control or Goodwill	
Paid-up value of (2,500 – 2,000) = 500 shares held by outsiders i.e. $500 \times ₹100$	50,000
Add: 1/5th share of pre-acquisition profits and reserves	20,000
1/5th share of profit on revaluation	22,500
1/5th share of post-acquisition reserves	25,000
1/5th share of post-acquisition profit	2,875
6. Cost of Control or Goodwill	
Paid-up value of 2,000 shares held by Kedar Ltd. i.e. $2,000 \times ₹100$	2,00,000
Add: 4/5th share of pre-acquisition profits and reserves	80,000
4/5th share of profit on the revaluation	90,000
Intrinsic value of shares on the date of acquisition	3,70,000
Price paid by Kedar Ltd. for 2,000 shares	4,00,000
Less: Intrinsic value of the shares	(3,70,000)
Cost of control or Goodwill	30,000

#24. Question | RTP November 2018 |

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 are as follows:

Particulars	Amounts as at 31st March, 2017	
	X Ltd.	Y Ltd.

	(₹ in lakhs)	(₹ in lakhs)
LIABILITIES		
Share Capital:		
Authorised	<u>20,000</u>	<u>8,000</u>
Issues and subscribed:		
Equity share of ₹10 each, fully paid up	15,000	6,000
15% preference shares of ₹10 each, fully paid up	4,000	1,000
General Reserves	2,500	1,450
Profit & Loss Account	2,750	1,250
Trade payables	<u>1,646</u>	<u>1,027</u>
	25,896	10,727
ASSETS		
Land & Building	3,550	1,510
Plant & Machinery	5,275	3,600
Furniture & Fittings	1,945	655
Investment in Y Ltd ₹450 Lakh Equity share in Y Ltd. purchased on 1st April, 2016	6,800	
Inventory	4,142	2,520
Trade Receivables	3,010	1,882
Cash and Bank Balance	<u>1,174</u>	<u>560</u>
	25,896	10,727

The following information is also given to you

- 10% dividend on Equity shares was declared by Y Ltd. on 31st March, 2016 for the year ended 31st March, 2016. X Ltd. credited the dividend received to its Profit & Loss Account.
- Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2016 was ₹650 Lakhs.
- General Reserve of Y Ltd. stood at same ₹1,450 Lakhs as on 1st April, 2016.
- Y Ltd.'s Plant & machinery showed a balance of ₹4,000 Lakh on 1st April 2016. At the time of purchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by ₹1,000 Lakh.
- Included in Trade Payables of Y Ltd. are ₹50 Lakh for goods supplied by X Ltd.
- On 31st March, 2017, Y's Ltd. inventory included goods for ₹150 lakhs which it had purchased from X Ltd. X Ltd. sold goods to Y Ltd. at cost plus 25%.

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 giving working notes. (Ignoring dividend on preference shares).

Answer

Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017

Particulars	Notes	Amount in ₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	19,000
(b) Reserves and Surplus	2	5,620
(2) Minority Interest	3	3,400
(3) Current Liabilities		
(a) Trade payables	4	<u>2,623</u>
Total		30,643
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	5	17,435
(2) Current assets		

(a) Inventories	6	6,632
(b) Trade Receivables	7	4,842
(c) Cash and Cash equivalent	8	1,734
Total		30,643

Notes to Accounts

		₹ in lakhs
1. Share Capital		
Issued, Subscribed and Paid up (1,500 lakh Equity Shares of ₹10 each fully paid up)		15,000
400 lakh Preference Shares of ₹10 each fully paid up		<u>4,000</u>
		19,000
2. Reserves and Surplus		
Credit Balance of Profit & Loss Account	2,750	
Less: Capital Receipt wrongly credited (Dividend @ 10% on ₹4500 Lakh Equity Shares)	450	
	2,300	
Add: Share in Y Ltd. Revenue Profit (Working Note i)	<u>825</u>	
	3,125	
Less: Unrealised Profit (Working Note iv)	<u>(30)</u>	3,095
Capital Reserve (Working Note iii)	<u>25</u>	
General Reserve	<u>2,500</u>	2,525
3. Minority interest		
100 Lakh Preference Shares of ₹10 fully paid up	1,000	
150 Lakh Equity Shares of ₹10 each fully paid up	<u>1,500</u>	2,500
Share in Revenue Profits (Working Note i)	275	
Share in Capital Profit (working Note ii)	<u>625</u>	<u>900</u>
		3,400
4. Trade payables		
X Ltd.	1,646	
Y Ltd.	<u>1,027</u>	
	<u>2,673</u>	
Less: Mutual owing	(50)	2,623
5. Tangible Assets		
Land & Building		
X Ltd.	3,550	
Y Ltd	<u>1,510</u>	5,060
Plant & Machinery		
X Ltd.	5,275	
Y Ltd (Working note v)	<u>4,500</u>	9,775
Furniture & Fixtures		
X Ltd.	1,945	
Y Ltd	<u>655</u>	2,600
6. Inventories		
X Ltd.	4,142	
Y Ltd	<u>2,520</u>	
	<u>6,662</u>	
Less: Unrealized Profit	<u>(30)</u>	6,632

Working Notes:

i. Calculation of Revenue Profits Y's Ltd Profit & Loss Account

		(₹in Lakhs)			(₹in Lakhs)
To	Equity Dividend 10 % of 6,000 lakh	600	By	Balance b/d	650
To	balance c/d	1,250		By Net profit for the year (Bal Fig.)	1,200
		1,850			1,850

Depreciation provided on Plant & Machinery	
Balance as on 1st April, 2016	4,000
Less: Balance as 31st March 2017	(3,600)
	400
Hence rate of Depreciation = $400/4000 \times 100$	10%
Net Profit for the year ended 31st March 2017	1,200
Less: Additional Depreciation	<u>100</u>
Revenue Profit	1,100
X Ltd's share- $1100 \times 450/600$	825
Y Ltd's share = $1100 \times 150/600$	275

ii. Calculation of Capital Profits	
Profit & Loss Balance as on 1st April, 2016	650
Less: Dividend Paid	<u>600</u>
	50
Add: General Reserve as on 1st April, 2016	1,450
Add: Profit on Revaluation of Plant & machinery	1,000
Capital Profit	2,500
X Ltd's Share in Capital Profit = $2,500 \times 450/600$	1,875
Y Ltd's Share in Capital Profit = $2,500 \times 150/600$	625
iii. Calculation of Capital Reserve	
Paid up value of 450 Lakh equity shares	4,500
Add: Share in Capital Profits	<u>1,875</u>
	6,375
Amount Paid to acquire the 450 Lakh Equity Shares	6,800
Less: Dividend received out of Pre acquisition profits	450
	6,350
Capital Reserve = $6,375 - 6,350$	25
₹150 Lakh $\times 25/125^* = 30$ lakh	

v. Plant & Machinery of Y Ltd.

Balance as on 31st March, 2017		3,600
Add: Addition due to revaluation	1,000	
Less: Depreciation on additional Value of Plant & Machinery @ 10 %	<u>100</u>	<u>900</u>
		4,500

* ₹150 lakh considered as cost to Y Ltd.

#25. Question | RTP May 2018 |

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

	Hello Ltd. (₹ in lacs)	Sun Ltd. (₹ in lacs)

Incomes:		
Sales and other income	10,000	2,000
Increase in Inventory	<u>2,000</u>	<u>400</u>
	12,000	2,400
Expenses:		
Raw material consumed	1,600	400
Wages and Salaries	1,600	300
Production expenses	400	200
Administrative Expenses	400	200
Selling and Distribution Expenses	400	100
Interest	200	100
Depreciation	<u>200</u>	<u>100</u>
	4,800	1,400
Profit before tax	7,200	1,000
Provision for tax	<u>2,400</u>	<u>400</u>
Profit after tax	4,800	600
Dividend paid	<u>2,400</u>	<u>300</u>
Balance of Profit	2,400	300

Other Information:

Hello Ltd. sold goods to Sun Ltd. of ₹ 240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing ₹ 48 lacs. Administrative expenses of Sun Ltd. include ₹ 10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include ₹ 20 lacs paid to Sun Ltd. as commission. Hello Ltd. holds 80% of equity share capital of ₹ 2,000 lacs in Sun Ltd. prior to 2015-2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017.

Answer

Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended on 31st March, 2017

	Particulars	Notes	₹ in Lacs
I.	Revenue from operations	1	11,730
II.	Total revenue		
III.	Expenses		
	Cost of Material purchased/Consumed	3	2,360
	Changes of Inventories of finished goods	2	(2,392)
	Employee benefit expense	4	1,900
	Finance cost	6	300
	Depreciation and amortization expense	7	300
	Other expenses	5	<u>1,070</u>
	Total expenses		3,538
IV.	Profit before Tax (II-III)		8,192
V.	Tax Expenses	8	<u>2,800</u>
VI.	Profit After Tax		5,392
	Profit transferred to Consolidated Balance Sheet		
	Profit After Tax		5,392
	Dividend paid		
	Hello Ltd.	2,400	

	Sun Ltd.	300	
		2,700	
	Less: Share of Hello Ltd. in dividend of Sun Ltd.		
	80% of ₹300 lacs	(240)	(2,460)
	Profit to be transferred to consolidated balance sheet		2,932

Notes to Accounts

		(₹ in Lacs)	(₹ in Lacs)
1.	Revenue from Operations		
	Sales and other income		
	Hello Ltd.	10,000	
	Sun Ltd.	2,000	
		12,000	
	Less: Inter-company Sales	(240)	
	Consultancy fees received by Hello Ltd. from Sun Ltd.	(10)	
	Commission received by Sun Ltd. from Hello Ltd.	<u>(20)</u>	11,730
2.	Increase in Inventory		
	Hello Ltd.	2,000	
	Sun Ltd.	<u>400</u>	
		<u>2,400</u>	
	Less : Unrealized profits ₹48 lacs	<u>(8)</u>	<u>2,392</u>
3.	Cost of Material purchased/consumed		14,122
	Hello Ltd.	1,600	
	Sun Ltd.	<u>400</u>	
		2,000	
	Less: Purchases by Sun Ltd. from Hello Ltd.	<u>(240)</u>	1,760
	Direct Expenses		
	Hello Ltd.	400	
	Sun Ltd.	<u>200</u>	<u>600</u>
			<u>2,360</u>
4.	Employee benefits and expenses		
	Wages and Salaries:		
	Hello Ltd.	1,600	
	Sun Ltd.	<u>300</u>	<u>1,900</u>
5.	Other Expenses		
	Administrative Expenses		
	Hello Ltd.	400	
	Sun Ltd.	<u>200</u>	
		600	
	Less: Consultancy fees received by Hello Ltd. from Sun Ltd.	<u>(10)</u>	<u>590</u>
	Selling and Distribution Expenses:		
	Hello Ltd.	400	
	Sun Ltd.	<u>100</u>	
		500	
	Less: Commission received from Sun Ltd. From Hello Ltd.	<u>(20)</u>	<u>480</u>
			<u>1,070</u>
6.	Finance Cost		

	Interest:		
	Hello Ltd.	200	
	Sun Ltd.	<u>100</u>	<u>300</u>
7.	Depreciation and Amortization		
	Depreciation:		
	Hello Ltd.	200	
	Sun Ltd.	<u>100</u>	<u>300</u>
8.	Provision for tax		
	- Hello Ltd.	2,400	
	- Sun Ltd.	<u>400</u>	<u>2,800</u>

Note: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not added to consolidated opening retained earnings (which is also not given).